It´s All About Asset Allocation

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The Russia-Ukraine crisis has supplanted COVID, the Fed, and inflation as the most pressing issue facing the world and financial markets, and rightfully so. As analysts and managers usually do at that times, we have looked back at **historical data and have found that 1998 and 2018 have several similarities** to the current environment - Russia in the case of 1998 and a hawkish Fed in 2018.

The Russian ruble crisis in the summer fall of 1998 was the culmination of a year of global financial instability. At that point, the Fed cut interest rates three times between September and November 1998. Many considered Greenspan's actions as cementing the "Fed put," or the central bank supporting financial markets during times of systematic risk. The 1998 decline barely met the criteria of a cyclical bear market, in the context of the 1982-2000 secular bull. Lasting 45 calendar days (taking the Dow Jones as a reference), it was the shortest bear on record, until 2020. The Fed was able to slash interest rates because inflation was low (1.7% in July 1998) despite the strong economy. Today, Inflation is running at 7.5% as of January 2022. If the crisis causes financial markets to seize up, the Fed faces a more arduous landscape than in 1998. Ultimately, we would expect the Fed to step in, but at a slower pace and at lower prices for risk assets.

Now, **let's remember what happened in 2018 but please, try not to get scared**…at least for now. Jerome Powell was seven months on the job when the S&P 500 peaked, and he seemed determined to remove the Fed put. In fact, the Fed raised its target rate four times in 2018, even as the stock market rolled over, turning what could have been a typical correction into a mini-waterfall decline.

The S&P 500 has been tracking the 2018 pattern closely so far. Whether it continues, in the form of another 13% decline into early April, may depend on whether the Fed remains hawkish even if economic conditions deteriorate. Like 1998, the Fed had more room to pivot in 2018 (with inflation running at 2.3%) than today. If financial markets come under pressure, **the primary question for the Fed** will be if they believe inflationary pressures will ease in the second half of 2022, allowing it to slow the pace of rate hikes. Market participants will have to decide if fewer hikes and/or less quantitative tightening is the same as the rate cuts of 1998 and 2018.

Our Global Flexible Fund, fLAB Core H-USD, has receded 2.56% in such a tough month, performing -4.25% YTD.

For March, our Asset Allocation model gives the following reading: 47% stocks, 35% bonds and 18% cash. Sentiment and yield indicators support stocks over bonds, but a weak technical and economic picture warrant some caution.

The Equity correction started earlier this year continued into February, aggravated by the escalation of geopolitical tensions that finally led to war. As usually happens around crisis developments, markets overreacted and get extremely oversold. Historical data show that after a panic into the event, on average, the market is cleaned out and a strong multi-month rally takes place. However, there are times when the "oversold" condition gets overwhelmed. These **few exceptions are often where the Fed has pricked a Bubble**. The rally over the past week looked like the market is respecting the pattern mentioned, but to trust it we would need some breadth thrust buy signals. Within equities, we have downgraded communication services to underweight and upgraded consumer staples to overweight, keeping our bets on energy and materials that are benefiting from higher commodity prices. On a geographical basis, we overweight Canada and Europe, this last on watch depending on how situation unfolds. Our stock portfolio has held up quite well the correction thanks to the outperformance of our European and emerging allocation. Fixed income has not helped in the whole month, although it does from mid February. Following tougher sanctions on Russia over the weekend, traders fled to safe-haven assets, such as government bonds. **Buying panics however, usually don't last**. And with the Fed way behind on inflation, a bullish result seems unlikely. We have taken advantage to the recent surge to further reduce the duration of the fund, now at 2.92. In terms of currency, we have tactically decreased our dollar exposure from 25% down to 15%.

Our Relative Return Fund, fLAB Satellite H-USD, has behaved extremely well (+0.30%) this month, offering investors a good place to hide against market volatility and uncertainty. The Fund not only has ended the month in positive, but is also performing a nice 0.79% YTD.

The compartment is currently invested 46% in a low risk, low duration diversified fixed income portfolio **plus 33% in some uncorrelated and tactical positions**, being the rest in cash. During this month we have strongly benefited from our commodity exposure, allocated 2.9% in Longer dated All Commodities and 3.7% in Industrial Metals (both raising above 6%) and from gold (7.6% exposure) which has also rallied. Our decorrelated short position on the iTraxx Crossover ETF (3.7% of the portfolio) has also helped in this risk off context (performing 2.3%). The equity Multistrategy allocation (12%) has retreated in line with the market, with the exception of European banks (2%) which have clearly underperformed on Ukraine turmoil. We have taken the opportunity by the end of the month to increase, tactically, stock allocation up to 15%. Bonds have receded again, on worsening inflation fears, but this has been partly offset by our short bet in the long part of the US and German yield curve (6% distributed equally). The US Dollar, now representing 15% of the fund, has strengthened amid geopolitics and the same can be said for the yen (weighting 5%) although its monthly attribution has been quite flat. We will continue to be flexible, in terms of equity portfolio and duration (now at 0.63 for the overall fund), always complying with our low target risk and Sharpe Ratio objective.