Richard Bernstein Advisors

UNCERTAINTY = OPPORTUNITY®

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The Opportunity Cost Keeps Growing and Growing

Richard Bernstein, Chief Executive and Chief Investment Officer

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In a recent report we demonstrated that, contrary to popular belief, investors are not faced with a low return environment. Through October 31st, the annualized five-year return on the S&P 500® exceeded 13%. We asked how long will returns need to exceed expectations before investors will admit that the financial markets are not in a low return environment? (See, http://www.rbadvisors.com/images/pdfs/New_normal.pdf).

It appears that a fear of equities and the resulting poor asset allocations have resulted in below normal returns. Investors as a group seem to be rationalizing their poor returns by agreeing with each other that it is difficult to achieve higher returns. The reality, however, is that equities are providing higher returns, and the opportunity cost of under-weighting equities is growing.

It's fear. It's not demographics

Many observers have claimed that investors' search for more conservative investments is attributable to demographics. It is common to hear that the baby-boomers are aging and have a greater need for income-producing investments.

We have disagreed with this theory. Of course it is true that the baby-boomers are aging, but their preference for fixed-income and income-oriented equity seems to be more a function of fear than of demographics. They feel that investing for income is safe, but investing for capital appreciation is risky. 2008's stock market debacle remains fresh in their memories, and income-producing strategies outperformed during that time because of the low betas imbedded in dividend strategies, and because of the negative correlation that existed between treasuries and stocks.

Safe strategies are safe until everyone thinks they are safe and makes those strategies the core of their portfolios. The over popularity of any strategy is ultimately its demise because valuations get stretched and the underlying macroeconomic environment typically changes. Investors can be left with overvalued investments that may be inappropriate for a subsequent economic setting.

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.

CONTACT RBA

Website: RBAdvisors.com
Twitter: @rbadvisors
Phone: (212) 692-4088

That appears to be the case today with many fixed-income investments. "Lower for longer" was this past summer's popular investment theme, but the popularity of that theme coincided with the trough in inflation expectations.

Chart 1 shows the 5-year 5-year forward inflation breakeven, which is supposedly the Fed's favorite measure of inflation expectations. Inflation expectations in the US appeared to have troughed in February. It seems unreasonable to expect broad fixed-income returns to be attractive if the recent trend in inflation expectations continues.

The US is not the only country in which inflation expectations have started to increase. Inflation expectations in the UK and in Germany are similarly rising, and they are stabilizing in Japan.

CHART 1:
US 5-Year 5-Year Forward Breakeven

Inflation expectations in the US appeared to have troughed in February. It seems unreasonable to expect broad fixed-income returns to be attractive if the recent trend in inflation expectations continues.

Source: Bloomberg Finance L.P.

The opportunity cost

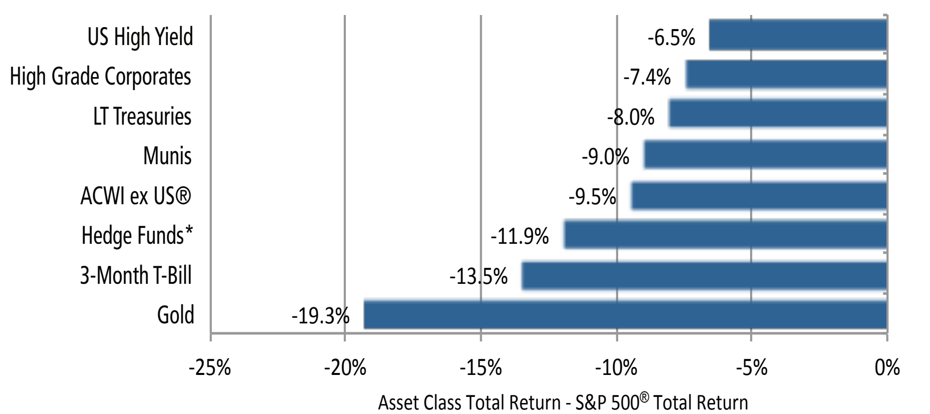
Few investors seem to appreciate the magnitude of the opportunity cost of avoiding equities. Individuals, pensions, endowments, foundations, and hedge funds have all suffered sub-par returns because of their fear of the equity market.

The following two charts show the cost of being scared of equities over the past five years. Chart 2 shows the relative performance of various asset classes' annualized returns versus the S&P 500®'s, and Chart 3 shows the same comparison versus global equities.

When comparing five-year returns against the S&P 500®, the closest performing asset class was US High Yield Bonds. However, the opportunity cost was over 650 basis points per year! Paying 650 basis points per year for perceived safety seems exorbitant. Although the opportunity cost versus global equities was not nearly as high (the US stock market has outperformed global markets), it was still meaningful. Instead of paying over 650 basis points per year, US High Yield only cost 160 basis points per year. That seems a high cost for an asset class with performance that is strongly correlated to that of equities.

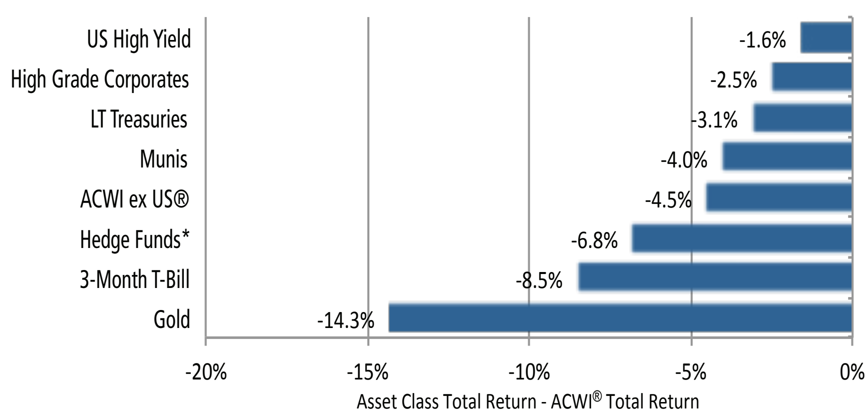
The following two charts show the cost of being scared of equities over the past five years. Chart 2 shows the relative performance of various asset classes' annualized returns versus the S&P 500®'s, and Chart 3 shows the same comparison versus global equities.

CHART 2:
Asset Class Opportunity Cost of Avoiding US Equities: Past 5 - Year Annualized as of 10/31/16



Source: Richard Bernstein Advisors LLC, MSCI, Standard & Poor's, BofA Merrill Lynch, Bloomberg Finance L.P. * Hedge Fund performance not yet reported for 10/31/16 so is lagged a month. For Index descriptors, see "Index Descriptions" at end of document.

CHART 3:
Asset Class Opportunity Cost of Avoiding Global Equities: Past 5 - Years Annualized as of 10/31/16



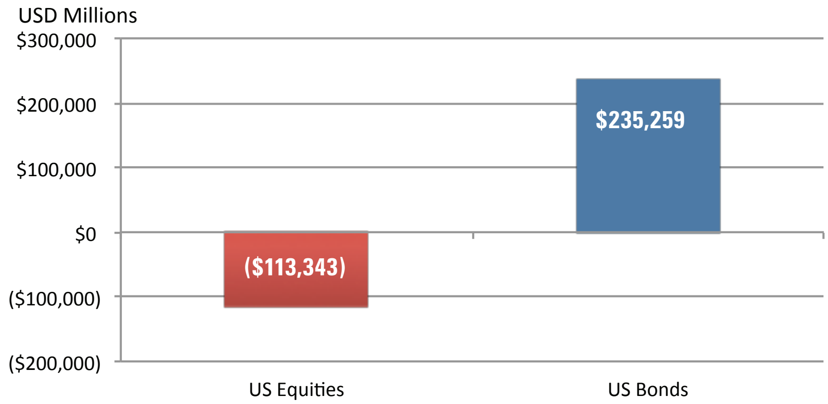
Source: Richard Bernstein Advisors LLC, MSCI, Standard & Poor's, BofA Merrill Lynch, Bloomberg Finance L.P. * Hedge Fund performance not yet reported for 10/31/16 so is lagged a month. For Index descriptors, see "Index Descriptions" at end of document.

Is your portfolio missing out?

It is incredible that investors have basically been wallflowers during the second longest bull market of the post-war period. Investors' fears about 2008's bear market repeating has led them to avoid equities and take unrecognized risks in other asset classes. Chart 4 highlights that this misallocation of investment capital has continued even during the last year.

Investors' fears about 2008's bear market repeating has led them to avoid equities and take unrecognized risks in other asset classes.

CHART 4:
Cumulative US Mutual Fund & ETF Flows: Past 12-Months (Thru 10/31/16)



Source: Investment Company Institute (ICI).
October flows based on ICI weekly estimated flows.

Meanwhile, pensions remain underfunded, hedge fund performance has suffered, and individuals are worried about saving for retirement as the opportunity cost of not investing in equities grows. Proper asset allocation could help alleviate some of those issues.

It's prudent to be somewhat fearful of riskier assets, but one needs to judge the opportunity cost and potential returns one is giving up to protect one's portfolio against downside risk. As we have since 2010, we believe that investors are too scared of the equity market and are paying too much for downside protection. Their portfolios may be missing out.

To better understand how RBA's portfolios reflect these comments, please contact your local RBA Representative. (http://www.rbadvisors.com/images/pdfs/Portfolio_Specialist_Map.pdf).

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.

S&P 500®: Standard & Poor's (S&P) 500® Index. The S&P 500® Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad US economy through changes in the aggregate market value of 500 stocks representing all major industries.

ACWI®: MSCI All Country World Index (ACWI®): The MSCI ACWI® Index is a widely recognized, free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of developed markets.

ACWI® ex US: MSCI ACWI® exluding United States Index : The MSCI World Index ex-US index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of developed markets excluding the United States..

Gold: Gold Spot USD/oz Bloomberg GOLDS Commodity. The Gold Spot price is quoted as US Dollars per Troy Ounce.

Hedge Fund Index: HFRI Fund Weighted Composite Index. The HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 2,000 single-manager funds that report to the HFR (Hedge Fund Research) database. Constituent funds report monthly net-of-all-fees performance in USD and have a minimum of $50 million under management or a twelve (12)-month track record of active performance. The Index includes both domestic (US) and offshore funds, and does not include any funds of funds.

3-Mo T-Bills: BofA Merrill Lynch 3-Month US Treasury Bill Index. The BofA Merrill Lynch 3-Month US Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. The Index is rebalanced monthly and the issue selected is the outstanding Treasury Bill that matures closest to, but not beyond, three months from the rebalancing date.

Long-term Treasury Index: BofA Merrill Lynch 15+ Year US Treasury Index. The BofA Merrill Lynch 15+ Year US Treasury Index is an unmanaged index comprised of US Treasury securities, other than inflation-protected securities and STRIPS, with at least $1 billion in outstanding face value and a remaining term to final maturity of at least 15 years.

Municipals: BofA Merrill Lynch US Municipal Securities Index. The BofA Merrill Lynch US Municipal Securities Index tracks the performance of USD-denominated, investment-grade rated, tax-exempt debt publicly issued by US states and territories (and their political subdivisions) in the US domestic market. Qualifying securities must have at least one year remaining term to final maturity, a fixed coupon schedule, and an investment-grade rating (based on an average of Moody's, S&P and Fitch). Minimum size requirements vary based on the initial term to final maturity at the time of issuance.

High Grade Corporates: BofA Merrill Lynch 15+ Year AAA-AA US Corporate Index. The BofA Merrill Lynch 15+ Year AAA-AA US Corporate Index is a subset of the BofA Merrill Lynch US Corporate Index (an unmanaged index comprised of USD-denominated, investment-grade, fixed-rate corporate debt securities publicly issued in the US domestic market with at least one year remaining term to final maturity and at least $250 million outstanding) including all securities with a remaining term to final maturity of at least15 years and rated AAA through AA3, inclusive.

U.S. High Yield: BofA Merrill Lynch US Cash Pay High Yield Index. The BofA Merrill Lynch US Cash Pay High Yield Index tracks the performance of USD-denominated, below-investment-grade-rated corporate debt, currently in a coupon-paying period, that is publicly issued in the US domestic market. Qualifying securities must have a below-investment-grade rating (based on an average of Moody's, S&P and Fitch) and an investment-grade-rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long-term sovereign debt ratings), at least one year remaining term to final maturity, a fixed coupon schedule, and a minimum amount outstanding of $100 million.

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 $3.1 billion collectively under management and advisement as of October 31st 2016. 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 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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