It´s All About Asset Allocation

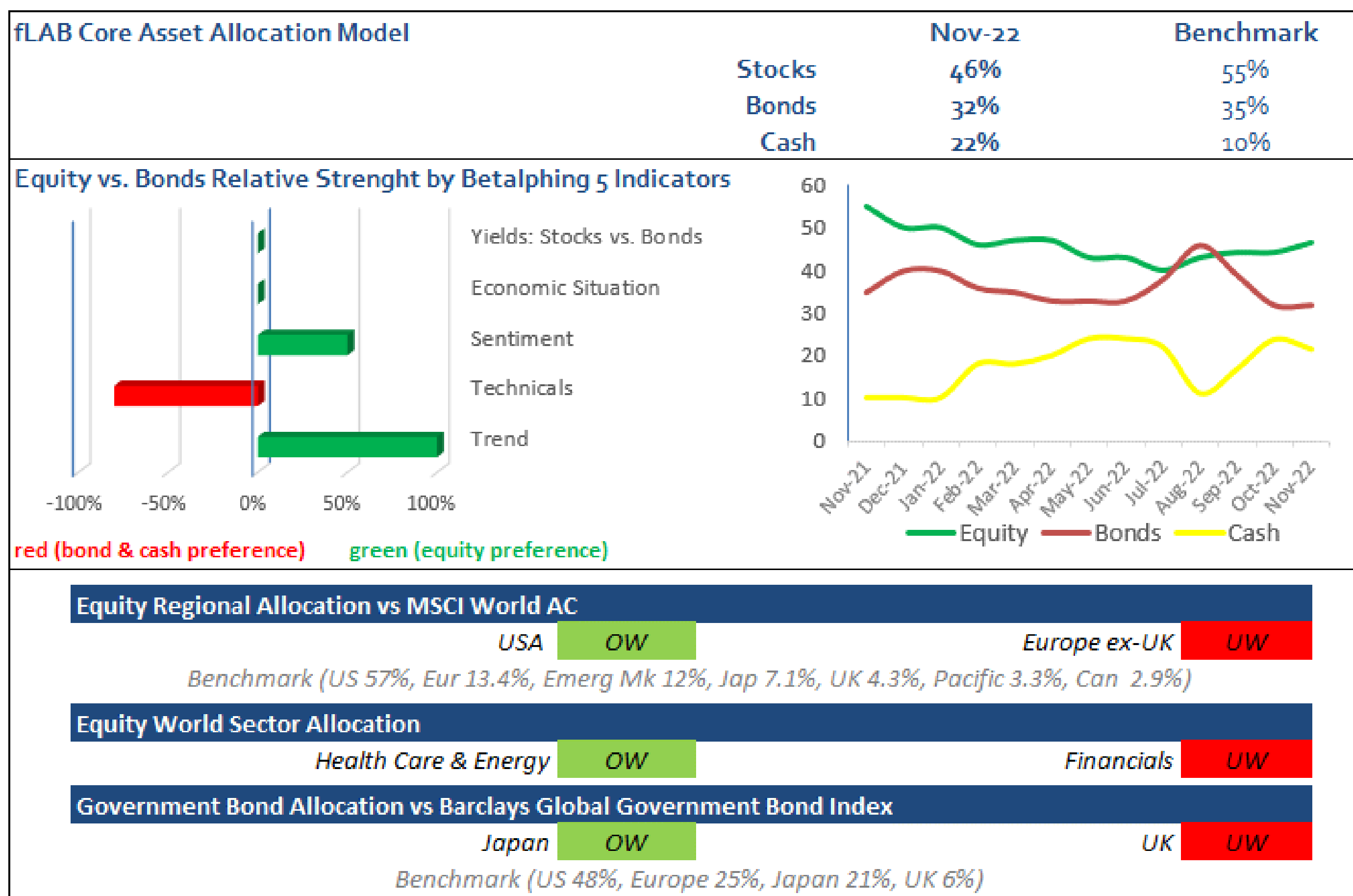
November 2022, Newsletter#77

In a backdrop of extreme pessimism and devastated markets it only took some hopes on Fed's possible downshift in rate hikes to flare a strong rally in October. The preceding steps undertaken by the Reserve Bank of Australia (RBA) and the Bank of Canada (BOC) in this matter, helped to prop up such recovery. Last week, Powell confirmed no pivot just yet, disappointing Wall Street. **New language inserted in the statement strongly hints that a downshift is coming and that it would likely be at one of the next two meetings**. But the Fed still has a ways to go and the ultimate level is likely to be higher than it was in September, probably 4.75% to 5.00%. He stressed that it was premature to be thinking about pausing the tightening cycle, leaving open the possibility to raise rates into Q2. The Fed also likely to keep rates at an elevated level for some time, which we think means around three quarters from the last rate hike. **Powell was clear that the risk is the Federal Reserve does too little, not too much, in fighting inflation.**

October's rebound was a continuation of big multi-week swings that have defined 2022. The S&P 500 averages 3.4 pullbacks of 5% or more per year, this year has already seen seven. Corrections of 10% or more happen about once a year, we have had three. Declines of 15% or more happen every two years, on average. 2022 has already endured two. Whether the current 4Q **rally can continue into 2023 will likely depend on macro factors like whether inflation rolls over enough for the Fed to pivot** or if earnings misses are limited to isolated industries and stocks. The market has been transitioning from the fastest earning acceleration since 2010 to the steepest deceleration since 2011. So it will remain to be seen if the earnings slowdown stops in the mid-single digits, as consensus suggests, or continues to fall toward -20%, as often occurs during recessions. For the time being, we will closely monitor technical indicators as they will likely tell us if the rally is sustainable before economic and fundamental do. Last month's market recovery triggered another round of breadth thrusts, for the fourth time this year, but this time with a new development. The momentum thrust and oversold indicators that did not fire earlier in 2022 registered bullish signals. This was a great start, but verification from intermediate-term and long-term breadth will be needed to feel confident in such a volatile year.

Our Global Flexible Fund, fLAB Core H-USD, has well recovered in October (+1.93%), performing -12.47% YTD.

For November, our Asset Allocation model increases 2% stocks against cash, positioning as follows: 46% stocks, 32% bonds and 22% in cash. The most important change this month has been the switch in our relative trend indicators from bonds to stocks.



The surge off the October lows was remarkable. The S&P 500 jumped 8.3% in just 13 trading days (8% in the overall month). The Dow Industrials Average posted its best October on record (13.95%) and best month since January 1976, By contrast, the Nasdaq 100 lagged far behind (+3.96%) dragged down by the bad performance of the FANMAG after weak earnings report. Emerging markets clearly underperformed (-3.15% in dollar terms) as Chinese stocks tumble to multi-year lows. Sector leadership was overwhelmingly Value over Growth with Energy, Industrials and Financials stocks soaring the most. By mid-month, and according to our sector model we raised value allocation upgrading Health Care and Energy to overweight, Materials to marketweight and downgrading Consumer Discretionary to neutral. On a geographical basis, we continue overweight US and slightly underweight in Europe.

Bond yields have jumped to their highest levels in over a decade. The 10-year Treasury yield eclipsed 4% for the first time since 2010 and is now at a 14-year high. Treasury yields from three months to five years are at levels not seen since 2007. As long as the central banks do not ease their restrictive monetary policy, bonds will remain under pressure and may not offer a great alternative, but for the first time in a long time, they are one. In fact, if we look at the percentage of S&P 500 stocks with dividend yields above the 10-year Treasury yield we will see that it has plunged from 78.0% in March 2020 to 12.53%, and that may encourage income-seeking investors to reconsider this asset class. The fund keeps a 32% allocation in fixed income, with a soft preference for Japanese government bonds over gilt's, and continues to be underweight in terms of duration (3.06).

Our Relative Return Fund, fLAB Satellite H-USD, has performed almost flat this month (-0.24%) and is accumulating a return of -4.87% YTD.

The compartment is investing 46% in a low risk, low duration (3.48) diversified fixed income portfolio plus 27% in some uncorrelated and tactical positions, being the rest in cash. The Fund has benefited from the global equity market recovery through its 13% exposure, which has been tactically increased up to 17% on renewed market volatility. Instead, global commodities (weighting 3.5%) have stalled, Gold (representing 3%) closed its seventh consecutive monthly fall and bonds, both corporate and sovereign, have continued to do poor overall. Our short bet on the iTraxx Crossover (3.2%), which has worked so well in such a tough year (+5.66% YTD) has

receded with the return of risk appetite. We will remain flexible in terms of equity exposure and duration (1.61 for the fund) trying to take advantage of the damage suffered in most assets.

fLAB Core-A awards, June 2022