fLAB

It´s All About Asset Allocation

March 2024, Newsletter#92

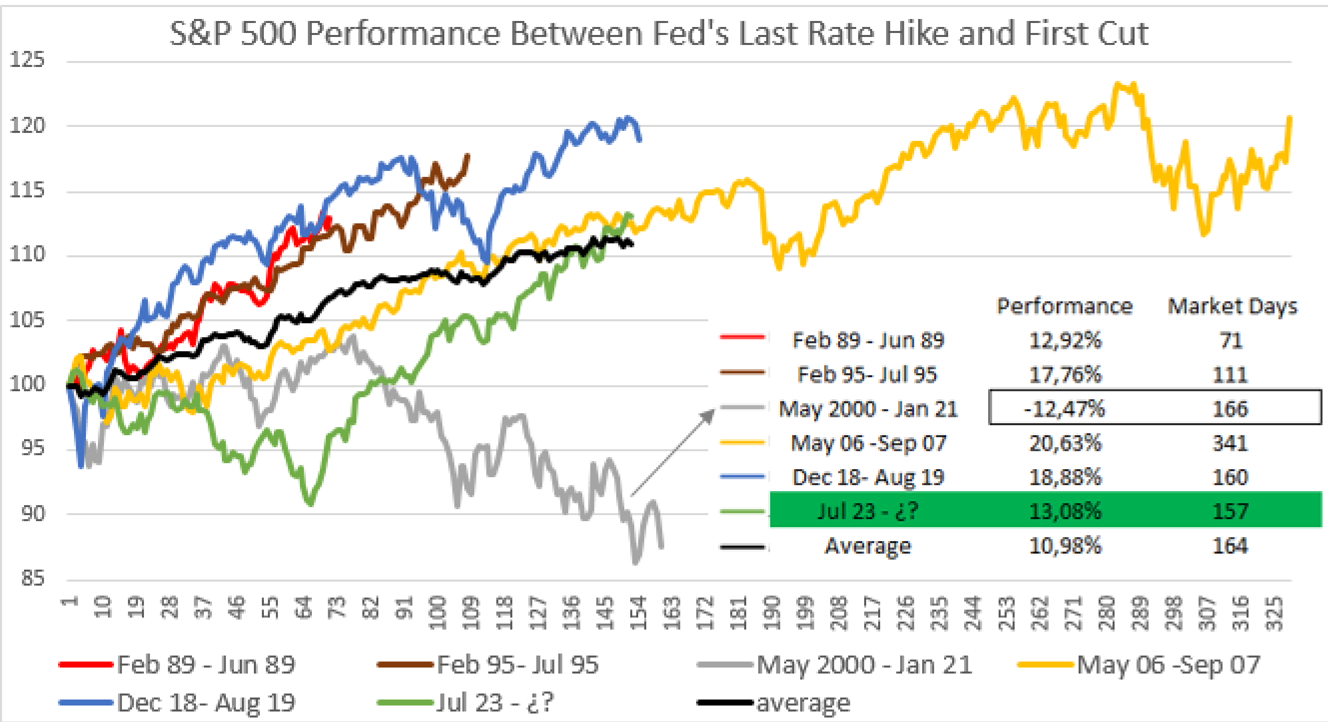
In last month's newsletter, I commented that the quiet way that the FED is taking to start the rate cuts was great news. It frequently happens that it is the 'fantasy' about future rate cuts and not the cuts themselves that the market perceives positively. Lowering rates too early can knock out the markets if inflation proves to be stronger than desired.

In today's newsletter I want to analyze in depth two facts, which usually go unnoticed despite their importance:

1. What has been the **real performance of the market, from the date of the last rate increase by the FED, until the beginning of the new cycle of rate cuts?**
2. **Has a slow or fast rate cuts cycle been better for the market?**

Since the last increase by the FED (July 26, 2023), the S&P 500, after some horrible first few months, has recorded **a rise of 13.08% in 157 market days** (green line). Is this a lot or a little, compared to other times?
Well, **during the last 40 years, in the 5 periods** from the last FED rate increases until its first decrease (Feb 89 - Jun 89; Feb 95 - Jul 95; May 2000 - Jan 21; May 06 - Sep 07; Dec 18- Aug 19) **the average S&P performance was +10.98% for an average period of 164 days** (black line).

Therefore, the current market behavior is very similar to the historical average.
However, there is some dispersion.



Thus, we observe that most of the periods are similar to the current one, some much longer (May 06 - Sep 07) or very short (Feb 89 - Jun 89). There is only a negative period, that of 2000/01

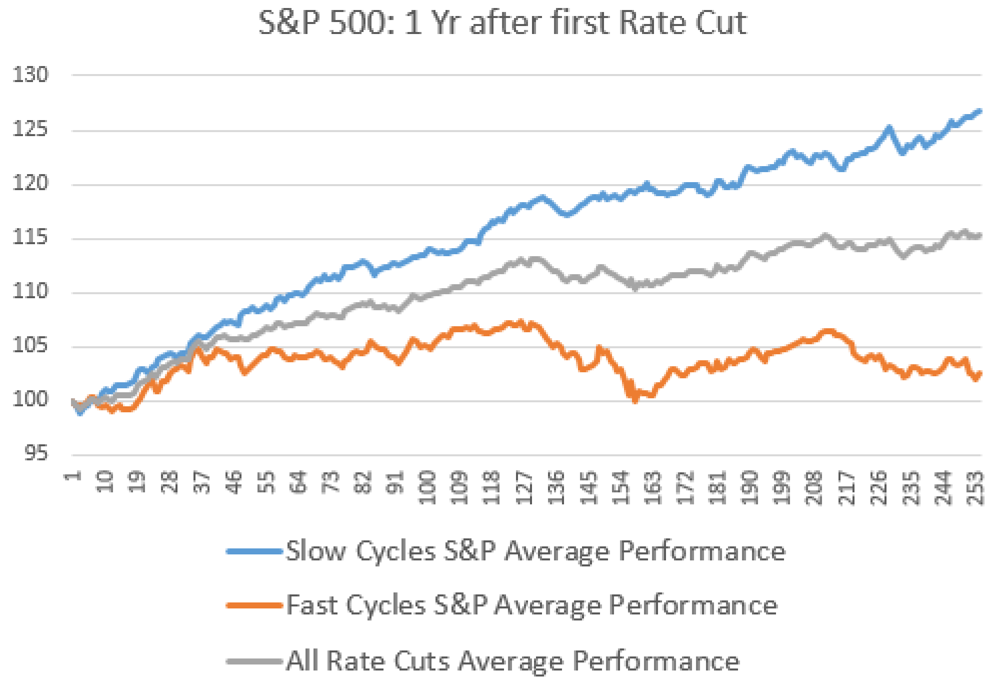
with a loss of -12.47%, although it should be noted that of all the scenarios studied it was the only one that marked the beginning of almost a decade of Secular Bear.
Therefore, as this is not our current scenario (hopefully), **the current pause mode of the FED seems fine to us**, since the historical performance helps us to be favorable to Equity.

Looking forward, when the new cycle of rate cuts begins, what should we prefer? If we want to continue in a bullish Equity scenario**, do we favor a fast and aggressive cycle or a relaxed one?**
On this occasion, we have analyzed different cycles of Federal Funds cuts, depending on whether they have been slow or fast. A fast cycle is five or more cuts over a 12-month period. Anything less than five is considered a slow cycle. We have been able to identify the following cycles since 1950 with their start date:

- Slow Cycles: 02/05/1954, 11/15/1957, 06/10/1960, 11/19/1971, 05/30/1980, 11/21/1984, 07/06/1995, 09/29/1998
- Fast Cycles: 11/13/1970, 12/09/1974, 11/02/1981, 06/06/1989, 01/03/2001, 09/18/2007, 07/31/2019

If we take a look at S&P 500 performance the year after the start of these cycles, the result could not be clearer: **The market behaves much better in a cycle of slow rate cuts**. Basically, we return to the same issue, since this dynamic keeps the 'lower-rates-fantasy' alive longer. Obviously, we cannot forget that very fast and abrupt rate cuts usually reflect serious problems and damage in the Real Economy.

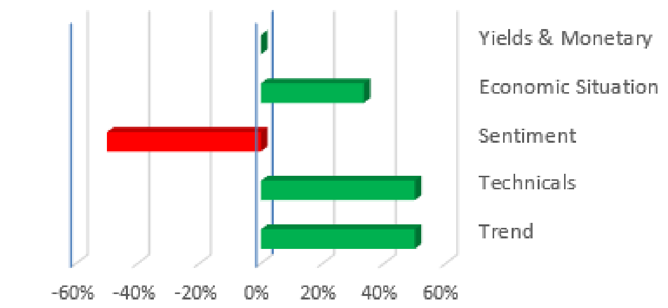
Note in the graph that the 40 market days performance after the first rate cut are very similar in all cases. However, from the second month onwards the market perceives perfectly whether these rate cuts are in a healthy environment or because the ship is sinking.

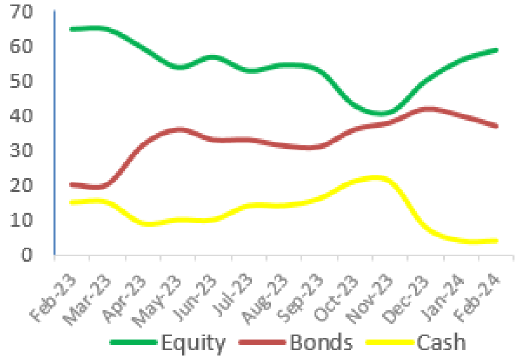


I also want to share the allocation of fLAB Core in March and attach the fact-sheets, with hardly any changes compared to last month.

fLAB Core Asset Allocation Model		Feb-24	Benchmark
	Stocks	59%	55%
	Bonds	37%	35%
	Cash	4%	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 Sector Allocation

Comm Serv	*OW*	*Materials & Cons Staples*	*UW*

Government Bond Allocation vs Barclays Global Government Bond Index

UK & Eurozone	*OW*	*Japan*	*UW*

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

The truth is that the fund is doing very well again: Our fLAB Core Clean EUR class is at +3.32% for the year and the **fLAB Core Clean USD at +3.45% (at its historical highs). Core USD Clean vs Morningstar:**