Active Risk Allocation

The state of indicators

August 2023

ORIGO CONSULTING

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Status

Divergence increasing for stocks vs Origo's "Rates higher-for-longer" scenario

- Key credit conditions is weakening
- China "grand re-open", is stagnating – potential deflationary forces, is pending
- Consumer excess savings getting depleted
- Long yields push towards new highs
- Asset correlations again high
- Margin pressure will accelerate, as will SMB bankruptcies.

Risk overview;
Short-term **Negative**
Medium-term **Positive**

Stocks – underweight

- Low vol

Bonds – underweight

- Overweight mid-term duration, IG credit

Alternatives – overweight

- Non-directional, uncorrelated assets and strategies

Macroeconomics

- Maximum centralbank tightening impact to be felt 2H 2023
- Consensus zooming in on China rebound flatline (1y after Origo)
- Inflation moderating, but still too high and too slowly
  - US relative outperformance continue on near-shoring and fiscal stimulus (IRA)
- Headline inflation halved a year after Russian war – core to stick for est. 2025

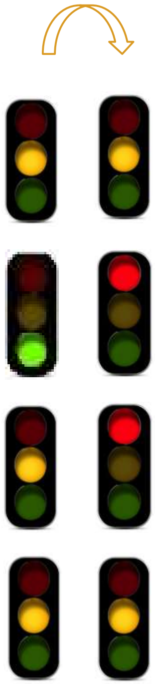
Indicators

- OPRA: Negative / Negative (risk gauge for balance risk/risk free)
- OMRI: Neutral / Negative (model volatility gauge)

Investment process

Indicators

Highly sophisticated models
analysing about 150 indicators



Fundamentals — Proprietary macro and micro economic models

Risk models — The investment value of diversification, volatility and correlations

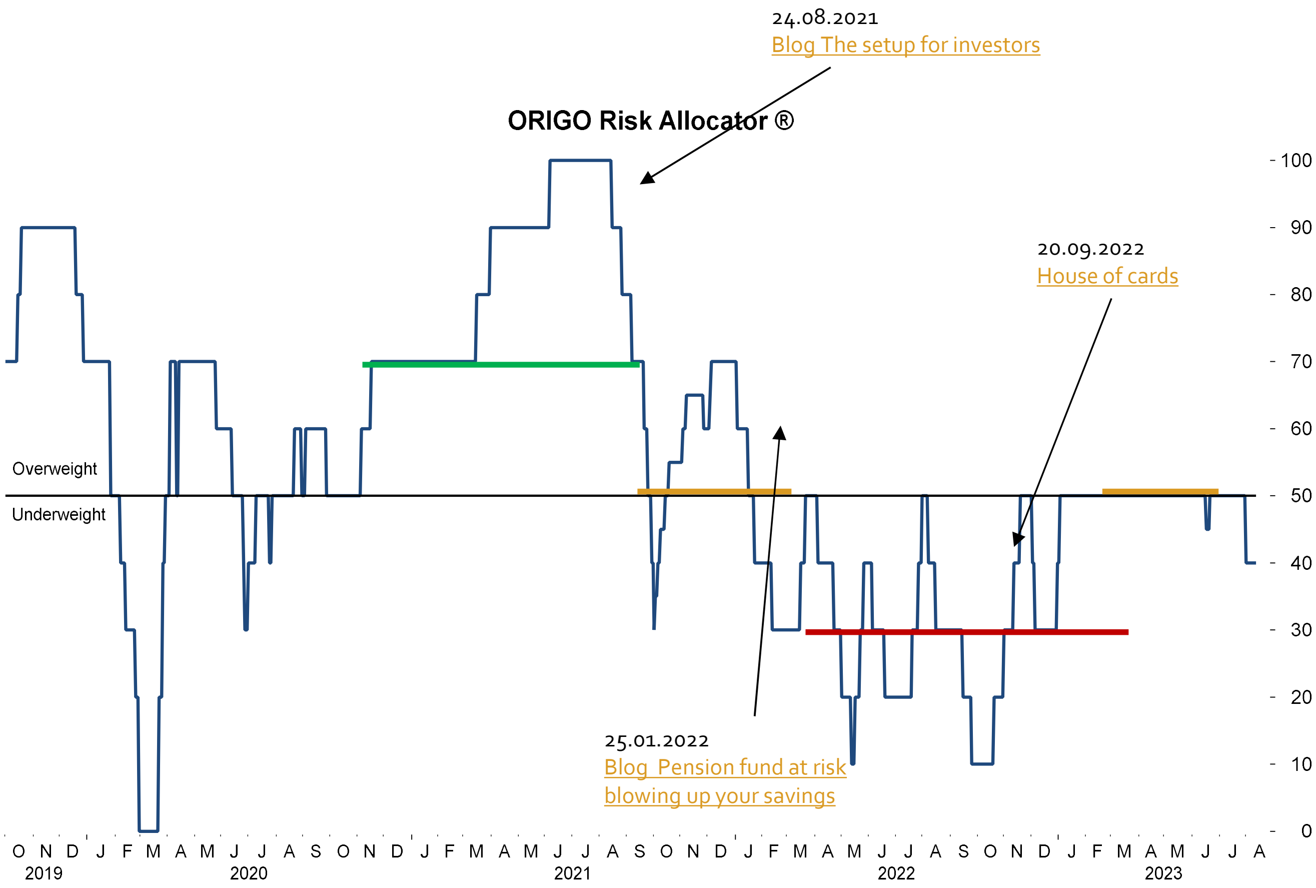
Market intelligence — Market positioning, risk perception and dynamics

Trend following — Trends, direction and strength

Market Intelligence finally takes a step towards Fundamentals

OPRA®
Origo Portfolio Risk Allocator

Timeline, 2019 -



OMRI®
Origo Market Risk Indicator

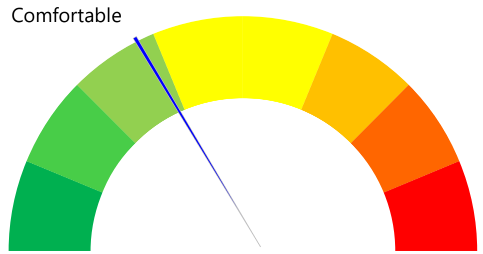
Short-term risk gauge

All factors have peaked and the fast components of Market Risk is deteriorating

Market Risk Indicator

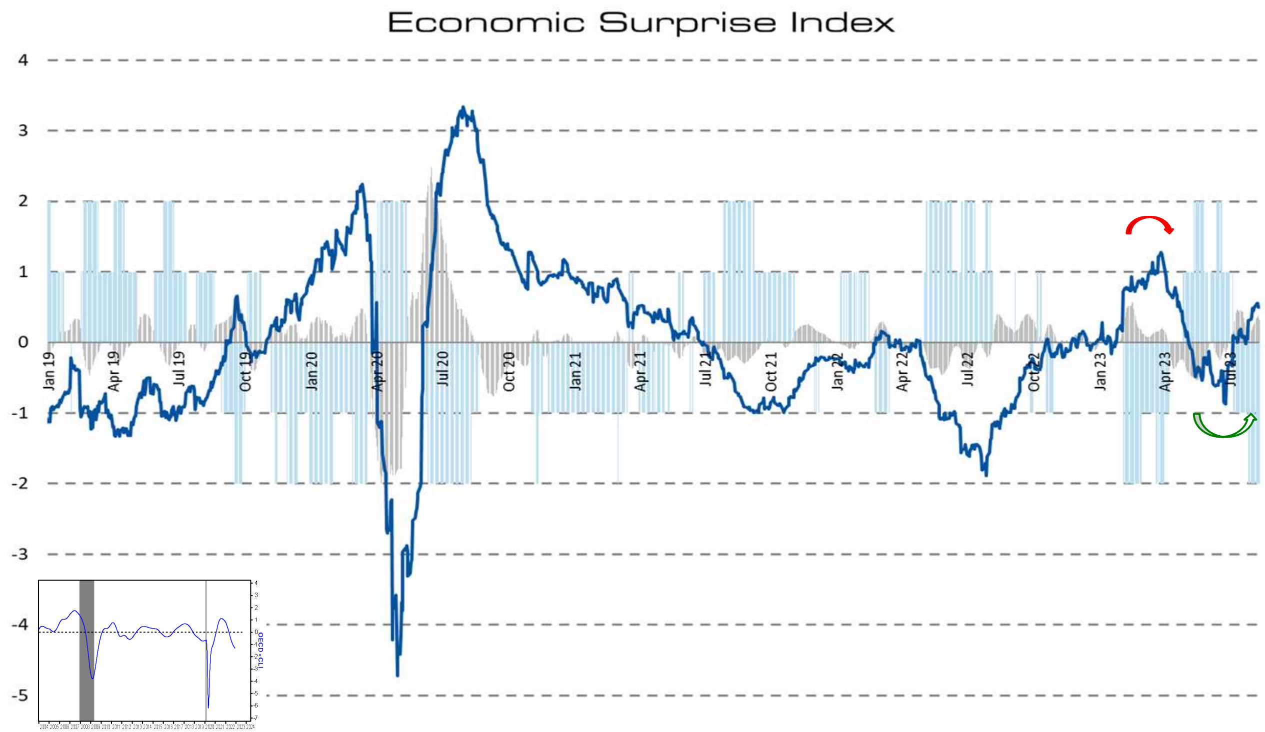
18 August 2023

Indicator	Sentiment	Last update
X-Asset correlation	Comfortable	18 Aug 2023
Economic Surprises	Feels good	21 Aug 2023
Financial Conditions	Neutral	18 Aug 2023
Global Financial Stress	Neutral	18 Aug 2023
Gepolitical Risk	Feels good	31 Jul 2023



Fundamentals

- **Macroeconomic models**
- Volatility and risk budgeting
- Market intelligence
- Technicals and trend following



Broad-based resilience, combined with inflation stickiness suggest centralbanks homework is not done, or just hasn't kicked in, yet

Economy holding up on service sector as consumer consumption max out credit cards and employment supported by post-covid and near-shoring. 2H-2023 remains the challenging phase, as consumer savings deplete and 1 year of monetary policy takes effect.

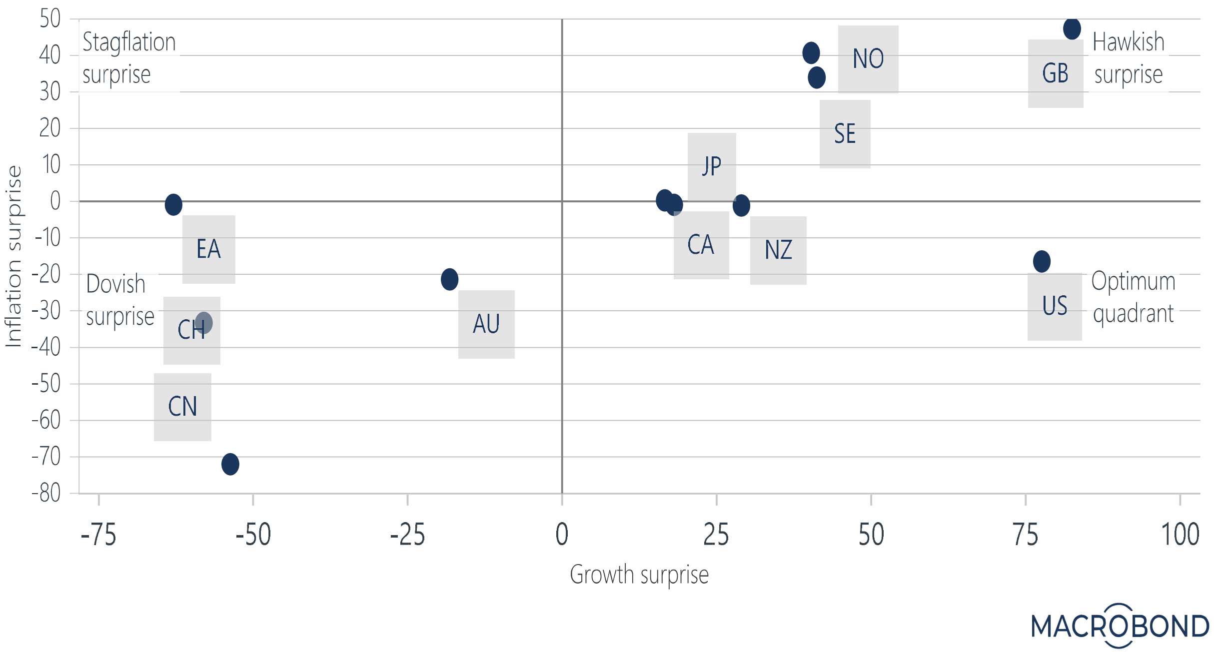
The ESI (above centre) is a powerful indicator of coming stress.

Fundamentals .. Countries

- **Macroeconomic models**
- Volatility and risk budgeting
- Market intelligence
- Technicals and trend following

Economic growth vs inflation surprise

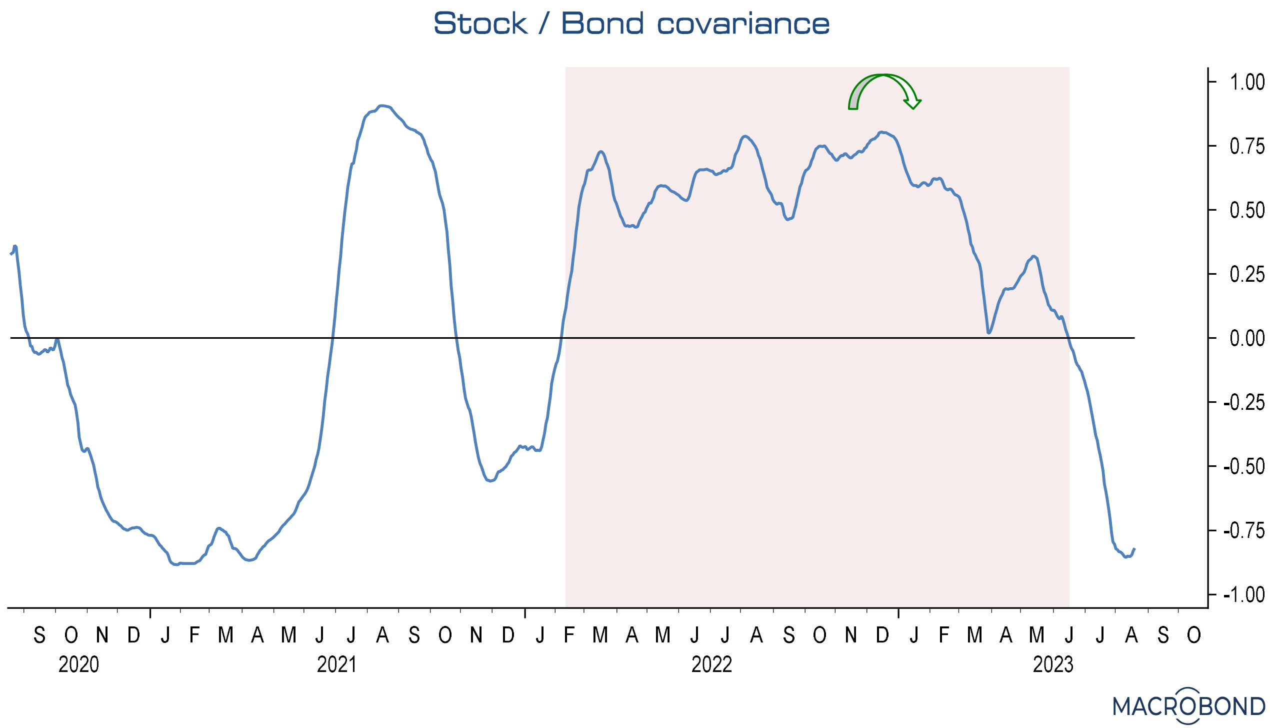
Source: Citi



- US in sweet spot, benefit consumers and "near-shoring" by Biden's IRA package.
- China, no economic rebound, PBoC lower rates but struggle with real-estate bubble
- Euro Area, 50/50 recession scenario
- UK, caught in; systemic low productivity, policy errors incl. Brexit self-inflicted harm ...
- Sweden, the Nordic epicenter of the effect of rising interest rates (RE)

Volatility and Risk budgeting

- Macroeconomic models
- **Volatility and risk budgeting**
- Market intelligence
- Technicals and trend following



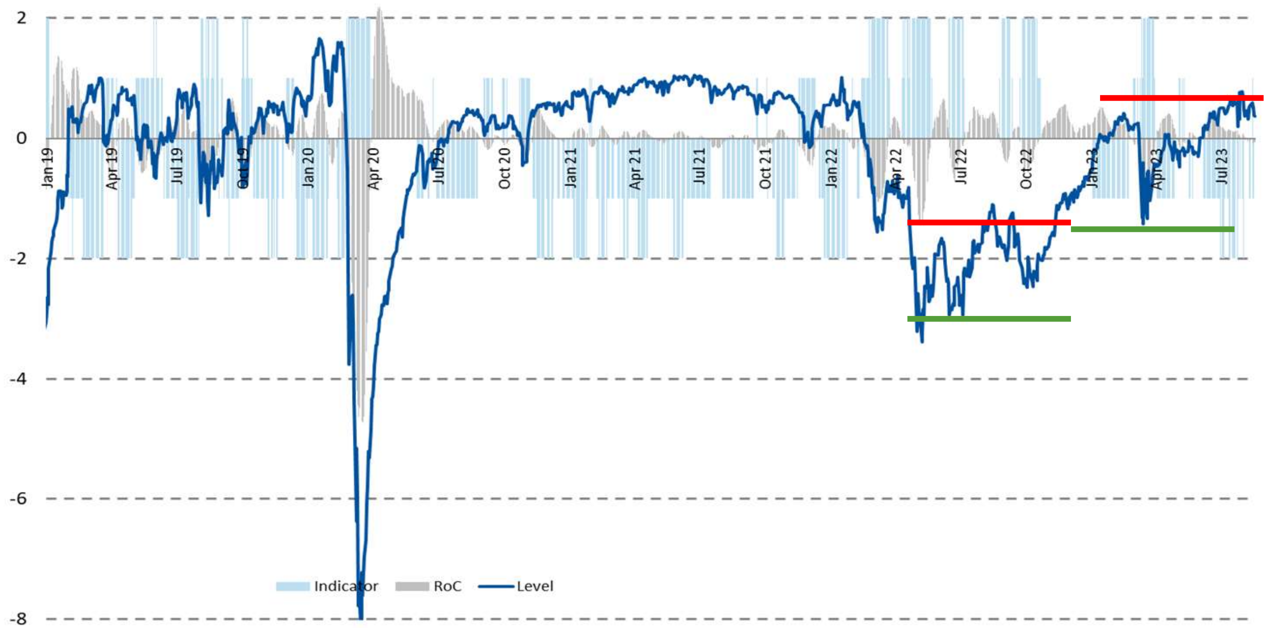
Correlations again high

The 60/40 passive fixed combination is based on the assumption of constant negative correlations. That is despite this being more an exception than a rule over the past 10 years – just as the entire year 2022 is a constant reminder.
When the diversification benefit is low, there is not much to be gained from diversifying. Cash and alternatives should then be meaningfully increased.

Market intelligence

- Macroeconomic models
- Volatility and risk budgeting
- **Market intelligence**
- Technicals and trend following

Financial Conditions

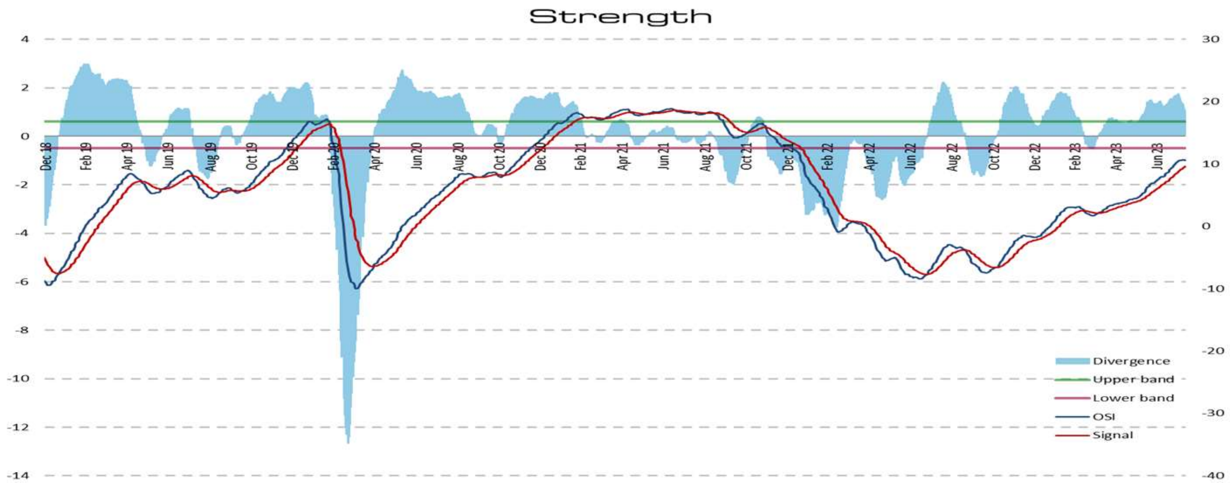


Financial conditions drop …
Headline focus to China no-rebound overshadow tightening credit conditions.

A measure of global cross-market measure of risk, credit conditions, hedging demand(volume, skew) and investor flows in the financial system.
The component may move quite fast in both directions reflecting the bi-polar nature of financial market participators' perception of risk and risk premia.

Technicals

- Macroeconomic models
- Volatility and risk budgeting
- Market intelligence
- **Technicals and trend following**

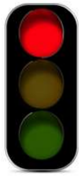


Short-term negative .. odds favour negative return for stocks on a one month horizon.
Medium-term trend is neutral.

Trend strength in the various market is an expression of the persistence of the currently existing trend.

Current status

Macroeconomics
Global economy, led by the US continue to show resilience. So does inflation - supporting our view for policy rates to stay higher for longer.
Consensus begin to zoom in on that China growth has stagnated.



Market Risk and market intelligence
US financial conditions is moderating as credit conditions continue to tighten.
Fear of credit contagion from China as large high profile RE cpy's default on bond payments.

Mr.market expectation for rates to drop remain out of lockstep with macro data and central bank guidance.

Technicals
Short-term turn decisively negative driven by change in Market Risk factor.
Medium-term trend for risk assets is neutral.
Short-term technicals keep switching between buy/sell.

Volatility and risk budgeting
Portfolio risk is increasing.
Portfolio risk is increasing from a very low level at a time asset correlation is very high.
This parameter in particular push allocation towards low risk and inverse asset exposure

Active Risk Allocation

2023

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Business as usual ?

ORIGO Sep 2021: ”A regime change is in the making …”

	2009-2021	Today
System	Neo-liberal multi-lateralism	Zero-sum nationalism?
Geopolitics	Stable	War (trade/conventional)
Clima	Predictable	Greater variance
Trade	Global	De-globalisation
Central bank behavior	Highly stimulative	Tightening
Inflation	Dormant	40-year high
Economic outlook	Positive	Global recession a 50/50
Likelihood of distress	Minimal	Rising
Mood	Optimistic	Guarded
Buyers	Eager	Hesitant
Holders	Complacent	Uncertain
Key worry	FOMO	Investment losses
Risk aversion	Absent	Rising
Credit window	Wide open	Restricted
Financing	Plentiful	Scarce
Interest rates	Lowest ever	More normal

On the radar

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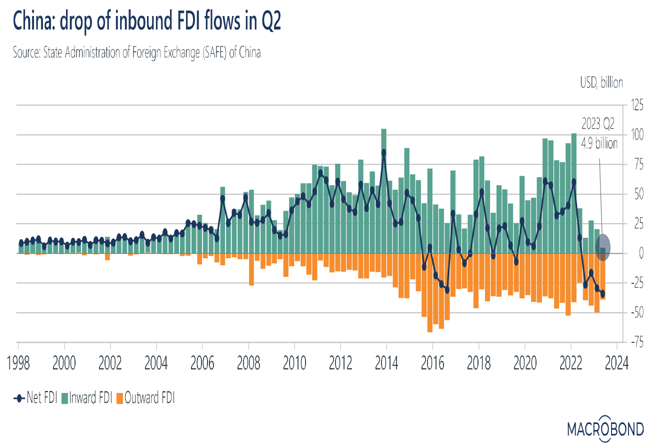
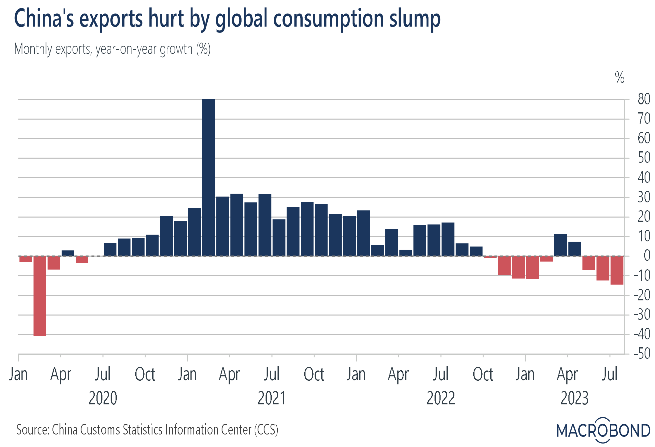
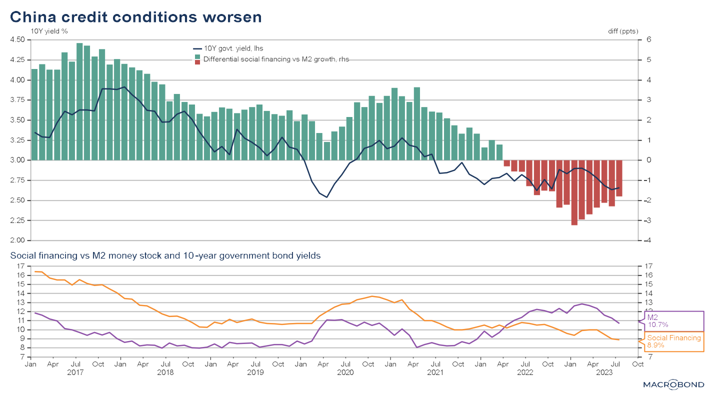
Macro risk - China

A stagnating economy on a cocktail of secular and tactical problems + Goodbye “peace dividend”

- Demographic decline (rapid aging and drop in absolute numbers ..)
- De-globalisation / re-shoring
- US-China trade war. US CHIPS Act 7 Oct 2022 (BIS bureau)
- Policy mistakes; one-child, zero-CoVID
- Corporate controls (IT and general corporate crackdown)
- Real estate recession (capital mis-allocation into unproductive concrete RE)
- Climate (draughts, river logistics ..)
- Belt & Road policy and debt trouble





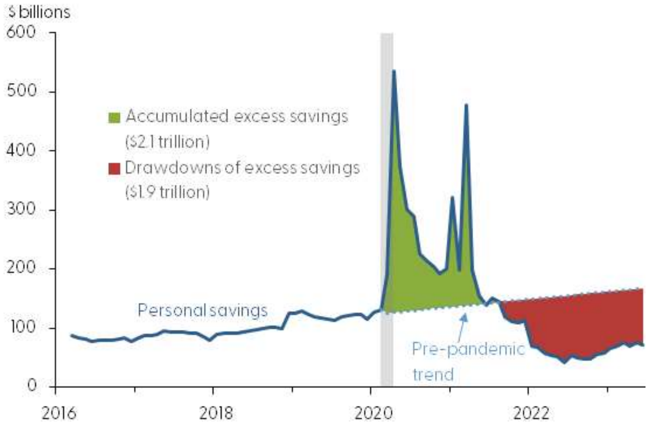


Geopolitical landslide: The autocratic cluster of countries represents an ideology of “might is right”, as opposed to the post-WW2 “rules-based” order. Re-organization of global alliances, globalization ideology, corporate investment flows (FDI), supply lines, military investments.

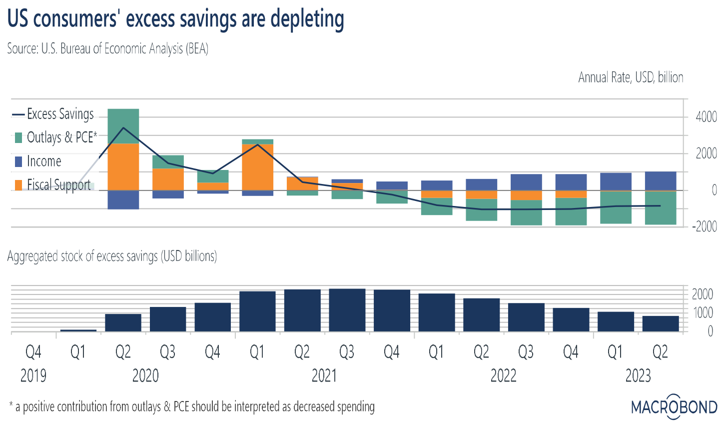
Macro risk - Consumer spending

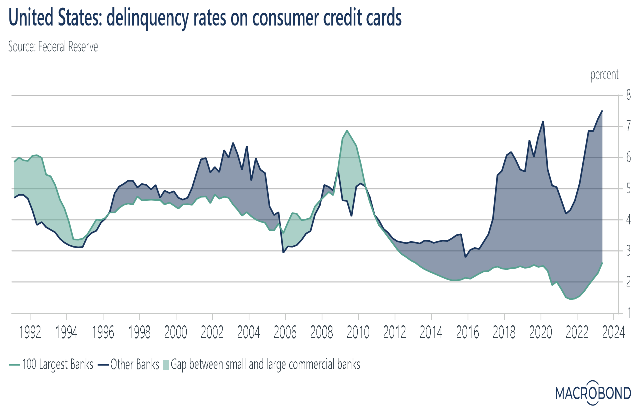
It is said:"Never underestimate the US consumer" … we add, "to spend money he don't have on things he doesn't need to impress people he doesn't like"

- US Q3 do look great, as consumers seems to go out with a bang
- Excess CoVid savings will by now be depleted
- Credit cards are max'ed out
- Economist' will focus on any sign of weakness in the remarkably strong labour market



[Excess No More? Dwindling Pandemic Savings | San Francisco Fed (frbsf.org)]

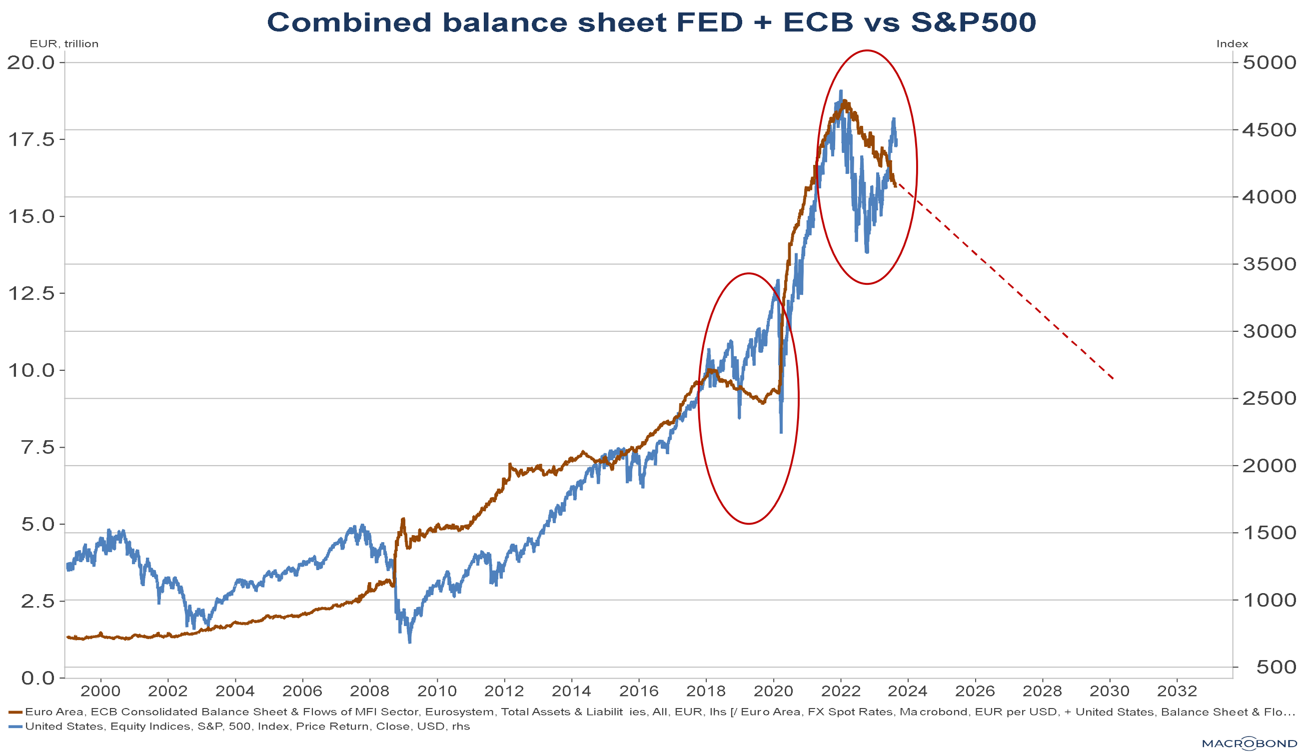




Capital markets risk
Monetary policy

Quantitative Tightening - on track

Combined rate hikes + QT in excess of 1 tn USD per year – every year, the next 10 years

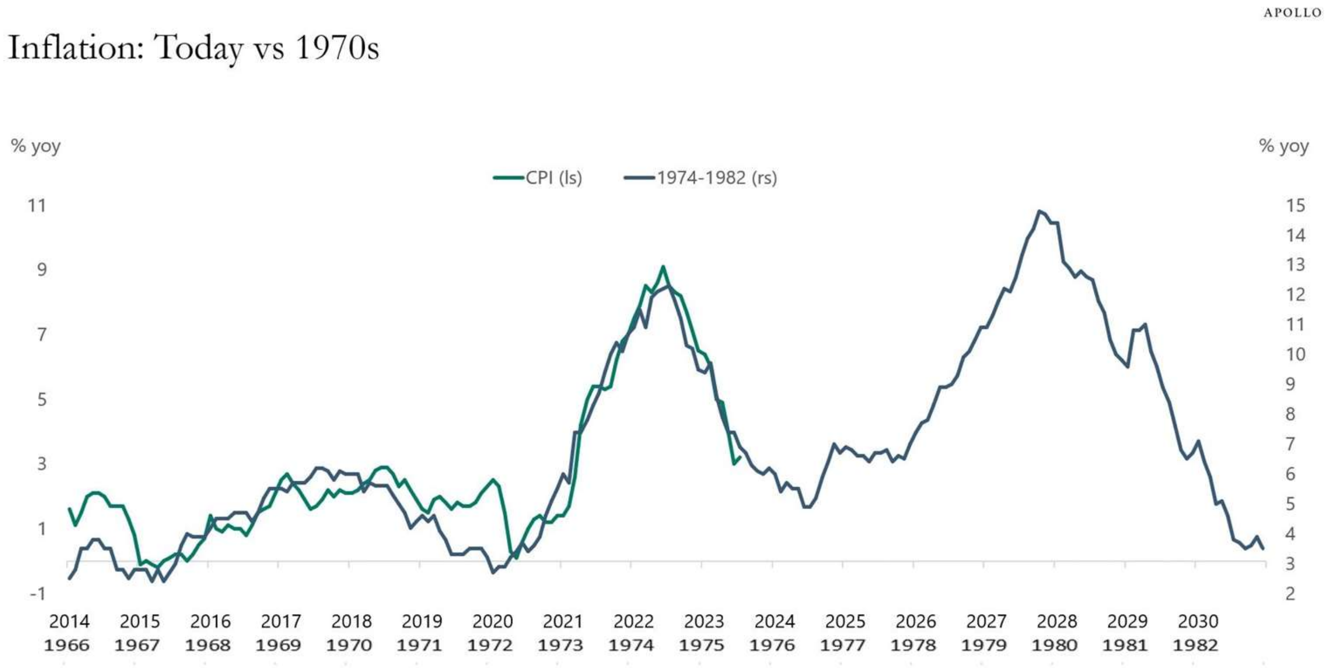


Macro risk
Inflation

Fed near done – but – in no hurry to lower interest rates - still the biggest gap to financial markets

The difference in being popular and right

- Fed turn dowish too early, inflation expectations will not come down to 2%
- Should the economic activity accelerate, rates will raise rates more
- Hence, rates-higher-for-longer remain our base case



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