It´s All About Asset Allocation

February 2021, Newsletter#58

High expectations for effective vaccine rollouts, eventual reopenings, resurgent economic momentum and ongoing profit growth improvement has led investors to **excessive optimism**. Proof of this, is the recent speculation and the retail herding that led to the short squeeze on Gamestop and others, which will be remembered as the time when a small brick-and-mortar retailer gripped Wall Street and Main Street. The complacency has left the market vulnerable to the disappointments that have been gaining attention.
After historically strong breadth readings in late-2020 we have seen some deterioration in global equity market participation and minor divergences in January. The market decline during the last week of the month can be viewed in the context of high investor optimism, with a market that had gotten short-term overbought rather than a major warning sign. A pullback would likely weaken breadth statistics, but since they are coming from such high levels, they would have to deteriorate much more from here to indicate the risk of a major correction. In fact, it would be a welcome development if it would relieve the optimism, improve the valuations, push bond yields back down and set the stage for another sustainable advance. **This scenario is currently supported by the massive excess of liquidity and improving economic prospects globally**. While our market outlook includes the possibility of a single-digit correction, it lacks double-digit bear market risk as the narrative of a strong global economic recovery in 2021 remains intact, and central bank and fiscal policies remain supportive.

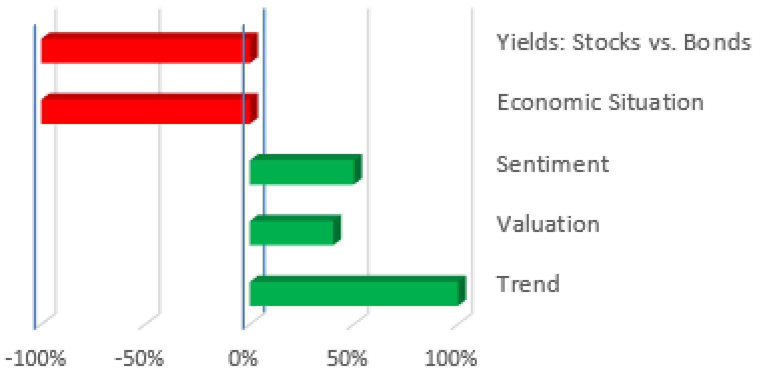
Our **Global Asset Allocation fund, fLAB Core H-USD**, started the year in good shape until market volatility eroded equity gains. January finished quite flat (0.07%) but is up again while I write this newsletter (1.91% on Feb 3…my name day, btw)

For February, our Asset Allocation model reduces equity & bond allocations a little bit (-3% both) in favour of cash, being at: 56% stocks, 20% fixed income and 24% cash. Relative strength indicators continue to support equities over bonds. Instead, what is catching our attention is the **relative preference from cash** (66% of indicators) over bonds these last two months.

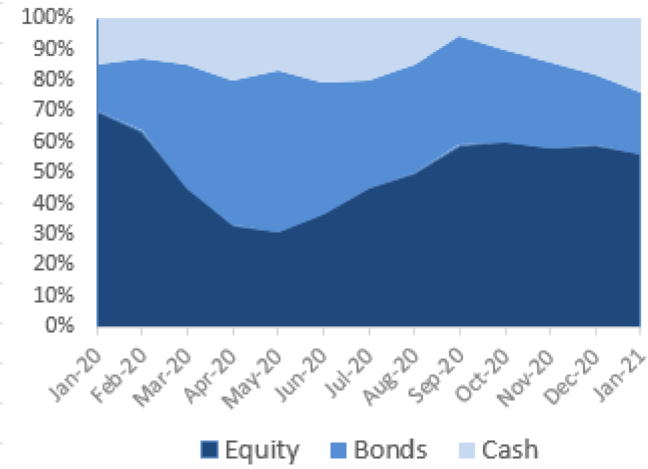
fLAB Core Asset Allocation Model - February 2021

	Model	Benchmark
Stocks	56%	55%
Bonds	20%	35%
Cash	24%	10%

Equity vs. Bonds Relative Strenght by Betalphing 5 Indicators



red (bond preference) green (equity preference)



Equity Regional Allocation vs MSCI World AC

Emerging Markets	*OW*	*UK, Japan & Pacific Ex-Japan*	*UW*

Benchmark (US 57%, Eur 13.4%, Emerg Mk 12%, Jap 7.1%, UK 4.3%, Pacific 3.3%, Can 2.9%)

Equity World Sector Allocation

Industrials & Financials	*OW*	*Consume Staples*	*UW*

Government Bond Allocation vs Barclays Global Government Bond Index

Euro	*OW*	*US*	*UW*

Benchmark (US 48%, Europe 25%, Japan 21%, UK 6%)

Global equity markets kick off the first part of the month strong fuelled by cyclical value sectors and led by Emerging and Pacific economies, until the market corrected. Since then, growth sectors gained traction with Nasdaq outperforming again. We expect the **reflation trade to reassert itself** once markets relieved excessive optimism or on positive data (fiscal stimulus plan, weakening of the third Covid wave, vaccine news...). In line with this view we overweight industrials and financials and underweight Staples. If interest rates continue to advance in an orderly fashion, rising steadily with a gradual steepening of the yield curve, cyclical Value sectors can be expected to remain market leaders while bond proxy sectors will continue to underperform. The exception has been when rates rise too quickly, becoming an impediment to the market. Moreover, full Democratic control of the Government has historically been a bullish backdrop for cyclical sectors. In terms of regional allocation, we overweight Emerging Markets due to its better growth prospects and valuations. In fixed income, we continue to **prefer European government bonds** (with a lower steepening of the curve) over Treasuries, and have a total portfolio duration of 2.45. Bonds have not acted as a hedge during the recent decline, but the US dollar has done its job. Now it remains to be seen whether this will be sustainable. We have a real dollar exposure of 14%.

Our **Relative Return Fund, fLAB Satellite H-USD**, finished January on positive territory (+0.30%).

The compartment is invested 62% in a low risk low duration (2.88) diversified fixed income portfolio plus 25% in some decorrelated and tactical positions, being the remaining in cash. By mid January, we reduced our Clean Energy exposure (somewhat overbought in the short term) as well as other fixed income allocations such as emerging, Euro government bonds (5-7yr tranche) and US corporate bonds, thus reducing the duration of the overall portfolio, from 2.07 to 1.79. We remain overweight investment grade corporate credit and **keep flexible in terms of duration** in a framework of higher rates. Within our tactical portfolio, we have 12% in equities and continue to hold: 5% in Gold (which has suffered due its inverse correlation with the dollar) , 5% in short Credit High Yield (that worked well) and 3% in Commodities to be aligned with our reflation view.