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# CONVERSATION SERIES

**Episode 2**

**Tom Herrick:** Welcome to episode two of the CIO Conversation series from Cary Street Partners. I'm Tom Herrick, Cary Street Partners Chief Investment Officer. My guest on this episode is Dan Suzuki, Deputy CIO at Richard Bernstein Advisors.

**Dan Suzuki:** Our preferred investments are in areas of the market where profit fundamentals are starting to improve, but nobody really cares because they've outperformed for so long. And that's the crux of how we look for our best opportunities.

**Tom Herrick:** Dan is a high profile equity market strategist who brings a valued perspective of a firm that is one of our great partners and a firm that is legendary in our business. We'll get Dan's insights into the different sectors of the market and the unique approach that his firm takes. Our conversation covers important issues and timely questions that are front of mind for investors right now.

Dan Suzuki, great to have you on the show.

**Dan Suzuki:** Thanks for having me, Tom. It's a pleasure to be here.

**Tom Herrick:** So we're recording this the morning of March 24th. Our audience can't see it, but Dan is wearing a black armband and mourning for his Duke Blue Devils that didn't make the NCAA basketball tournament for the first time in a bazillion years.

**Dan Suzuki:** Well, Tom, it's definitely a rebuilding year for sure. But one of the reasons that I love Duke, being an alumni, but probably also the reason that everybody hates Duke is that no matter how low we get, how bad it gets, you know that they'll be back. So, I would not be a seller, in fact, if Duke were a stock, you know, it's probably a good contrarian opportunity to buy.

**Tom Herrick:** So let's as we get into the discussion on stocks, let's hope we're not having a rebuilding year in the stock market.

First, it gives people a sense on how Richard Bernstein Advisors works, and I'll reference it as RBA from here on in. But maybe you could just give us a 10,000-foot view of the process to start with.

**Dan Suzuki:** Absolutely. Of course, there's a lot of intangibles that go into it, but I'd say that at the core, you know, the two drivers behind our success are: 1. the type of investing that we do and the discipline around sticking to that and 2. the process by which we analyze and identify investment opportunities. So, you know, the type of investment that we do is it's really top-down macro fundamental investing. And I think that's where there's huge opportunity and less competition, which is sort of the best of both worlds.

And what I mean by macro investing is that we spend zero time considering which stock is better. Instead of the picking stocks, we focus on the bigger allocation exposures. You know, how much stock should you hold versus bonds, cash and commodities? What regions and countries should you be exposed to? You know, how much did you have in each sector or each style of investing? And by virtue of focusing on making investment decisions that ultimately determine a larger portion of portfolio exposures, the impact of the decisions that we make tend to be much greater.

**Tom Herrick:** You guys are incrementally overweighting or underrating, expressing those viewpoints. You're always taking a very diversified approach. You're incrementally, you know, kicking up international versus domestic if you happen to like that as just one potential viewpoint, is that an accurate reflection?

**Dan Suzuki:** That's right. I mean, it can be a region. It can be, you know, overweighting specific sectors, specific styles. Really, you know, the world is our oyster, which I think is great because we're really not limited by where we can go and what we can invest in for

the most part.

And, you know, when you compare that macro approach to stock picking, unless you're running a concentrated portfolio of like 15 to 20 stocks, the impact of single stock decisions just aren't big enough at the portfolio-level to make a big difference. You know, by the way, you know, I say 15 to 20 stocks. I think there was a study done recently that showed that the average advisor portfolio has over 3000 stocks. I mean, it's a far cry from a concentrated portfolio when you consider all the stocks are held by the mutual funds and ETFs that people hold.

**Tom Herrick:** If you typically have a model of mutual funds, for instance, and you had, I don't know, a dozen of those names with hundreds each year easily into the thousands, easily in the thousands, that's very, very accurate. You know, regarding you mentioned fundamentals, how do you get to a fundamental viewpoint?

**Dan Suzuki:** Yeah, well, you know, the crux of fundamental investing, I think it's people, you know, have generally lost sight of what they even means these days. Most investors have become more and more short-term trading oriented, i.e., event-driven. Right? And we see the most consistent opportunity from sticking to fundamentals, which really don't change minute to minute. There's this perception that returns over time are an aggregation of the day-to-day news, which is partly perpetuated by the financial media. But in actuality, it's actually quite the opposite. The day-to-day fluctuations in reaction to the news are really more noise, and in order to see the true market trends, you really need to step back to see the forest from the trees. As an example, you know, the S&P 500 is up almost 500 percent since the financial crisis and over 600 percent if you include dividends. We probably wouldn't realize that if you're focused on the fact that the S&P 500 was down almost half of the days over that time period, I think it's technically 44 or 45 percent of days. The market's down. And if you kept focusing on that day to day move, you lose sight of the bigger picture. And this was essentially the crux of the book that Rich wrote in the second book he wrote, which was "Navigate the Noise," which is basically making that point.

**Tom Herrick:** So when the RBA approach going back to those fundamentals, where is the focus then for RBA looking for fundamental viewpoints? How do you get there?

**Dan Suzuki:** So, our key focus is really around three things. Those three things are profits, liquidity and sentiment/valuation. And especially these days, you have a lot of investors that really have lost sight of what investing really is. They think that buying a stock is about betting on a story, forgetting that what they're really doing is they're providing a company money in exchange for part ownership of the company and the profits that go along with it. It happens all the time in the market where the story actually comes true, you know, but because there's no consideration of profits, liquidity and sentiment, the investment turns into a disaster. The best example of that was, you know, in the tech bubble in 2000, where all the promises of the tech bubble came true. But it didn't matter because people are overpaying and the profits didn't turn out to what they had expected. So we have two principal guiding mantras in our investment process and the way we allocate capital. The first is that profits are the most powerful driver of investment returns. We have decades of analysis illustrating that there's an incredibly consistent leadership that you see during different parts of the profit cycle. And then the second guiding principle is that returns are greatest when capital is scarce. Every single boom and bust in history has in some form or another been a function of capital, starting us out as being very scarce, people not willing to provide capital to a particular industry or particular type of company.

And then when these things start to work, capital becomes abundant and investors are piling over themselves to invest and provide money to these industries or these investments. And so therefore, sentiment goes from fearful to greedy. And we've all heard Warren Buffett telling people that you want to be greedy when others are fearful, fearful when others are greedy. So our preferred investments are in areas of the market where profit fundamentals are starting to improve, but nobody really cares because they've outperformed for so long. And that's the crux of how we look for our best opportunities.

**Tom Herrick:** So you're marrying up all those fundamentals with a bit of a contrarian approach to, you know, to that overweight, underweight, as I described it at the outset of your allocation. Is that a sort of an accurate summation?

**Dan Suzuki:** Yeah, Tom, you know, that's absolutely right. You know, I would say that what's really unique for us is that when I mention those strong profits, liquidity and sentiment, you know, that sentiment, valuation, that contrarian aspect comes in at the back end. You know, most people start with valuations and they move on from there. We think that without the fundamentals of

profit, profitability and improving profit outlook, it's very, very difficult for everything else to work out. And we've all seen the studies or if people haven't, i'm happy to share it with them later on. But, you know, valuation is just a terrible timing indicator. So just using valuation alone, you know, you'd better be prepared for years of tough times before those things start to work.

**Tom Herrick:** Yeah, you're preaching to the choir there for evaluation. Has a big role to play in, but it is the back end, not the front end. For again, for our audiences' benefit, what with this all leads to eventually is a portfolio of ETFs. And maybe you could just tell us quickly what that looks like, you know, in a very simple format.

**Dan Suzuki:** Yeah. Because we are macro investors and we're not specifically focused on, you know, how much exposure we have to individual stocks, you know, the growth of ETFs has been a perfect marriage for us because in the way we manage portfolios, because it's the perfect, you know, tool for us to implement this, our views and strategies, because there are ETFs for pretty much every sort of style factor, region factor, you know, asset class that you want to invest in.

So basically what we do is invest in roughly, let's say, 15 to 25 specific ETFs to create this portfolio that essentially has all the exposures that we're really looking for that we think are going to drive Alpha over the next couple of years.

**Tom Herrick:** And this is this leads to the RBA branded word, I'll call it, of pactive, which, you know, is that industry wide at this point. But pactive is the combination of using passive vehicles to express active viewpoints is that would be my definition. Is that fair?

**Dan Suzuki:** Yeah. You know, everybody talks about the growth of passive, but very few people realize that they're making active bets when they're trying to be passive. You know, if your equity exposure is S&P 500 ETF, for example, you're actually making a big bet on us large caps. You know, that's been great over the past decade. But people are quick to forget that the prior decade prior to this last one, the US was a stinker. You know, it's really the only major market index in the world to post negative returns and large caps, too. They've had a great run over the past 10 or 15 years, but they massively underperformed small caps in the prior decade. And incidentally, there are literally thousands of ETFs out there with more and more being offered every year. All of these providers are telling you that passive is the best thing since sliced bread, but they're not actually offering you guidance as to what mix of passive you should own. So our macro focus lends itself incredibly well, as I said, to ETF based investing, because it allows us to engineer the exact macro exposures we want. And in that sense, we specialize in the active management of passive investments, which, as you mentioned, we trademarked with the term perspective.

**Tom Herrick:** There's a second point here that I think is equally important for our audience. In addition to sort of engineering the strategy overall strategy which Arber is doing, these instruments are very, very efficient in terms of working with portfolios on a on a tax aware basis to add tax loss harvesting to accounts which can add to tax law after tax return in a huge way. That's just the phrase tax alpha. And it's a bit boring. But but it is an important feature to that complements the RBA portfolios really. Well, maybe we could pivot a little bit to today's market at this point and talk a little bit about what I'm calling a great rotation that's going on within the markets and leading to a lot of messy days, but it is not unheard of in the market. So, Dan, where are you guys overweighted right now? What do you what do you like now? What are you expressing in the way of viewpoints?

**Dan Suzuki:** Well, Tom, if you think about the three things I mentioned that we really care about profits, liquidity and sentiment, I think you can deduce pretty quickly what we like right now, because from a big picture market perspective, we're probably going to see the biggest pickup in profits growth in a decade, going back to 2010, coming out of the financial crisis. So we really want to own the stuff that's going to drive that acceleration, that's going to leverage that profits acceleration. And at the same time, liquidity is extremely strong. Right? I mean, we know that money supply growth is off the charts. We know that banks are now opening up the purse strings and starting to lend to customers. We know that people are sitting on a ton of cash and not just people, corporations as well, you know, after the massive amount of issuance you saw last year. So corporations flush with cash, households flush with cash. And you just had, you know, Jay Powell and Janet Yellen yesterday telling us that there's going to be no end in sight to this policy support in this strong liquidity environment. So liquidity looks very strong. So then the real fly in the ointment is that sentiment valuation component, because I think it's it's pretty clear in most that, you know, things are expensive right now. Stocks are are expensive. People love stocks. A lot of that liquidity that I was talking about is going into the stock market and driving up some kind of frothy activity and sparks and speculative investments. And so that's that's something to be concerned about for us in terms of positioning. The best thing we can do is to, you know, the more expensive and sort of speculative that this market gets to to try to reduce the exposure to those areas of the market where sentiment and high valuations are most concerned because it's not

uniform. I think we all know what parts of the market are extremely well-loved, crowded, and where the sort of the speculation lies. So, you know, it's sort of broad innovation, tech and disruption themes. Well, we're extremely underweight those types of parts of the market, and that essentially puts us into the rest of the market, which is going to put up much better profits growth. I mean, the deep cyclical areas of the market, you know, call it energy industrials, small caps, value discretionary materials, financials, all that stuff is going to put up earnings growth. That is going to dwarf, you know, the numbers that these growth and innovation type of companies are going to put up this year because there are going to have a lot more room to recover.

**Tom Herrick:** And so you guys are really heading towards or have headed towards. I'll call it the underground part of the market if I get my figures right here, I think I remember last year the energy portion of the S&P was down to low single digits. I mean, all the energy companies in the S&P added up to probably not even Amazon's waiting or maybe Amazon plus one, that kind of thing. You're owning not last year's winners, but the under owned stuff in a relatively speaking, a dramatic way or overweighting way. That's what I'm hearing. Is that accurate?

**Dan Suzuki:** Yeah, that's absolutely right. You know, if you look at the performance and the sort of the share of the market and valuations, you know, what's clear is that, you know, what everybody owns and when everybody wants to buy and is willing to pay for is the winners. The last decade, you know, investors always are sort of investing in the rearview mirror. We think it makes sense to sort of invest, you know, looking out the windshield. What's coming? Because the history of markets shows that the leadership, the prior decade, the leadership, the prior cycle never repeats. So this is the time to start to be proactively rebalancing portfolios. And what better time to do it when you know the areas that you're rotating into are going to put up much better profit fundamentals.

**Tom Herrick:** So as we've had this rotation, which has begun towards these names, you know, the what I'll call the cyclical part of the market, where are we in that game? You know, using a baseball analogy, what inning are we in here? Because, you know, as we all know, nothing stays the same forever. And we still in early innings of that middle innings later, I that's one thing I struggle with. And I'm always very sensitive to the thought that prices move way faster than fundamentals and things like that. You get price prices reflect this quickly when you get a shift like this that I'm curious what your thoughts are as to where we are in that that rotational cycle.

**Dan Suzuki:** Yeah, I think that there's plenty of runway for this thing to continue to play out, if you look at valuations, you look at the share of the overall market. I have some great charts that show, you know, basically that three themes dominate everybody's portfolios because they've outperformed so much us over international large caps, over small caps and broad sort of tech related stuff over everything else. You know, if you look at the rotation that's happened that everybody is talking about, that's so consensus. Now, we really we really haven't scratched the surface in terms of getting back to sort of normal levels, let alone, you know, a full reversal, you know, back to, you know, the extremes in the other direction. So I think that there's plenty of room. It's hard to argue that, you know, the rotation, you know, out of tech is completely done. And, you know, everybody's given up on tech. When I think on Monday you actually had the large like for the net, like one of the biggest Nasdaq 100 ETFs out there, which is sort of the poster child for, you know, the secular growth in innovation. You know, on Monday, I think it was they had their largest one day inflows since the tech bubble. Right. So it's hard to argue that people have given up on that story if you're seeing that type of headline. Right. So I think there's plenty of room to go. But again, you know, we've had this, as you mentioned, aggressive, aggressive outperformance of, you know, the deep cyclical stuff that we own since September. Since November, however you want to look at it. And these things don't tend to go in straight lines. Right. So as we've seen over the last couple of days, you're going to have periods that will call that that that rotation into question. And I think that's a good thing. But longer term, I think there's plenty of room.

**Tom Herrick:** And you're seeing are you seeing do you have the same viewpoint when you kind of extend that that cyclicality thinking to not just the large cap space, but small mid, which I commonly sort of blend together? Are you seeing it there and internationally? How does that play out, too? Because how does your thinking extend overseas and into the smaller capitalizations?

**Dan Suzuki:** Yeah, I think every time everything you said is pretty spot on. I mean, you know, if you think about like the the global profit cycle, it got a bit out of sync a few years ago, partly to do with the tax cuts, the corporate tax cuts in the US, but for other reasons as well.

With the pandemic, we're firmly back in sync. So we're going to see, you know, again, a very, very strong and synchronized global profit cycle, profit acceleration. And so I think all regions of the world are going to benefit from this and they're all going to show

these very strong profit dynamics. So then the question is, who's going to be showing the most powerful profit dynamics? As you mentioned, you know, emerging markets tend to be more leverage to global growth. And so they're going to be sort of a higher beta way to to play that. And then, you know, the other aspect is what's most out of favor? Where's where's that pick up in profits growth? Not as priced in. And it's probably going to be more on the international front in general just because, you know, see, valuations are so much more expensive than everything else. And and that's true as you go down even in the US, in the cap spectrum, usually, you know, small caps traded like a significant premium to large caps. I think right now, you know, they still trade at a discount to large caps. So there's still an element of it being out of favor. Yet they're going to put up a much, much stronger earnings growth. I think you'll probably see, you know, maybe double, if not more earnings growth from small caps in the US than you are from the large cap. So, again, we're looking for the areas that are going to put up the best profit fundamentals, as well as the areas where those fundamentals are probably being underestimated today. So I think everything you mentioned falls into the sweet spot there.

**Tom Herrick:** Another topic that's been in front of in front of everybody here in the last few weeks, actually since the beginning of the year. The yield curve, the yield curve is the expression of the various maturities and corresponding yields or rates that they that they pay a lot along the Treasury curve is commonly what it's referenced. Clearly, we've had a big steepening of that curve. I think it's the steepest since twenty fifteen at this point.

You've still got short term rates completely anchored at zero, but you've got that that 10 year treasury, which is the reference benchmark, have been moved up a lot, a lot relative to where it was three, four or five months ago. And that pace has been a little disturbing because it's been really fast.

How does that play into your thinking in terms of equities? And maybe maybe you could also comment from a from a bond credit market perspective.

As well, to to some degree, you know, it's definitely causing a lot of pain for bond investors, that that's sort of the easy take away. It's a little more nuanced when you talk about equities. What are your thoughts there?

**Dan Suzuki:** The yield curve?

You know, it's it's interesting because, you know, there's so many people that follow the yield curve bit by bit every day trying to look at what it's doing without a real understanding for why they care so much about it. Right. And for us, we look at it as, you know, partly a sign, an indicator of liquidity, because it's sort of doing implicitly is comparing central bank policy, which is the short end of the curve, which is that's what that's what the central bank controls the Fed controls and comparing it to future growth. That's why when the yield curve inverts, that's such an important signal because it's telling you the policy is too tight relative to the future growth outlook. So usually the yield curve starts to steepen before recovery even starts because the policy starts to bring in the short and the curve. And then as growth recovers, demand for the safe haven assets fall. Markets start to bake in future rate hikes. Inflation expectations pick up because growth is picking up and the market has to factor in the extra supply from all the extra stimulus that we're doing, particularly today. And so you have this rapid rise in the yield curve. If you look at the yield curve compared to pretty much every other sort of measure of risk, asset performance, the yield curve and the long term Treasury interest rates have lagged significantly. And that's really a reflection of central banks, you know, dampening, you know, the normal natural forces. Right. But as the recovery progresses and this is part of the focus of the last Fed meeting, you know, at some point, you know, people are they're going to have to reduce the pace of purchases of long term treasuries. That's going to put less demand for those treasuries and that's going to make those interest rates go up even further. So our view is that interest rates are going to continue to go up. I think that's to be expected. I think that's nothing to worry about. But it should worry you depending on what you own. Right. Because, you know, there are beneficiaries and there are areas of the market that get hurt. Probably the biggest area of risk there, if we're going to see a continued rise in interest rates, is long duration equities. Now, it's something that people are talking about now that people haven't historically talked about as duration, you know, interest rate sensitivity in the context of stocks. But really, if you think about it, a high multiple expensive stock by definition is pricing in a lot of growth. And that means a lot of those profits are far off into the future. And if you just think about the value of those future profits, you know, the more the interest goes up, the less those profits, those dollars are worth today. And so they're most at risk to this dynamic of raising rates. And that's why you've seen over the last couple of months, you know, tech has sold off and those high multiples stocks have sold off in the face of rising rates. So I think that's something to consider. Is is your portfolio correctly positioned toward the beneficiaries of rising rates? If you think that's going to continue, then from a bond perspective? Absolutely. I mean, we just a couple of days ago, we actually

officially ended the bull market in in long term treasuries that had been going on since the 80s. You know, finally ended, you know, a few days ago we hit below 20 percent downside and long term.

**Tom Herrick:** So, yeah, in that long duration equity description really answers the question that we're getting asked a lot, which is, you know, on these days where you get rate upward rate pressure. You know, the pattern is that you alluded to you see these days where you see what what's the real weakness in the market? A lot of people are puzzled by that pattern. So thank you for that answer.

Before we say goodbye, maybe a final thought, you know, of everything we've kind of discussed here.

Dan, what are you most optimistic about for the next three or four quarters where most optimistic on is, you know, this recovery story, the profit cycle acceleration and therefore the beneficiaries that profit cycles people need to be careful not to be too myopic and and really think about what that means from a global perspective. I mean, I think emerging markets and global cyclically oriented stocks are probably going to be, you know, the sweet spot over the next couple of years, despite the fact that they've had a good run already.

Dan, thanks for your perspective and insights, as always. Great speaking with you.

**Dan Suzuki:** Happy to be here and very excited about being on the podcasts and now being to our partnership as well.

**Tom Herrick:** Thanks again to Dan Suzuki and our friends over at Richard Bernstein Advisors, and thank you for listening to the Cary Street Partner CIO Conversation series podcast. For more information and insights, please visit our website at carystreetpartner.com. I'm Tom Herrick. Talk to you next time.

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