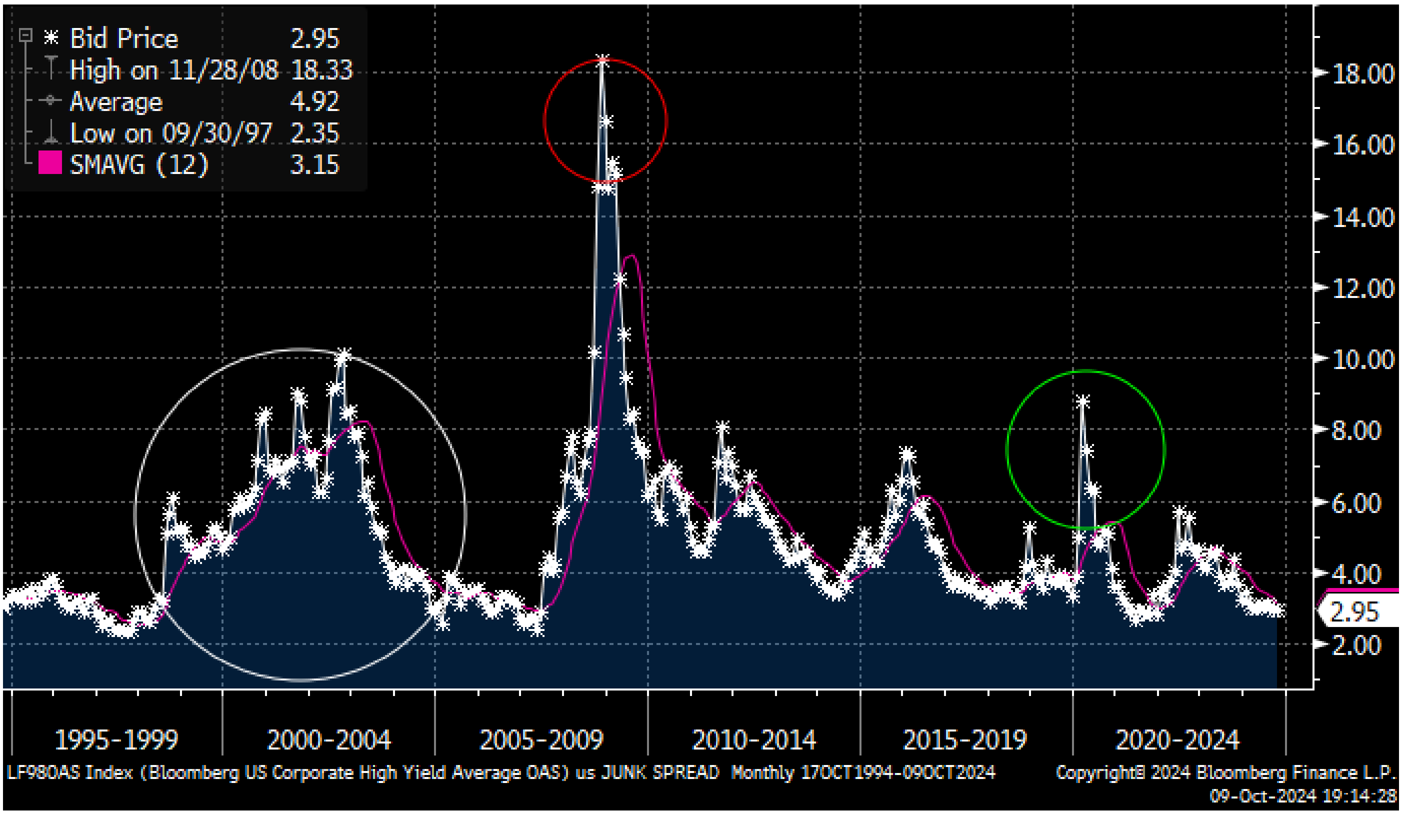
It´s All About Asset Allocation

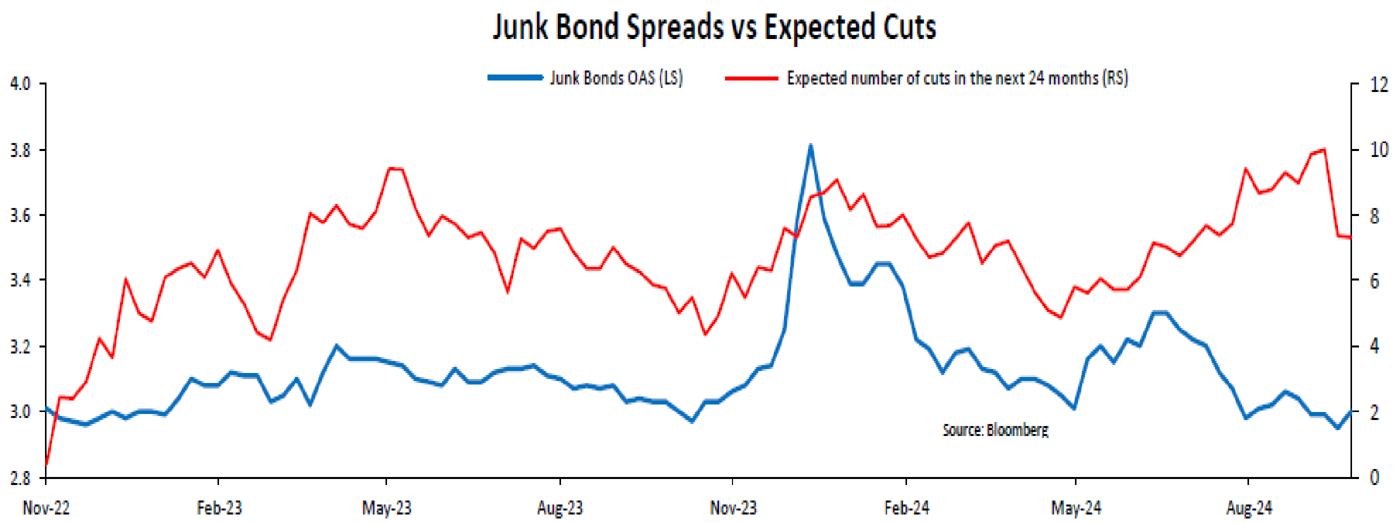
October 2024, Newsletter#98

In our old books of Finance we learnt that Junk bonds carry a higher risk of default than other bonds, but they pay higher returns to make them attractive to investors. If more investors are buying them, their willingness to take on risk indicates optimism about the economy. And we know from past painful experiences that **credit spreads rise with recessions and skyrocket with depressions.**
Junk bonds have hit several bumps in the road : The huge crash in the Savings & Loan Crisis of the 80s, the "Dot Com" Crash of 2000-2002 where Investors put their money into ideas, not ebitdas, and as a result, the market crashed and the great Financial Crisis of 2007-2009, where junk bond defaults rose as high as 13.4% by Q3 of 2009.

Well, and how are we doing now? **Best than ever, if we have to trust the Junk Bond Market**. In the last 30 years the average of the Bloomberg US Corp High Yield Spread has been 4.92% above Treasury rates. Currently it only pays 2.95%!



At the same time, it is projected that there is a probability of 40% to 60% (depending on the data provider) that the United States will fall into another economic recession in one year time.



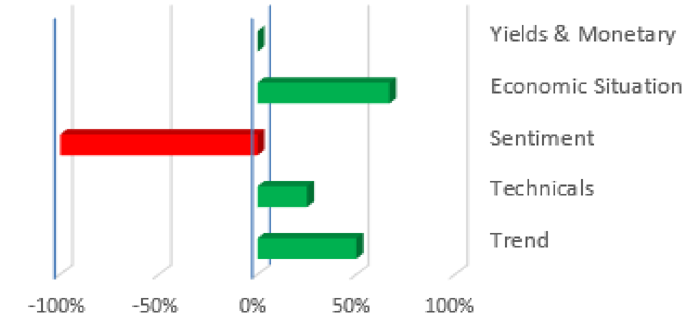
So who do we have to believe?
To the siren song of the Fed´s dot plot that discounts an endless string of rate cuts in the next 12 months, in the face of the more than assured and imminent recession, or to the Junk Bond Market, which does not show any fear and even pays almost 200bp less than the historical average?

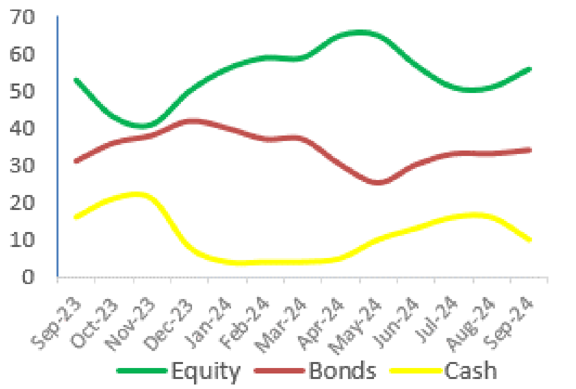
One thing is for sure, **one of the 2 is wrong: or Junk Bonds face a more than probable sell-off or the Recession story is just gossip.**
Maybe we should follow Rudyard´s advice and treat those two impostors just the same.
Or as Vincent Deluard reminds us: The curious schizophrenia of the bond market which prices Treasuries for depression and junk bonds for economic nirvana should eventually get solved.

In the meanwhile, our fLAB Core USD fund is achieving its all-time highs these days. We are currently 8.16% (Sep 30) with this Asset Allocation:

fLAB Core Asset Allocation Model	Oct-24	Benchmark
Stocks	58%	55%
Bonds	32%	35%
Cash	10%	10%

Equity vs. Bonds Relative Strength by Betalphing 5 Indicators





Equity Regional Allocation vs MSCI World AC

US & Pacific ex-Jap	*OW*	*Japan & UK*	*UW*

Benchmark (US 63%, Eur 12%, Emerg Mk 10.5%, Jap 5.5%, UK 3.5%, Pacific 2.8%, Can 2.7)

US Sector Allocation

Health Care, Utilities	*OW*	*Materials & Comm Services*	*UW*

Government Bond Allocation vs Barclays Global Government Bond Index

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

Benchmark (US 55%, Eurozone 25%, Japan 14%, UK 6%)