fLAB

It´s All About Asset Allocation

February 2023, Newsletter#80

We couldn't have asked for a better way to welcome 2023. Some of the major fears/headwinds for financial markets such as inflation, the tightening cycle and recession have softened, which has strongly boosted the prices of the main financial assets, after the awful year that we have left behind. **Not only have investors recognized a 'better' scenario, but so did the Federal Reserve last week**, downshifting its pace of rate hikes to 25bp and acknowledging the improvement in inflation. Powell continues to characterize it as 'elevated' and repeated that ongoing increases will be appropriate but he will also reiterated that they will be data dependent and operate meeting by meeting. He seemed unconcerned by the easing of financial conditions, and attributed it to the market thinking inflation would come down faster than the Fed does. That helped give a green light to risk assets. Investors celebrated a more dovish tilt than expected, which I hope will not be cool down while I'm writing these lines (awaiting for Powell, again), following Friday's strong employment report.

The equity comeback of the past three months has been broadening out globally, with the U.S. market now participating to a greater extent, FANMAG stocks supporting the market rather than weighing it down and the performance of risk-on proxies becoming more decisive relative to the performance of risk-off proxies. **The trend improvement has been significant and should not be dismissed as a bullish development**, especially given the lack of compelling evidence that we've seen the end of the secular bull market intact since 2009. It remains likely that as with the global cyclical bears of 2011, 2015-2016, 2018, and 2020, the 2022 bear market will be followed by a return to record highs on the global benchmarks. Despite the lingering macro risks, markets have been trying to form a bottom for the last months and are now flashing positive background signals. One of the most important and awaited for us, is **that long-term breadth indicators finally registered bullish signals for the first time in nearly a year,** something that did not happen in any of the 2022 rallies. The percentage of stocks above their 200-day moving averages, the growing percentage of sectors and markets participating in the global equity advance since October lows is quite encouraging and **it looks more like the beginning of a new bull rather than a bear market rally.** In fact, one of our concerns in December was that stocks and sectors leading the rebound were not the ones typically seen at the beginning of a bull. That is no longer the case.

Continued broadening is also supported by the trend of receding bond yields, now that the ACWI and global aggregate bond yield have an inverse correlation. Currently, there's little evidence that the economy is collapsing to such an extent that an earnings-driven market descent will follow. And the resilience of copper and most other commodities is not consistent with a severe recession. Of course, it's premature to declare victory against a hard landing/recession, as macroeconomic data are quite mixed at this point. However, with inflation and long-term interest rates coming down, we don't see the Fed as hostile and with room to pivot, if they choose.

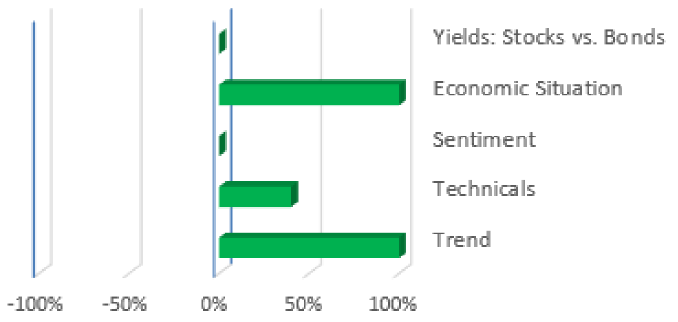
Our Global Flexible Fund, fLAB Core H-USD, has started the year in very good shape, performing 4.32% at the end of January.

For February, our Asset Allocation model echoes the improvement from the technical and economic point of view, increasing equity allocation (+8%) against fixed income (-7%) and cash

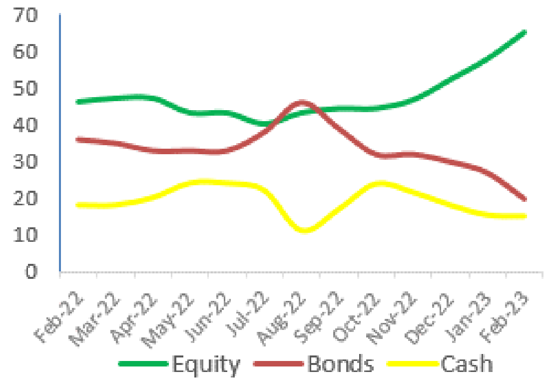
(-1%). Our fusion analysis reflects a strong environment for stocks, with an investment level (65%) not seen since November 2020.

fLAB Core Asset Allocation Model		Feb-23	Benchmark
	Stocks	65%	55%
	Bonds	20%	35%
	Cash	15%	10%

Equity vs. Bonds Relative Strenght by Betalphing 5 Indicators



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



Equity Regional Allocation vs MSCI World AC

Europe ex-UK, Pacific Ex-JAp	*OW*	*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

Health Care & Energy	*OW*		*UW*

Government Bond Allocation vs Barclays Global Government Bond Index

	OW	*Japan*	*UW*

Benchmark (US 48%, Europe 25%, Japan 21%, UK 6%)

Global equities have started January 'on fire', posting a positive return of 6.4% (ACWI local currency), even higher if you look at Europe, Pacific ex-Japan or Emerging Markets. The S&P 500 performed in line with the global benchmark (6.2%), with sector leadership decisively risk-on. Defensive sectors were the only to posted negative returns (Consumer Staples, Health Care and Utilities) while the growth sectors (Consumer Discretionary, Communication Services and Information Technology) which experienced the largest declines in 2022 were the top performers to begin the year, pushing the Nasdaq 100 and the FANMAG index by 11%. **Whether or not Growth sectors can maintain leadership status will largely depend on if the group can sustain beyond its long-term downtrend, now that valuations seem more reasonable**. By mid-month, we removed our underweight position in Consumer Discretionary, which has finally been the top performer sector in January, due the turnaround led by the sector's mega-caps, Amazon and Tesla. On a geographical basis, and according to our models (based on price and fundamental indicators) we have added Pacific Ex-Japan to overweight and downgraded Japan to underweight.

Global receding yields, have been key in this stellar beginning, and have positively contributed to our fixed income exposure (30%), giving its 8.6 duration. Decreasing inflation data, which has recently culminated in a more 'dovish Fed's tone' has led the 10-Year Treasury yield to the lower band of our expected trading range (3.4% - 4.3%). The market continues 'to fight the Fed', and the same can be said in the case of the ECB. **Perhaps it isn't necessarily wrong but it could be too early**. As we mentioned last month, any legitimate breakdown (or breakout) should be confirmed globally, which is still not the case. Aligned with our model we decrease 7% the allocation to Bonds, leaving U.K. and Japan underweight against benchmark, thus reducing the duration of the fund till 2 (from 2.68 previous).

Our Relative Return Fund, fLAB Satellite H-USD, has performed 1.44% in such a promising new year.

The compartment, kicked off the year invested 47% in a low risk, low duration (3.44) diversified fixed income portfolio plus 27% in some uncorrelated and tactical positions, being the rest in cash. January has been a great month for the fund as we have benefited from a **strong recovery in most assets**. The global equity exposure (17% of the portfolio), has been our main source of profitability followed by the positive return of our bond portfolio, which has gained traction amid lower yields and narrowing credit spreads.

Within equities, we actually keep some thematic bets that we continue to like over the medium term, such as global infraestructures (3.4%) and water (1.7%), mixed with a low beta approach (through a 3% investment in low volatility stocks) and a more tactical risky stance (3.2% in security selection and 3.3% in Nasdaq 100 Futures). Gold (3,6% of the fund) has also risen on expectations that real yields will continue to trend lower, powered by a strong demand from central banks and supported by the weakness on the US Dollar (due its inverse correlation).

We will remain flexible in terms of equity exposure and duration (1.60) trying to take advantage of market volatility and/or some counter-trend rallies given overbought conditions after this stunning start.