RBA Investment Committee

Richard Bernstein Advisors LLC (RBA) is an investment manager 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.

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You can lead a horse to water, but you can't make it lend

Introductory economics classes discuss monetary policy's inconsistent lead times. Many observers have described monetary policy as a blunt tool with which to steer the economy because of the unpredictability of both the timing and magnitude of effects associated with the easing or tightening of monetary policy.

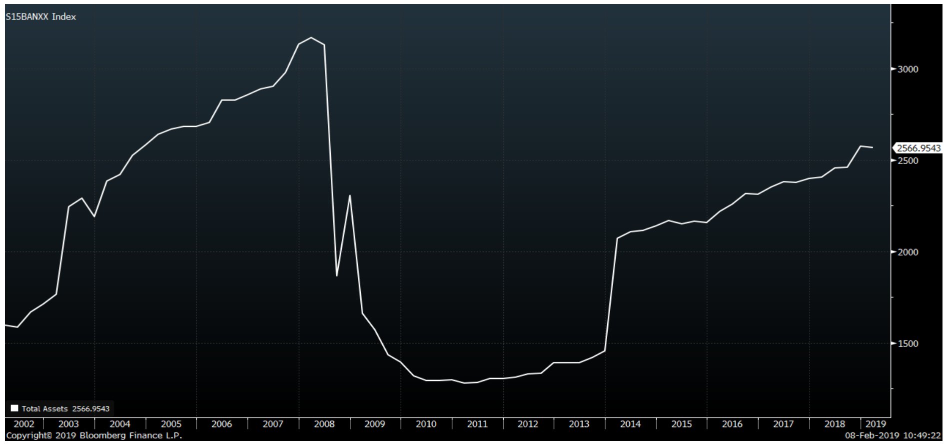
A primary cause for that unpredictability is that the Federal Reserve cannot force banks to lend or not lend. The Fed might prefer a certain monetary policy track, but there is no guarantee that the private sector banking system will abide by the Fed's desires. At the trough of a cycle, banks perceive lending to be so risky that their risk aversion can overwhelm the Fed's desire for the banks to increase lending. That in turn forces the Fed to further ease monetary policy. Such risk aversion was so prevalent during the last recession that even 0% interest rates did not spur lending. We coined the phrase at that time, "you can lead a horse to water, but you can't make it lend".

At the peak of a cycle, however, banks' lending profits can be so large that the thirst to lend more overwhelms the Fed's desire for the banks to calm down. That in turn forces the Fed to further tighten policy. In most cycles, the Fed eventually tightens too much, and a recession subsequently occurs.

Chart 1 shows the total assets of the S&P 1500® Supercomposite Bank Index. Bank assets grew at a rapid pace in 2006/7 despite lending risk increasing significantly and the Fed raising rates. Bank assets then fell precipitously after 2008's recession and it took years for banks to again expand their balance sheets. There are, of course, many reasons why bank balance sheets might change in size other than monetary policy. One should also examine accounting changes, regulatory changes, and the like. Nonetheless, bank balance sheets during the past 20 years reflect the long-standing problems associated with the lags associated with monetary policy.

Bank assets grew at a rapid pace in 2006/7 despite lending risk increasing significantly and the Fed raising rates. Bank assets then fell precipitously after 2008's recession and it took years for banks to again expand their balance sheets.

CHART 1:
S&P 1500® Supercomposite Banks Index: Total Assets (Mar. 2002 – Jan. 2019)



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

Once again, this cycle is more normal than investors believe

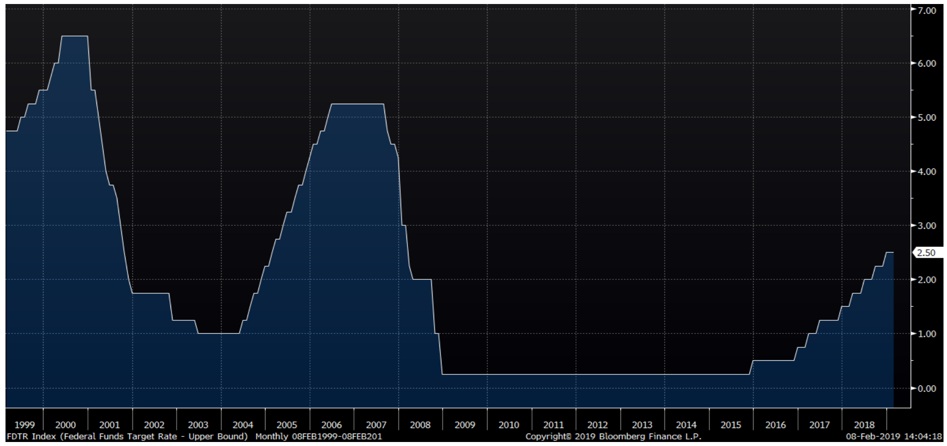
The current economic cycle remains remarkably normal despite claims that the cycle is unique or unprecedented. Similarly, the relationship between the Fed's desire to set monetary policy and the banks' business decisions have been somewhat out of step. As in previous cycles, the Fed raised rates before banks began to tighten credit.

Chart 2 shows the Fed's target rate for Fed Funds, and the Fed started raising rates (i.e., tightening policy) in December 2015. However, Charts 3-5 highlight that banks have only recently begun to tighten credit policies. These charts come from the Fed's Senior Loan Officer Opinion Survey, and rising lines suggest a tightening of credit conditions. In some cases, such as Commercial and Industrial (C&I) Loans, banks were easing credit conditions during 2016 and 2017 despite that the Fed was tightening monetary policy.

The Fed has recently seemed squeamish about continuing to tighten monetary policy considering increased equity market volatility. However, the Fed's survey of loan officers suggests that loan officers are tightening lending standards. Should this trend continue, banks would seem to be moving in the opposite direction of the Fed.

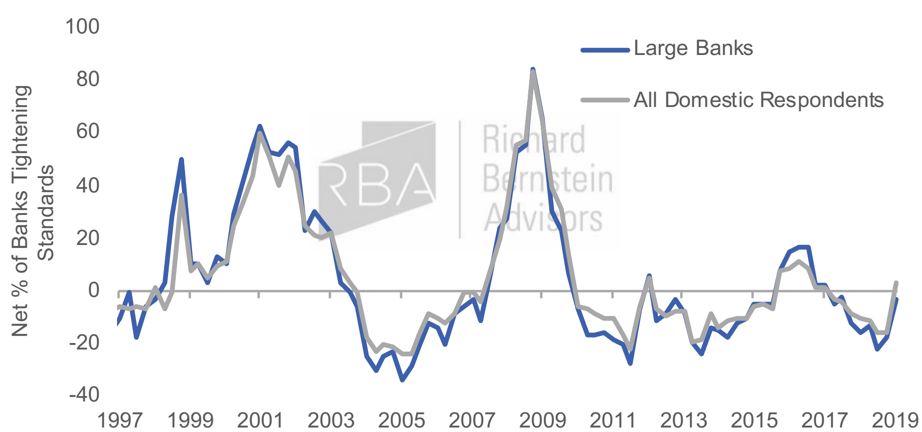
Fed's target rate for Fed Funds, and the Fed started raising rates (i.e., tightening policy) in December 2015.

CHART 2:
Fed Funds Target Rate
(Jan. 1999 – Jan. 2019)



Source: Bloomberg Finance L.P.

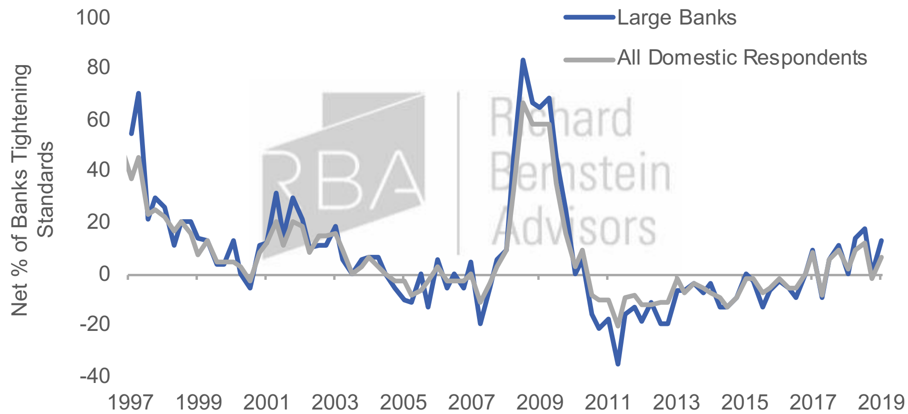
CHART 3:
Credit Standards: C&I* Loans to Large & Medium Firms
(Jan. 1997 – Jan. 2019)



Source: Richard Bernstein Advisors LLC. FRB. *Commercial and Industrial. For Index descriptors, see "Index Descriptions" at end of document.

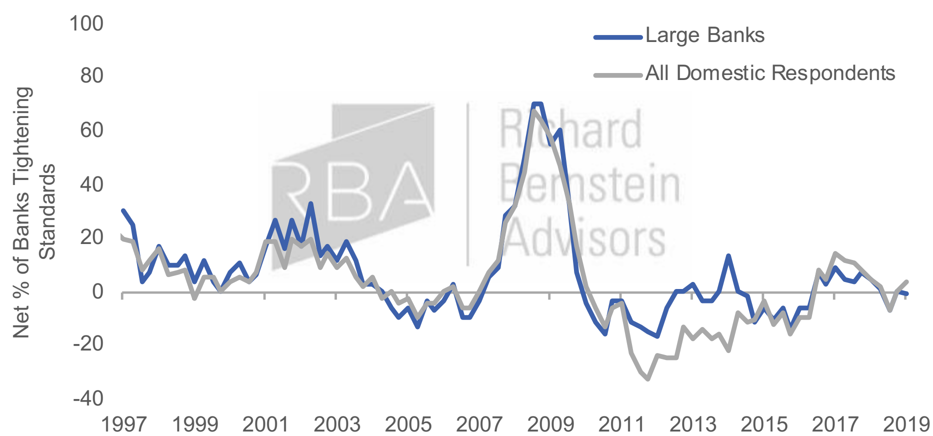
Banks have only recently begun to tighten credit policies. These charts come from the Fed's Senior Loan Officer Opinion Survey, and rising lines suggest a tightening of credit conditions. In some cases, such as Commercial and Industrial (C&I) Loans, banks were easing credit conditions during 2016 and 2017 despite that the Fed was tightening monetary policy.

CHART 4:
Credit Standards: Consumer Credit Card Loans
(Jan. 1997 – Jan. 2019)



Source: Richard Bernstein Advisors LLC. FRB. For Index descriptors, see "Index Descriptions" at end of document.

CHART 5:
Credit Standards: Consumer ex Credit Card Loans
(Jan. 1997 – Jan. 2019)



Source: Richard Bernstein Advisors LLC. FRB. For Index descriptors, see "Index Descriptions" at end of document.

Market implication: watch banks not the Fed

The Fed has recently indicated that the equity market's volatility has influenced the path of monetary policy, and many investors have suggested that a swift and sudden decline in equity prices would cause the Fed to ease. The markets, however, seem skeptical.

The slope of the yield curve, a reliable leading indicator of the economy, has continued to flatten. The yield spread between the 10-year t-note and the 2-year t-note was about 35 basis points before the fourth quarter's financial market volatility. It is currently about 17 basis points, or roughly half as steep as it was before the recent period of increased volatility and concern. (See Chart 6.)

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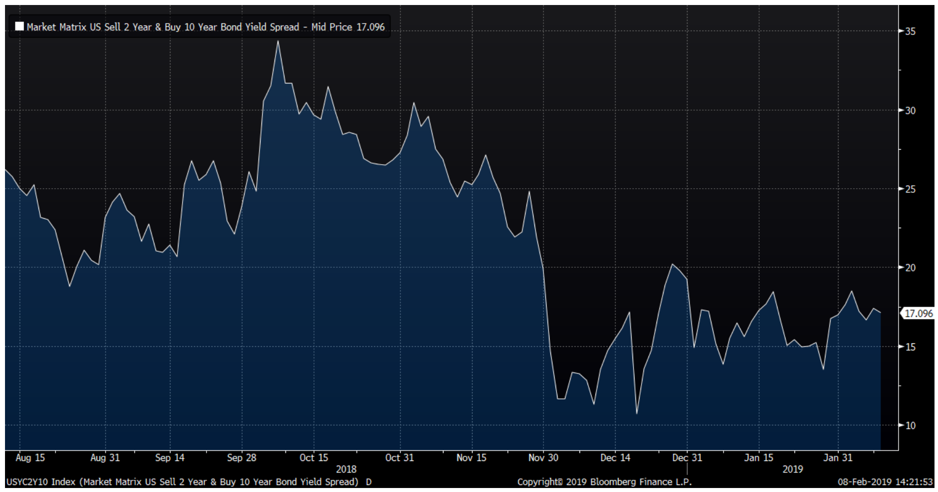
CHART 6:
Slope of the Yield Curve: 10-Yr Treasury – 2-Yr Treasury (Aug. 2018 – Jan. 2019)



Source: Bloomberg Finance L.P.

A flat, but not inverted, yield curve has not historically been a warning signal. However, we find it curious that investors were very worried about the flattening yield curve when the 10-2 spread was twice what it is today, but today seem relatively unconcerned. The curve seems to be paying more attention to actual lending conditions (i.e., the loan officers) than to the Fed's rhetoric.

RBA's portfolios

Our portfolios remain relatively conservative based largely on our view that profits growth will significantly decelerate during 2019. A further tightening of actual lending conditions would further support that positioning:

Our US equity positions focus on stability and quality of earnings growth because those factors tend to perform well when profits decelerate.

Outside the US, we are overweight Chinese stocks because China is the only major country attempting to stimulate its economy, and because China is one of only two major economies with accelerating leading economic indicators.

Our fixed-income portfolios are positioned with very short duration and very high quality. Lower quality companies' cash flows are likely to come under increased pressure if profits decelerate and credit conditions continue to tighten.

To learn more about RBA's disciplined approach to macro investing, please contact your local RBA representative.
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 1500® Supercomposite Bank Index: Standard & Poor's (S&P) 1500® Composite Bank Index: The S&P 1500® Composite Bank Index is an unmanaged, capitalization-weighted index designed to measure the performance of companies included in the S&P 1500® that are classified as members of the GICS® Level 2 Banks industry group.

Credit Standards: Measures the net percentage of respondents tightening based on the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices. The Senior Loan Officer Opinion Survey includes up to eighty large domestic banks and twenty-four U.S. branches and agencies of foreign banks. Questions cover changes in the standards and terms of the banks' lending and the state of business and household demand for loans. Note due to changes in the FRB's categories, the Consumer Loans ex Credit Cards data is compiled as the "Consumer loans excluding credit cards" category prior to 2011 Q2, and is the sum of the "New and used autos" and the "Consumer loans excluding credit cards and autos" categories for the period 2011 Q2 through present.

About Richard Bernstein Advisors

Richard Bernstein Advisors LLC is an investment manager. RBA partners with several firms including Eaton Vance Corporation and First Trust Portfolios LP, and currently has $9 billion collectively under management and advisement as of January 31st, 2019. RBA acts as sub-advisor for the Eaton Vance Richard Bernstein Equity Strategy Fund, 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. 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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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.

Richard Bernstein Advisors