Active Risk Allocation

The state of indicators

October 2023

ORIGO CONSULTING

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Status

Portfolio risk rising, as asset correlation increase

- Credit conditions continue to weaken
- China "grand re-open" has stagnated
- 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.
- Middle East war escalation

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

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 by 2H 2023 – now!
- 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

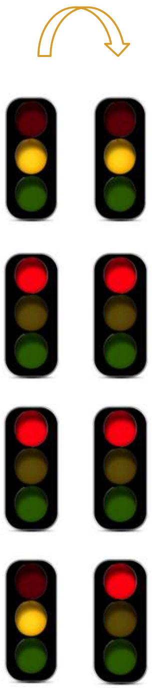
Indicators

- 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

OMRI®
Origo Market Risk Indicator

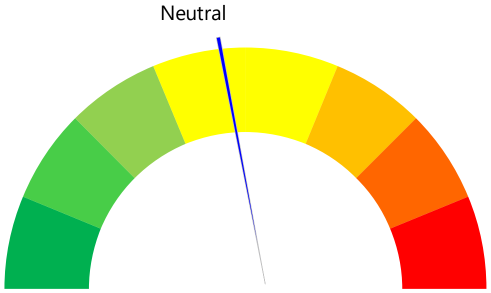
Short-term risk gauge

Rapid increase in correlations

Market Risk Indicator

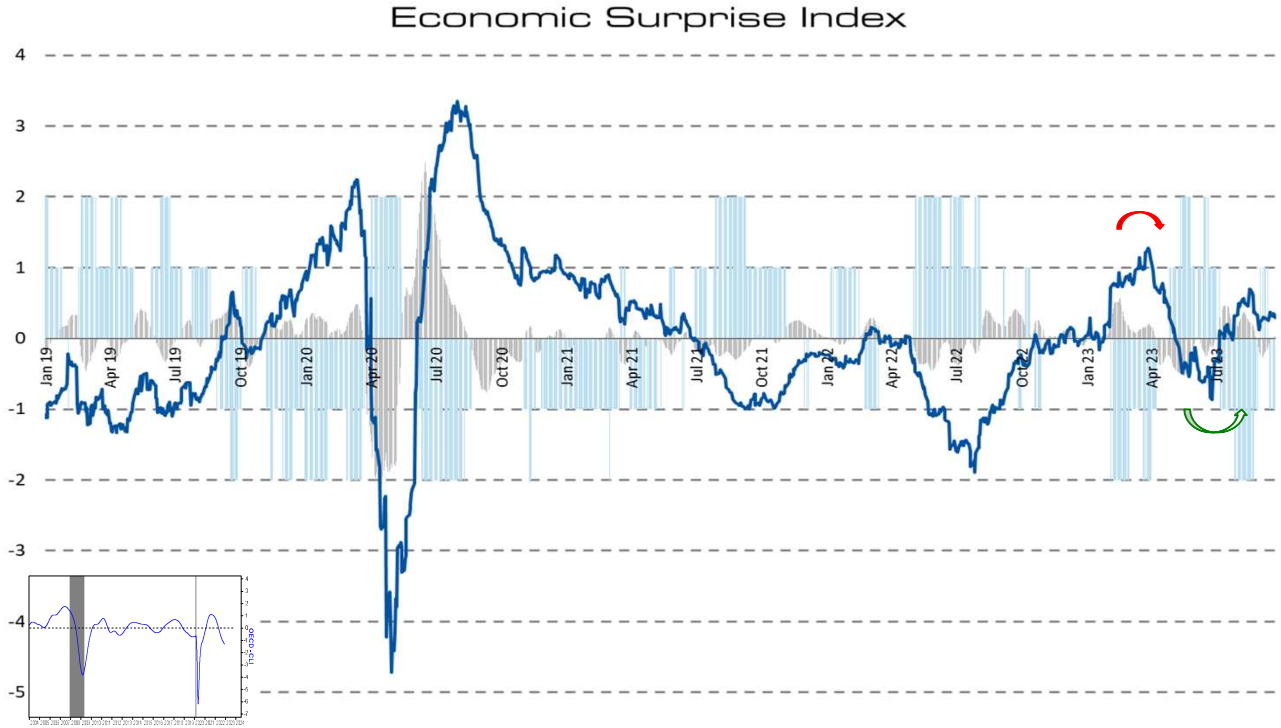
08 September 2023

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.

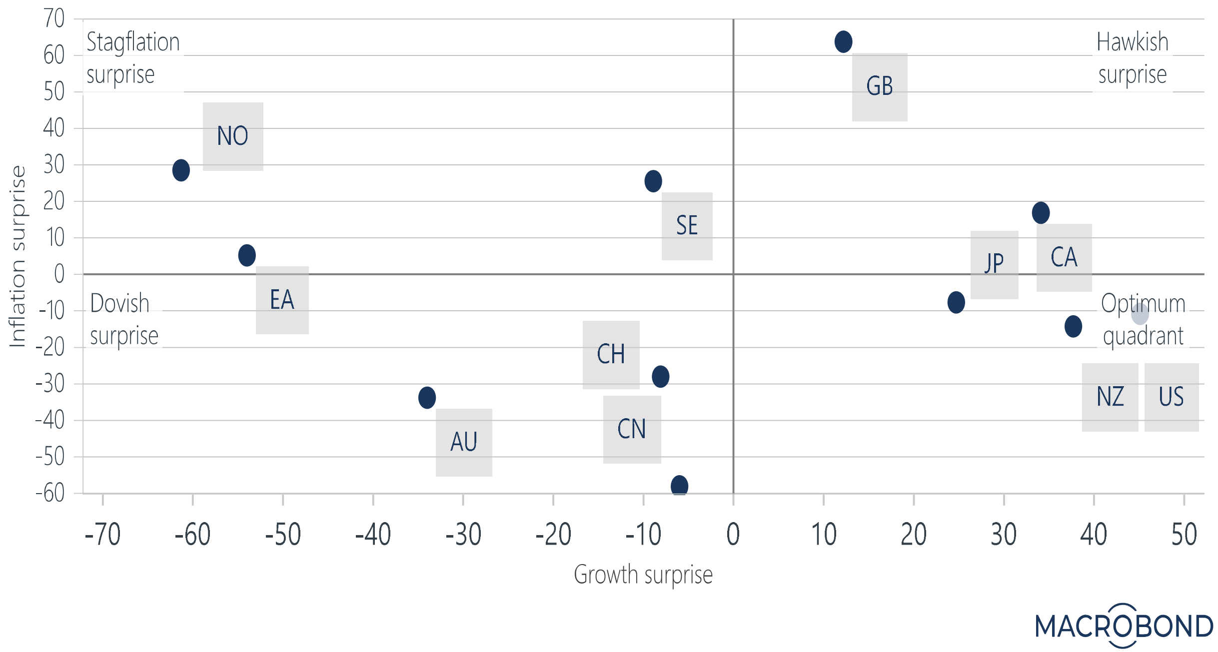
The ESI (above centre) is a powerful indicator of coming stress.

Fundamentals .. Countries

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

Economic growth vs inflation surprise

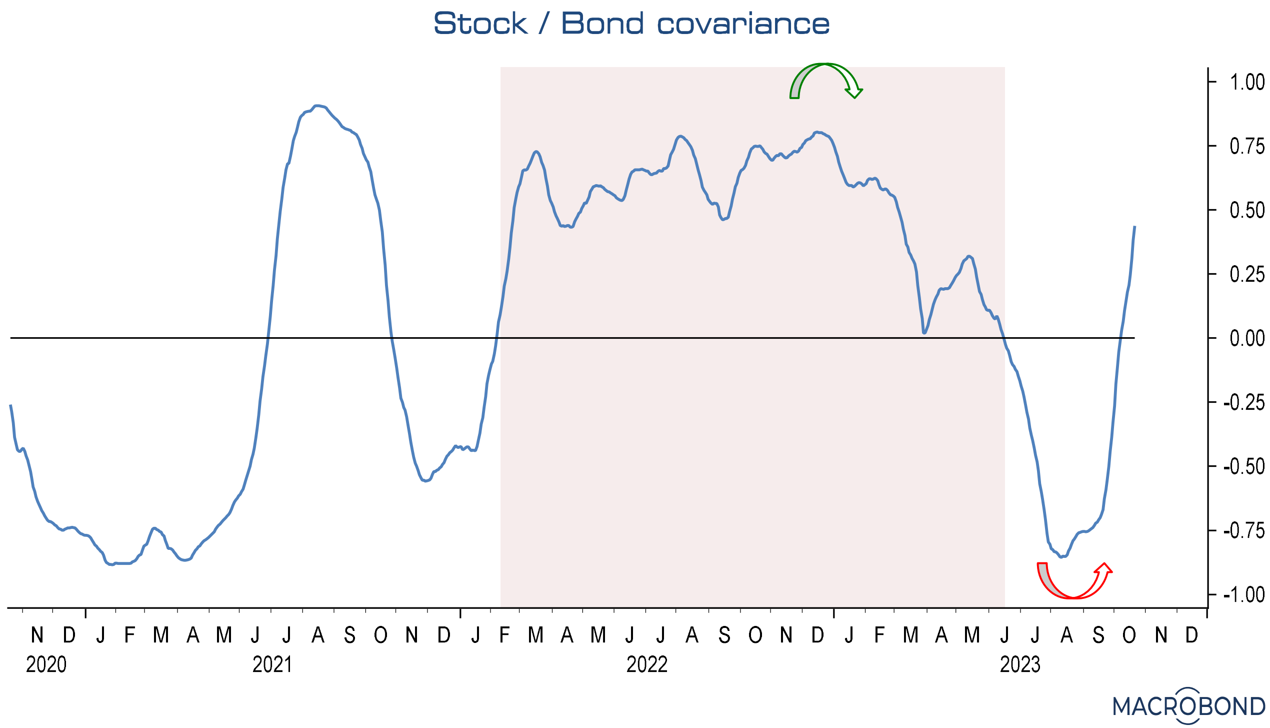
Source: Citi



- 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

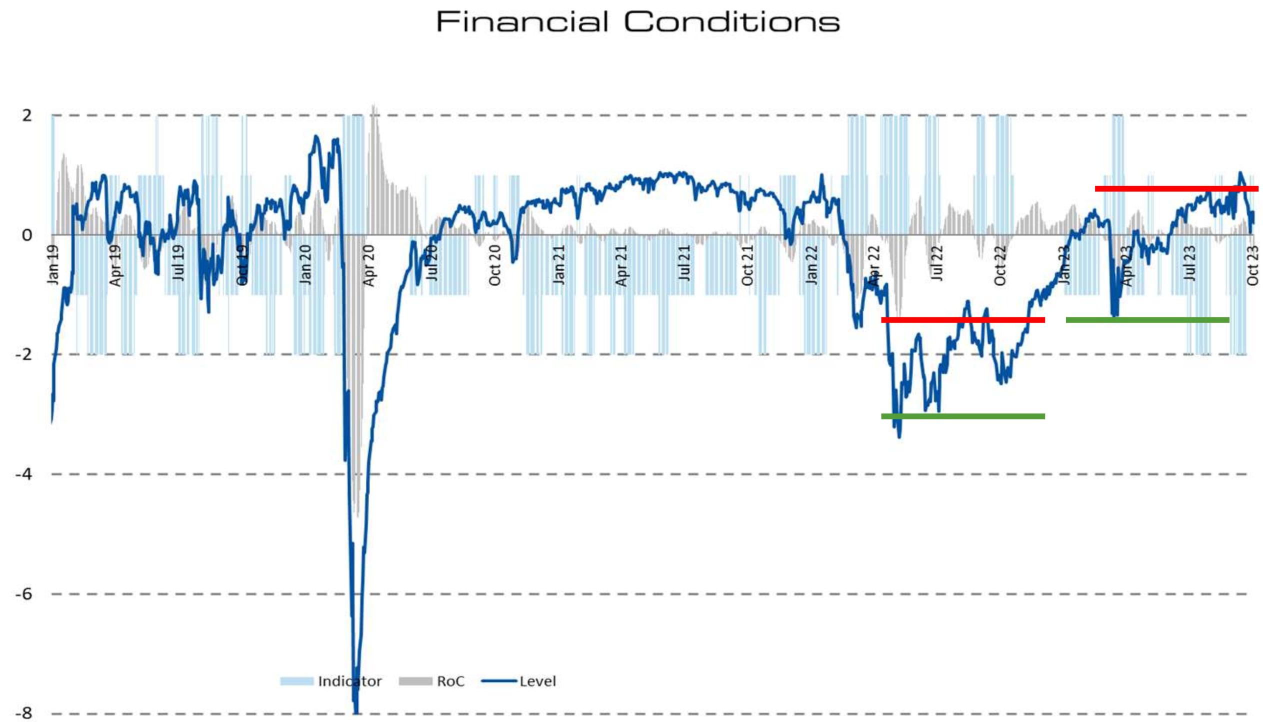


Correlations, again turns high

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

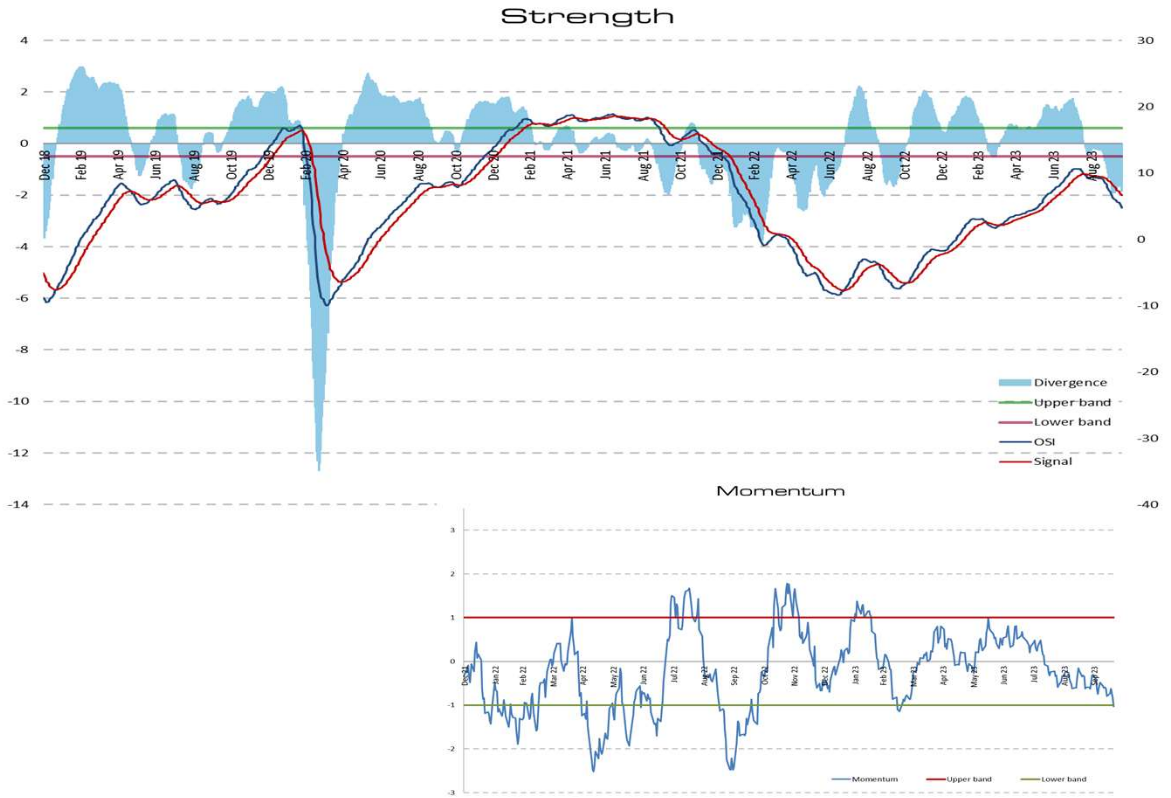


Financial conditions drop …
Headline focus to China no-rebound and Middle East war overshadow tightening credit conditions.

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**

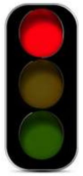


Short-term negative .. odds for 1month stock returns are getting stretched but with increasing momentum, they remain negative.
Medium-term trend is neutral.

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 a return for a positive real return regime.
Consensus economists begin to detect that China growth has stagnated.



Market Risk and market intelligence
US financial conditions are deteriorating fast 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 'soft landing/ inflation dead and rates to drop quickly - remain out of sync with macro reality and central bank guidance.

Technicals
Short-term driven by China slump and headlines on escalating MiddleEast war.

Short-term technicals keep switching between buy/sell.

Volatility and risk budgeting
Portfolio risk is increasing volatility is added to high asset correlation.
This parameter in particular push allocation towards low risk and inverse asset exposure.

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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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Capital market risk — The rate regime

Indications of a rate regime change

- Yield curve bear-steepen

.. A return to the "old normal" of positive real interest rates?

Curvation, US 10-2Y

Macro risk – The banking system

Good times are behind

- Deposit crash, removing banks risk free return
- Credit growth collapse
- Defaults rising fast

U.S. bank deposits

Overall deposits at U.S. banks declined after sharp inflows in the wake of pandemic aid. Following Silicon Valley Bank's collapse March 10, 2023, deposits at small banks fell sharply.

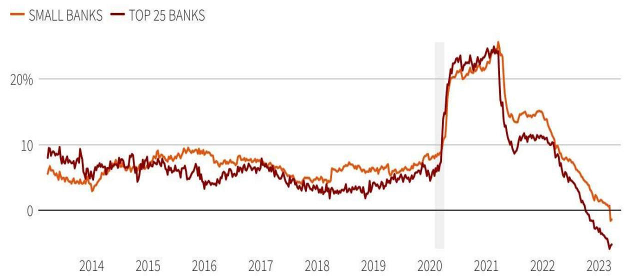
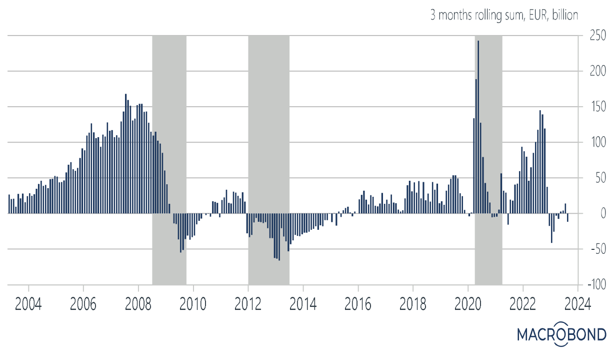


Chart shows year over year change
Source: Federal Reserve Board

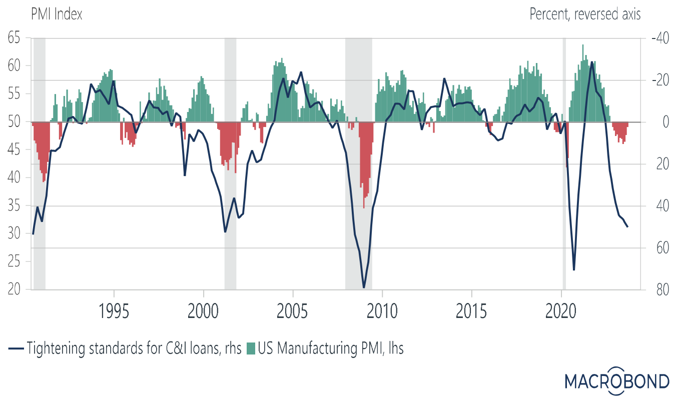
Euro Area: loans to non-financial corporations

Source: Macrobond Financial AB, ECB (European Central Bank)
Recessions bands in grey



As industrial loan standards tighten, manufacturing contracts

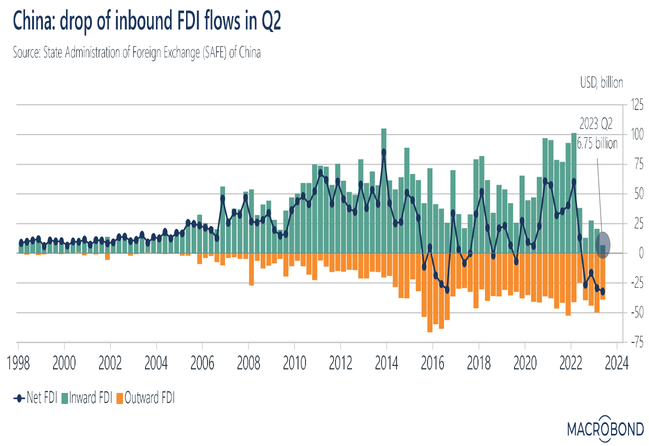
Source: Institute for Supply Management (ISM), Federal Reserve

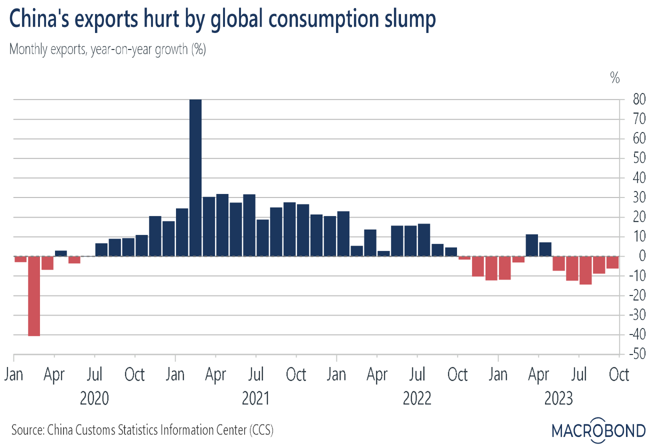


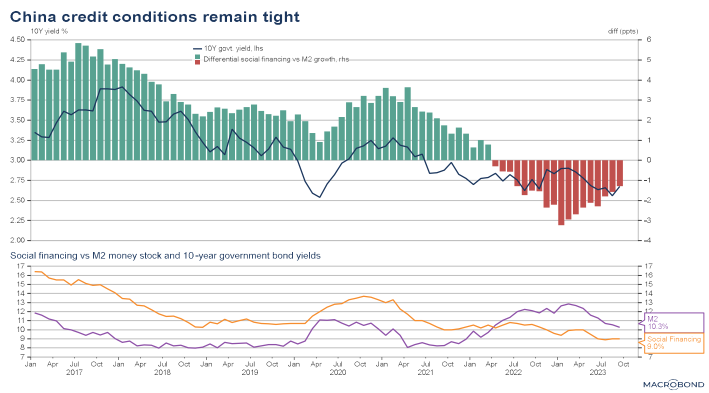
Macro risk
Geopolitics - China

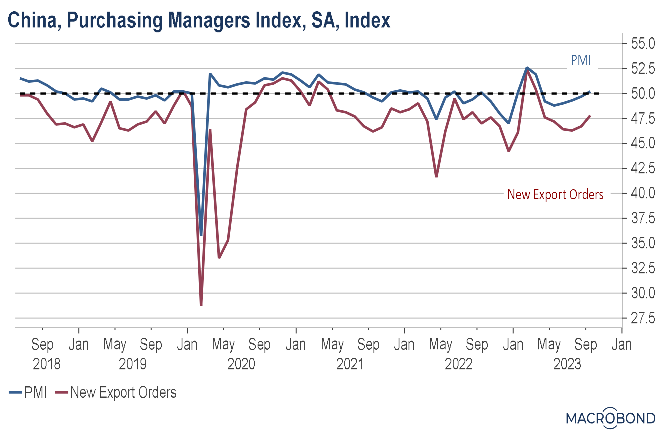
Economy stagnating
A cocktail of secular and tactical problems

- 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









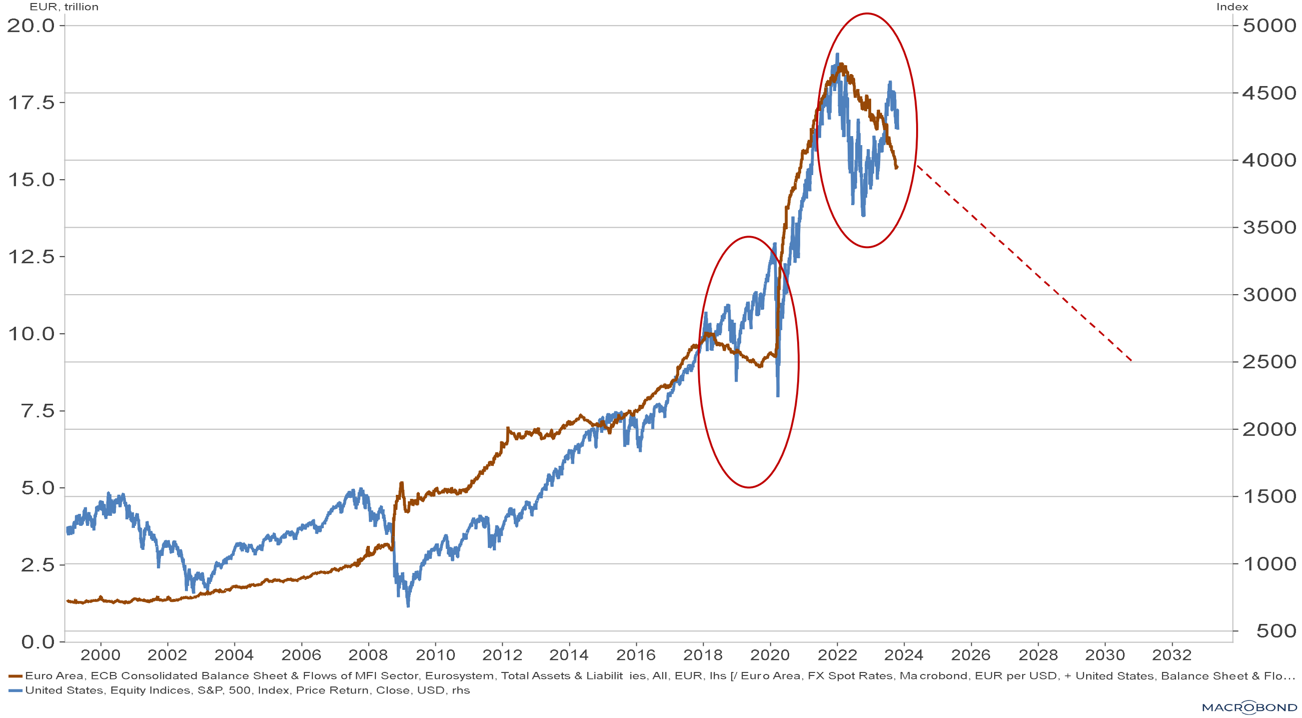
Goodbye "peace dividend": The autocratic cluster of countries represents an ideology of "might is right", as opposed to the post-WW2 "rules-based" order. Re-organization of global alliances, globalization ideology, corporate investment flows (FDI), supply lines, military investments.

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

Combined balance sheet FED + ECB vs S&P500



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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