It´s All About Asset Allocation

September 2024, Newsletter#97

The traditional Festa dos Callos (beef tripe) is celebrated on the first Sunday in September in the town of Salceda de Caselas (Pontevedra-Spain). There, like every year, I found myself in the company of my Galician family. These `callos´ are a local stew made of tripe, chickpeas, chorizo, and dried ham. The success of this event does not lie in any case in the tripe itself (delicious by the way), but in wondering during the rest of the year about how the party with family will be like, which wine we will accompany the tripe with, the band that will liven up the party and many other intangibles. While I was concentrated eating and drinking, something led me to think about Central Banks and their monetary policy (yes, you can call me weird). And just as the gallegos fantasize about this or any other popular festival (the wine festival, the lamprey festival, the empanada festival, etc.), the financial markets and those of us who wander around all year long, fantasize about the possible interest rate cuts by the Central Banks, when in fact, the drop in rates itself does not affect our real economies as much as it affects many other variables that can derail or skyrocket our investment portfolios (CPIs, euro-dollar, asset allocation, etc.).

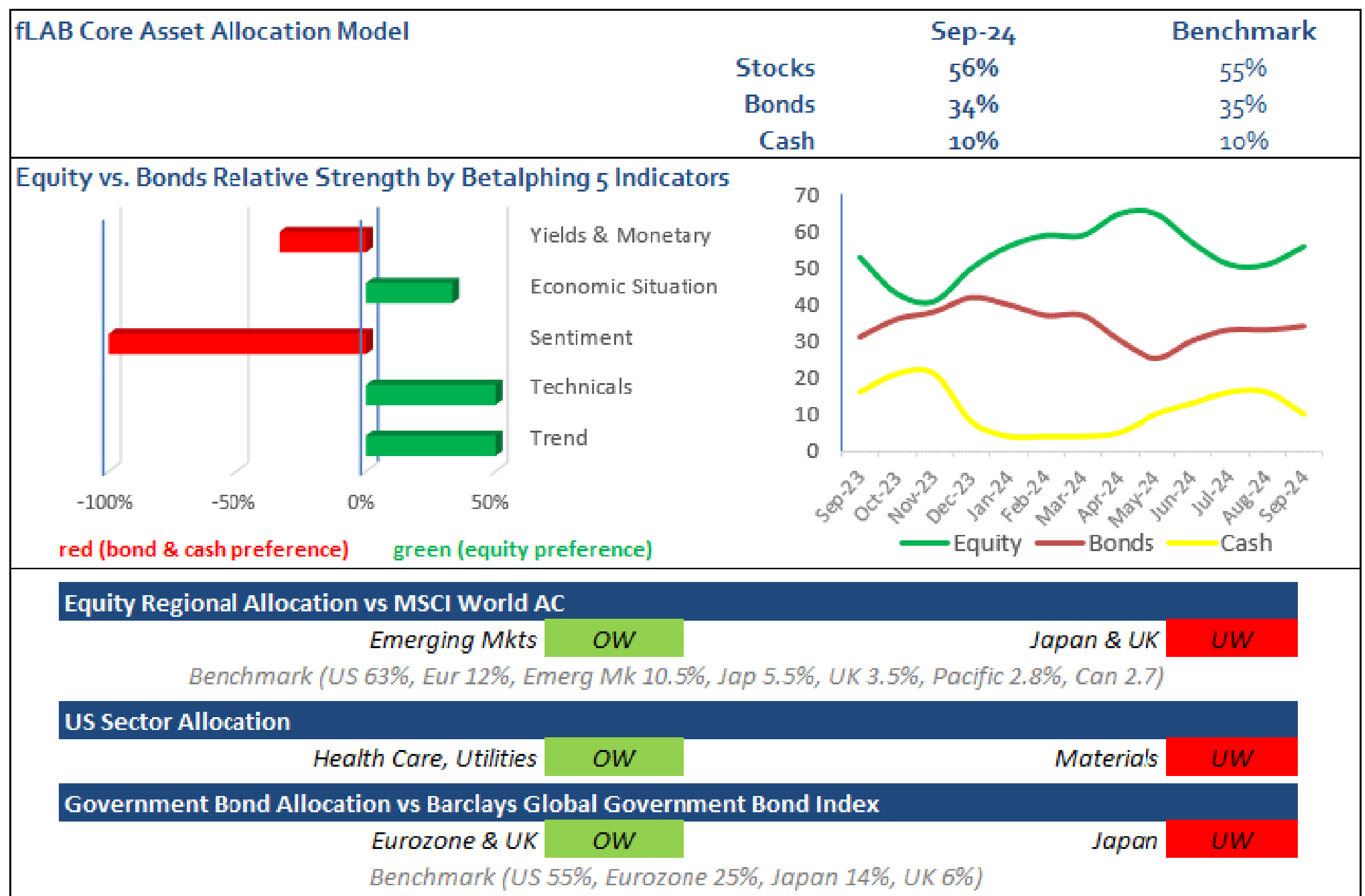
Even more: the callos tapa is not better because it has a greater amount of tripe. The key to its excellence lies in the quality and cooking time of the tripe along with its wonderful secondary ingredients (choricito, ham and chickpeas). In the same way, an aggressive monetary policy does not necessary mean to be better, where the Central Bank (FED, ECB, SNB, BoE) strongly reduces rates many times in record time. History shows us that small drops cooked over a longer period of time together with other economic and fiscal policies have produced better returns in the medium term for any investment portfolio.

Thus, in the American economy we find two pieces of evidence: its labor market has slowed down

while its economy has avoided falling into a spiral of recession. And hopes of a soft landing and lower interest rates are supporting financial markets. Investor attention is now focused on differentiating between cooling trends that reflect benign economic adjustments and those that signal a more serious deterioration. In past newsletters we have already commented on the convenience of this new cycle being one of slow declines, that is, less than 5 cuts in a year; since this fact probably tells us that the health of the economy is still thriving and does not need excessive doping by central banks. Another question is whether the FED will be more aggressive than the ECB and the BoE, who on this occasion (a rarity to take into account) have led the beginning of the bearish cycle and the effect that we can expect on currencies.

However, we perceive excessive optimism or poor memory everywhere: the futures' market pricing of nine cuts by the end of 2025 suggests that monetary policy is about to turn very, very accommodative, even as financial conditions are already looser than they were at the Fed's first hike in March 2022, lending standards are easing and bank credit is rebounding. We believe that a second wave of global inflation could perfectly happen around the end of this year. Therefore, be alert: It is one thing not to add too many tripe to the stew and quite another to end up eating chickpeas. Raw.

Given the good performance this 2024 despite the increasing volatility and nerves of the summer, the remarkable performance of fLAB Core (6.66% Clean-EUR and 7.47% Clean-USD), makes it easy for us to position our Asset Allocation practically as the Benchmark: Stock Market at 55%, Governments 35% and T-Bills and similar at 10%. In Equity we only overweight Emerging Markets, purely for tactical reasons and underweight UK and Japan, being HealthCare and Utilities our main sector bets. In bonds, we bet for Eurobonds and Gilts and underweight Japan. We have slashed our yen position as we have taken profits from our long yen position initiated in June.



fLAB Core Asset Allocation Model	Sep-24	Benchmark
Stocks	56%	55%
Bonds	34%	35%
Cash	10%	10%

Equity Regional Allocation vs MSCI World AC			
Emerging Mkts	*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*	*UW*

Government Bond Allocation vs Barclays Global Government Bond Index			
Eurozone & UK	*OW*	*Japan*	*UW*

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