Richard Bernstein Advisors

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Research

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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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China vs. Brazil

Highlights:

Latin America remains our favorite Emerging Market region. Sharply accelerating profits, supportive leading indicators, and bargain valuations make Brazil and Latin America overall seem very attractive. At the other extreme, Chinese equities (our favorite from 2019 to early 2021) appear very unattractive because of peaking profits growth, expensive valuations, and a weak liquidity backdrop.

- **Brazil's profits growth is now faster than China's!** Corporate profits growth in Brazil recently surged past that in China. We expect growth to peak for both countries in the second half of the year, but strong leading indicators suggest more resilient growth in Brazil than in China. Government policies in China might also hamper future profits growth.
- **Brazil stocks remain a significant contrarian play**. Brazil stocks trade cheap to history whereas China stocks are expensive. We suspect Brazil stocks will reprice higher as investors gain confidence in the recovery.
- **Liquidity turning uncertain**. Liquidity within Brazil and China could be changing and needs close watch. China's credit impulse growth turned negative this spring, but recent policy looks more neutral. Brazil, however, began to incrementally tighten policy this year.

Continue to page 2 for full research report.

As the global economy reopens and as growth matures, investors find themselves looking outside developed economies for opportunities. One of the challenges, however, is that although there have been periods of synchronized growth across many Emerging Market countries, "EM" consists of 27 different countries – each with its own economy, set of risks, and market exposures. As part of a global equity allocation, differentiating between Emerging Market countries is increasingly important when fundamentals diverge. Currently we see opportunities within Latin America – especially Brazil – as tailwinds for growth remain supportive and equities still appear cheap. China, on the other hand, is increasingly facing headwinds from slowing liquidity and drivers of growth.

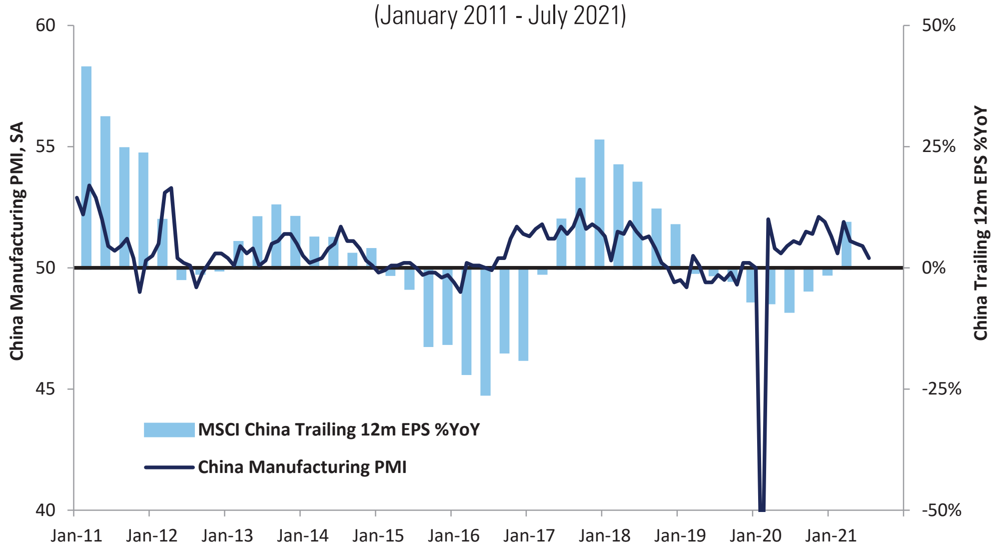
Profits Growth Looks Poised to Diverge in 2H21

Brazilian versus Chinese profits growth is just one of several areas that highlight all Emerging Market countries are not created equal. For example, Brazilian trailing four-quarter profits have grown 94% year-on-year and have been accelerating at among the fastest rates globally, while those for Chinese companies – still increasing 9% in Q2 – have slowed relative to the rest of the world. Although it would be easy to dismiss the Brazilian growth dynamic as driven by 2020 base effects, we have found that markets consistently focus on the change in earnings growth – "better" or "worse" – and less on whether that growth is driven by easy comparisons.

So, even though Chinese profits are growing, and we expect their growth rate to peak next quarter in the mid-20%s, the steep declines in 2020 earnings of Brazilian companies have supercharged 2021 growth rates, which we expect to further accelerate and remain well above 100% through year-end. Further, in 1Q22 – by which time the easy comparisons from 2020 earnings will have rolled out – analysts expect relatively stronger profits growth of Brazilian companies (43% year-on-year) as compared to Chinese companies (17% year-on-year).

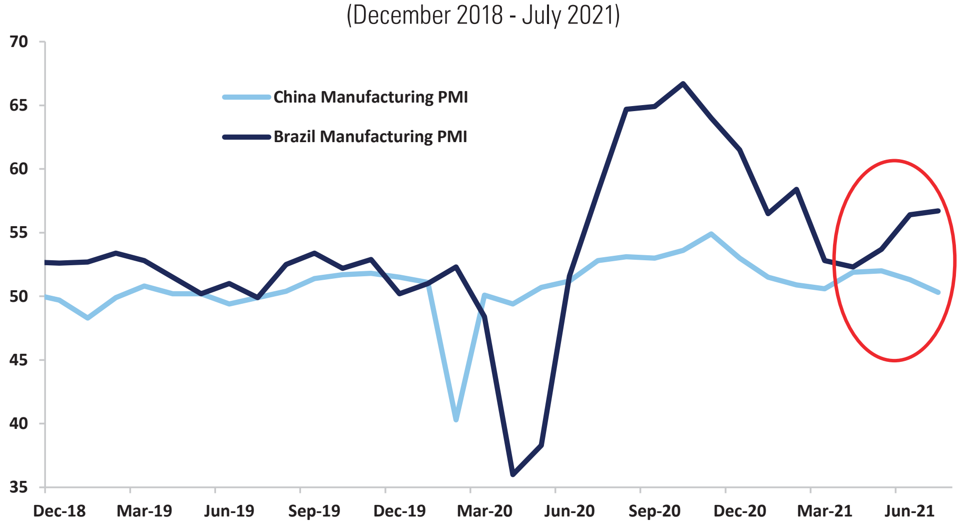
Looking to the future, leading indicators of profits appear resilient in Brazil but weakening in China. Most recently, 6 of the 8 indicators (or 75%) in our Brazil profits cycle model were positive, whereas 7 of the 11 (or 64%) in our China profits cycle model were positive. As an example, our work shows that Purchasing Manager Indices (PMIs) of manufacturing firms have historically provided insight into the direction of future profits growth (Chart 1). Note inflections in China's Manufacturing PMI have historically led to inflections in its profits cycle. Recently, manufacturing PMIs for China have clearly peaked, while those for Brazil have recently reaccelerated (Chart 2), suggesting profits growth for Chinese companies will be moderate while Brazilian companies may see strong growth continue.

CHART 1:
China Manufacturing PMI vs. Trailing 12m EPS %YoY
(January 2011 - July 2021)



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

CHART 2:
Manufacturing PMI for China and Brazil
(December 2018 - July 2021)



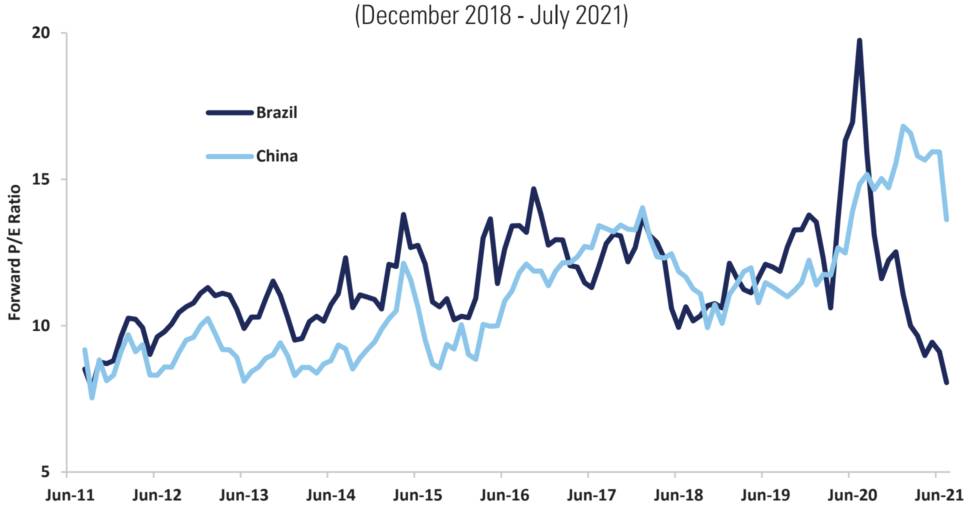
Source: Bloomberg Finance L.P. and Markit. For descriptors, see "Index Descriptions" at end of document.

Brazil Stocks Remain Out-of-Favor

In addition to identifying profit outlooks, our research has shown that sentiment can be a key driver of equity returns as well. With Brazilian stocks lagging the returns of global equities over the last fifteen months, investors still appear skeptical of Brazil's COVID recovery, as shown in Chart 3.

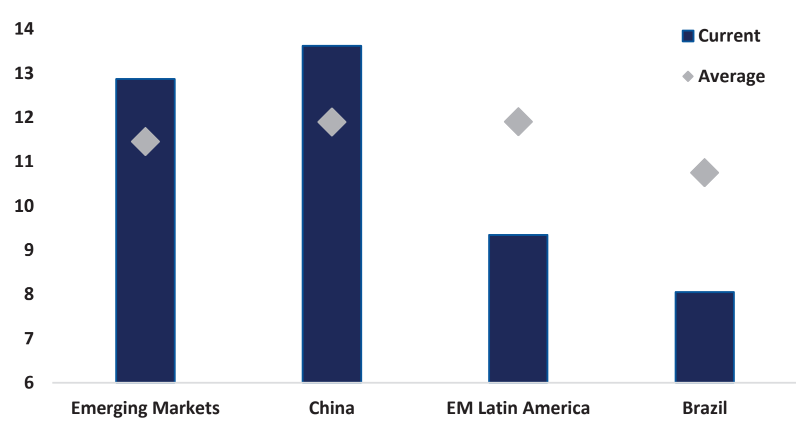
This pessimistic outlook may explain why Brazilian stocks continue to trade at depressed forward price-to-earnings multiples relative to broader Emerging Markets, and especially China (Chart 4). Chinese stocks, conversely, are still rich relative to their historical average, even despite the recent sell-off in Chinese markets. We suspect this is partly due to investors extrapolating China's recovery and their markets behaving as a safe haven during the onset of COVID-19.

CHART 3:
Forward 12m Price-to-Earnings Ratios for Chinese and Brazilian Equities
(December 2018 - July 2021)



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

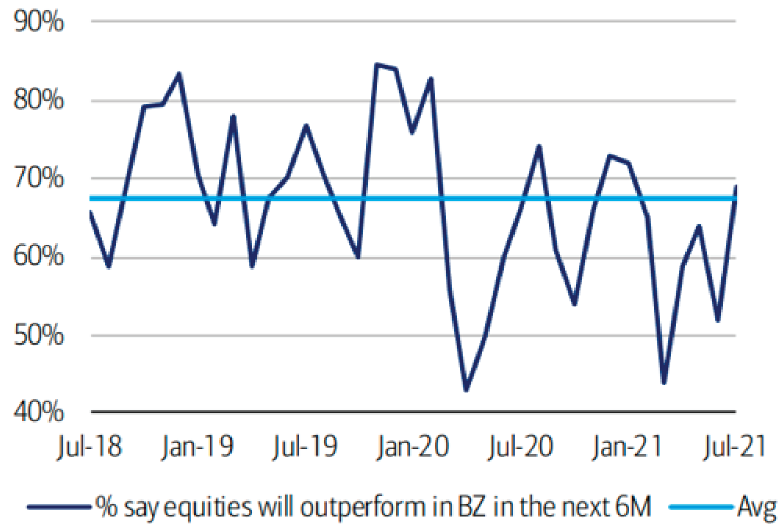
CHART 4:
Forward 12m Price-to-Earnings: Current versus 15-Year Average
(Monthly, As of July 31, 2021)



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

Looking at investor sentiment from another angle, we note that BofA Research's monthly Fund Managers' Survey shows investors have largely been less optimistic on Brazilian stocks since the onset of the pandemic. The July survey noted that investors have become incrementally more constructive on Brazilian stocks, but even with that improvement sentiment is still only just at average levels (Chart 5).

CHART 5:
Sentiment towards equities in Brazil



Source: LatAm Fund Manager Survey

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We anticipate that as Brazilian companies deliver on strong earnings growth, investors will become increasingly constructive on their equity prospects. China's rebound, on the other hand, appears largely priced in, and any earnings disappointment may cause investors to reprice those stocks.

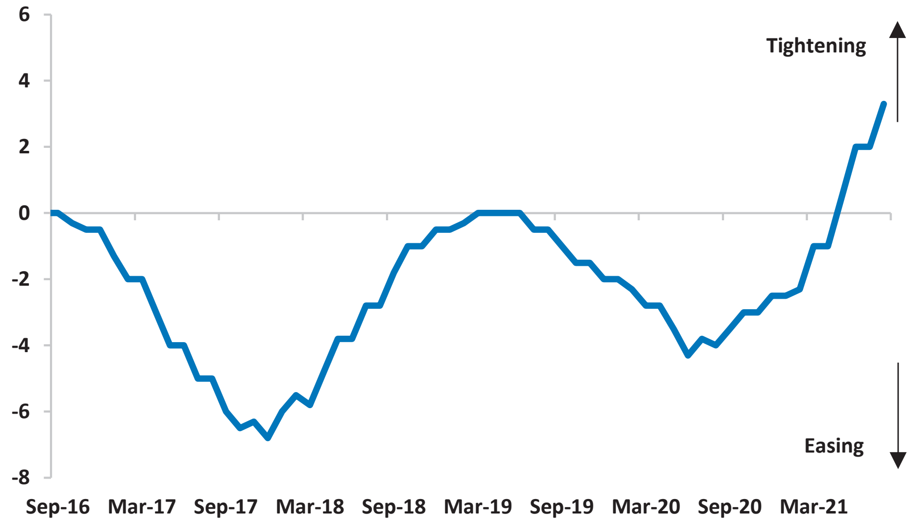
Changing Currents in Liquidity

Over the last 18 months Brazil met the pandemic head on with sizeable fiscal stimulus and a dramatic easing of its policy rate (the Selic), as shown in Chart 6. These policy moves helped stabilize, and more recently, have provided a tailwind to growth. China, on the other hand, enacted fewer pro-growth policies during 2020 and 2021, in part because their domestic economy was damaged less by the pandemic. History suggests that policy tends to work with long lags, and as such we expect Brazil's easing a year ago to continue to positively reverberate throughout the country, particularly in contrast to China.

CHART 6:

Year-over-Year Change in the Selic Rate

(September 2016 – August 2021)



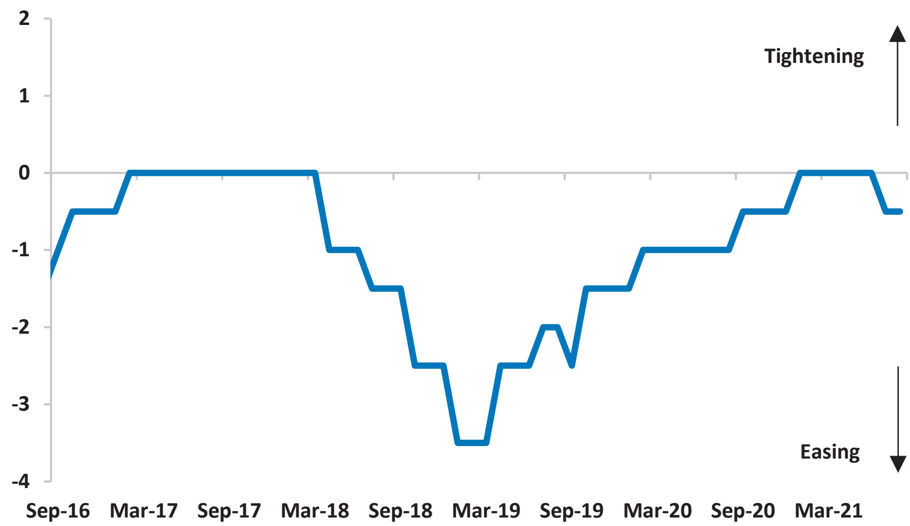
Source: Bloomberg Finance L.P.

More recently, the pace of Brazil's easing has slowed, with the Banco Central do Brasil (BCB) beginning to raise the Selic in March to combat sharply accelerating inflation and following through with three subsequent rate hikes. When the BCB adjusts the Selic rate up or down, it is effectively changing the cost of credit. Although the BCB has been raising rates, the current Selic level remains quite accommodative relative to history. However, the BCB's shift from easing in 2020 to tightening in 2021 may pose a headwind to growth toward year-end and next year.

Turning now to China, the most recent policy move has been one of slight easing rather than tightening. Until recently, the PBOC had left the Required Reserve Ratio (RRR) unchanged, but on July 9th it reduced the rate by 50 basis points for all banks (Chart 7)[1]. Although this change should increase the quantity of credit available, history would suggest reducing the RRR by this magnitude is unlikely to have a substantial impact on credit availability and lending.

[1] The RRR is the minimum amount of reserves that banks must hold rather than lend out.

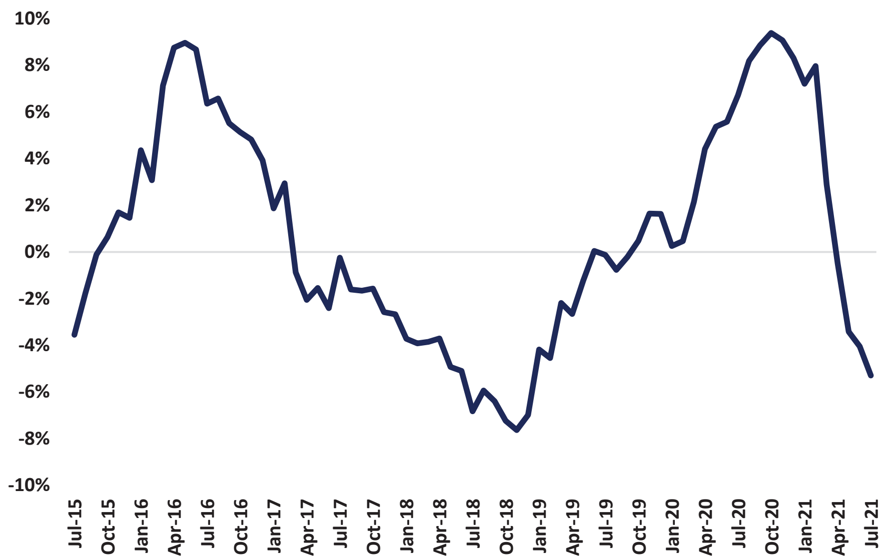
CHART 7:
Year-over-Year Change in the Required Reserve Ratio (RRR)
(September 2016 – August 2021)



Source: Bloomberg Finance L.P.

This policy move also comes on the heels of several quarters of slowing credit growth, as evident from China's slowing and negative 12m change in its credit impulse, which peaked in October 2020 (Chart 8)[2]. We see the RRR reduction as a sign that tighter credit over the last few quarters may have stymied the growth outlook more than desired. We do not expect sustained easing by the PBOC in the immediate future as they remain focused on de-risking the financial sector, and therefore, tight credit likely remains a headwind to accelerating growth in the coming quarters.

CHART 8:
China Credit Impulse, 12 Month Net Change
(July 2015 – July 2021)



Source: Bloomberg Finance L.P.

[2] Credit impulse is the YoY change in new credit as a percentage of trailing four quarter GDP.

Of course, we would be remiss if we did not also mention the recent market volatility and policy news out of China. Within the last month, several companies in China's property market are increasingly showing signs of stress, government reforms were announced on companies in China's tutoring sector, and Chinese regulators took action against several high-profile companies. The direction of China's policy is an important determinant of the outlook for its market, especially to the extent it positively or negatively impacts the profits, liquidity, or sentiment backdrop.

Fundamentals Driving Performance

The brighter outlook for corporate profits growth, cheaper valuations, and a more constructive credit backdrop in Brazil over China highlight that it may be advantageous to be tactical within Emerging Market equities – especially now and during last year. As we stated previously, not all Emerging Market countries are created equal- indeed, in 2021 thus far, there has been over a twelve-percentage-point spread in the performance of Brazil (+3.12%) and China (-9.58%) equities.[3] This is all that more important in times of diverging country fundamentals.

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To learn more about RBA's disciplined approach to macro investing, please contact your local RBA representative.

[3] Performance of MSCI China index and MSCI Brazil index for the period 12/31/2020 – 8/10/2021.

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.**

Brazil: The MSCI Brazil Index. The MSCI Brazil Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of Brazil.

China: The MSCI China Index. The MSCI China Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of China.

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

EM Latin America: The MSCI Emerging Markets Latin America Index. The MSCI Emerging Markets Latin America Index is a free-float-adjusted, market-capitalization-weighted index designed to measure the equity-market performance of EM Latin America.

About Richard Bernstein Advisors

Richard Bernstein Advisors LLC is an investment manager focusing on long-only, global equity and asset allocation investment strategies. RBA runs ETF asset allocation SMA portfolios at leading wirehouses, independent broker/dealers, TAMPS and on select RIA platforms. Additionally, RBA partners with several firms including Eaton Vance Corporation and First Trust Portfolios LP, and currently has $14.7 billion collectively under management and advisement as of July 31st, 2021. 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. RBA's investment insights as well as further information about the firm and products can be found at **www.RBAdvisors.com**.