It´s All About Asset Allocation

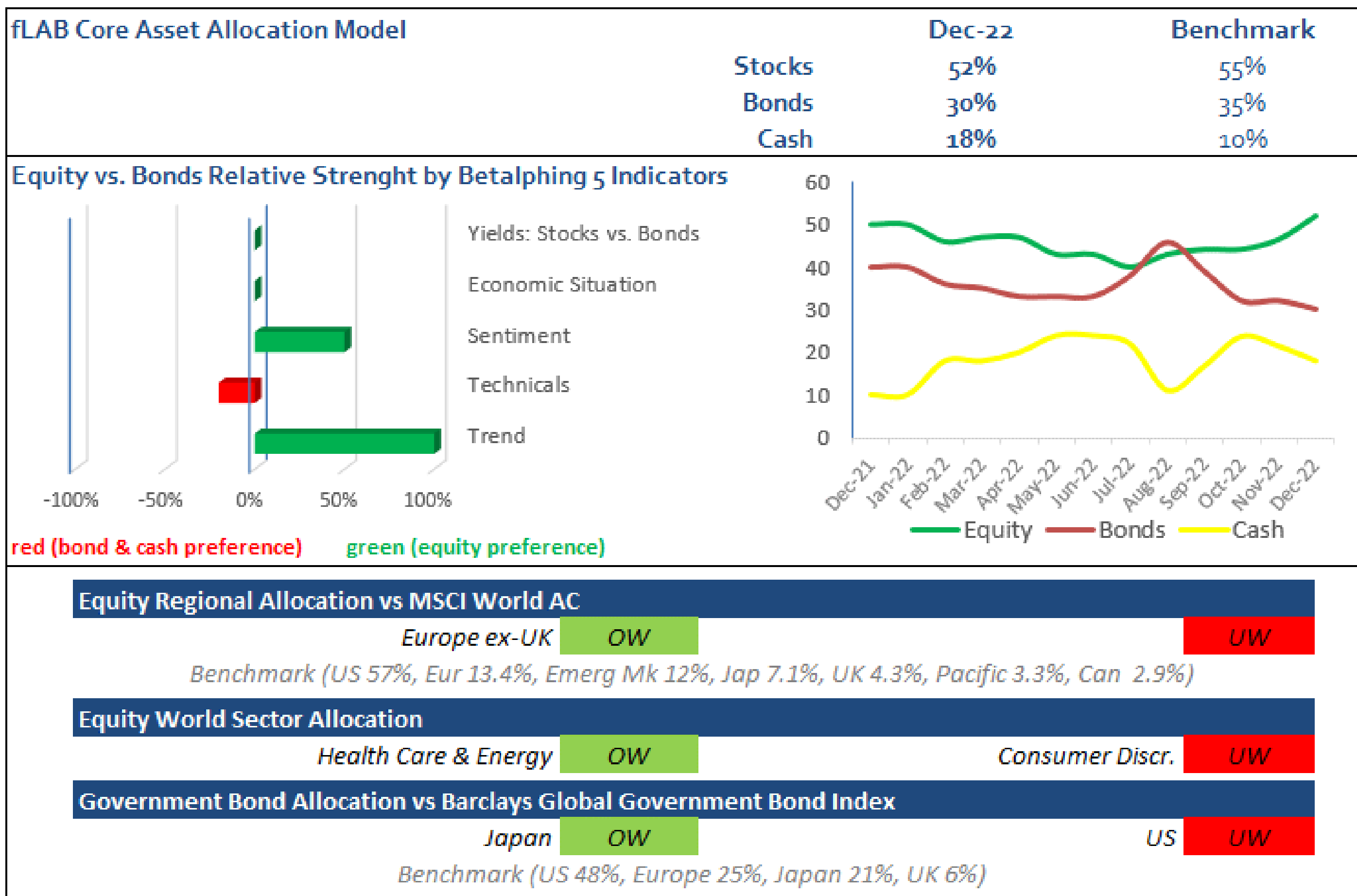
December 2022, Newsletter#78

With the growing recognition that US inflation has peaked, making it more likely that central bank aggression is peaking as well, we have seen **several reverses that have helped to mitigate the battered portfolios**. The global equity rally off the October lows has been, undoubtedly, the most impressive. The S&P 500 has gained as much of 14%, the Dow Industrials and the Euro Stoxx 50 have done even better (19%) and even the struggling Nasdaq Composite has logged a double-digit recovery of 10%. Breadth has been solid and the advance broad-based, supporting the case for the rally to continue through year-end. But, as usual after such a powerful movement, the **short-term sentiment composite has jumped into the excessive optimism zone** (up to levels not seen since mid-August for the S&P 500) suggesting the market recovery may be nearing an inflection point. For the time being, December has started correcting. Today's US CPI release and tomorrow's last FED meeting of the year will likely set the tone for sentiment. If elevated short-term optimism can be relieved without excessive technical damage, current investor positioning (large speculators are net short and individuals are at the lowest equity level since June 2020 and highest cash allocation since November 2011 – excluding the spike in March of 2020) should support an extended rally.

Global bond yields have also reversed, which is not surprising as stock and bond prices have moved together this year, lower on rising worry and now higher on signs of hope. We believe we are approaching the end of the tightening cycle in the US, and that the bulk of the yield increase is behind us with **10-year Treasury likely to settle in a trading range (3.4% - 4.3%)**. Of course, we can't guarantee that yields won't test the high of 4.33% or even break slightly above it, as the Fed remains data dependent. We expect the Federal Reserve to end its tightening cycle sometime in Q1, somewhere in the range of 4.5% to 5%, even holding policy at a restrictive level for some time. Usually, the Fed remains on hold for seven to nine months after the last rate hike before cutting rates, so we shouldn't expect a rate cut before the September meeting. But bonds could easily rally before the Fed pivots on evidence of recession (our base case), taking 10-year Treasury yields below 3.00% to around 2.50%. Unlike 2022, bonds, particularly Treasuries, could provide in 2023 an effective hedge for equities against growth and earnings concerns.

Our Global Flexible Fund, fLAB Core H-USD, jumped 4.92% in November and is performing -8.17% YTD.

For December, our Asset Allocation model echoes some technical improvement of stocks relative to bonds, thus turning a little bit more constructive by increasing stocks (+6%) against bonds (-2%) and cash (-4%). Our positioning is: 52% equity, 32% fixed income and 18% money market. However, intermediate and longer-term measures have not yet risen to levels that would suggest a continuation of the rally deep into 2023.



The global equity market continued its ascent through the last month (+6.3% MSCI ACWI local currency) with Emerging Markets pushed by the Asian giant, leading the way (+14.6% in dollar terms). Key Chinese stock gauges in Hong Kong and on the mainland roared back in November after months of losses, as shares tied to reopening, tech and property have seen outsized upswings. The S&P 500 gained 5.3%, with all sectors posting positive returns and mixed leadership trends. **The number of S&P 500 sectors trading above their 50-day moving averages rose from zero in early October to all 11 by November month end**. Longer-term improvement, however, has been relegated to Value sectors, with Growth sectors such as Technology, Consumer Discretionary, and Communication Services all remaining below their 200-day moving averages. The implication is that more long-term breadth improvement will be needed to suggest the market's rally can continue into next year.

Our bond portfolio, which has a duration of 9, has well recovered in this framework. Considering that the 10-year Treasury yield has drop up to the bottom of our trading range along with our model recommendation, we have reduced US debt exposure to underweight. Our portfolio keeps a soft preference for Japanese Government Bonds and continues to be underweight in terms of duration being at 2.79 for the overall fund.

Our Relative Return Fund, fLAB Satellite H-USD, has appreciated 2.1% over the last month, posting a return of -2.87% YTD.

The compartment is investing 46% in a low risk, low duration (3.49) diversified fixed income portfolio plus 27% in some uncorrelated and tactical positions, being the rest in cash. November, has been a great month for the fund as we have benefited from the recovery in most assets. The global equity multistrategy exposure (17% of the portfolio) has been the main source of profitability, followed by the positive return of our bond portfolio, which has gained traction amid lower yields and narrowing credit spreads. Within fixed income, we have 28% of the fund in Corporate Investment Grade, 9% in Govies and other small bets such as emerging (2.7%), TIPS (2%), Covered (1.75%) or High Yield (1%). Our tactical position on Gold (3.3%) has finally been rewarded (+6.78%) and so does our global commodity exposure (+4.1%) representing 3.4% of the total portfolio. Our short bet on iTraxx Crossover (weighting 3%) has receded in such a risk-on environment. We will remain flexible in

terms of equity exposure and duration (1.59 for the fund) trying to take advantage of market volatility and the continuation (or not) of the market recovery.

fLAB Core-A awards, June 2022