

WHO WE ARE

Astoria is an investment management firm that specializes in the construction, management and model delivery of tactically constructed, cross asset ETF managed portfolios. Our research driven portfolios are stress tested through various quantitative risk models in order to best understand our portfolio risks and to help determine when risk budgets should be expanded or contracted.

Astoria Portfolio Advisors LLC. (“Astoria”) designs **Multi-Asset ETF Model Portfolios.**

We utilize a **disciplined, cross-asset quantitative investment process** to participate in **upside exposure** while hedging **downside risks** during stressed markets.

Our investment management process is a **constant feedback loop** between **research, portfolio construction, and risk management.**

Investment decisions are made using **strong economic and quantitative rationale** backed by **data.**

“When you get too far off course, your internal compass tells you something is wrong, and you need to reorient yourself. It requires courage and resolve to resist the constant pressure and expectations confronting you and to take corrective action when necessary” – Bill George, Discover your True North, 2015, John Wiley & Sons.

Astoria employs **ongoing research assessment** of these models to **manage** to determine when risk budgets should be **expanded** or **minimized.**

Game Theory is an important and, we believe, a distinguishing factor into our investment process.

When selecting ETFs for our portfolios, we leverage our **ETF selection model** which is based on **rigorous testing** and **research.**

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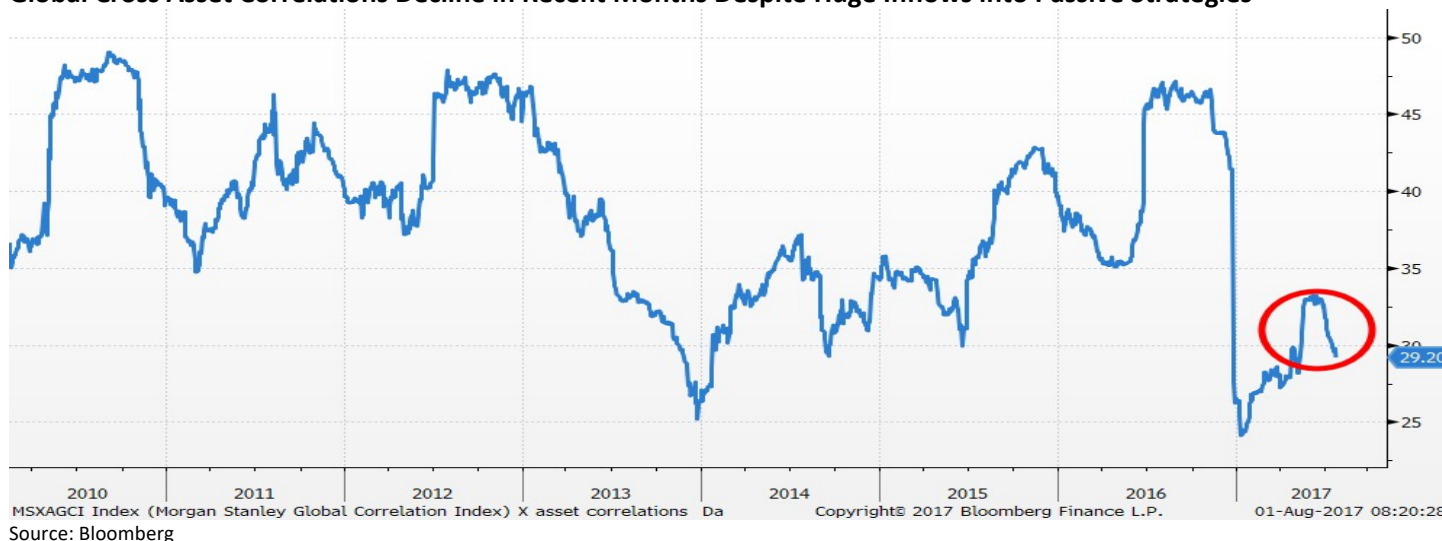
Active vs. Passive.

- My colleagues and friends tell me that this topic is **constantly** in the press.
- I don't read daily newsletters or watch the news. **Astoria uses a disciplined cross-asset quantitative investment process. We have models, study our indicators, watch for signals, focus on the big picture, and then model accordingly with a long-term time horizon.** Focusing on daily price action or reading daily articles would create noise for our models.
- However, given my background in Equity Derivatives Research where I wrote Index and ETF research back in 2000, I would be remissed not to comment on the Active vs. Passive topic given **Astoria** straddles both sides.
- I have written, discussed, and presented on this topic throughout my career. Frankly, it has become quite a tiring topic at this point. **All portfolios contain active components** (although investors probably never realized it). **The minute you open your portfolio, decide what to put in it, and decide how much weight you will give an asset class, it becomes an active decision. Period.**
- The cynical side of me says that this **ultimately comes down to cost** which is a shame. On a 1-2 year time period 50-100bps shouldn't drive your decision to shift from active to passive. I am worried that investors are making these shifts at the wrong part of the cycle. Studies show that active funds do better during down cycles than bull markets.
- While we firmly believe in using very **low-cost ETFs** in our retirement Model Portfolios given the extended time horizon, our **Multi-Asset Risk Allocation & Risk Managed Dynamic Income Model Portfolios** are open architecture and we use some ETFs with high management fees because it's the right solution for our clients.
- We have been in a **QE induced bull market** for most of this post credit crisis period which ironically most investors missed as we will discuss later in this piece. Now is when you want active management.
- In fact, **Astoria** has been arguing that the current environment is **ideal** for active management for these reasons:
 1. The Fed has **shifted away** from monetary policy and has begun a tightening cycle.
 2. The S&P 500 is up **350%** since 2009. We are in the latter stages of the economic cycle and as mentioned, active tends to work better during down cycles.
 3. **Dispersion amongst sectors has risen** and has created opportunities for active managers. The difference between S&P 500 Technology vs. Energy sector year to date is **35%**.

4. **Global cross asset correlations** are at **very attractive levels**. In fact, they have **declined of late**. Wait a minute, I thought all those massive ETF inflows were going to increase correlations and make it difficult to pick stocks?

- What do you see from the chart below that would suggest the **\$1 trillion** of inflows into ETFs in the past **4-5 years** are having a disproportionate impact from a correlation perspective? So much for that theory.

Global Cross Asset Correlations Decline in Recent Months Despite Huge Inflows into Passive Strategies



- Ultimately, ETFs have become one of the **most successful products** in financial history in a very short time period and this is partly why it receives a lot of pushback. This is no different from other successful products. Futures received quite a bit of pushback when they gained momentum and now many institutional managers utilize them. The same story applies for options.
- At the end of day, there's **\$4 trillion** in ETFs and **\$15 trillion** in mutual funds globally. Have ETFs impacted the investment landscape and impacted capital markets? Yes. But in our view, we have a long way to go before they dominate the marketplace.

Macro Views

- The **pro-growth, cyclical recovery** thesis that **Astoria** have been arguing for some time continues to **play out**. The MSCI **ACWI** index was up **2.8%** in July and is up **15.4%** YTD. Earnings revision breath remains **upward trending** in the US, Europe, Japan, and EM.
- The environment for **cyclical equities** is as **good** as it has been in several years. **Global growth remains solid** and supports a **pro cyclical bias** (EM & DM over US, EM debt over US credit, value over growth, equity risk over yield

& carry) in our view. Moreover, realized **inflation remains weak enough** globally to **keep** central banks from tightening policy too aggressively. What more can you ask for from an equity market's perspective?

- Are there **risks** in the marketplace? Of course, there always are. It's all about the **distribution of outcomes** and **modeling it accordingly**. Astoria thinks the **risk reward is attractive** until either (1) **inflation picks up** (2) **Fed talks up rate hikes** (3) Central Banks overseas **materially slow their accommodation**. However, this is **not our base case** in the short term.
- As we argued in our **July Macro Insights** (<https://www.linkedin.com/pulse/macro-insights-from-astoria-portfolio-advisors-llc-john-davi>), the market's **repricing** of the **reflation trade** in Q1 of this year was largely tied to the **political uncertainty** in the U.S. rather than a breakdown of the underlying dynamics which drove the reflation. Some investors have argued that the **flattening US yield curve** is signaling a **deflation** scare.
- We would argue against that thesis.
 1. A lot of the indicators we examine still point to an economy that is **expanding** and **very healthy**. The economic recovery is global in nature with earnings inflecting higher across the world. For the **first time since Q4 2011**, earnings have been **simultaneously growing** on a year on year basis at the MSCI US, EMU, EM, World, and AC World level.
 2. Granted some macro data has **moderated** of late but many remain very elevated compared to recent history. Importantly, the Fed remains **largely accommodative** and central banks overseas **remain very supportive**. Equities continue to **remain attractive** in the content of low interest rate, loose financial conditions, and a supportive economic backdrop.
 3. Until the **US yield curve inverts** (usually the kiss of death for equities), **Astoria** thinks the risk reward of **staying long pro-growth, cyclical equities** remain attractive.
 4. **Astoria** believes it's highly unlikely that **International Small Caps** and **EM equities** would be up **20-25%** if we were experiencing a deflationary scare. Admittedly, there are some sizeable flattener positions that have been put on when examining CFTC futures data. However, we are focusing on our suite macro-economic indicators instead of obsessing over 1 positioning data point.
- What's the **biggest story** of 2017? We have no quantitative way to show this but we would venture and say a good chunk of investors would argue that Trump's inability to get legislation passed would be at or near the top of the list. However, from an equity shareholder perspective the bigger story for 2017 is **Emerging Markets** and **International Small Caps** which are this year's market leaders.

- Remember, Small Caps are plays on local economies. If economies around the world weren't expanding, it **would be hard** to see Small Caps up 20-25%.
- The Fed will continue to **emphasize normalization** but the **real risk** is whether we get a **3rd** rate hike in 2017 and Yellen's job next year. The balance sheet reduction has been **talked about quite a bit** and is likely in the **price**. **Astoria** believes the Fed will **announce normalization plans in September**, see how **financial conditions respond** (US dollar, rates, equities, volatility) in October and November before deciding whether to hike in December.
- **The market is skeptical of further rate hikes.** The implied rate hikes in the next 12 months has **consistently fallen all year** and currently resides around **1.2**. The bottom line is that investors don't believe in inflation materializing or the Fed's ability to hike rates.
- The Fed has consistently sided with the market's rate hike expectation throughout this cycle. 2016 was a classic example when they were implying 4 rate hikes at the start of the year and ultimately caved in their dot plots. It was **risk on for the rest of 2016**. Under this Fed administration, we think the probability of the Fed going against the market's expectation is low. And as mentioned, the **real risk** is likely who becomes the next Fed chairperson.
- When you factor in **muted inflation globally**, the probability of more aggressive tightening lowers. For us, this is an **attractive scenario** for pro-growth, cyclical equities but we are monitoring these probabilities closely.
- We commented on EM equities and FX in our last Macro Insights so we won't delve further here. A few thoughts on why we believe Japan has several tailwinds.
 1. Global growth is increasing and Japanese large caps by design are a play on the rest of the world. In case you are wondering how the local Japanese economy was doing, Japanese Small Caps are up **20%** this year.
 2. Margin of safety: Japan is trading at **20% discount** to US on a **12-month forward PE basis**.
 3. Japanese earnings growth is projected to hit a **3-year high**.
 4. The BOJ is still **very accommodative** and remains **much** further behind the US from a tightening standpoint.

US Earnings

- To be clear, **Astoria** own **US** equities in our **various** Model Portfolios but in our view the risk reward is relatively more **attractive** overseas. However, we acknowledge that there are **some strong tailwinds** for US equities.

1. There is **very little priced in from a Trump perspective**. US Small Caps are up only **4% YTD**. When the probability of US legislation increases, the **gap** between US and International Small Caps (+20%) should **narrow**.
 2. The significant dollar selloff will **kick in** for US multinational earnings which **dominate** the S&P 500. Another tailwind.
 3. The bears will argue that the **rate of change for Q2 earnings season** is below Q1's stellar performance. Don't forget that for most of 2015 when we were witnessing a deflationary scare due to the bear market in oil/energy sector that **S&P 500 earnings were negative**. So even though Q2's rate of change is **lower** than Q1's, it still is elevated and one of the reasons why US equities are rallying.
- Year to Date, US Fixed Income ETFs and Mutual Funds have seen approximately **\$100 bln** more inflows compared to US equity strategies. Geez, despite S&P 500's +12% YTD gain, **US equities can't catch a break**.
 - When you dig deeper, this trend of dominate inflows into Fixed Income has been a consistent over the past decade. Since '07 there has been approximately **+\$1.5 trillion** into bond strategies and **\$200 bln** outflows from equities. This speaks to the most hated bull market ever thesis and another reason why the US keeps rallying.
 - Lastly, we wanted to point out 2 things:
 1. Here is an interview **Astoria** recently did with **ETF.com** about our investment process. <http://www.etf.com/sections/features-and-news/why-model-etf-portfolios-need-active-mgmt?nopaging=1>
 2. Here is a link to a podcast that **Astoria** recently participated with **Jeremy Schwartz**, Director of Research from Wisdom Tree and **Pankaj Patel**, Head of Quantitative Research at Cirrus Research. <https://soundcloud.com/user-20931378/behind-the-markets-podcast-john-davi-pankaj-patel>

Best, John Davi,
Founder & CIO of Astoria

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