Gauging future turning points

5th May 2022

Didier DURET – Chairman | Joel GUGLIETTA – Chief Investment Inovator | Alexis CHIRINIAN - Senior Advisor

The Omega Wealth Management March Investment Committee decided to raise its cash allocation at the expenses of European equities in a risk reduction move adjusting to mounting risks of recession and reaffirming a definite quality stance towards bond quality. The significant year-to-date rise of US bond government and Investment grade yields offer opportunities to reinvest at yield above 3% for limited duration risk. The interest to accumulate equities that pass the test of inflation hedge is maintained with a preference for US equities and value as style. An effective diversification to weather a period of inflation fight and higher risk of recession necessitates to include alternative investments that benefits from tensions on the energy and commodity complex and hedge funds such as CTA that can profit from brisk trend reversals.

Higher risk of recession as side effect

The Federal Reserve Board has clearly confirmed at its May 4th FOMC its priority to fight inflation at the risk of slowing the economy. Fed Funds rates are now expected to rise to close to 3% by year end and it led to a momentous rise and flattening of the US yield curve (see Fig.1). We believe the Fed will be (too) successful in curbing the inflation spiral. The risk of a tightening slippage is real due to deteriorating demand conditions in the rest of the world, in particular in Europe. The looming risk of recession, est. 28% in the US (Source CME), could augur a turning point over the coming months and US long maturity bonds could be first to anticipate a policy reversal. In the meantime, a war led energy transition and resource scarcity maintain interest into energy and commodity sectors. Deeply negative bond yields keep an attraction pull towards private assets, and high dividend equities before stabilizing bond yields start supporting growth equities later in the year. With uncertain timing, reacting to turning points is not an option, preparing is the name of the game.

Figure 1: Omega tactical views (3-6 months)

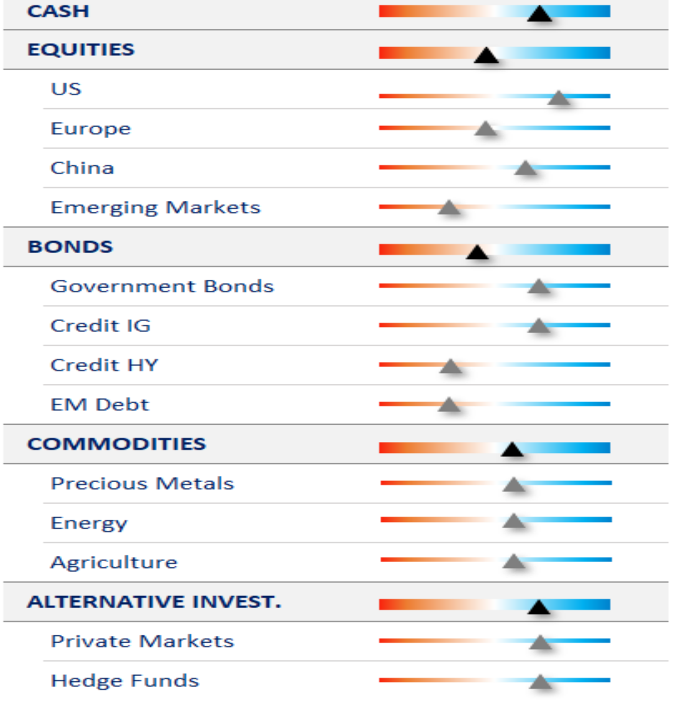
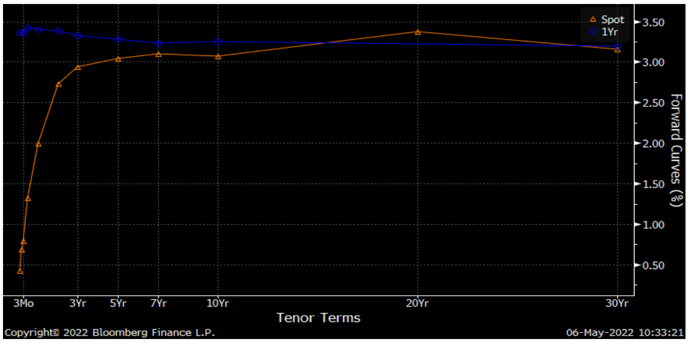


Figure 1: US long bond is anchoring the curve around 3%



DAAO benefits in uncertain times

Asset allocation in such an environment is challenging as portfolios are undergoing rare shocks (such a drawdown in global bonds has been seen only 4 times in 100 years for e.g.). Dynamic Asset Allocation by Omega (DAAO) remains our best line of defense through stacking uncorrelated sources of returns. We essentially have four wealth modules. In the volatility control space, (module 1) our CTA certificate is very effective, exploiting trends in commodities and bonds. This is less true for our long-only allocation, which we de-risked massively with a large cash position. Our hedge-funds (module 2), exposed to fixed income arbitrage and multi-strat arbitrages, posted a solid ytd performance as well as our private-equity module 3. Finally, we have reduced our equity tail-hedge exposure as dislocations in the volatility space has hurt this strategy (CTA being a far superior solution).

Tactical opportunities

Positive outlook for energy gold and agriculture commodities with ETF as well as equity solutions.

Add a quality spin to growth style: cash rich firms with stable earnings and robust business models can outperform while inflation, risk of recession, prospects of higher rates are headwinds for average growth stocks.

South East Asia equities with diversified instruments and long/short **Greater China multi-PM fund. Shift toward China equity** on Europe market strength with the rationale of better growth response in China.

A **selection of CTA** have demonstrated their diversifying power in the midst of the Ukraine crisis.