It´s All About Asset Allocation

June 2023, Newsletter#84

Until very recently, we thought that **Greed was the Deadly Sin that moved the markets** and the remorseful souls of heartless investors, even though we grew up with Gordon Gekko's famous Wall Street adage: "Greed is Good!"
But how wrong we were! What truly moves our poor spirits and the gears of the market is another Deadly Sin. Undoubtedly, Nvidia (uh, sorry, **Envy**) **is behind all the recent financial disasters**. We've seen it in recent months with Artificial Intelligence, which has it all. For starters, the name: Who would be foolish enough to criticize something with the word 'Intelligence' associated with it? You'd be a poor fool if you did. For this reason, and as with other previous trends, from Clean Energy, Digitalization, Hydrogen, the Electric Car, the Metaverse... and so on, back to the Internet in 1999, the railway companies in the 19th century, and the famous tulips of the 17th, the problem has always been the same: Envy.

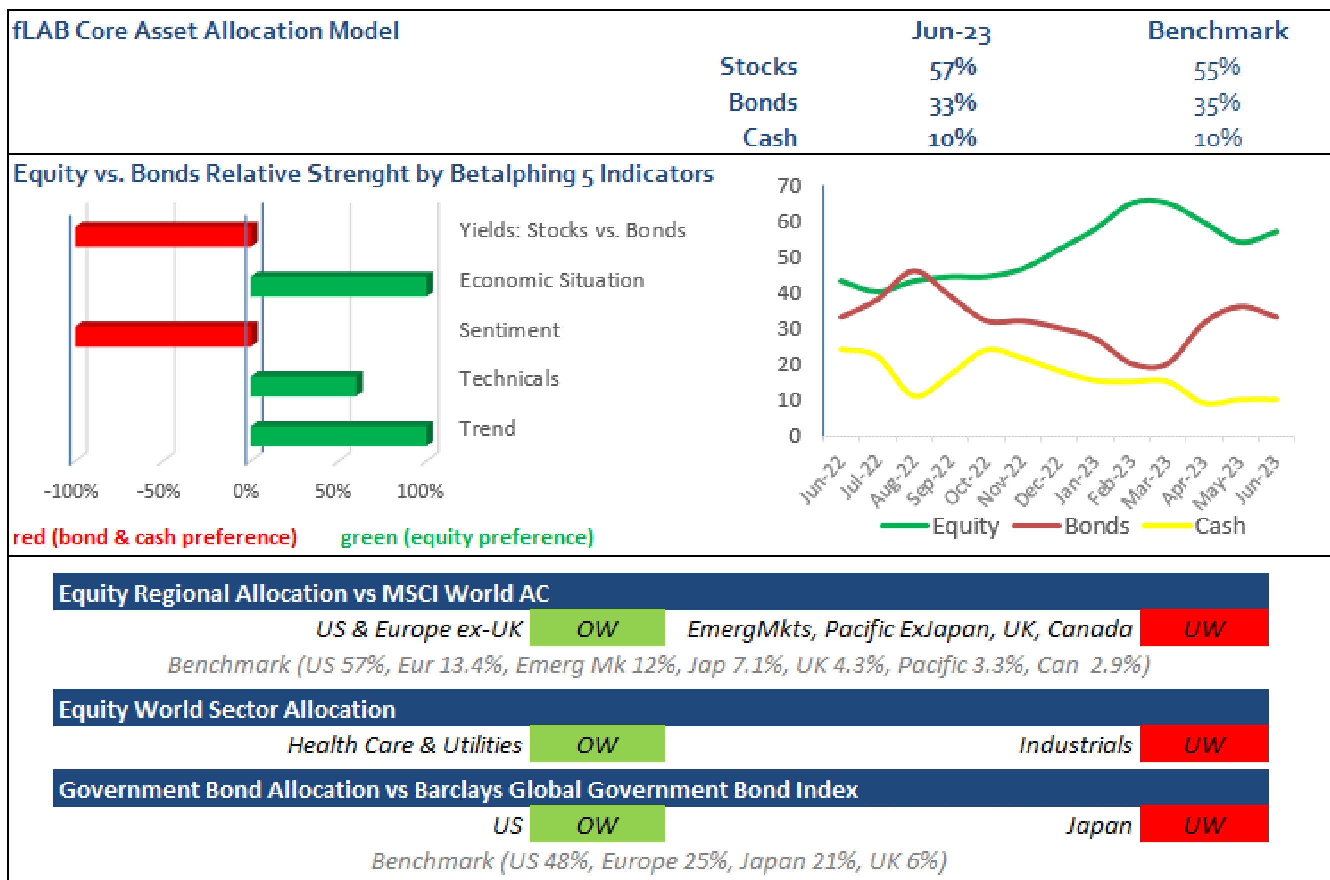
Knowing that someone is getting rich from something makes us want it too. The problem with this FOMO is that in the markets, supply is always limited, and demand can be infinite, causing the price of the desired good to be absurdly high. And if we add to that the **most popular Deadly Sin of this century: Sloth** (or its alter ego: **'one-click access'**), we have the perfect mess. Hence, the exponential growth of ETFs and Index Funds that seek to replicate a trending sector or theme, without actually having any idea of what we're really buying. If we analyze the composition of thematic ETFs in depth, the direct exposure to the theme they aim to emulate is often much less than desired, since truly disruptive companies, if any, are a rare commodity. As a result, this massive volume of envious money ends up buying anything which appears to be similar, including shares of things which just happened to be around.

Nevertheless, the world of ETFs is a great way to replicate a consolidated, large-scale geographical index or economic sector. However, a disruptive, fashionable theme is typically made up of a small group of leading companies (which quickly trade at an astronomical P/E ratio), a handful of follower companies that may benefit in the medium term, and a vast number of usual suspects, which (surprise, surprise) are found in all ETFs that replicate any seemingly disruptive theme. Take the Metaverse as a perfect example: since a few groundbreaking companies started in this field just a few years ago, up to 23 ETFs have been created to invest in it. Obviously, in these ETFs, the unicorns were hunted long ago, leaving behind not even a trace of their horns ... only the usual suspects.

By the way, **if you put together the 3 deadly sins mentioned here**: Envy – Sloth – Greed, you get the beautiful trendy acronym of this century: ESG…..**disturbing, isn't it?**

Well, back to business... our Global Flexible Fund, fLAB Core H-USD, has continued to appreciate in May (0.22%), posting an outstanding return of 6.18% (June 5th).

In June, our Asset Allocation model increases 2% stocks against bonds, due to the improvement on a technical basis.



What a month! Well, for some more than others since the performance of the stock markets and sectors couldn't be more uneven. Growth overwhelmed Value and the winners, we already know them (Tech, Nvidia and all related to AI). The rest had an erratic behavior overall (MSCI ACWI -0,55% in local currency) and quite negative in some of the main geographical areas such as Europe (-3.2%) and Pacific ex Japan (-6.6% in USD). On the other hand, Japan stood out, shooting up 7% (Nikkei 225) to 33-year highs. **The key question from now on will be whether the Technology stock performance (Risk-On par excellence and highly correlated with the global stock market) is a prelude of market trends to come, or not.** If the rebound does not broaden out and leadership continue to be narrow and dependent on a handful of mega-Cap tech names (they look like the only game in town), the dependence on those stocks would leave the market vulnerable to a Tech-induced collapse. Its influence is evident when we look at the top 20 stocks carrying the ACWI market cap (17 of them U.S. stocks and seven in the Tech or Communication Services sectors). The top 20 now account for 24.7% of the market cap, above the extremes reached in September 2020 and December 2021. In short, we need the rally to expand to give it confidence to deep into the 2H. So far, we keep our geographical and sector bets and a neutral stance in terms of style (Growth vs Value).

Treasury yields moved higher in May but pulled back to close out the month. There were several factors that contributed to the rise: optimism about reaching an agreement to raise the debt ceiling (removing some of the safe haven bid), a pair of FOMC members said they were open to another rate hike, the US labor market remains tight and banking stress decreased (with spreads narrowing). In the U.S, twos, fives, and 30s all approached trading near short-term support levels. This was not the case for tens where support can be found around 4.00%. **What bothered us the most, was the rally in European yields, with 10-year gilt yields rising above 4.00%**, exceeding its early March peak when its Treasury counterpart crossed that level. The rest of the yields on the continent didn't confirm and reversed on best inflation data. Currently, **we expect global yields to continue in a trading range and even trend lower** in the US, which has been the normal response at the end of tightening cycles. As a result, we keep overweigh US and with a global bond portfolio duration of 10,26 (3.40 for the whole fund).

Our Relative Return Fund, fLAB Satellite H-USD, has performed very well during the month (+0.61%), thus accumulating 1.87% YTD.

The compartment is investing 51% in a low risk, low duration diversified fixed income portfolio plus 22% in some uncorrelated and tactical positions, being the rest in cash. On the fixed income side, and in line with was previously pointed out, the portfolio has managed to reverse much of the monthly accumulated losses, even reaching positive in the case of the European debt (both, sovereign and corporate). For the time being, we keep portfolio duration at 4.24 (being 2,18 for the overall fund) and continue to lean defensive within credit. The equity multistrategy allocation (representing 13%) has outperformed the global stock market (MSCI ACWI) while gold (4% exposure) and global commodities (1,7%) have been weak (-1,1% and -5% respectively). We will remain flexible in terms of risk exposure and duration, trying to take advantage of the opportunities arising from an uncertain framework, given investor's changing interest rate expectations.

fLAB Core H-USD, Jan 2023