It´s All About Asset Allocation

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In the early ´90s, there was a response to the ethics of profit, to ´80s fake optimism. Nirvana´s `*Smells Like Teen Spirit*´ became an anthem for Generation X’s apathetic youth, plenty of sarcasm and indifference. In this song Kurt Cobain, one of the last outsiders of last century, wrote some of his most brilliant lyrics and caught my attention at that time (… I was in my early twenties).
In the first verse of the song, Kurt describes a girl he knows with these words: *She’s over-bored, self-assured.*

Analysing Equity Markets these last weeks, Cobain´s words came to me again…after almost 30 years… Why? Maybe because of this situation of **Nirvana in the Equity Markets, where investors seem fully self-assured, so confident**, while at the same time we can be sure that we are living one of the worst world Health Crisis in the last century, government spending and deficits have soared, inflation is a real threat, real interest rates are just rubbish, the market breath is broken… and Equity Market have lived one of its best years with valuations skyrocketing. It´s like investors were so bored and tired of thinking about these issues that they had achieved the Nirvana. Nothing can hurt them anymore. All is perfect and cryptos will save the world.

Anyhow, we run Asset Allocation Funds, and while it is true that investing our portfolios 100% in Equity in the last 2 years would have beaten our real performance, **we cannot fall in this Self-Assured Nirvana, we must avoid complacency** and be prepared for bumps in the road. We have to be aware that last 2 years Nirvana has been possible due to massive liquidity flowing from Central Banks to all type of Risk On Assets: from Cryptos and Private Equity to Real Estate or Listed Equity. Normally, Fed tightening ultimately leads to a slowdown in growth and inflation. The Fed says QE should end by March of 2022. And we know liquidity has already fallen from the bullish zone to neutral. And if one subtracts out the demands from the economy (industrial production and PPI commodities) from the money supply, we are approaching a zone of negative liquidity that has historically hurt stocks, and subsequently the economy, on average. We are now in that tricky part of the economic cycle and will remain vigilant in case a more Risk Off scenario is needed.

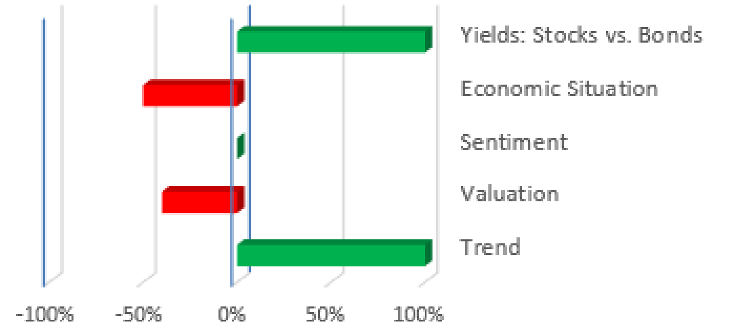
Our Global Flexible Fund, fLAB Core H-USD, has performed 8.06% in 2021, maintaining our good 12 years track record.

Global equity markets have soared 20% in 2021, with the US dominating again. The S&P 500 notched 70 record highs on the way to a 26.9% gain and outpaced the Nasdaq Composite for the first time since 2015. Europe ex UK was the third major region to rise over 20% in 2021 (just behind Canada) and most developed international markets gained over 10%. Emerging markets were the clear losers, ending the year on negative territory led by China - the biggest culprit, as both the biggest country in the index and worst performer, falling 22.7%. In terms of style, outside of mega-caps, Value outperformed Growth and defensive sectors were the biggest laggards on the year.

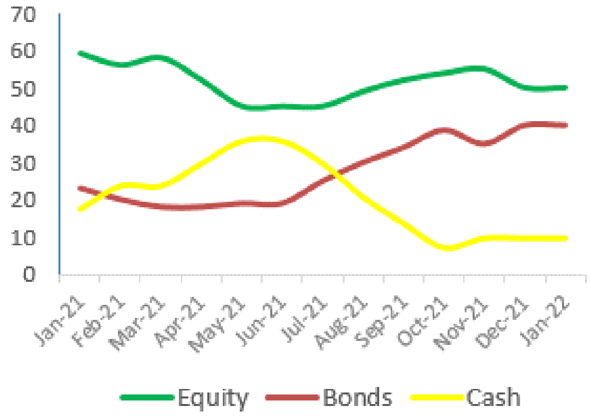
Strong equity gains have been possible thanks in large part to **record earnings revisions, the strongest economic growth in decades and unprecedented stimulus from Central Banks**. Those conditions will almost assuredly not be as market friendly in 2022. The year ahead should include **plenty of reversals**: several major central banks will send interest rates higher, Global economic growth will head lower, earnings growth will roll over and market valuations will start to worsen. The uncertainty surrounding these changes should lead more volatility. We expect a positive year for stocks, with a slower pace of gains and more frequent pullbacks in risk assets. In fixed income, only a few days into the new year and global bond markets are already approaching a critical juncture, particularly in Europe. We're a little shy about jumping the gun on further exposure reductions from our current position. There were three unconfirmed breakouts last year that eventually saw yields retreat. As a result, we are looking for a confirmed escape across countries before implementing it. Should such a breakout occur, we will likely see a steepening of the yield curve but it should be viewed as short-term in nature, at least in the US, as history shows the curve usually flattens as the Fed starts to hike rates.

fLAB Core Asset Allocation Model	Jan-22	Benchmark
Stocks	50%	55%
Bonds	40%	35%
Cash	10%	10%

Equity vs. Bonds Relative Strenght by Betalphing 5 Indicators



red (bond & cash preference) green (equity preference)



Equity Regional Allocation vs MSCI World AC			
US & Europe Ex-UK	*OW*	*UK & 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	*OW*		*UW*

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

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

We start 2022 investing 50% in stocks, 40% in bonds and the remaining 10% in cash. Within equities, we overweight Europe and United States and underweight UK and Pacific ex Japan. In terms of sectors, we remain positive on Financials and Energy. Unlike previous COVID waves, leadership has been less Growth oriented during the Omicron wave. Investors may be looking past the less lethal variant as the economic fallout is not expected to be as great as prior surges. Defensive sectors surge to close out the year and several cycles, including the economic, the stock market and the Fed, suggest that leadership could be more defensive this year. Regarding bond allocation, we prefer European govies over treasuries, since yields could rebound strongly with the tapering in place. Our real dollar exposure is at 25%, although we will remain flexible on this matter.

Our Relative Return Fund, fLAB Satellite H-USD, has posted a nice 3.44% in the year. The fund, which has a conservative profile, has managed to do well in a year where bonds have been generally poor performers.

In 2021, we have benefited from the strong performance of the equity markets (15% exposure), commodities (weighting 10%) and from dollar appreciation (18% exposure on average). Shortages in several commodities and rising inflation expectations have catapulted them as the top asset class (with the S&P GSCI gaining 37%). Gold was the exception, dropping 3.6%, although the yellow metal rebounded 4.2% in Q4. Normally commodities and the U.S. dollar are inversely correlated, but the greenback managed a 6.9% gain on the year (against the euro). As mentioned, bonds (54% exposure) did not well, with some exceptions such as TIPS (2.6% of the fund) , lower rated credit (2%) and Chinese bonds (weighting 3.9%), the latter delivering strong returns (+14% in euros). The compartment kicks off 2022 **with the same asset allocation:** 54% in bonds, 29% in decorrelated and tactical positions and 17% in money market instruments. Three risks are likely to weigh on corporate bond returns and equities this year: tighter monetary conditions, higher rates and margin pressure. To managed them, we will continue to be flexible in terms of equity exposure (now at 15%) , bond duration (actually at 0.88) and currency exposure (20% in USD). We keep our positive view on commodities (gold included) and on the US Dollar.