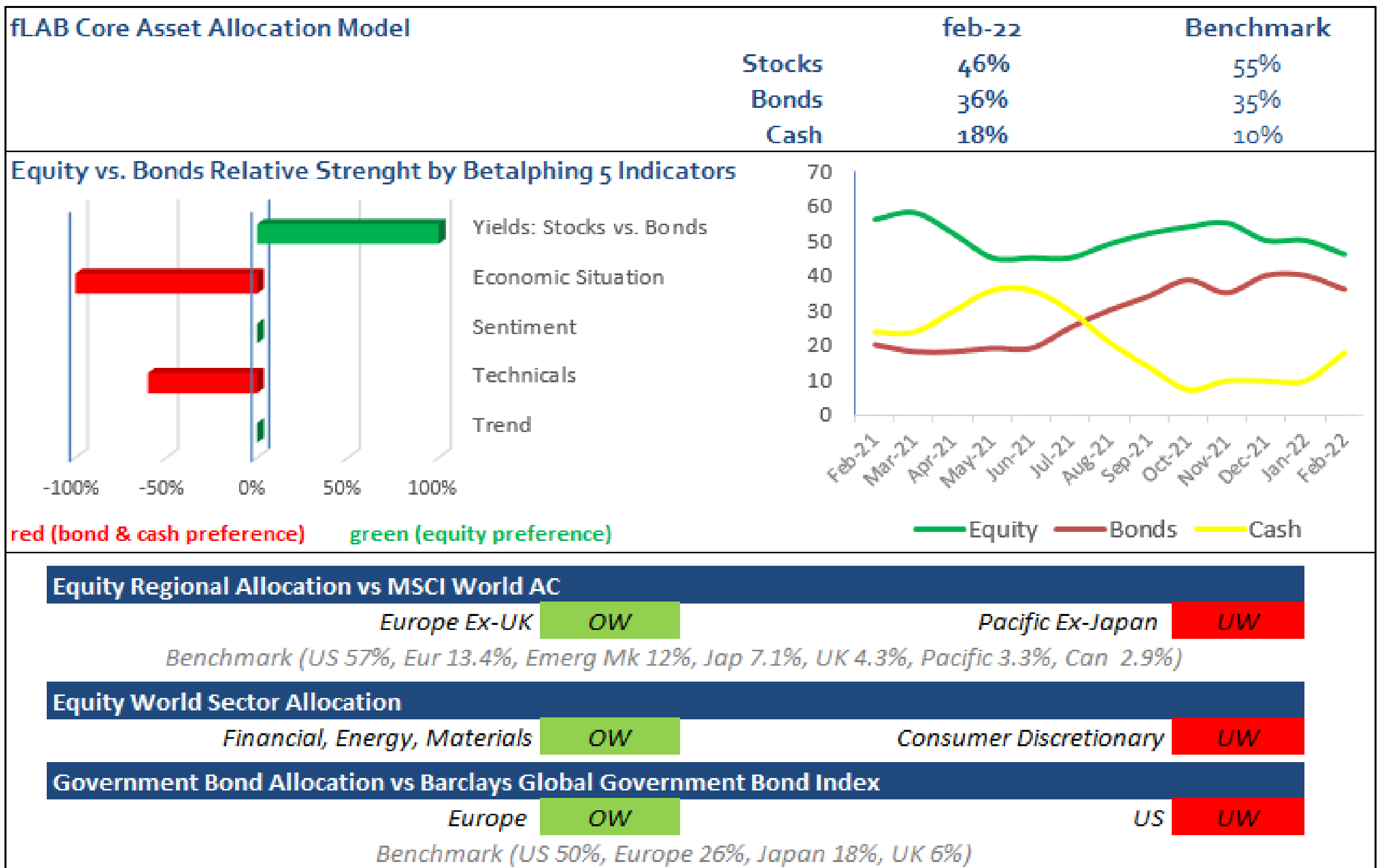
It´s All About Asset Allocation

February 2022, Newsletter#69

In our last month's report, we talked that 2022 should include more frequent pullbacks in risk assets and increased volatility. Four weeks into the year, and it has not disappointed. **There have been no shortages of catalysts for the selloff.** Higher inflation has led to a more hawkish stance from the Fed, yields have jumped back to pre-COVID levels, and absolute valuation readings remain near record highs, while earnings growth is slowing (and disappointing), to name a few. January saw US stocks suffer their worst month since March 2020 (the S&P 500 slumped 5.3%) and the VIX climb to its highest level in a year. Monday 24th was a an exceptionally volatile day, with intraday declines of 3.99% in the S&P 500 and 4.90% in the Nasdaq Composite, only for both to close higher on the day. **Such reversals are rare**, in fact it was among the top five all time. Technical and sentiment data imply the market is oversold short term, but more work is needed to prove the uptrend is ready to resume.

Our Global Flexible Fund, fLAB Core H-USD, has held up quite well January's correction, performing –1.74% YTD.

For February, our Asset Allocation model echoes some trend and macro deterioration thus turning a little bit more defensive: 46% equities, 36% bonds and 18% in cash. Our Relative strength indicators argue to remain alert and somewhat defensive for the moment, especially if we don't get breadth thrust buys on any rally.



fLAB Core Asset Allocation Model	feb-22	Benchmark
Stocks	46%	55%
Bonds	36%	35%
Cash	18%	10%

Equity Regional Allocation vs MSCI World AC			
Europe Ex-UK	*OW*	*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			
Financial, Energy, Materials	*OW*	*Consumer Discretionary*	*UW*

Government Bond Allocation vs Barclays Global Government Bond Index			
Europe	*OW*	*US*	*UW*

Benchmark (US 50%, Europe 26%, Japan 18%, UK 6%)

The January market decline could be described as a **stiff rotational correction rather that the start of a new bear market**, at least for now. In bailing out of Technology, investors have sold the sector that's been the most overvalued and most prone to underperform when bond yields are rising. Among indices, Tech has the most weight in the MSCI U.S. Index, which helps explain why the U.S. has been the worst performing regional index since the ACWI's January 4 high. Meanwhile, 17 of the ACWI's components have risen since then, with markets tending to benefit if they have been relatively cheap, if they've had relatively high exposure to resource and cyclical sectors, and if they've had relatively little Tech exposure. One or more of those criteria have generally applied to emerging markets, which account for 14 of the markets that have risen. The UK index posted gains while Europe could not, although it outperformed the MSCI ACWI.
Sector leadership was overwhelmingly Value over Growth, broad based. Within equities, we have benefited from the outperformance of our European and emerging markets exposure, specially Latam. Our bets on Financials and Energy have also been key in this context. Unless the global market technical picture notably deteriorate, which we would lead us to a more defensive stance, we will keep our tactical allocation.

Since investors have been scared about a more hawkish FED, global bonds have posted negative returns and failed to act like a safe-haven. Even with the January swoon in equities, yields only pulled back to their respective breakout points. If our bond models further deteriorate, we will probably adjust further duration on the downside (actually at 3.56 for the overall fund). **However, one thing that prevent us from getting more bearish is that the market doesn't believe longer-term yields are going that much higher** (the 10-year forward is around 20 bp above the current level and the 30-year forward is below last year's peak). With the Fed on the inflation case, investors anticipate slower growth and lower inflation in the months ahead. In terms of currency exposure, we have a real dollar exposure of 25% as a potential hedge against market volatility, which will be dynamically managed.

Our Relative Return Fund, fLAB Satellite H-USD, has performed -0.24% YTD, in such a volatile month.

The compartment is invested 54% in a low-risk, low-duration diversified fixed income portfolio plus 30% in some decorrelated and tactical positions, being the rest in cash. The year kicked off on bad shape for global equity markets but in a very heterogeneous way, with clear losers and winners, as mentioned before. Besides inflation, geopolitical worries helped to push commodities higher, again. In this context, **we have taken advantage from our global commodity and industrial metal exposure** (6.2% of the fund), our investment in **European Banks** (weighting 2.7%) and from our u**ncorrelated short position on the iTraxx Crossover ETF** (which weights 3.8% and has performed +1.9%). **Dollar appreciation** (+1.19% against the euro) has been another great contributor (due to our 18% exposure) and the same can be said for the yen (representing 5% of the fund). The equity MultiStrategy position (12%) has been obviously affected by the global correction but we have offset it by a long tactical on the MSCI World (5.4%), settled with profits. The global bond portfolio has receded slightly, supported by the positive returns of Chinese government bonds (4.1%) and the short bet in the long part of the US and German yield curve (6% distributed equally). Gold has not shined this month, giving us the opportunity to increase exposure from 5% up to 7.5%. We will try to take profit from market volatility in terms of equity exposure and/or duration (now at 0.69 for the overall portfolio), always complying with our low target risk.

fLAB Core-A awards, Jan 2022