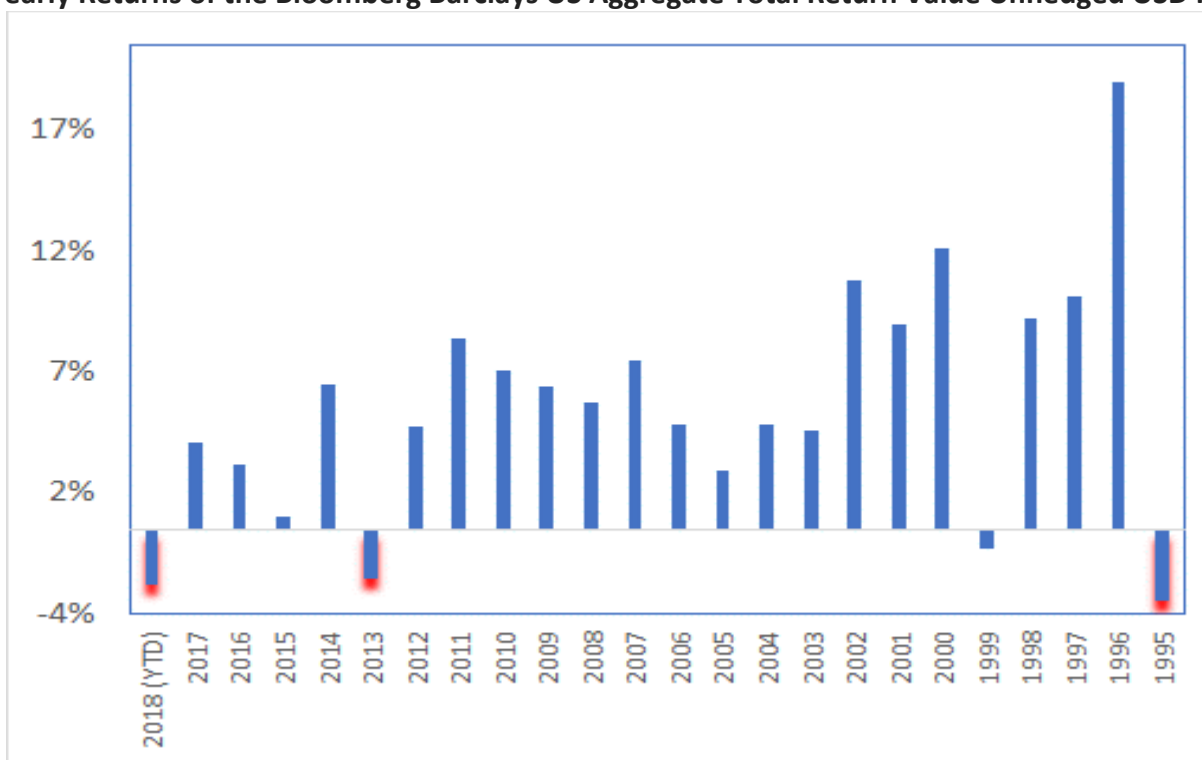


Bonds Are Having Their Worst Year Since 1994!

Astoria Has Been Warning About the Dangers Of The Bond Market.

- The **Bloomberg Barclays US Aggregate Bond Index** is currently having its worst **yearly return since 1994** (see chart below).

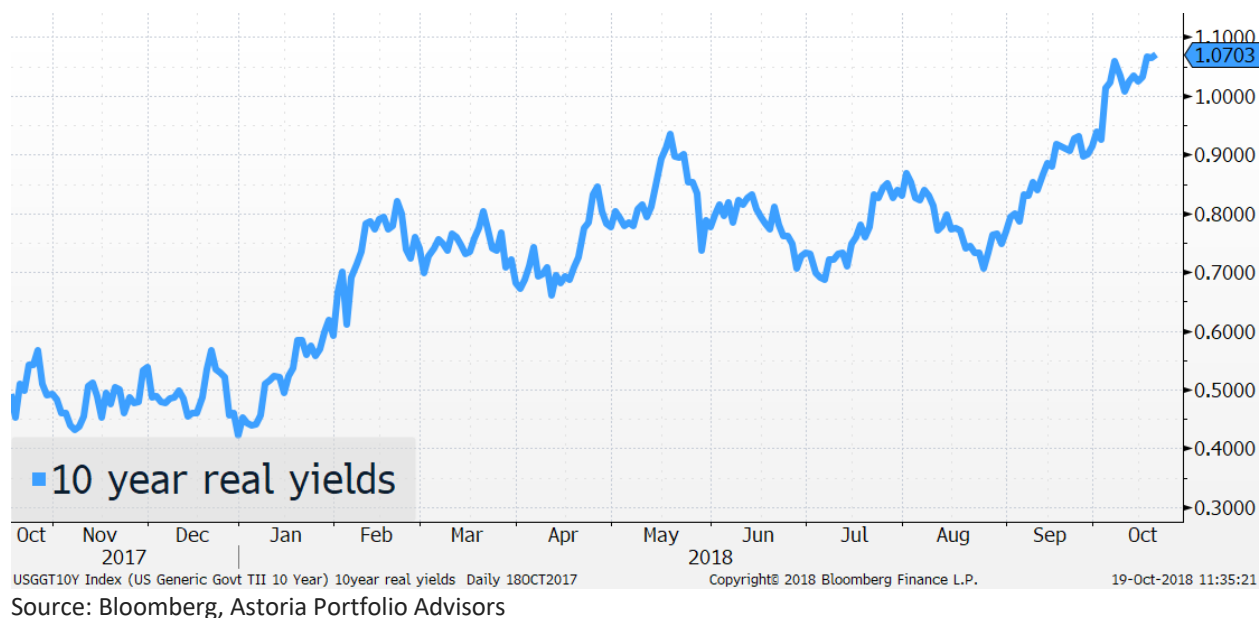
Yearly Returns of the Bloomberg Barclays US Aggregate Total Return Value Unhedged USD Index



Source: Bloomberg, Astoria Portfolio Advisors. Year to Date returns for 2018 are as of October 18, 2018.

- To put 2018's disappointing return into perspective, the Bloomberg Barclays US Aggregate Bond Index has registered only **3 negative total return years in the past 40**.
- At Astoria, we are **not surprised** by this year's disappointing US bond returns. We have long warned about the challenges that bonds face in an environment where valuations are expensive (hence, no margin of safety), US rates are rising, and US inflation is trending higher. To read our previous blogs on the danger of the bond market, click [here](#), [here](#), and [here](#).

10-Year Real Yields Are Up Nearly 40bps Since Late August 2018

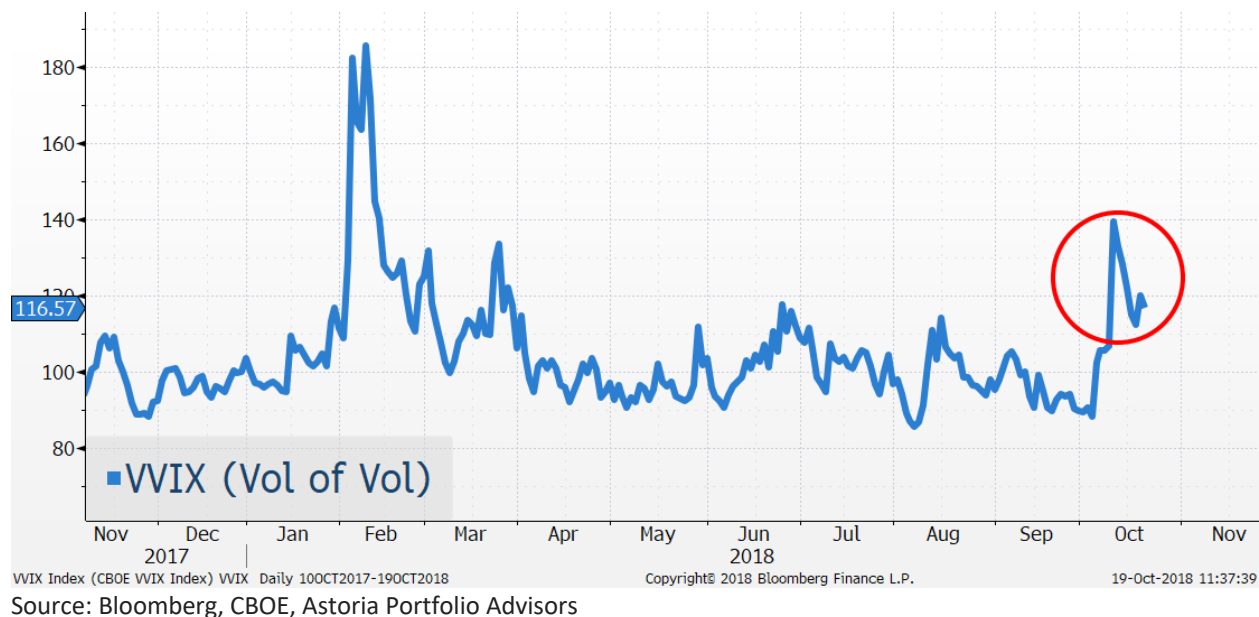


- Astoria has been particularly vocal about avoiding **most traditional US credit and interest rate spread products**. Moreover, we have suggested that **bonds would no longer provide the downside protection towards equities** as they did in the past.

Astoria Isn't Surprised with the Equity Sell-Off Either.

- On a broader scale, Astoria **isn't surprised by the equity market selloff**. In fact, we wrote an op-ed article on **ETF.com** titled "**Time to De-Risk Your ETF Portfolio**" on Sep 13, 2018 (click [here](#)) arguing that investors should tactically rotate their ETF portfolios into higher quality assets across asset class. Given that the **SPY ETF has fallen 7.3%** (peak to trough post our article) **and bonds are having their worst year since 1994**, Astoria believes we had the **right call**.

Keep Your Eye On The VVIX. The Volatility of Volatility Index (VVIX) Spiked Higher In October And Remains At Elevated Levels.



Don't Rely On Bonds to Hedge Your Equity Risk

- The **Equity Risk Premium is well understood**. Equities have outperformed all major asset classes over extended periods of time (i.e. the concept of holding “Stocks for the Long Run”).
- Astoria has been vocal in suggesting that investors **should earn their equity risk premium** but in doing so, construct a **diversified** portfolio, **hedge equity risk** appropriately, **diversify across factor exposures**, largely **avoid bonds**, include **inflationary linked assets**, and **utilize cash** to produce attractive risk adjusted returns across varying market cycles.
- Everyone looks like a **hero** when the market **goes straight up** (as it did last year) with **no volatility**. We would argue that most of the 2012-2017 period **exhibited abnormally low volatility along with a momentum driven US market** (by definition, QE provided a floor for most financial assets).
- **Astoria argued that 2018 would be quite different**. Astoria presented at a Bloomberg Best Ideas conference in Dec 2017 (click [here](#)) and went on Bloomberg TV in Dec 2017 (click [here](#)) arguing that investors needed to hedge their risk assets in 2018. That was our **motto for this year** and we continue to **believe that is the right strategy**.

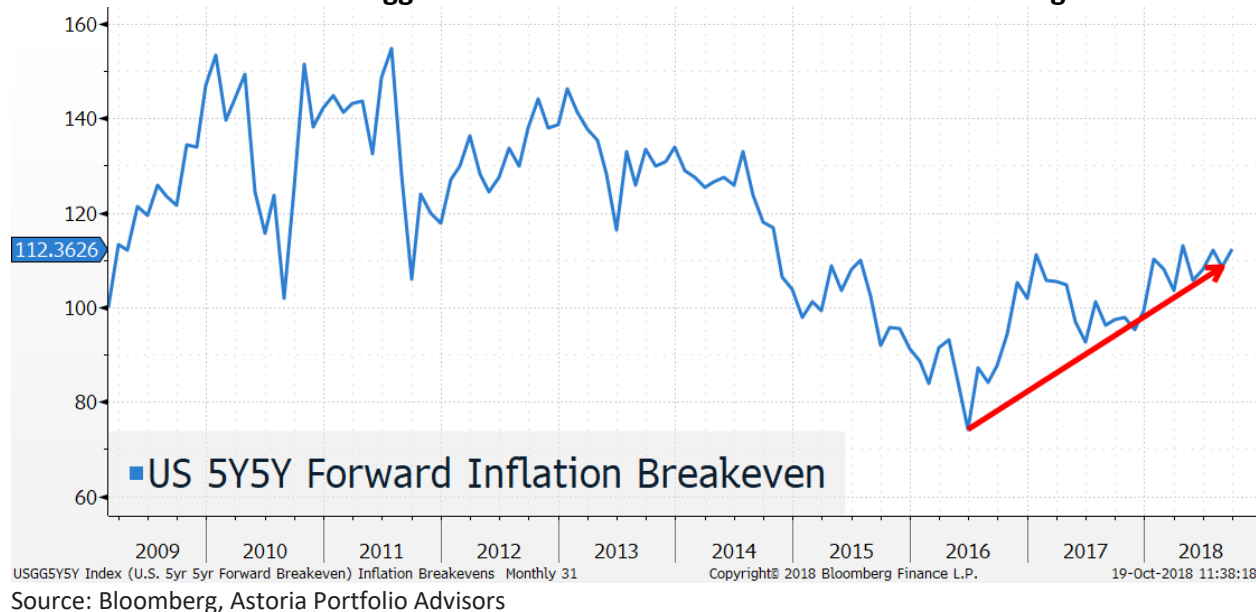
Most Portfolios That Use Stocks And Bonds Are Likely To Be Disappointed Thus Far in 2018.

- If 2018 ended today, most multi-asset investors would be **disappointed** if they relied **solely** on bonds to hedge their equity risk. At the start of 2018, the consensus equity trades were to be overweight

International Markets (EM and then DM in that order) and underweight the US equity market. Meanwhile, SPY (S&P 500) has outperformed ACWX (All Country World ex US ETF) by **15%** from December 29, 2017 to October 18, 2018).

- As bonds have been in a powerful bull market for the past 40 years and have been mostly uncorrelated to stocks, most investors use bonds to **hedge their equity risk**. When you factor in a traditional model portfolio (60% stocks and 40% bonds) and adjust for the volatility of bonds, 2018 is likely to be tough for investors that weren't properly diversified.

Bonds Will Continue To Struggle If Inflation Break-evens Continue To March Higher.



Why Do People Use Bonds?

- It's simple to understand why investors have gravitated towards bonds the past half a century. As mentioned above, US bonds have produced only **3 negative years out of the past 40**. Buying a broad-based US bond portfolio, historically would have given you **high income, diversification, and carry**.



Illustration only. Source: Astoria Portfolio Advisors

- Since 2009, investors have poured **over \$2 trillion into bond funds and ETFs**. Unfortunately, most of the historical attributes for bonds have declined significantly in our view.

- In 2015 & 2016, investors began buying bonds for growth and bought dividend yielding stocks for income and perceived levels of safety. **That is the ultimate irony!** Bonds are supposed to be a **boring, dull, and relatively low risk asset**. Certainly, they aren't designed to provide growth!
- Meanwhile, stocks are **levered instruments, carry debt**, and contain **asymmetrical risks to the downside**. Stocks may appear to be low volatility when US rates fall below 2% but in an era of rising US rates, high dividend yielding stocks are likely to become highly volatile.
- In a recent **Yahoo! Finance interview** (click [here](#)), we commented that on a per unit of risk basis, cash and ultra-short bond funds are significantly more attractive than high yield bonds or intermediate corporate bonds.
- Astoria strongly believes that multi asset portfolios should look at other asset classes such as **commodities** (a play on inflation and provides positive carry), **alternatives** (systematic HF replication, convertible bonds, gold), and utilize **cash** to help soften the volatility of one's portfolio (as opposed to using bonds).

The Days Of Being Outright Long Beta Are Over.

- **Nobody truly knows the direction of US rates.** If we knew the forward level of US rates, we would all position our portfolios accordingly.
- Astoria's vantage point is that **US rates are starting from such a low base** and investors aren't providing themselves with any margin of safety should rates rise higher. Moreover, there are other ways to generate income or to diversify one's portfolio (this is exactly what Astoria's ETF Model Portfolios have been doing).
- Bonds were a **great investment when central banks globally gobbled up \$15 trillion in financial assets** (a good chunk of which were bonds). Those days are now largely over (with the exception of the BOJ) and Astoria believes that bonds will be **securely**

challenged in an environment where interest rates are trending higher, rising inflation, and expensive valuations.

Everything Works...Until It Doesn't. Hence, Why Astoria Has Advocated Hedging One's Portfolio.

- There is a saying on Wall Street that **everything works - until it doesn't**. Well, bonds worked great over the past 40 years but we believe the probability of material positive returns for traditional credit and spread products will be challenged in the years to come.
- In a recent blog (click [here](#)), Astoria highlighted that in 2018 there have been a series of events which separately may appear "inconsequential" but packaged together represent an important trend. It

started with the **collapse of the VIX ETN product suite in Q1 2018**. Around the same time, the cryptocurrency space accelerated its decline (most coins are down 50-75% this year). **China** subsequently began its decline (it is now down 50% since June 2015). The China slowdown along with trade tariffs have put the broader EM equity, currency, and debt space into a bear market.

- As mentioned above, the US bond index is having its worst year since 1994. Some market pundits have argued that there is a bear market brewing and has been rotating around various asset classes. We tend to agree.
- Does that mean Astoria is bearish? No. We are **attracted to assets where there is intrinsic value** and especially **where we can purchase those assets below intrinsic value**. But Astoria continues to **advocate alternatives, diversify across factor exposure**, and to **largely avoid bonds where there is no margin of safety**. Remember, **markets trade on the margin and the rate of change ultimately drives financial assets**.

How Does Astoria Distinguish Itself?

- In **Astoria's Multi-Asset Risk Strategy (MARS) ETF portfolio**, we own **64%** in stocks (of which we are diversified globally and across factors) and we are hedging our risk via alternatives, gold, non-traditional fixed income products, and cash. We believe products such as SRLN (Senior Loans), CWB (Converts), VTEB (Munis), VMBS (Mortgage Backed), IGSB (Short Term Corporate Bonds: effective duration = 2.7), QAI (Systematic HF replication), and IAU (Gold) offer a more compelling opportunity than traditional bonds.
- If you are interested in **viewing our MARS ETF portfolio** or any of the other solutions that Astoria provides (income, strategic, tactical, and long-term asset allocation strategies), click [here](#).

Best, John Davi
Founder & CIO of Astoria

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