# Active Risk Allocation

The state of indicators

September 2023

ORIGO CONSULTING

Independent | Transparent | Disciplined

## Status

**Portfolio risk rising as as asset correlation increase**

- Credit conditions continue to weaken
- China "grand re-open" is stagnating
- US consumer excess CoVid19 savings are now depleted
- Long yields push towards new highs
- Asset correlations turning higher
- Margin pressure will accelerate, as will bankruptcies as they hit the refinancing wall.

**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

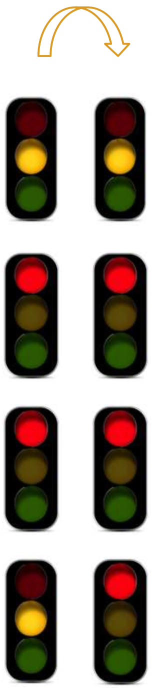
### Macroeconomics
- Maximum centralbank tightening impact to be felt 2H 2023
- Consensus zooming in on China as re-open flatline (1.5y after Origo)
- Inflation moderation flatline and may even see a minor 2nd wave
  - US relative outperformance continue on near-shoring and fiscal stimulus (IRA)
- Headline inflation halved by base-effect a year after Russian war – core to stick for estimated 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

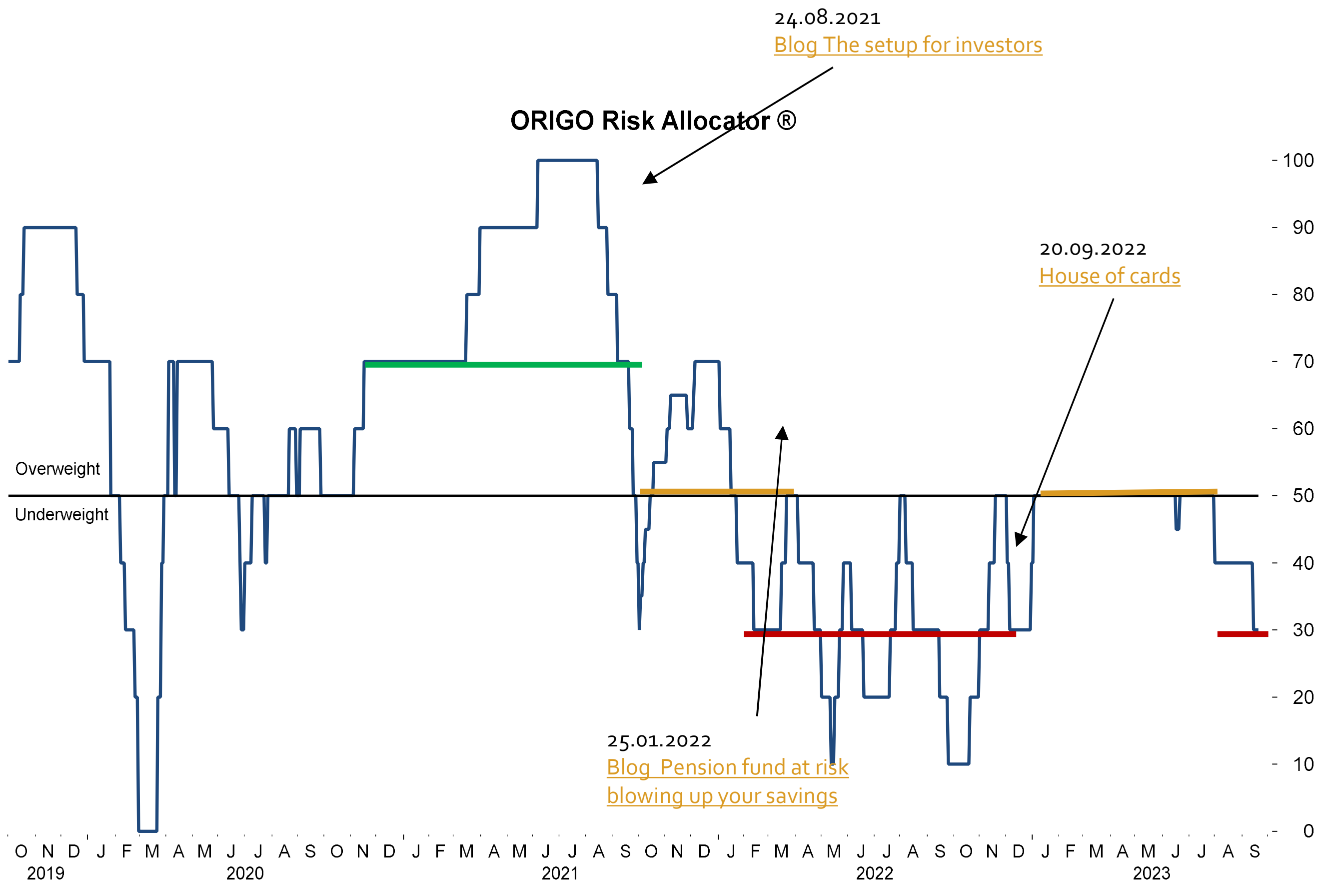


| | |
|---|---|
| **Fundamentals** | Proprietary macro and micro economic models |
| **Risk models** | The investment value of diversification, volatility and correlations |
| **Market intelligence** | Market positioning, risk perception and dynamics |
| **Trend following** | Trends, direction and strength |

Market Intelligence finally takes a step towards Fundamentals

# OPRA®
# Origo Portfolio Risk Allocator

Timeline, 2019 -



OMRI®
Origo Market
Risk Indicator

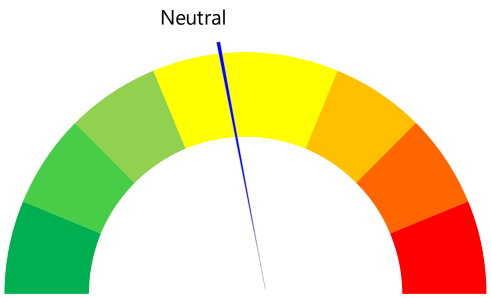
**Short-term risk gauge**

Rapid increase in correlations

## Market Risk Indicator

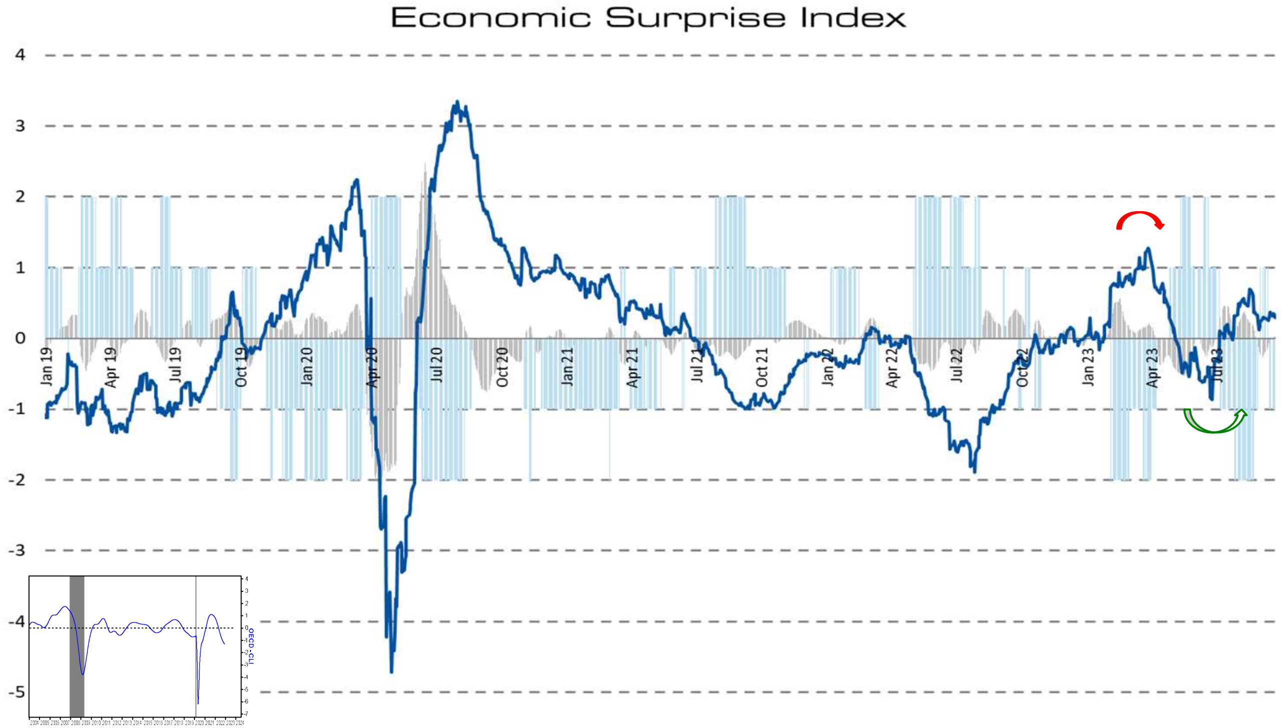
08 September 2023

| Indicator | Sentiment | Last update |
|---|---|---|
| X-Asset correlation | Tense | 08 Sep 2023 |
| Economic Surprises | Tense | 08 Sep 2023 |
| Financial Conditions | Feels good | 08 Sep 2023 |
| Global Financial Stress | Feels good | 08 Sep 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.

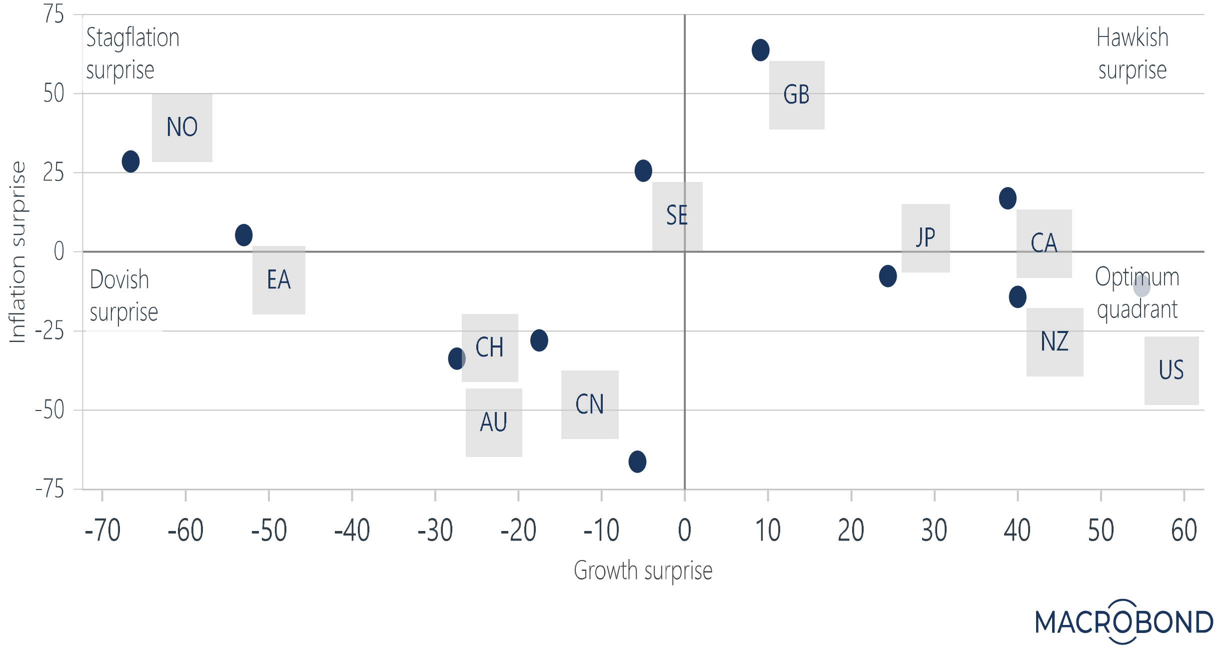
The ESI (above centre) is a powerful indicator of coming stress.

# Fundamentals
# .. Countries

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

## Economic growth vs inflation surprise

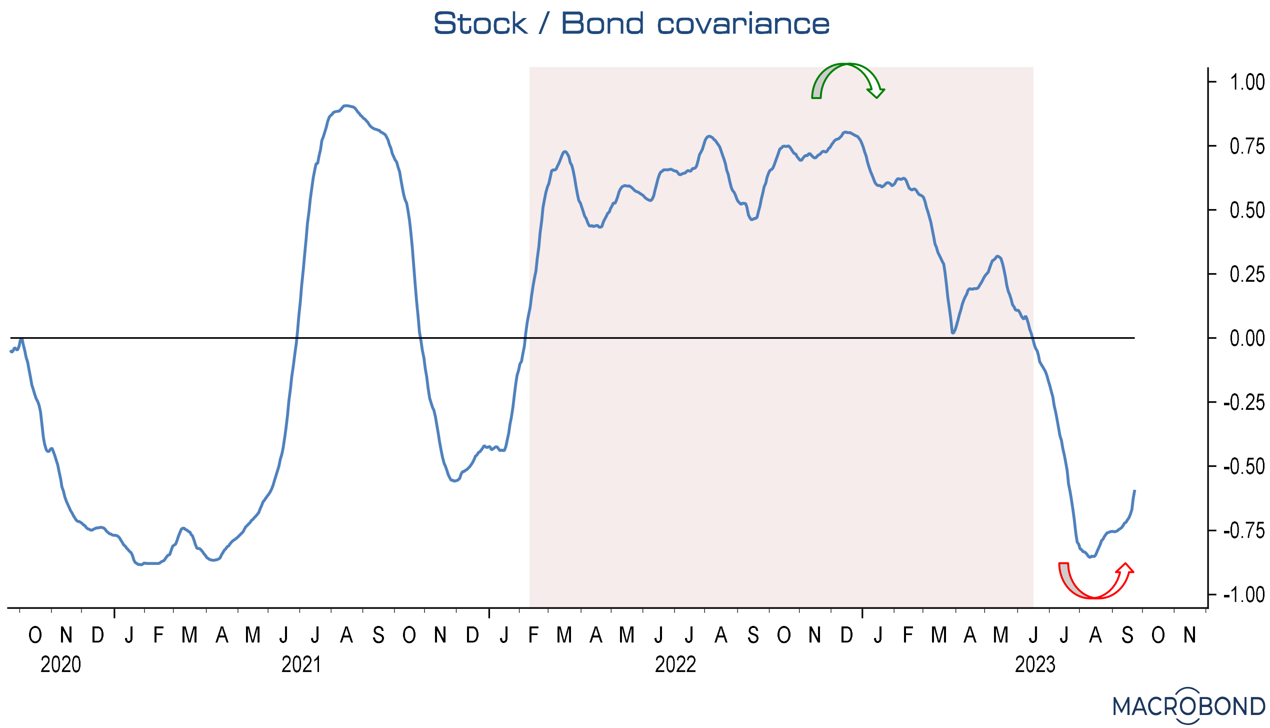
Source: Citi




- US in sweet spot, boosted by "near-shoring" and Biden's IRA package
- China, no economic rebound
- 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

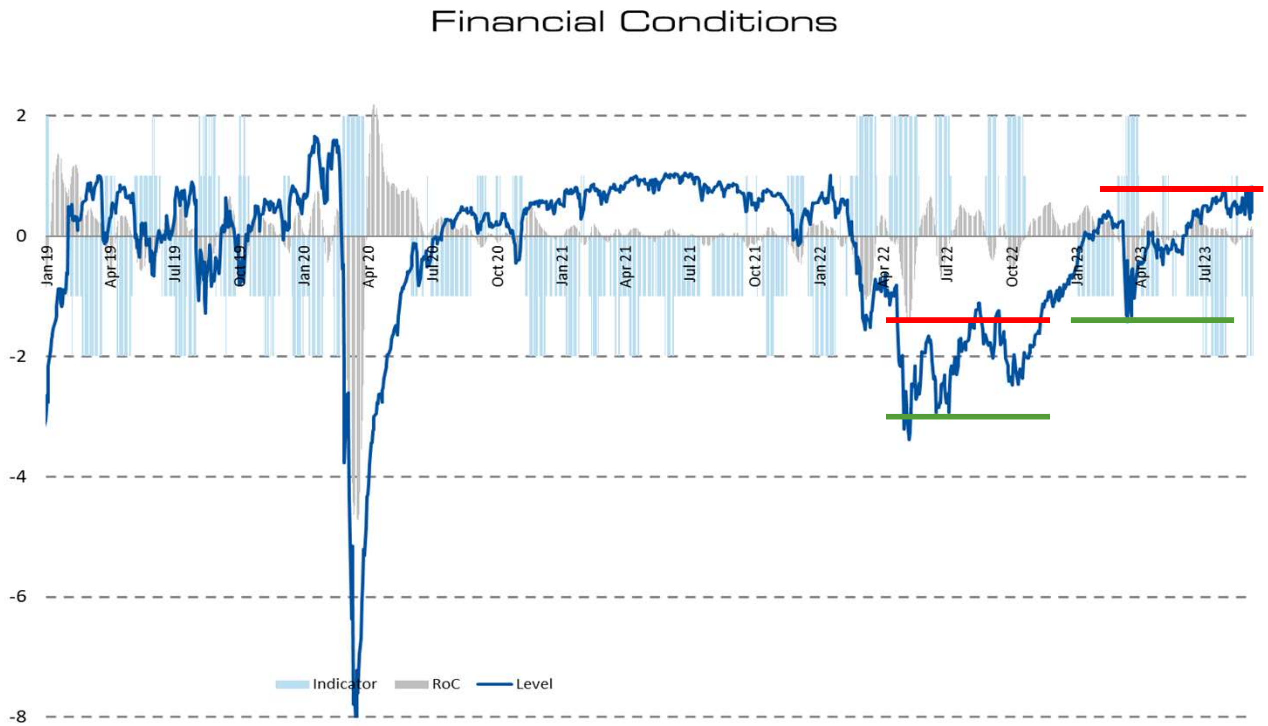



**Correlations again high**

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

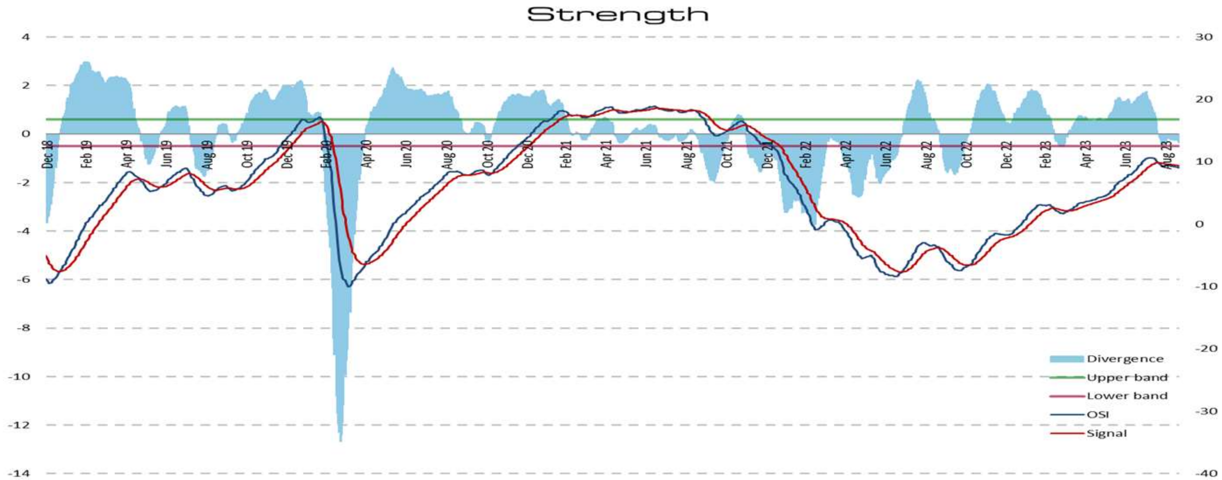


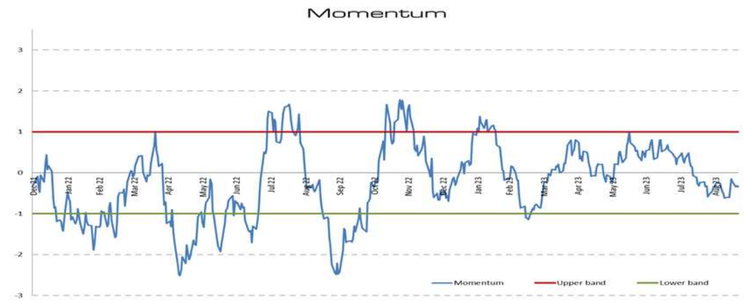

**Financial conditions drop ...**
Headline focus to China no-rebound overshadow tightening credit conditions.

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**



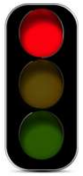




**Short-term negative** .. odds for 1month stocks turn negative.
Medium-term trend is neutral.

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 as headline pickup for a potential 2nd wave. Supporting our view for policy rates to stay higher for longer.
Consensus economists begin to detect that China growth has stagnated.



**Market Risk and market intelligence**
US financial conditions are neutral, though 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 'soft landing, inflation dead and rates to drop quickly meaning remain out of sync with macro reality and central bank guidance.

**Technicals**
Short-term turn negative driven by change in Market Risk factor.

Short-term technicals keep switching between buy/sell.

**Volatility and risk budgeting**
Portfolio risk is increasing as asset correlation rise.
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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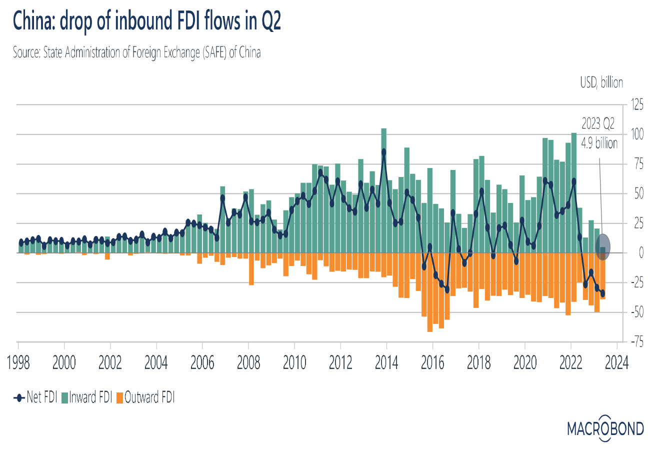
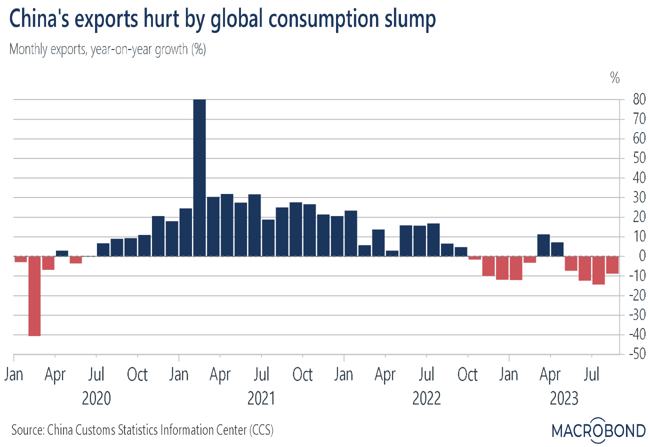
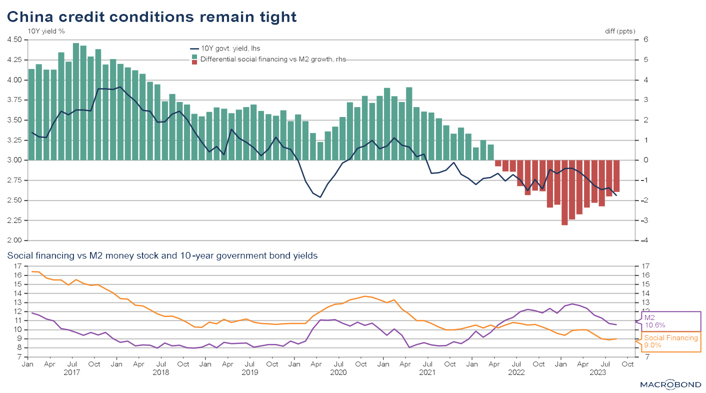
# Macro risk
# Geopolitics - China

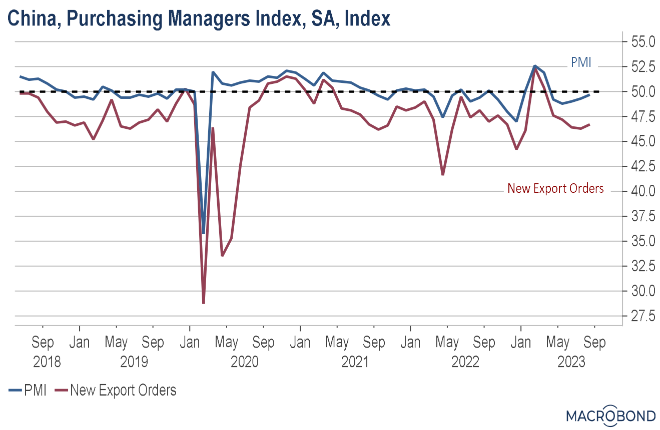
**Market focus growing on stagnating economy. A cocktail of secular and tactical problems**

- Demographic decline (rapid aging, drop in absolute numbers, 20% youth unemployment ..)
- 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 RE)
- Climate change (draughts, river logistics ..)
- Belt & Road policy and debt trouble



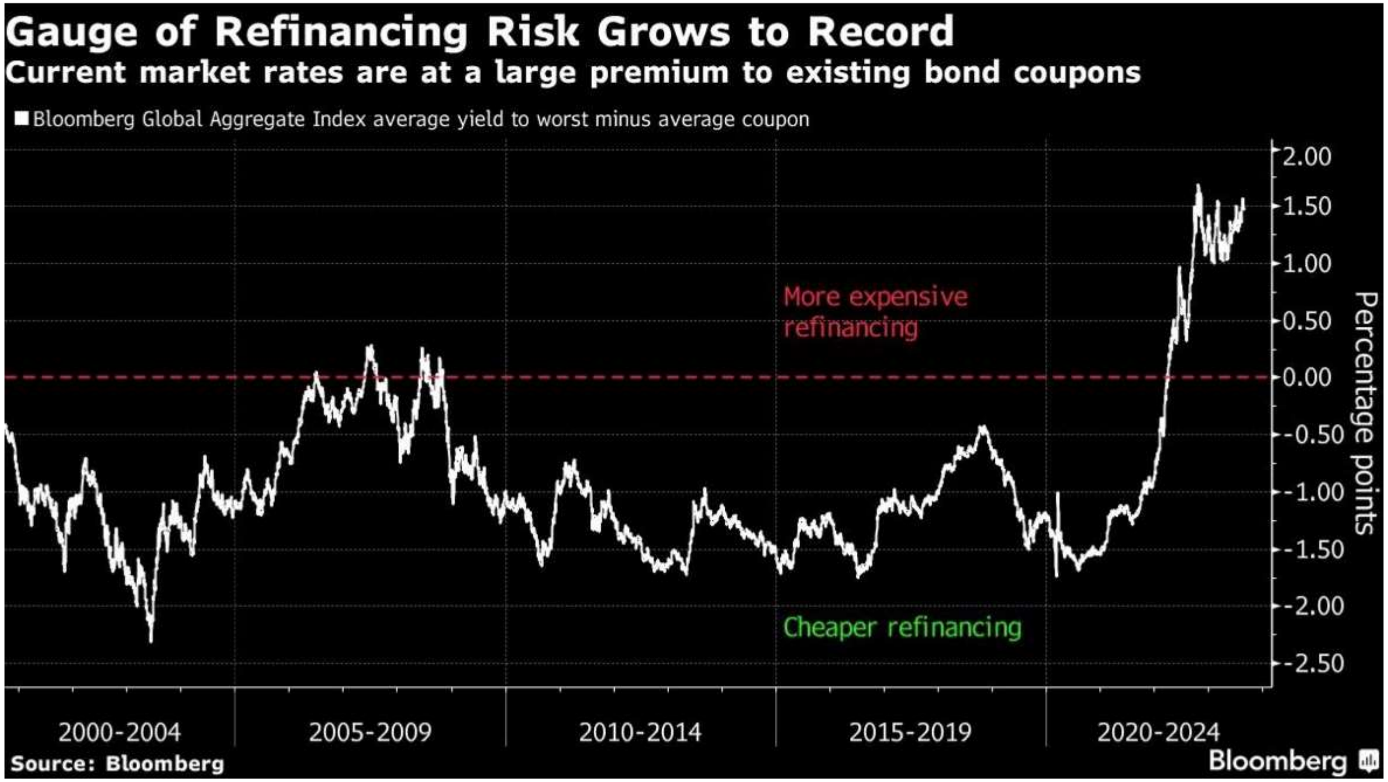




**Goodbye "peace dividend"**: The autocratic cluster of countries represents an ideology of "might is right", as opposed to the post-WW2 "rules-based" order. Re-organization of global alliances, globalization ideology, corporate investment flows (FDI), supply lines, military investments.

# Macro risk
# Credit

**The refinancing wall**

The difference between what government + corpprates are paying today vs if refinanced today

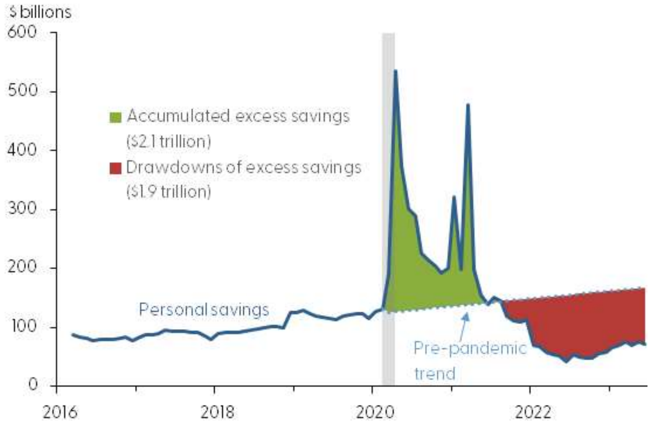



The credit squeeze has commenced 1H2023, pressure will peak by 2H2023 - but it will continue for the coming years.
The masses of zombie companies including those in Private Equity not-marked-to-market SPV's, will hit the wall

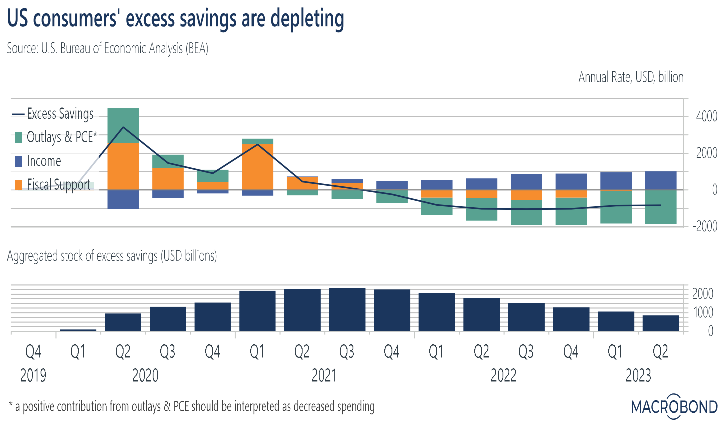
# Macro risk - Consumer spending

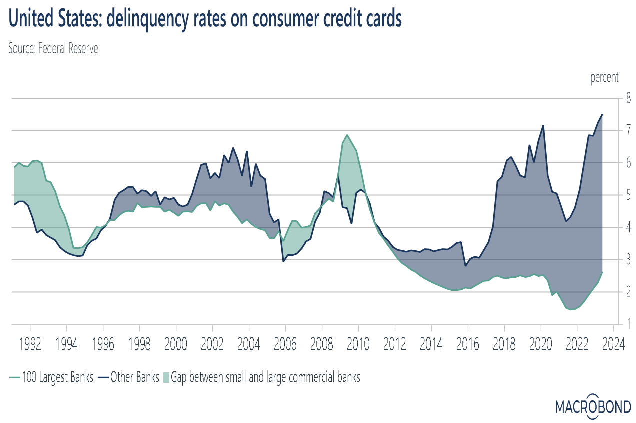
**“Never underestimate the US consumer” … we add, “to spend money he don’t have on things he doesn’t need to impress people he doesn’t like”**

- US Q3 do looks ok, as consumers seems to go out with a bang
- Excess CoVid19 forced savings are now depleted
- Credit cards are max’ed out
- Fed will still focus on any sign of weakness in the remarkably strong labour market




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

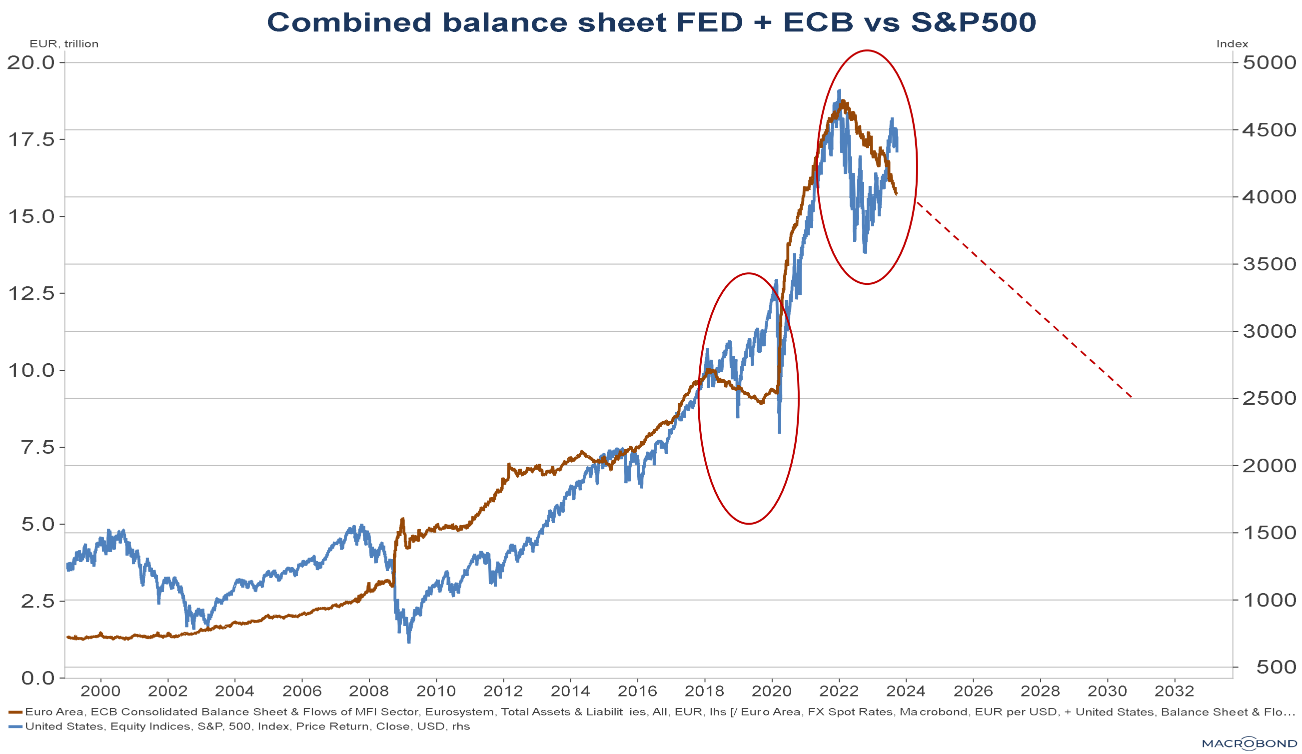


# Capital markets risk
# Monetary policy

## Quantitative Tightening – continues relentless

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




Parts of capital markets run on fumes. Free and ample liquidity lifts all boats is history.
Stocks run on combination of "new economy"(AI), legacy perceptions of past zero rate days and investor FOMO

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