*f*LAB

It´s All About Asset Allocation

October 2023, Newsletter#87

September and October first week, are following their weak seasonal pattern **as investors appear taking the Fed's higher-for-longer rhetoric seriously.** The Federal Reserve surprised the market on September 20th, with its guidance for another rate hike this year and fewer cuts next one. Market's response was immediate. The S&P 500 Index has recently broken the October 2022 uptrend, a very relevant level that if not recovered soon, would have bearish implications. Short term the market is oversold and the **sentiment has fallen into extreme pessimism zone**, setting the stage for a year-end rally. As is logical within any decline, short-term technical indicators have deteriorated but no long-term ones. Whether the latter break down can determine if the pullback is part of a cyclical peak. Market tops are usually – but not always – a process and not an event. If the market mounts a year-end rally, watch for lower highs from long-term breadth readings for a sign that a topping process is under way but, let's go step by step.

The market decline has coincided with a breakout in bond yields across the Treasury curve, especially in the long term. The most worrisome it that those movements have been broad-based. As long as the stock/bond yield correlation remains negative, a stock market rebound appears unlikely without falling yields. The current spike, removes one of the few bullish valuation arguments for equities. Stocks have been expensive on an absolute basis and relative to cash (T-Bills) for months but were not relative to long-term bonds. That is no longer the case. The S&P 500 earnings yield has fallen below the 10- year Treasury yield for the first time since 2009. **In other words, stocks are more expensive than bonds for first time in 14 years**. The backup in yields and steeper curve reflect a variety of factors, least of which is higher inflation expectations. Most of the increase is due to higher real yields and a rising term premium, which can be traced back to better than expected growth and Fed policy projections for a soft landing and fewer rate cuts in 2024. The market seems to have gotten way out in front of the fundamentals. Extreme readings in bond momentum and bond sentiment argue for some stabilization in yields in the coming weeks.

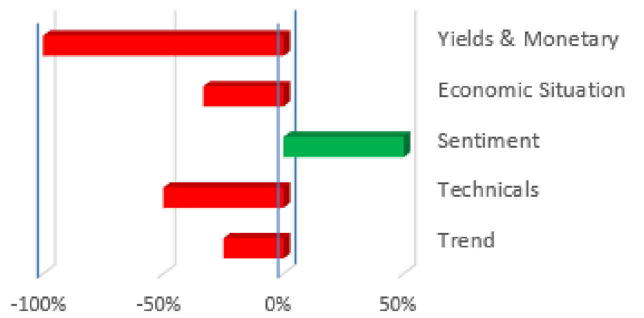
The market is vulnerable from several angles. How can the market pull out of its slump? A simple answer would be to reverse the above. The market could hit such oversold levels that it triggers a rebound. Interest rates could retreat. Economic data could point to a soft landing and valuations can become more attractive in one of two ways: prices come down or earnings go up. **A robust Q3 earnings season may be needed to support a year-end rally.**

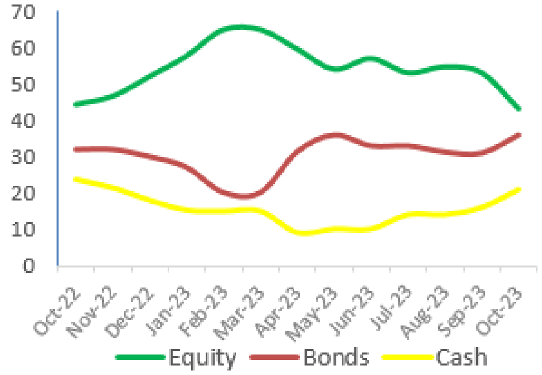
Our Global Flexible Fund, fLAB Core H-USD, has not been immune to the equity and bond selloff and has retreated 2.50%. The fund is posting a positive return of 4.10% YTD.

In October, our Asset Allocation model reduces stocks (-10%) in favor of bonds (+5%) and cash (+5%). The only indicators that favor stocks over bonds right now are the sentiment ones.

fLAB Core Asset Allocation Model		Oct-23	Benchmark
	Stocks	43%	55%
	Bonds	36%	35%
	Cash	21%	10%

Equity vs. Bonds Relative Strenght by Betalphing 5 Indicators





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

Equity Regional Allocation vs MSCI World AC			
US	OW	Pacific ExJapan, UK	UW

Benchmark (US 57%, Eur 13.4%, Emerg Mk 12%, Jap 7.1%, UK 4.3%, Pacific 3.3%, Can 2.9%)

US World Sector Allocation			
Energy	OW		UW

Government Bond Allocation vs Barclays Global Government Bond Index			
Eurozone	OW	Japan	UW

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

The equity market correction has been widespread (-3.64% MSCI ACWI local currency terms). The S&P 500 (-4.87%) and the Nasdaq 100 (-5.07%) have underperformed the global benchmark while Europe (-1.63% MSCI Europe) and those already punished, emerging markets (-2.81%) and Pacific ex Japan (-3.64%) have held up relatively better, in dollar terms. Japan, which has been the best major region year to date has continued to outperform. **We remain overweight in U.S. due to better relative economic prospects**. In terms of sectors, we have observed that after a growth's dominance during the first half, there has not been a decisive broad-based sector leadership rotation during the last quarter. Some major leadership developments have been at the individual sector level, driven by higher commodity prices and yields. Thus, Energy has been for the second consecutive month, the only sector to register profits as oil (WTI) jumped to a fresh one-year high. Another notable distinction between these two periods has been the divergence of mega-cap performance. For all this, we continue to adopt a neutral stance in our U.S. equity portfolio (except for energy).

In terms of bonds, one of the most important things regarding the technical breakout in yields is that it was not just limited to the U.S. We have seen long-term European yields confirm the Treasury breakout last week and JGB yields continuing to creep higher. Only gilts have not confirmed. The Fed is most restrictive but the ECB and BoE are narrowing the gap. The transmission of the tightening of monetary policy seems to be having a greater impact in Europe and the U.K. than it is having in the U.S. As all of the developed market central banks (except the BOJ) have been delivering a similar message restrictive for longer, curves have steepened around the world (including Japan). Technical breakouts across the curve and around the world warrant caution, although fundamentals question the sustainability of the move. Aligned with our AA model, **we have increased exposure (+5%) to European govies, where we believe the selloff has been excessive** given the gloomy outlook for the region. The duration of our fixed income exposure is at 9.61 (3.65 for the overall fund).

Our Relative Return Fund, fLAB Satellite H-USD, is accumulating 2.06% YTD.

The compartment is investing 52% in a low risk, low duration diversified fixed income portfolio plus 20% in some uncorrelated and tactical positions, being the rest in cash. As we mentioned last month, it has been **very tough to obtain gains in a framework in which stocks and bond**

yields are inversely correlated. Gold in turn (3.9% of the fund), has also been impacted (-4.7%) by higher yields and the strong appreciation of the dollar (Dollar Index has risen 2.5%). As explained, energy has been the only global sector that has avoided losses (supported by a rise in crude oil) but the global commodity index (CRB) has not run the same good path. Our equity multistrategy allocation (12%) has performed in line with the global equity benchmark and the global bond portfolio (with a duration of 4.16) has not been immune to the strong rebound in bond yields and the weak performance in the corporate space. For the time being, we continue to lean defensive within credit in view of a global economic slowdown. We will remain flexible in terms of risk exposure and duration (2.16 for the overall fund) trying to take advantage of the opportunities arising from high volatility and investor's changing interest rate expectations.

REFINITIV **10 Year Ranking** LIPPER LEADERS

	Total Return	Consistent Return	Preservation	Expense Ratio
fLAB fUNDS Sicav- fLAB Core A EUR	4	4	4	5
fLAB fUNDS Sicav- fLAB Core H-SGD	5	4	2	4
fLAB fUNDS Sicav- fLAB Core H-USD	5	4	2	4
fLAB fUNDS Sicav- fLAB Satellite A EUR	3	4	5	3
fLAB fUNDS Sicav- fLAB Satellite H-USD	5	5	3	3