Richard Bernstein Advisors

The Leaders In Pactive® Management

Insights

July 2018

Richard Bernstein, Chief Executive and Chief Investment Officer

Richard Bernstein Advisors

Richard Bernstein Advisors LLC (RBA) is an independent investment adviser focusing on longer-term investment strategies that combine top-down, macroeconomic analysis and quantitatively-driven portfolio construction. We strive to be the leading provider of innovative investment solutions for investors, and our competitive edge is our research-driven macro style of investing.

Our top-down macro approach differentiates our firm from the more common, traditional bottom-up approach of most asset managers. Our extensive array of macro indicators allows us to construct portfolios for clients that are innovative, risk-controlled, and focused on overall portfolio construction instead of individual stock selection.

Overheating Ahead

The economy by itself is heading for higher inflation

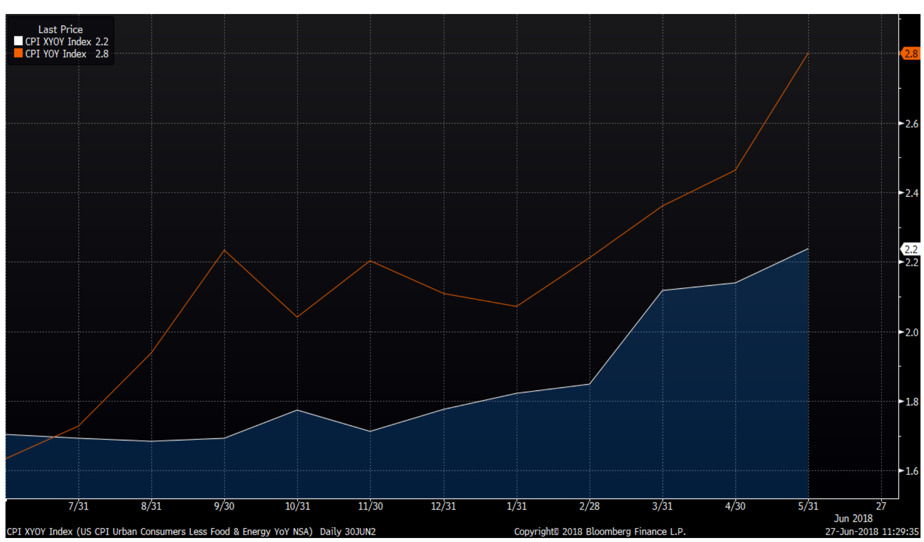
Current US economic fundamentals suggest our portfolios remain correctly focused on assets that benefit from higher inflation. Late-cycle environments are generally characterized by rising inflation, and the current late-cycle is so far mimicking history. Chart 1 shows the increasing year-to-year change in the core and headline CPIs over the past year. The headline CPI is up 65% whereas the more stable core measure is up roughly one-third.

A late-cycle increase in inflation is normal. Product and labor markets tend to tighten, and delays and shortages become more common as increasing activity strains the limits of the economy. It took longer than normal for the recent US economy to reach these late-stage constraints because of the slow growth trajectory of the recovery and expansion. However, the business cycle has not been repealed, and inflation has been building as it always does during late-cycles.

Investors appear unaware of how high US inflation already is relative to inflation rates around the world. Chart 2 shows that the US currently has the highest inflation rate in the world among developed nations.

CHART 1:

Core CPI and CPI YoY (Jun. 2017 – May 2018)



Source: Bloomberg Finance L.P. For Index descriptors, see "Index Descriptions" at end of document.

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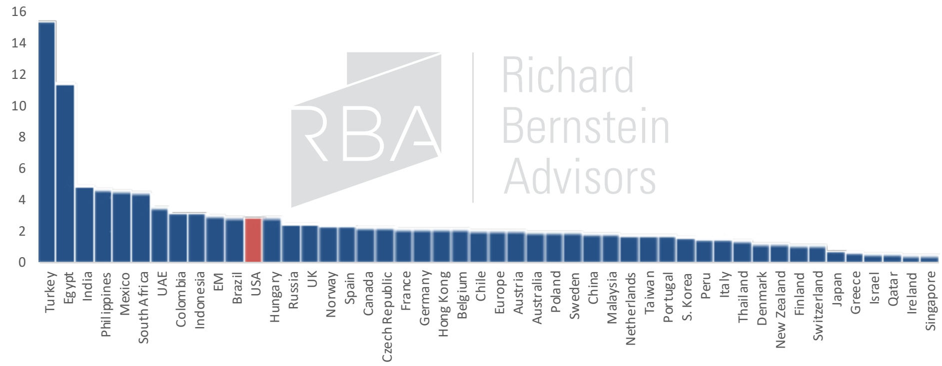
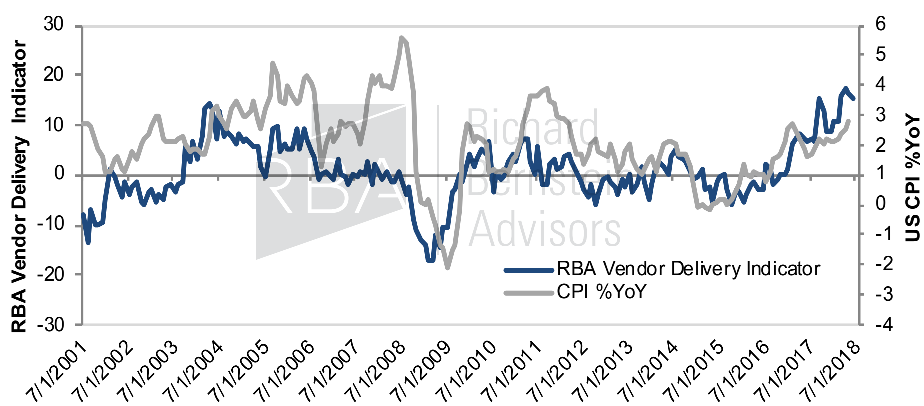
CHART 2:
Global CPI % YoY
(Latest Available as of Jun. 30 2018)



Source: Richard Bernstein Advisors LLC, Standard and Poor's, Bloomberg Finance L.P.

The limits of the US economy are quickly becoming evident. Product and labor markets have become extremely tight. Chart 3 shows our proprietary measure of vendor delivery time (i.e., how long does it take for a commercial order to be delivered). Longer vendor delivery times suggest demand is outstripping supply, and prices rise when demand is greater than supply. **Vendor delivery times are not only lengthening, but are currently among the longest in the history of our data.**

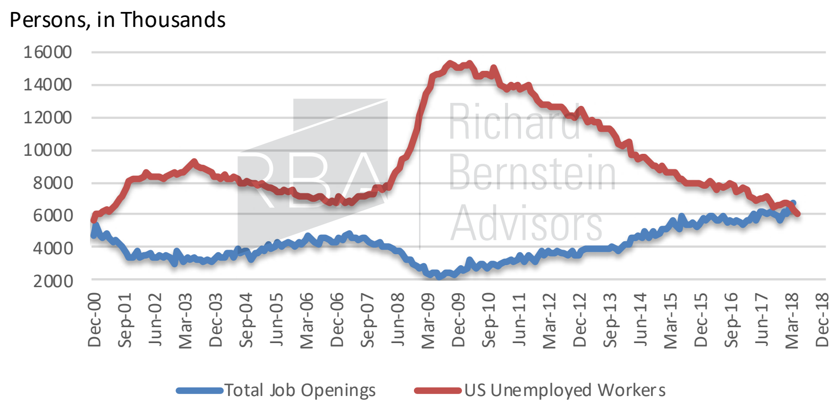
CHART 3:
US CPI % YoY vs. RBA Vendor Delivery Indicator
(Jul. 2001 - Jun. 2018)



Source: Richard Bernstein Advisors LLC, FRB, Bloomberg Finance L.P.

There simply isn't enough available skilled labor within the US economy. Chart 4 demonstrates that **job openings are now the best in the history of the data.** Labor markets are like any other product market, and the price of labor (i.e., wages) generally increases when the demand for labor outstrips the supply. Anecdotal evidence regarding labor union activity also reflects the current tightness of the labor market. Workers typically don't form unions and strike when they are worried about job security. However, union power is apparently gaining as workers realize replacement workers are very difficult to find.

CHART 4:
Job Openings vs. Job Seekers
(Dec. 2000 – Apr. 2018)



Source: Richard Bernstein Advisors LLC. BLS, Bloomberg Finance L.P. For Index descriptors, see "Index Descriptions" at end of document

Public policy is currently very pro-inflation

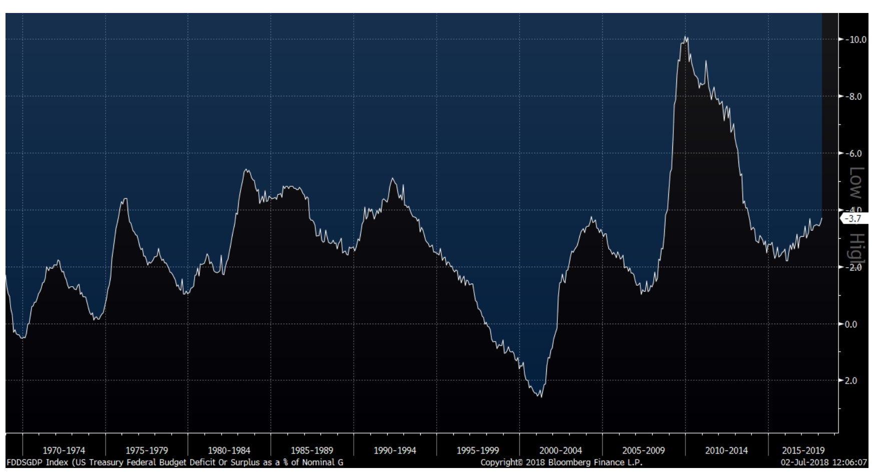
Public policy has become a difficult topic about which to discuss. Emotions run high these days, which means that investors must be even more dispassionate and objective when assessing investment opportunities. As mentioned in earlier commentary, RBA tries to solely focus on the investment implications of policy. We are not, in the comments that follow, expressing an opinion that policies are appropriate or not.

Typically, the government uses fiscal stimulus and deficit spending as tools to ameliorate a recession and not to further stimulate the economy during the 9th year of an economic expansion. It is somewhat surprising to us that investors seem more caught up in the political hype of fiscal stimulus than in assessing the investment implications of injecting significant stimulus into a late-cycle economy. It also appears to us as though public policies will exacerbate the late cycle's bottlenecks, which could further spur inflation. We have considered the inflation potential caused by each of the following policies:

1. Government spending and tax cuts

Both federal and state & local government spending is increasing. Evercore ISI has estimated that spending by the largest states is now rising roughly 6% year-to-year. The federal deficit as a percent of GDP is growing again after decreasing for about six years. Most important, Chart 5 shows that deficits normally contract during latter stages of an economic cycle, but the deficit is increasing during the current late-cycle. Stimulating a late-cycle economy with local, state, and federal stimulus seems likely to overheat an already tight economy and cause inflation that may be significantly higher than most investors are currently forecasting.

CHART 5:
Federal Budget Deficit or Surplus as a % of Nominal GDP
(Dec. 1968 – Mar. 2018)



Source: Richard Bernstein Advisors LLC. US Treasury, BEA, Bloomberg Finance L.P.

2. Tariffs

Tariffs, by definition, are always inflationary because they are supposed to negate competitive advantage (whether fair or unfair) by taxing imported lower priced products so that those products' prices are equal to higher priced domestic ones. Price increases could prove temporary if a tariff's higher prices stymie demand, but that is less likely to happen now because the underlying economy is quite strong. Because product markets are already tight, tariffs' impeded flow of goods and services could worsen existing shortages and extended delivery times.

3. Immigration

Of course, one should always want thorough, consistent, and meaningful immigration standards. However, US labor markets are tight, and current immigration discussions are not addressing the need within the US economy for additional labor. Current public policy seemingly ignores that the price of labor (i.e., wages) is already rising because of the growing scarcity of available qualified workers. Labor shortages could easily worsen given the stimulus previously mentioned, but immigration seems unlikely to alleviate even a dramatic labor shortage that could occur.

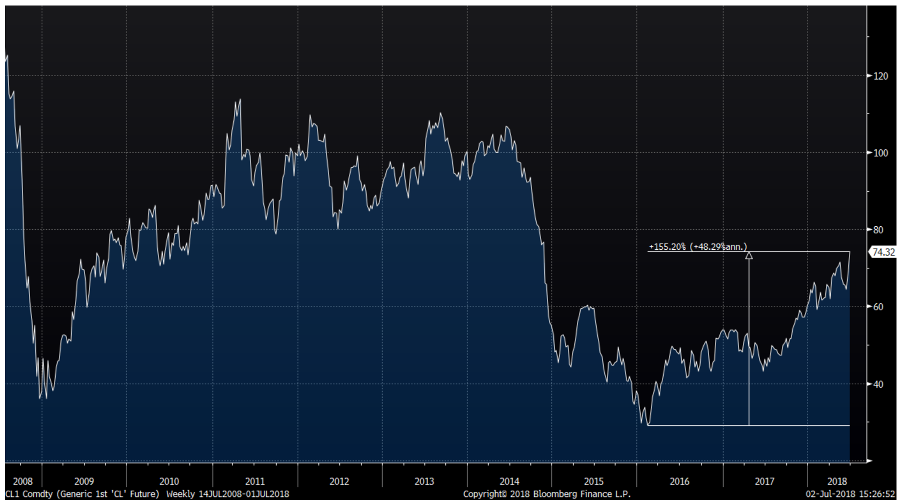
4. Iran & Oil

One could agree or disagree with the recent positions on Iran. However, oil supplies could be significantly constrained. Chart 6 highlights that oil prices (WTI) have more than doubled since early 2016 largely because of an improving economy. The combination of additional supply restrictions and a strong economy will likely further increase prices.

According to Cornerstone Analytics, a leading independent energy research firm, OPEC does not have enough spare capacity to make up for a full reduction in Iranian exports and non-OPEC production is running near full capacity. If their analysis is correct, then any supply constraints could result in meaningful higher prices.

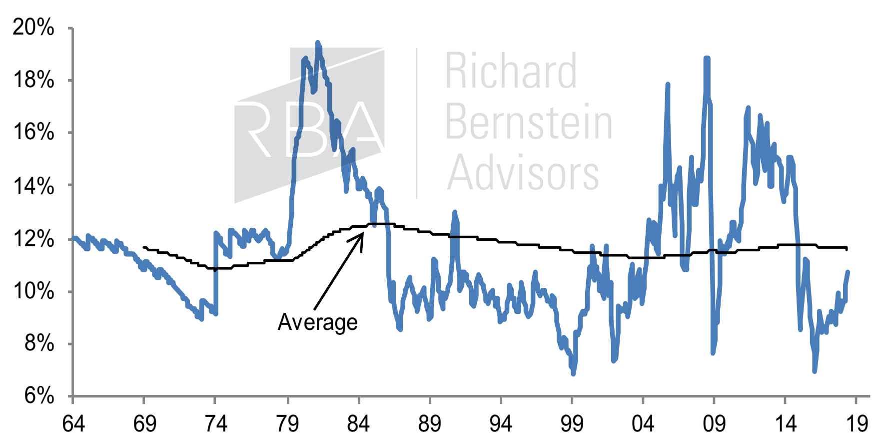
One should not assume that an increase in energy prices might be temporary. Energy prices would likely have to substantially increase before damaging the US economy. Chart 7 shows gasoline prices as a percent of hourly wages, and the significant increases in gasoline prices so far has equated to a relatively small proportion of wages.

CHART 6:
Weekly Oil (WTI) Prices
(Jul. 14 2008 – Jul. 1 2018)



Source: Richard Bernstein Advisors LLC. Bloomberg Finance L.P.

CHART 7:
Price of a Gallon of Gas as a % of Wages
(Jan. 1964 – Jun. 2018)



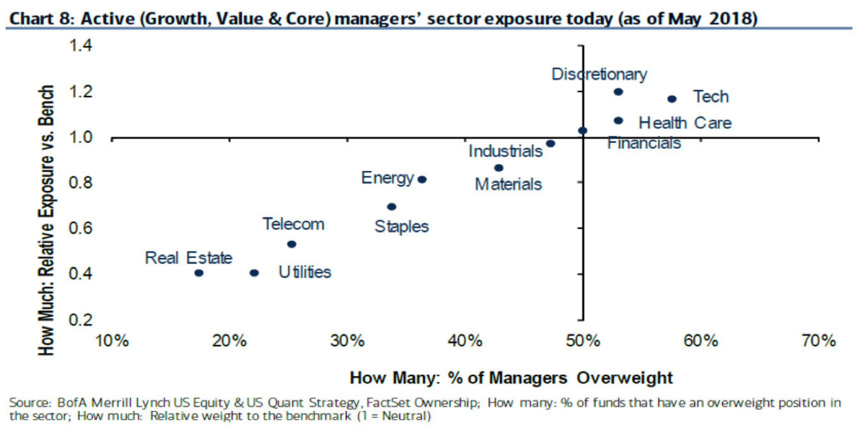
Source: Richard Bernstein Advisors LLC. US EIA, BLS, Bloomberg Finance L.P.

Our positioning for nominal growth still appears unique

Significant investment opportunities may still exist in sectors that benefit from nominal growth. The chart below, courtesy of BofAML[1], highlights that the majority of equity managers are underweighting the sectors that might benefit the most from accelerating nominal growth (Energy, Materials, and Industrials).

Similarly, a recent study by Evercore ISI[2] noted that bond portfolio managers had lowered their portfolios' durations by only a small amount in anticipation of higher interest rates. The latest data suggested that, in aggregate, bond portfolio managers were roughly 92% of benchmark duration versus RBA's roughly 25-30% of benchmark duration. Overall, both our equity and fixed-income positions seem unique.

CHART 8:
Equity Managers underweight Energy, Materials & Industrials



It is unfortunate that so many investors are enthralled with Washington's political show rather than remaining dispassionate and objective. At RBA our analyses suggest that accelerating nominal growth may be the next important investment theme, and few investors appear to be appropriately positioned should that occur.

To learn more about how RBA's portfolios are uniquely structured, please contact your local RBA representative.
www.rbadvisors.com/images/pdfs/Portfolio_Specialist_Map.pdf.

[1] Active managers' holdings update, July 02, 2018, BofAML

[2] Evercore ISI Investor Surveys|Institutional Bond and Equity Managers, June 27, 2018

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INDEX DESCRIPTIONS:

The following descriptions, while believed to be accurate, are in some cases abbreviated versions of more detailed or comprehensive definitions available from the sponsors or originators of the respective indices. Anyone interested in such further details is free to consult each such sponsor's or originator's website.

The past performance of an index is not a guarantee of future results.

Each index reflects an unmanaged universe of securities without any deduction for advisory fees or other expenses that would reduce actual returns, as well as the reinvestment of all income and dividends. An actual investment in the securities included in the index would require an investor to incur transaction costs, which would lower the performance results. **Indices are not actively managed and investors cannot invest directly in the indices.**

CPI: The Consumer prices (CPI) for all Urban Consumers are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Core CPI : Core Consumer prices are a measure of prices paid by consumers for a market basket of consumer goods and services excluding the Food and Energy categories. The yearly (or monthly) growth rates represent the core inflation rate.

Job Openings: Job Openings and Labor Turnover Survey (JOLTS). JOLTS defines Job Openings as all positions that are open (not filled) on the last business day of the month. A job is "open" only if it meets all three of the following conditions: A specific position exists and there is work available for that position. The position can be full-time or part-time, and it can be permanent, short-term, or seasonal, **and** The job could start within 30 days, whether or not the establishment finds a suitable candidate during that time, **and** There is active recruiting for workers from outside the establishment location that has the opening.

Job Seekers: Number of persons unemployed as reported monthly by the Bureau of Labor Statistics (BLS). Data is based on the Current Population Survey (CPS) to measure the extent of unemployment in the country. People are classified as unemployed if they do not have a job, have actively looked for work in the prior 4 weeks, and are currently available for work.

About Richard Bernstein Advisors

Richard Bernstein Advisors LLC is an independent investment adviser. RBA partners with several firms including Eaton Vance Corporation and First Trust Portfolios LP, and currently has $8.4 billion collectively under management and advisement as of June 30th, 2018. RBA acts as sub-advisor for the Eaton Vance Richard Bernstein Equity Strategy Fund and the Eaton Vance Richard Bernstein All-Asset Strategy Fund and also offers income and unique theme-oriented unit trusts through First Trust. RBA is also the index provider for the First Trust RBA American Industrial Renaissance® ETF and the First Trust RBA Quality Income ETF. Additionally, RBA runs ETF asset allocation SMA portfolios at UBS, Merrill Lynch, Morgan Stanley Smith Barney, Wells Fargo, RBC, Janney and on select RIA platforms. RBA's investment insights as well as further information about the firm and products can be found at **www.RBAdvisors.com**.

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RBA Investment Process:

- Quantitative indicators and macro-economic analysis are used to establish views on major secular and cyclical trends in the market.
- Investment themes focus on disparities between fundamentals and sentiment.
- Market mis-pricings are identified relative to changes in the global economy, geopolitics and corporate profits.

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