



Richard
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Diversification remains difficult

April 12, 2012

Our firm believes three core principles build long-term wealth:

- 1) Extend the investment time horizons.
- 2) Compound dividend income.
- 3) Truly diversify portfolios.

Although these principles sound obvious, few investors actually follow them consistently.

In particular, we remain quite concerned that investors appear grossly under-diversified. Diversification is not dependent on the number of asset classes, but rather it depends on the correlations among those asset classes. Because correlations among asset classes have been so high, investors must be extra careful to ensure portfolios are indeed well-diversified.

Many have claimed that asset classes began to correlate highly during and subsequent to 2008's bear market, but we disagree. There was evidence that asset class correlations were rising as far back as 2005/2006. These correlations have been so high for so long that one could consider the period of high asset class correlations to be a secular event rather than a short-term statistical blip.

The following charts show the correlations between the S&P 500[®] and various asset classes through time. There are several factors worth noting:

- 1) Correlations are dynamic rather than static. Investors should not assume that past correlation studies are accurate today. For example, correlations today are vastly different from those of ten years ago.
- 2) One can make short-term correlations yield any desired result by using different time periods or frequency of returns. For that reason, we examine the trend in correlations. We believe this is a much more meaningful statistic because it incorporates longer-term investment results.
- 3) As was true six years ago, treasuries are the only major asset class that has negative correlation to equities. As such, we continue to maintain larger-than-consensus weights in treasuries in our asset allocation strategies to help reduce portfolio volatility.



Chart 1:

“Asset Classes that 10 years ago provided diversification are now much more correlated to the S&P 500.”

“Treasuries remain the only asset class with a negative correlation to equities.”

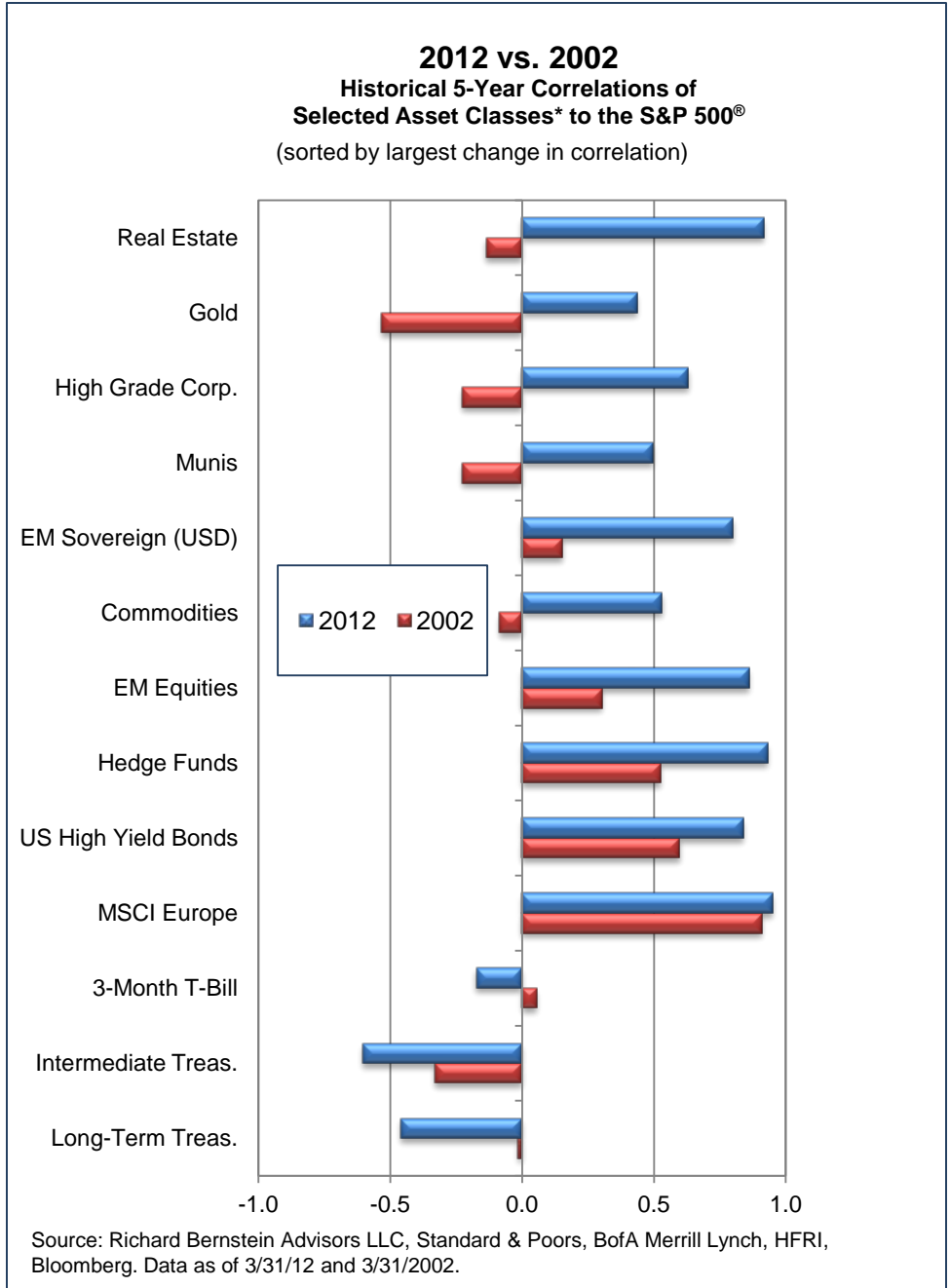




Chart 2:

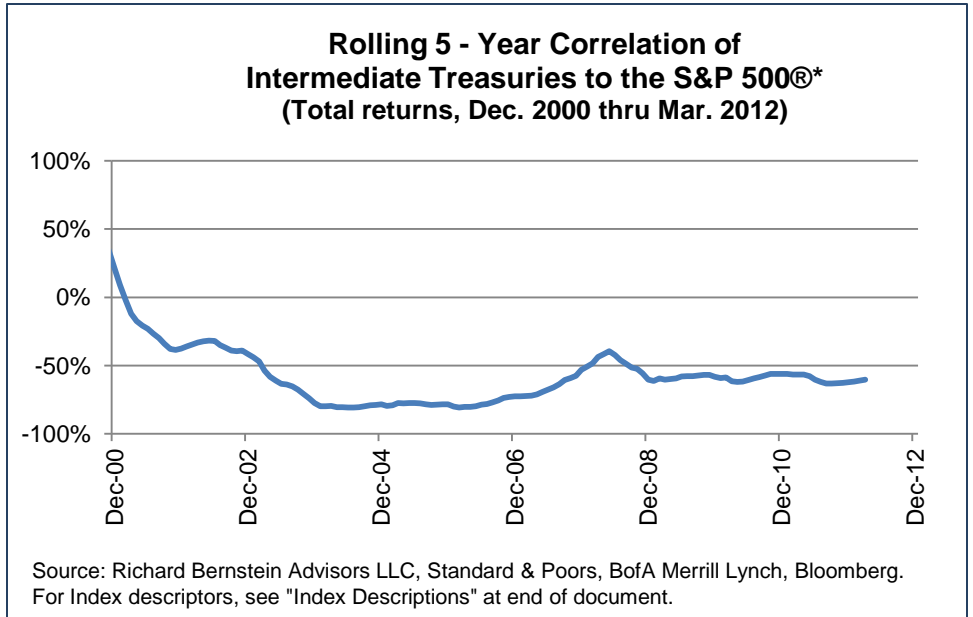
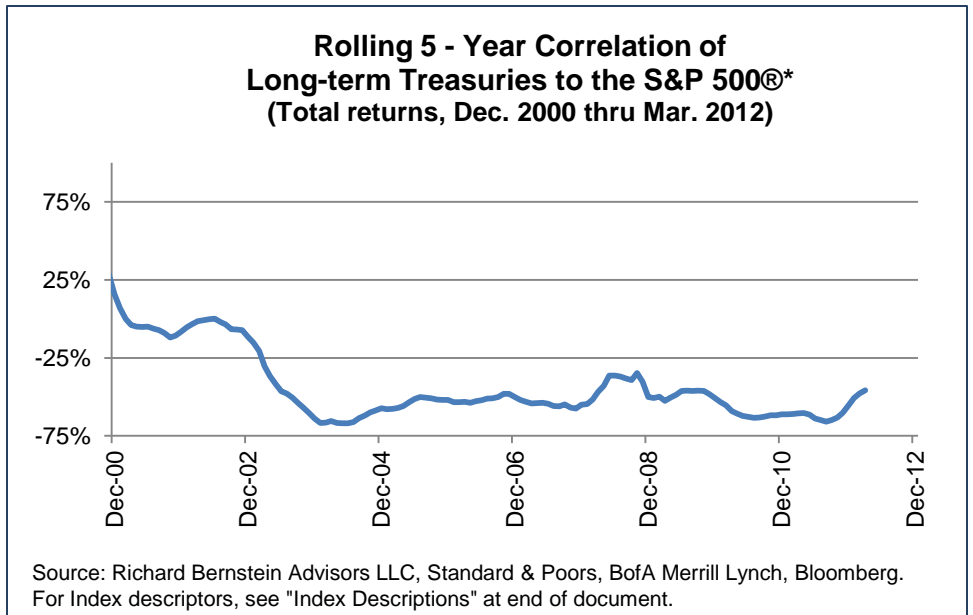


Chart 3:



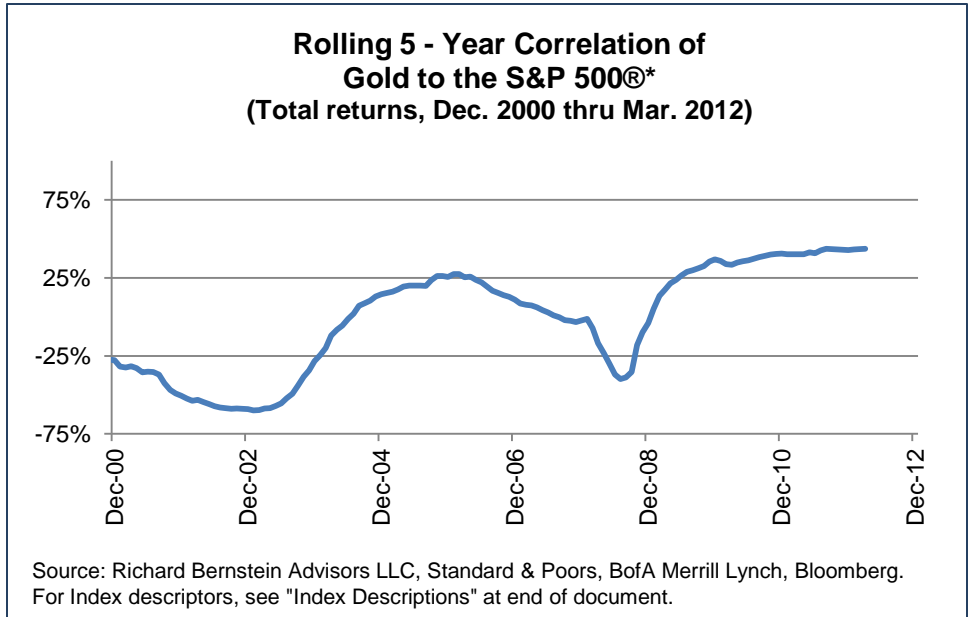
“We continue to maintain larger than consensus weights in Treasuries in our asset allocation strategies to help reduce portfolio volatility.”

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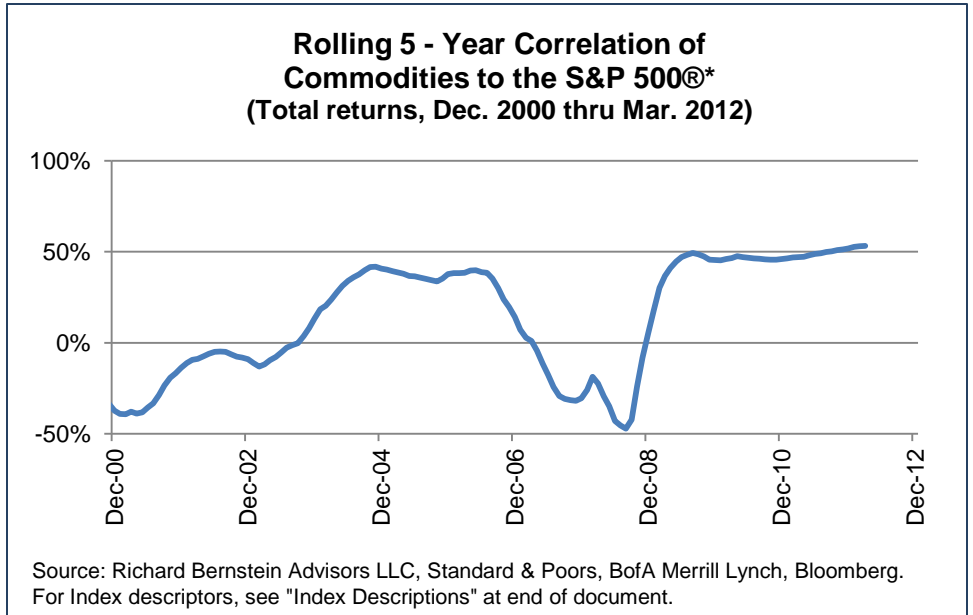


Chart 4:



“Gold and commodities are no longer major diversifiers as they were 10 years ago.”

Chart 5:



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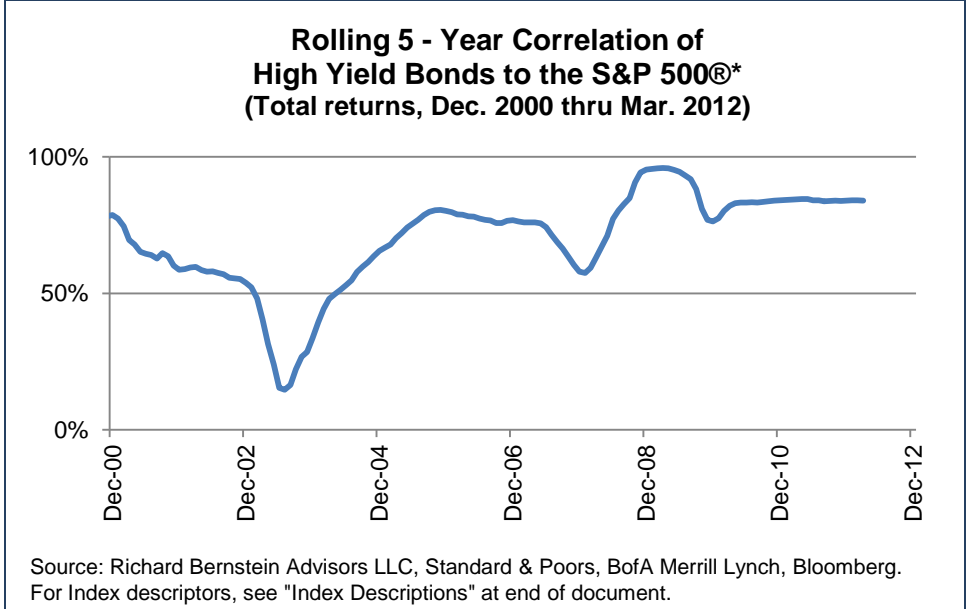
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Chart 6:



“Even munis are now
more highly correlated
to stocks.”

Chart 7:



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“Investors might be surprised to see how highly correlated their emerging market stocks are to the S&P 500.”

Chart 8:

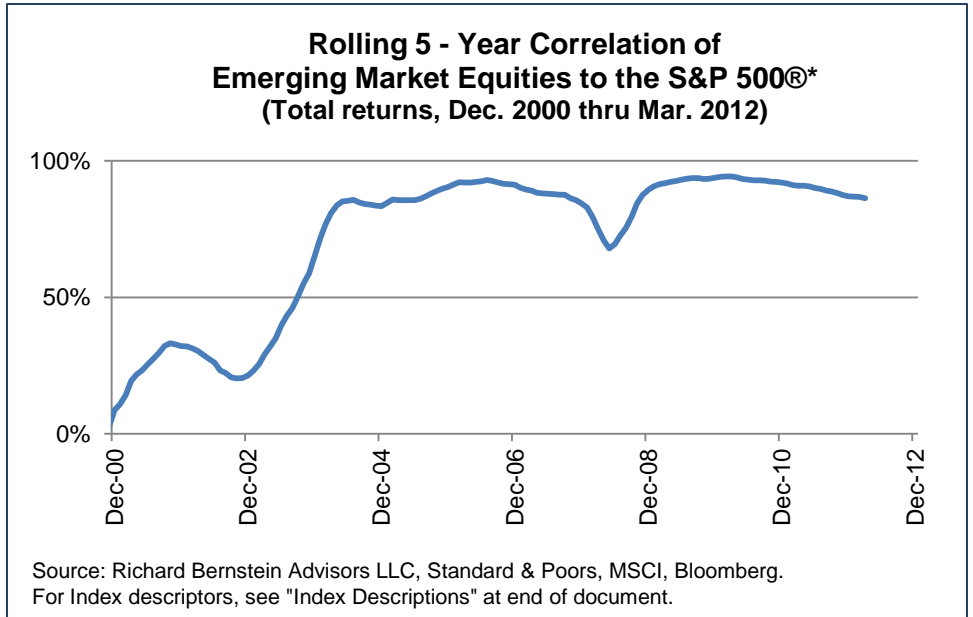
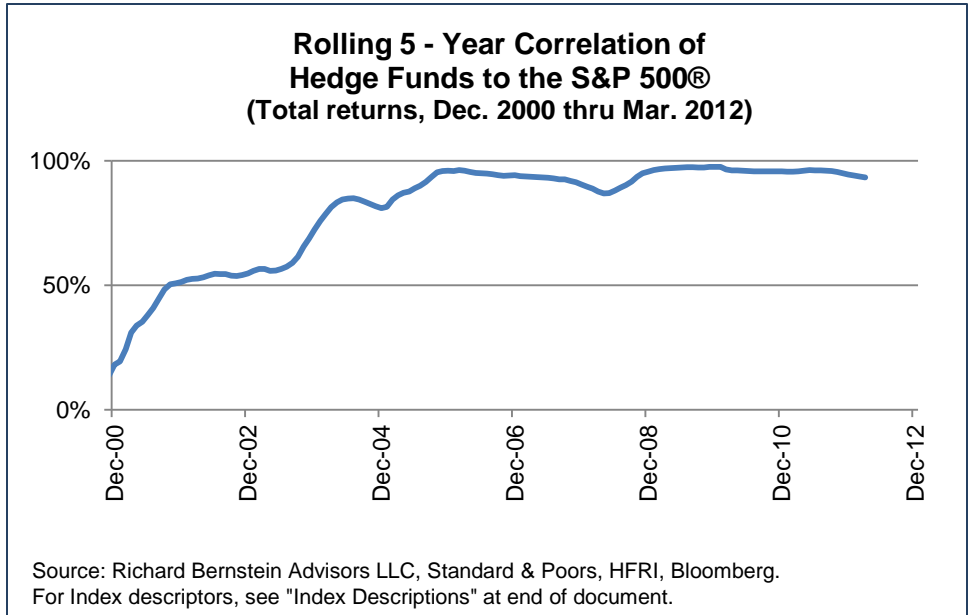


Chart 9:



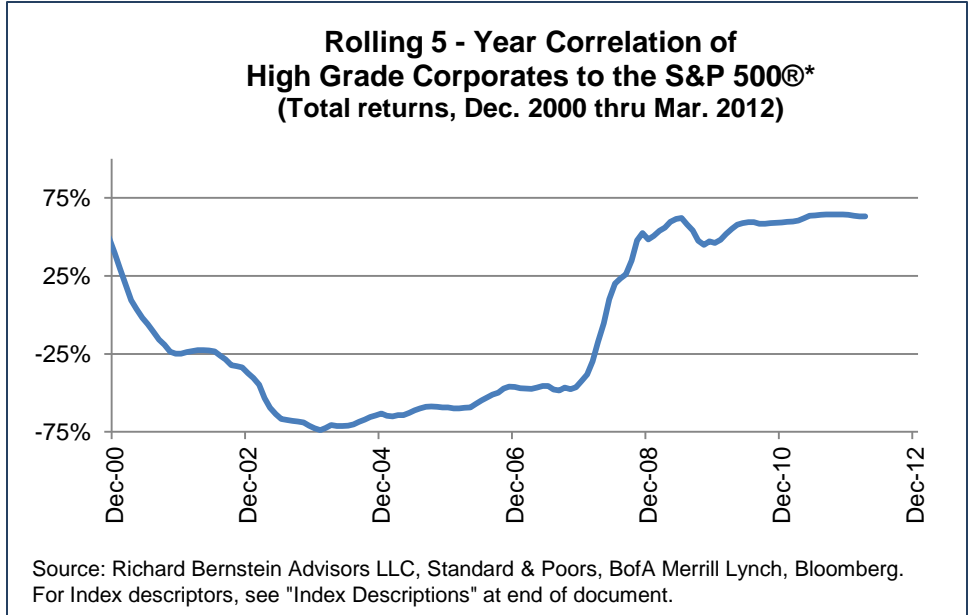
“Hedge Funds provide little diversity in an overall portfolio.”

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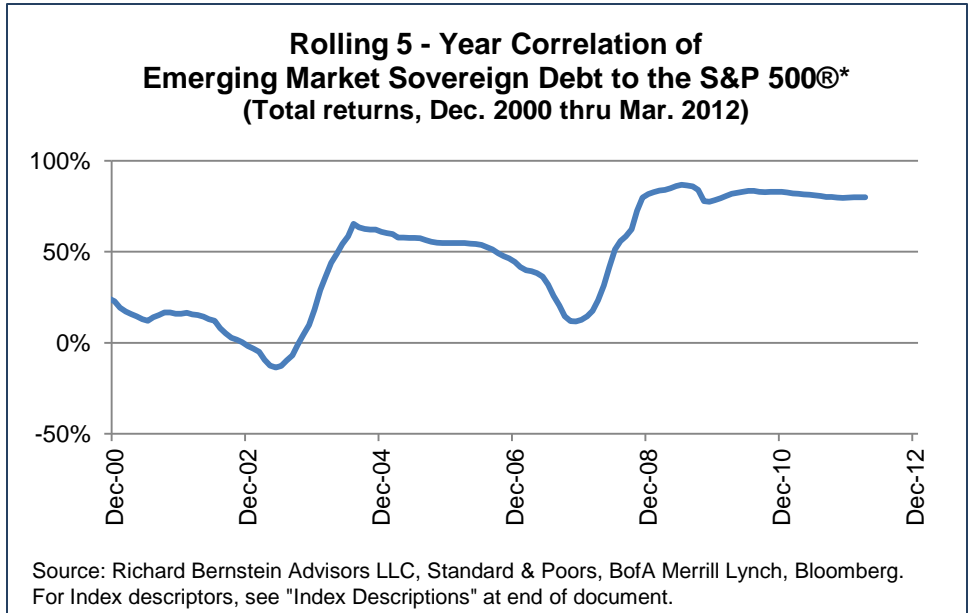


Chart 10:



“Corporates and EM debt have seen correlations rise significantly since 2006.”

Chart 11:





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“Even REITs – once thought of as great diversifiers – today are highly correlated to stocks.”

Chart 12:

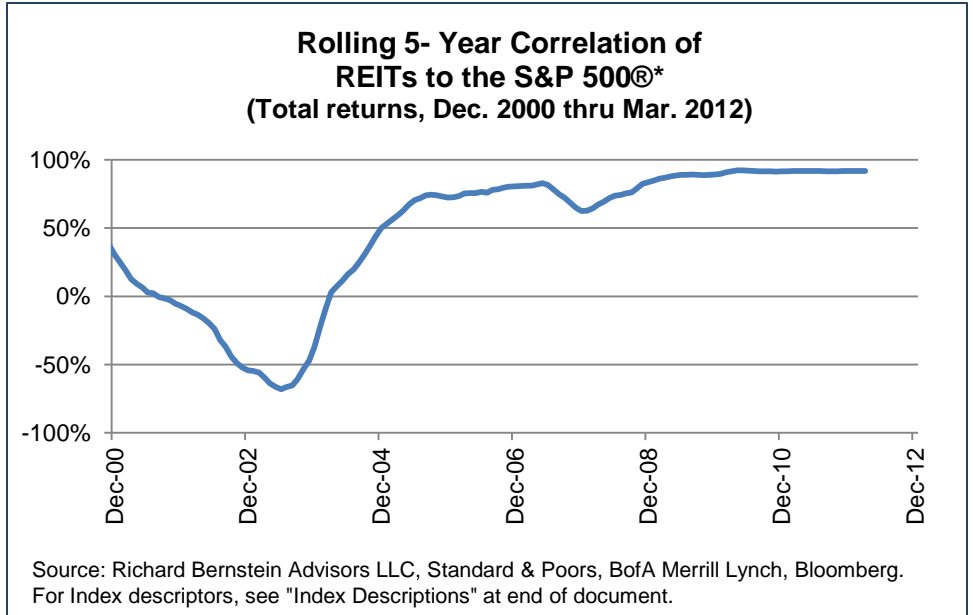
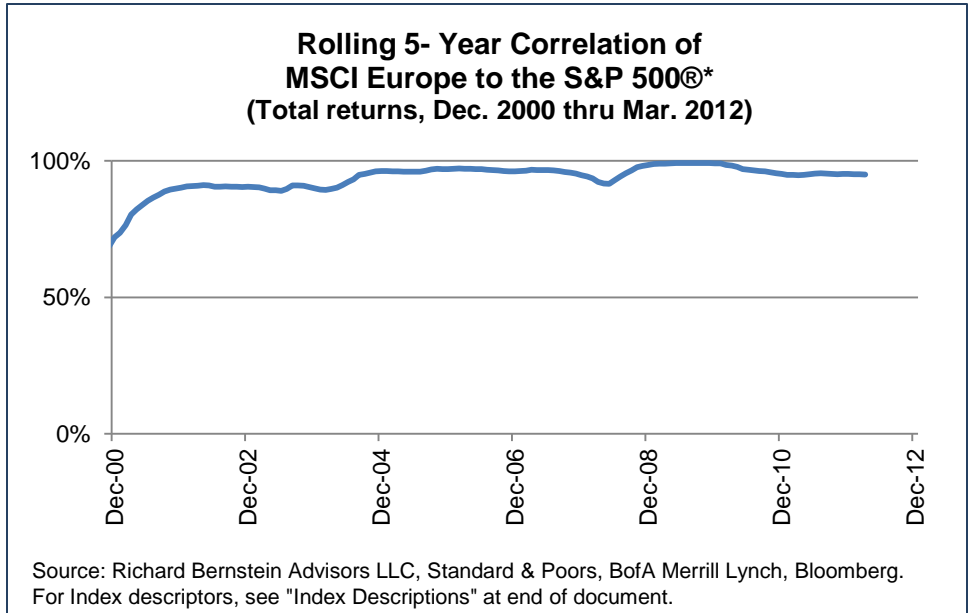


Chart 13:



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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.**

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.

Europe: MSCI Europe Index. The MSCI Europe Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of the developed markets in Europe. The MSCI Europe Index consists of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom

EM Equity: MSCI Emerging Markets (EM) Index. The MSCI EM Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of emerging markets.

U.S. Small Caps: Russell 2000 Index. The Russell 2000 Index is an unmanaged, capitalization-weighted index designed to measure the performance of the small-cap segment of the US equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index.

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

Commodities: S&P GSCI® Index. The S&P GSCI® seeks to provide investors with a reliable and publicly available benchmark for investment performance in the commodity markets, and is designed to be a "tradable" index. The index is calculated primarily on a world production-weighted basis and is comprised of the principal physical commodities that are the subject of active, liquid futures markets.

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.

REITS: THE FTSE NAREIT Composite Index. The FTSE NAREIT Composite Index is a free-float-adjusted, market-capitalization-weighted index that includes all tax qualified REITs listed in the NYSE, AMEX, and NASDAQ National Market.

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.



INDEX DESCRIPTIONS: cont'd

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.

Intermediate Treasuries (5-7 Yrs): The BofA Merrill Lynch 5-7 Year US Treasury Index. The BofA Merrill Lynch 5-7 Year US Treasury Index is a subset of The BofA Merrill Lynch US Treasury Index (an unmanaged index which tracks the performance of US dollar denominated sovereign debt publicly issued by the US government in its domestic market). Qualifying securities must have at least one year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of \$1 billion, including all securities with a remaining term to final maturity greater than or equal to 5 years and less than 7 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 least 15 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.

EM Sovereign: The BofA Merrill Lynch US Dollar Emerging Markets Sovereign Plus Index The BofA Merrill Lynch US Dollar Emerging Markets Sovereign Plus Index tracks the performance of US dollar denominated emerging market and cross-over sovereign debt publicly issued in the eurobond or US domestic market. Qualifying countries must have a BBB1 or lower foreign currency long-term sovereign debt rating (based on an average of Moody's, S&P and Fitch). Countries that are not rated, or that are rated "D" or "SD" by one or several rating agencies qualify for inclusion in the index but individual non-performing securities are removed. Qualifying securities must have at least one year remaining term to final maturity, a fixed or floating coupon and a minimum amount outstanding of \$250 million. Local currency debt is excluded from the Index.