It´s All About Asset Allocation

October 2022, Newsletter#76

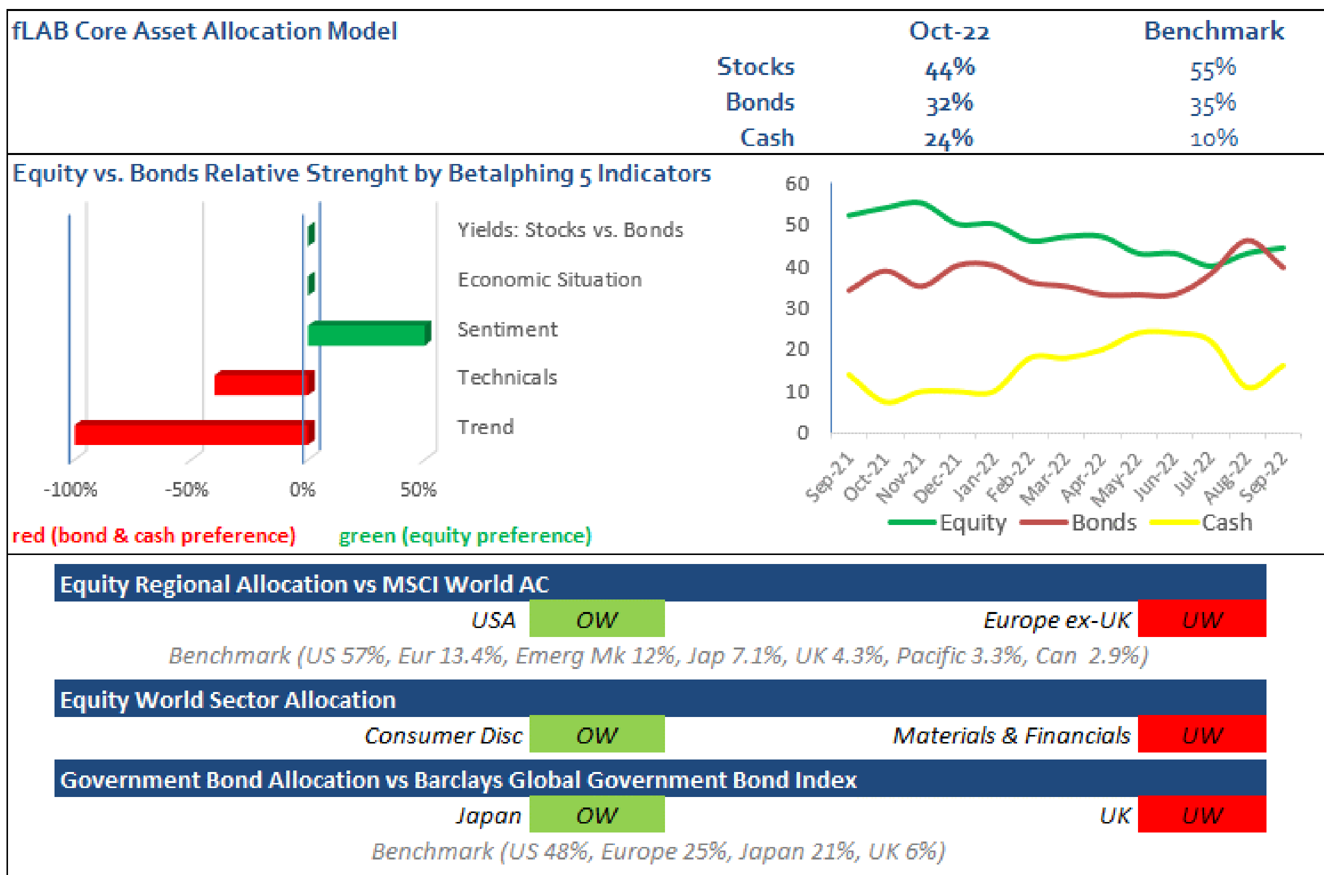
With global inflation at multi-decade highs, we're currently seeing some of the broadest and fastest global central bank tightening in history, which historically has presented headwinds to equities and the global economy. To get an idea of such magnitude, currently the are only 12% of the world's central banks in easing cycles (China, Russia, Turkey and Japan), a level not seen since 2006. In addition, **Central Banks have tightened at massive speed**. The Global Central Bank Rate has doubled since the beginning of the year (from 1.16% up to 2.86%). A central bank pivot will come when there are clear signs that inflation has turned lower. **There are some constructive signs that inflation pressures are easing.** However, due to both cyclical and some possible secular factors, inflation is likely to remain elevated in the near-term, keeping central banks hawkish. Therefore, we must all will agree that it's getting harder to fight the world's central banks.

That said, we cannot ignore the damage already done in the stock and the bond market, nor the critical juncture for equities at the end of September. So much emphasis is placed on whether indices are above or below previous lows that their importance is almost a self- fulfilling prophecy, but retests are about more than popular averages. In some cases, a break of the lows can be the final capitulation (on retests after waterfall declines, the DJIA has broken its initial low by a median of 3.9%) so **it is possible to go modestly below support levels and still have a successful retest**. We start to get concerned that it has failed when we see indexes and stocks fall more than 5% below current support levels. It was discouraging that, as of September 29, the Dow Jones Industrial Average (DJIA), S&P 500, and NYSE Composite were all below their June/first-half lows but none of them were below the mentioned threshold. The stock market has started October rebounding strongly, encouraged by the good news coming from the UK and the Reserve Bank of Australia (which has slowed the pace of interest rate rises) and by strong overselling. **However, it's too early to say that the worst is behind us**. The macro and monetary backdrop are less than promising amid growing recession fears.

Our Global Flexible Fund, fLAB Core H-USD, has ended the quarter at -14.13%.

For October, our Asset Allocation model reduces bonds (-7%) and equities (-1%) in favor of cash. The Fund is investing 44% stocks, 32% bonds and 24% in cash. The most significant and concerning change has been the switch from our relative trend indicators from stocks to bonds: caution is warranted.

Global Equity markets have plummeted during last month. Wall Street has posted the worst monthly return since the start of the pandemic, with S&P 500 falling 9.2%, Dow -8.8% and Nasdaq 100 retreating 10.5%, dragging the global equity benchmark to new lows (the MSCI ACWI local currency plunged 8.4%). Emerging markets clearly underperformed (-11.7% in dollar terms) while Europe held up relatively better (-5.6% for the Eurostoxx 50). **We keep overweight US and slightly underweight in Europe, as the economic prospects for the region are dimming.** In terms of sectors, we remain overweight consumer discretionary, which has achieved to remain well above the first-half low, and underweight materials and US financials.



Bond markets have been impacted by **higher interest rates and for a panic melt-up in yields**. Since the U.K. announced on September 15 that it would deliver an emergency mini-budget on September 23, yields rose not only in the U.K., but in other developed bond markets. Last week, the Bank of England came to the rescue with a bond buying and the same did the British government on Monday. These movements calmed markets. But the BoE remains in a tough spot trying to fight inflation and maintain financial stability and, the Fed and the ECB remain in a similar predicament. Neither is likely to end its tightening cycle before next year. We have taken advantage from the yield pullback to reduce our bond exposure. From a regional allocation perspective, fortunately we have been overweight Japan and underweight the U.K, and marketweight the U.S. and Europe. We continue slightly underweight in terms of duration (3.19 for the overall fund).

Our Relative Return Fund, fLAB Satellite H-USD, has not been immune to market volatility and has retreated 4.64% YTD. Even so, the fund continues to stand out among its main competitors.

Last month we talked about the difficult situation for conservative products, like our Satellite, to deliver positive results in such a tough year. Well, as explained before, the situation has worsened in September. US dollar has been the only asset class to gain during that period. Global commodities (3.3% of the fund) have continued its reversal process (from their June highs), Gold (3% of the portfolio) has added its sixth consecutive monthly fall (-3%) and stocks and bonds race to the bottom. Our equity multistrategy position (representing 12% of the fund) has been hurt by the global equity sell-off and our low risk-low duration bond portfolio (weighting 44%) by the yield melt-up and widening credit spreads. We will remain flexible in terms of duration (1.55 for the overall fund) and risk exposure, trying to take advantage of market volatility.