



**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.

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## Looking for risk in all the wrong places

We recently received an email from a reporter asking whether we were concerned that there was too much good news. We quickly pointed out that bear markets do not typically occur when good news makes investors nervous. Rather, bear markets typically occur when investors ignore an increasing volume of bad news.

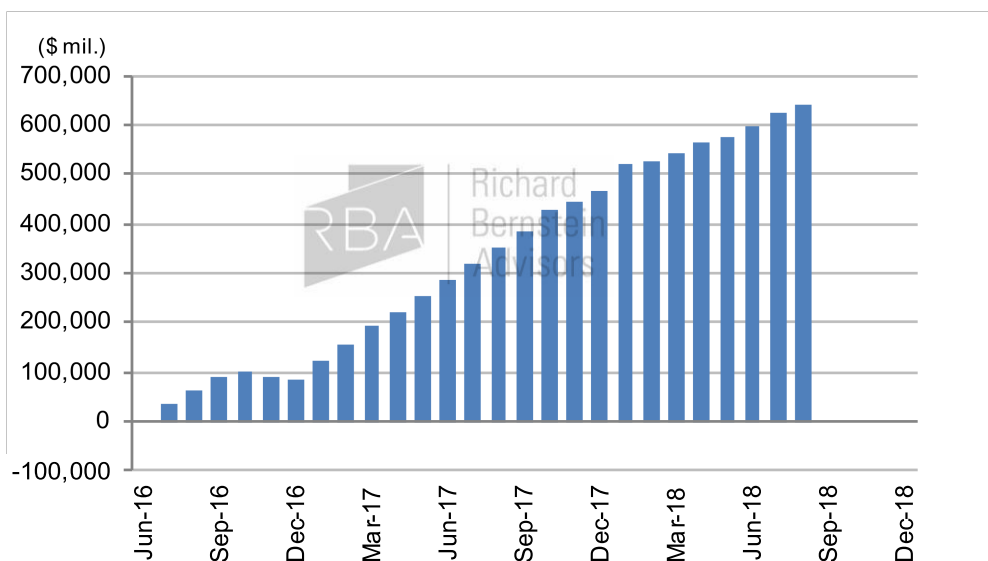
Disregarding or rationalizing deteriorating fundamentals tends to result in higher than expected volatility. Investors generally ignored the deterioration in housing fundamentals prior to 2008, ignored the deterioration of technology fundamentals prior to 2000, but are eagle-eyed regarding every aspect of today's equity market. It's hard to argue that investors are potentially overlooking equity market risk because the data universally show that a broad array of investor classes remains skittish toward equities.

### Ignoring actual risks

We've repeatedly commented that investors are largely ignoring the growing risks in the fixed-income markets. In fact, investors have continued to allocate to fixed income despite that bond market fundamentals have been deteriorating and bonds have been underperforming for more than two years (see Chart 1). When comparing asset class returns since mid-June 2016 (when inflation expectations troughed), only bonds have provided negative total return. Bond investors haven't seen significant negative returns (yet?), but the opportunity cost of investing in bonds instead of other asset classes has been dramatic (see Chart 2).

Inflation risks continue to increase, but fixed-income investors enthusiasm continues unabated. Enthusiasm for an asset class in the face of deteriorating fundamentals seems a classic setup for a significant bear market in bonds. For more on the large and growing risks to fixed-income, see our report "Overheating Ahead" ([http://www.rb advisors.com/images/pdfs/Overheating\\_Ahead.pdf](http://www.rb advisors.com/images/pdfs/Overheating_Ahead.pdf))

**CHART 1:**  
**Cumulative Bond ETF and Fund Flows**  
**(Jun. 30, 2016 – Aug. 31, 2018)**



Source: Richard Bernstein Advisors LLC., ICI

**CHART 2:**  
**Asset Class Performance since Inflation Trough**  
**(Jun. 15, 2016 – Sep. 12, 2018)**



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

**Bond investors haven't seen significant negative returns (yet?), but the opportunity cost of investing in bonds instead of other asset classes has been dramatic**

## Looking for risk in all the wrong places

Marginal borrowers tend to have financing problems when global liquidity dries up. Global liquidity is ample, but is indeed starting to recede. Accordingly, weaker companies and countries are beginning to have the funding problems that accompany the withdrawal of liquidity from the global financial markets. The potential funding issues faced by Turkey and others seem quite normal within this context.

Investors have become increasingly worried whether emerging markets can meet their debt obligations. Some of this fear is normal, but some seems to be looking for risk in all the wrong places.

Chart 3 shows CDS (credit default swaps) spreads for Argentina and Turkey. The rapid increase in the cost of default protection reflects a genuine fear that the significant depreciation in these countries' currencies will make it substantially more difficult for them to meet their US dollar-based obligations.

**The rapid increase in the cost of default protection reflects a genuine fear that the significant depreciation in these countries' currencies will make it substantially more difficult for them to meet their US dollar-based obligations**

**CHART 3:**  
**CDS Spreads: Argentina and Turkey**  
**(Sep.12, 2017 – Sep. 12, 2018)**

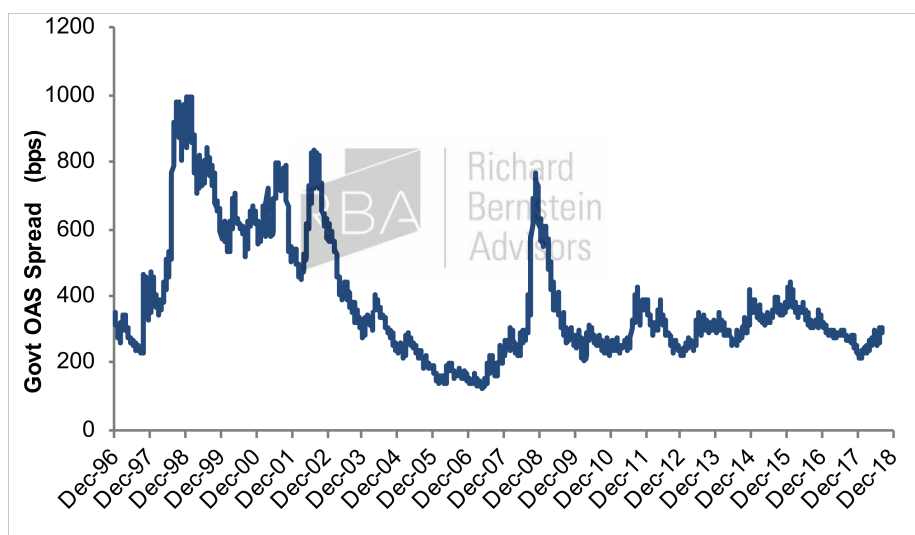


Source: Bloomberg Finance L.P.

Emerging market debt spreads versus US Treasuries have increased, but hardly suggest contagion is imminent

However, one should probably be judicious predicting “contagion” among all emerging markets. Chart 4 shows that emerging market debt spreads versus US Treasuries have increased, but hardly suggest contagion is imminent. Compare today’s spreads to those of the late-1990s when there truly was contagion during the Russian and Asian crises. Investors generally ignored the warning signs during the late-1990s that emerging markets were starting to have funding problems. The result was calamity, and debt spreads severely widened. Investors today talk frequently of emerging market contagion, yet broad emerging market debt markets seem under control.

**CHART 4:**  
**Emerging Market External Sovereign USD: Government OAS Spread\***  
**(Dec. 30, 1996 – Sep. 7, 2018)**



Source: Richard Bernstein Advisors LLC. ICE® BofAML Bond Indices®

The contrast between investor fear and market-related data is even more pronounced in Chart 5, which shows the CDS spreads for China and the US. **Despite all the hoopla regarding trade barriers, etc. CDS spreads for China are narrower than are those for the US!!** We are not suggesting that China is a better credit than is the US, but investors again seem to be looking for risk in all the wrong places. The situations in Argentina and Turkey seem considerably more isolated than investors’ fears and headlines would indicate.

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CDS spreads for China  
are narrower than  
are those for the US

**CHART 5:**  
**CDS Spreads: China vs. US**  
**Jan.1, 2018 – Sep. 12, 2018**



Source: Bloomberg Finance L.P.

Investors seem myopically concerned about equity market volatility, but don't seem very concerned at all regarding the growing risks in fixed-income and seem oblivious to the bonds' already multi-year underperformance.

As we told the reporter, **bear markets don't typically occur when there is too much good news and investors are concerned the good news can't continue. Bear markets are usually fueled by investors disregarding deteriorating fundamentals and rationalizing underperformance. That doesn't seem true of the equity market, but rather seems to depict well today's fixed-income markets.**

*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](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.

**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 global developed and emerging markets.

**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.

**Bloomberg Barclays US Aggregate Bond Index:** The Bloomberg Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

**Bloomberg Barclays Global Aggregate Total Return Index:** The Bloomberg Barclays Global Aggregate Bond Index is a broad-based measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

**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.



**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.

**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 9.3 billion collectively under management and advisement as of August 31<sup>ST</sup>, 2018. RBA acts as subadvisor for the Eaton Vance Richard Bernstein Equity Strategy Fund and the Eaton Vance Richard Bernstein AllAsset 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<sup>®</sup> ETF. Additionally, RBA runs ETF asset allocation SMA portfolios at UBS, Merrill Lynch, Morgan Stanley Smith Barney, Wells Fargo, RBC, Janney, PNC 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](http://www.RBAdvisors.com).

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