BERNSTEIN

# BACK TO BUSINESS

*"What a difference a year makes!" has become a familiar refrain of late. At the end of the second quarter of 2020, the world grappled with lockdowns. Every economic metric imaginable was flashing red as we all waited for an elusive vaccine to emerge. Twelve months later, we have vaccines (plural) and many places in the US and around the world are back to pre-pandemic norms.*

The questions have evolved from, "When will I go back to work in person?" and "When will my children go back to a classroom?" to "How…?" How will the newly opened world look compared to what we remember? How will we resume our "normal" lives?

Based on the Google search trends displayed below, many people are already thinking along those lines. Summer has clearly arrived, sports and music are top of mind—and people are balancing eagerness and caution as they try to put the pandemic behind them.

**Top Google Search Trends**

| 2020 | June 2021 |
|---|---|
| Election results | Euro 2021 (international soccer tournament) |
| Coronavirus | Nicki Minaj/Polo G (musicians) |
| Kobe Bryant | Myocarditis (inflammation of the heart occurring in some people post CV vaccine) |
| Coronavirus update | James Harden (basketball) |
| Coronavirus symptoms | Tsitsipas (French Open) |

With the return to normalcy, companies are also trying to reignite unused or lightly used machinery (figuratively and literally). At our annual Sanford C. Bernstein Strategic Decisions Conference a few weeks ago—where we hosted virtual fireside chats with the CEOs/CFOs of nearly 140 leading companies—we heard a real-time rundown of "The Great Reopening" across sectors.

Technology CEOs commented that laptop demand remains very strong as people have learned they can work from anywhere. In the industrial sector, their fellow CEOs discussed dusting the cobwebs off production lines and ramping up manufacturing to meet surprising levels of demand for a variety of goods. The president of a leading global property manager noted that their office buildings in China are coming back to full tenancy. And in European cities, where many workers live (and have been working) in cramped apartments, similar back-to-office trends are afoot. An elevator services CEO highlighted the pickup in elevator activity in US office buildings, too.

Recently, we have also seen considerable mismatch between what is available in the pipeline versus what's required to meet this rising demand (**Display 1**). Inventories sit at historically low levels, while orders have risen to historically elevated levels.

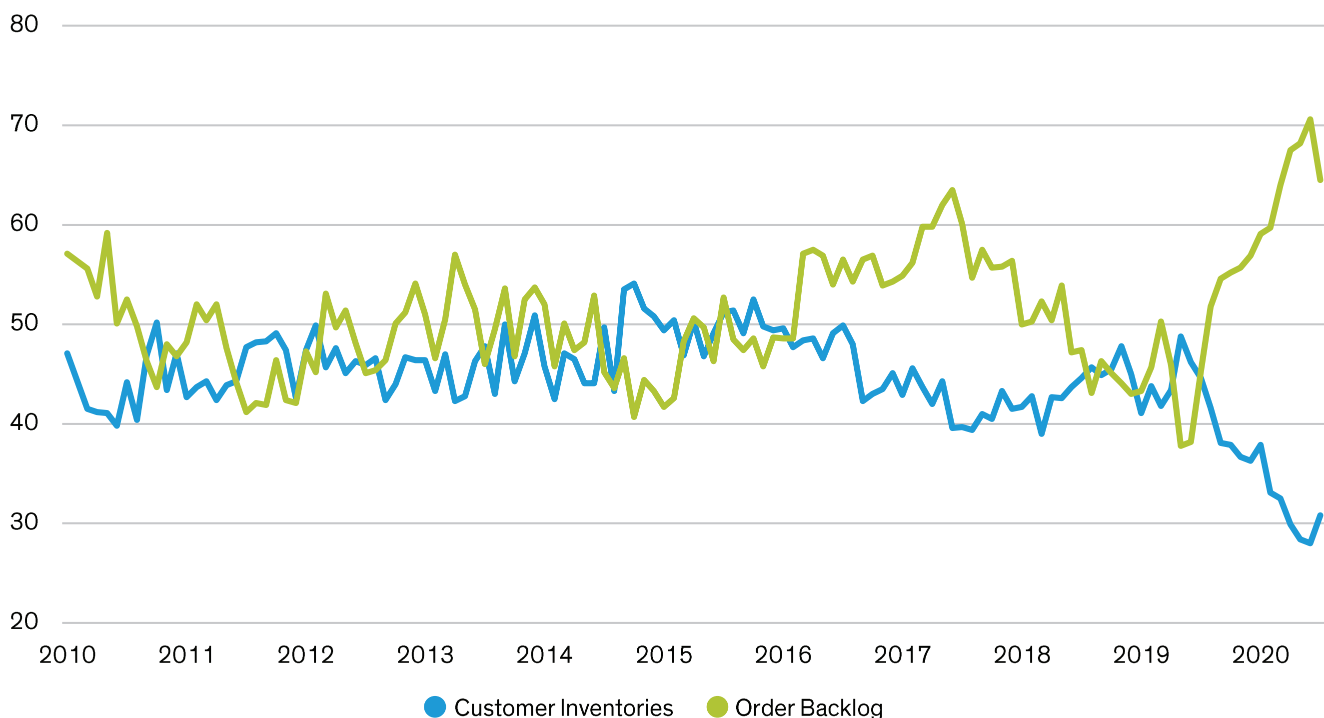
Elsewhere in the US, the housing market has emerged as a hot topic. Everything related to housing is booming. Homebuilding CEOs commented on the post-WWII low in US housing availability and many builders forecasted a multiyear effort to build back supply. Costs for all types of materials are rising quickly, not only due to the supply/demand imbalance—the Do-It-Yourself crowd is also pushing prices higher. If homeowners can't afford a new home, they're spending money to upgrade their current one, having spent a year staring at what they don't like.

Demand for technology devices, automobiles, airline tickets, and homebuilding/renovation activity is driving prices higher and higher and contributing to inflation concerns. Bernstein's views on inflation will be more fully discussed in an upcoming white paper, but to summarize it in one word, we would say "transitory." Our advice will cover a more expansive solution set as different people have different sensitivities to inflation and to distinct *types* of inflation. Your portfolio should meet your personal needs, even if inflation levels don't reach extremes.

While near-term inflation data will be high, we view this more as a function of temporary supply chain disruptions and the comparisons to last year's depressed prices. Of course, the readings are higher this year compared to 2020! Last year we were stuck in our homes. This year, we're planning our vacations, buying new cars, and living our lives. It feels like many American consumers are trying to squeeze two years of consumption into one calendar year. That effect is likely to subside as supply chains normalize and people return to work. But there will always be some risk of inflation and there are important asset allocation implications for clients who are most sensitive to these risks.

## GIVEN THAT BACKDROP, WHAT ARE WE WATCHING?

In the first week of February 2020, when only China and Italy seemed to be impacted by the new troublesome virus referred to as SARS-CoV-2, our Chief US Economist responded to a question about when it would most dramatically impact the US economy. His warning was simple: "*watch the schools*." While he may not have known how prescient a forewarning this would turn out to be, it has proven correct. Between the time you read this letter and our next edition, we will have seen a return to school for many students across the country and the world. Children, teenagers, even college students in classrooms means that the economy is not only open, but that it's especially open to those who rely on their




Source: Bloomberg, Institute for Supply Management, and Bernstein analysis

kids being in school so they can work. So, we are watching the schools. And we are excited and relieved for kids and their families to experience a return to normalcy (together, admittedly, with some trepidation).

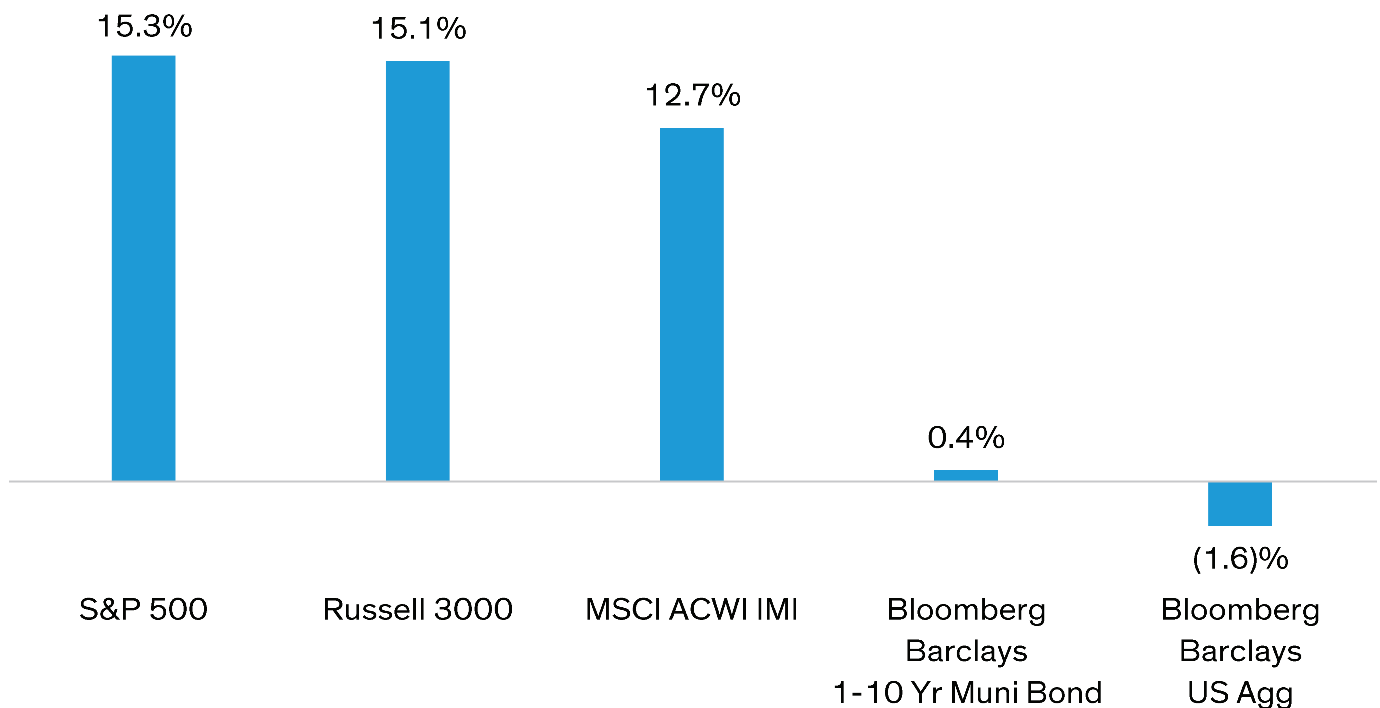
We're also watching the Return to Office (simply known now as "RTO") across the country and the world. The return has been slow to improve in the US for a variety of reasons, and in early June, remained down around 30% from pre-COVID levels. It appears that many companies will be rolling out their RTO regimens fully by the fall. The pace at which people return to offices and how closely daily commuters resemble the pre-pandemic world remains a hotly contested debate.

## TRACKING THE MARKETS

In the context of the Great Reopening, the markets have responded enthusiastically. With bitcoin as a noteworthy exception (see our white paper on cryptoassets and the challenges of a fundamental approach to valuing them). The second quarter treated most assets well, with the Russell 3000, an all-capitalization US index, +8.2%. Investors continued to embrace the recovery and that has brought US and global equity returns YTD to double digits. (**Display 2**). Ongoing upward revisions of analysts' earnings expectations has been a key driver and analysts now expect around $210 in earnings per share in 2022 for the S&P 500. That's up from their estimate of $193 at the end of December and back at the level anticipated for 2022 early last year, before the coronavirus became part of our vernacular. That is a remarkable rebound and one that we highlighted late last year as a potential "surprise" of 2021 that wouldn't truly surprise us.

Looking at the equity landscape over the past several months, two trends stand out. First, it's been a better environment for stock pickers. There has been more differentiation in sector performance as the large-cap tech "stay-at-home beneficiaries" that led the way last year sold off markedly this year. We are enjoying success in many of our own active equity strategies, thanks to strong stock and sector selection among our portfolio management teams.

### DISPLAY 2: ASSET CLASS RETURNS YTD




**Past performance does not guarantee future results.** The unmanaged S&P 500 Index comprises 500 large-capitalization US stocks and is a common measure of the performance of the US stock market. The Russell 3000 is a capitalization-weighted index tracking 3,000 US companies of all sizes and seeking to measure the returns of the broad US stock market. The MSCI All-Country World Index (ACWI) is a market-capitalization-weighted index designed to provide a broad measure of equity market performance throughout the world. The Bloomberg Barclays 1-10 Year Municipal Blend Index is a market value-weighted index which covers the short and intermediate components of the Barclays Municipal Bond Index—an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.
Source: Bloomberg and Bernstein analysis

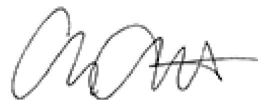
Second is the importance of diversification—even within stocks, the recovery has been uneven, with value stocks outperforming growth stocks. Geographically, the differences have also been pronounced. Over the past quarter, frontier-market stocks were the best performers while emerging-market stocks lagged. Developed markets globally offered returns in the high single digits. As ever, our goal is for our clients to benefit from growth across the board, with the short-term challenges in one category offset by outperformance in others.

Looking ahead, cyclical stocks—which tend to fall into the value investing style—could outperform further, especially amid a broad-based recovery and if interest rates and inflation expectations continue to rise. At the same time, many quality stocks have lagged in recent months, creating attractive opportunities to upgrade our portfolios' holdings. We also continue to believe that innovation is an important catalyst for long-term success. Companies that are willing to disrupt themselves should remain compelling multiyear holdings—even if there is short-term valuation pressure.

In addition, we continue to balance our portfolios across asset classes while attempting to understand new ones. Outside of equities, we see relatively attractive opportunities in select areas of the credit markets, including those exposed to the US homeowner. Then there is the municipal bond market, where an imbalance of supply and demand is likely to support prices in the coming months. Cryptoassets have captured a lot of attention as of late but we are not building allocations dependent on them.

As always, we approach the markets with our clients' long-term performance and objectives in mind. Along with our portfolio managers, we will opportunistically fine tune exposures based on expected risk-adjusted rewards. But our overriding goal is to maintain stable strategic exposures over time to allow our clients to meet their goals. The world has calmed down over the past year, but we remain vigilant for signs of underappreciated risks. We thank you and look forward to continuing to serve as responsible stewards of your investments.

Beata Kirr



Alex Chaloff

*Beata Kirr and Alex Chaloff are co-heads of the Investment Strategy team at Bernstein, a group of senior investment professionals who develop our investment advice and are responsible for investment outcomes. The team oversees Bernstein's investment offerings, ensuring that our asset allocation advice, suite of strategies, and development of new investment ideas is continuously focused on moving our clients forward with strong after-tax risk-adjusted returns. Both Alex and Beata have spent their Bernstein careers refining our investment platform, listening to clients, and conducting deep research into investment topics that are critical to achieving clients' goals.*

*Each quarter, we'll use this section to pull back the lens and reflect on some personal big-picture observations.*

For instance, we are both optimistic about what lies ahead and excited about "The Return," with the US leading the way due to its vaccination status. But we could not be successful in our roles if we did not worry. Worries sharpen our focus on market as well as industry changes that we need to anticipate to be successful investors. That's why, this quarter, we both named one big worry that keeps us up at night.

**Beata:** *"Americans never stop spending. That may be good for now in terms of economic growth, but how can America retire? Where will the savings come from? According to Vanguard's 2020 Retirement Account study of five million plan participants, the average 401(k) balance for age 65+ is $217K, but the median is just $65K! Sixty five thousand! As we all know, that will not go far. Women have saved even less despite their longer life expectancy. Whether we look at averages or medians, Americans simply do not have enough to fund their expected longevity in retirement. I worry about the potential ramifications of this under-saving trend."*

| Gender identity | Average 401(k) balance | Median 401(k) balance |
|---|---|---|
| Men | $131,045 | $34,246 |
| Women | $88,393 | $22,434 |
| 65 and up | $216,720 | $64,548 |

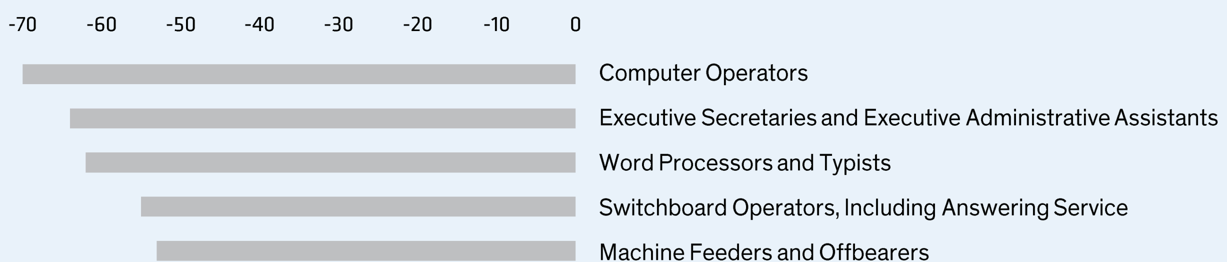
Source: https://www.businessinsider.com/personal-finance/average-401k-balance

**Alex:** *"I'm worried that the automation trends that accelerated during COVID will destroy the long-term prospects for much of our country's youth. As a parent, I worry about the future for all of America's children—and the increasing disparity among those with fewer advantages to pivot and reeducate themselves."*

In the World Economic Forum's October 2020 Report, "The Future of Jobs," 43% of businesses indicated that they are set to reduce their workforce due to technology integration. By 2025, the time spent on current tasks at work by both humans and machines will be equal. While there is an offsetting argument that technology will create a new workforce, the destruction of jobs we saw even before COVID remains front and center. And companies are using COVID to rethink everything they do.

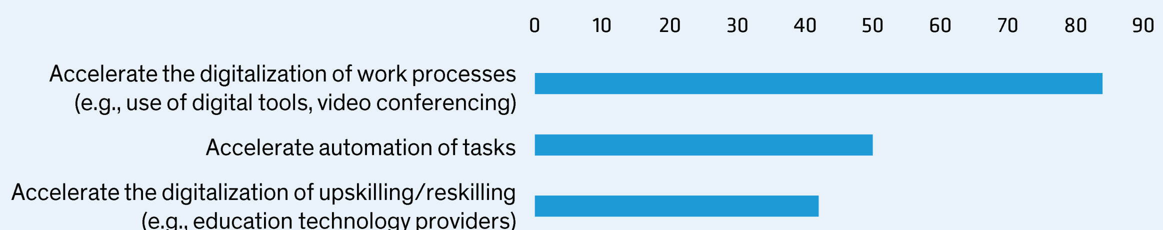
Because so many of the new economy jobs over the next few years will be created by companies that do not yet exist—or are in their nascent stages—evidence of success sits below the surface. It remains to be seen whether America's education system can catch up with these trends before it is too late.

**Employment trends for jobs in the United States at high risk of automation, 2007–2018**
Employment change 2007–2018 (%)




Source: Ding, et al., 2020

**Planned business adaptation in response to COVID-19**
Share of employers surveyed (%)




Source: Future of Jobs Survey 2020, World Economic Forum

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