# ASTORIA Portfolio Advisors

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# Astoria Portfolio Advisors’ Macro Insights

- The **pro-growth**, **cyclical recovery** continues to *shift* to the Rest of the World (RoW) where there is a **greater margin of safety**, **better EPS prospects** and more **leverage** to global growth.

- The recovery is global in nature with **earnings** and macro data inflecting higher. The Fed still remains largely **accommodative** and central banks overseas remain **very supportive**. Equities are very attractive in the content of low interest rate, loose financial conditions, and a supportive economic backdrop.

- The market’s **repricing of the reflation trade** is largely tied to the spike in **political uncertainty** as opposed to a breakdown of the underlying reflation dynamics. Numerous indicators still point an economy that is in expansionary phase.

- The economic recovery began with the **bottoming** of US inflation break evens in Q1 ’16 following a **recession in US cyclical sectors** in ‘15. The **US led the global recovery last year** (as it always does) and leadership has now moved into Rest of World (RoW) securities. Given we are in the later stages of the economic cycle, positioning in **late cycle sectors**, **value and low quality stocks provides a greater margin of safety**. Overweighting regions with **higher sensitivity to global growth** (i.e. Emerging Markets, Europe, & Japan) is also an attractive risk reward.

- The Fed has generally been behind the curve over the past 20 years and this time likely won’t be any different. Adding fiscal stimulus at this late in the cycle is **extreme** and the risk is that the economy **overheats** if these packages are implemented.

**Our Macro Insights deck is updated on a monthly basis. Refer to our website for updates**
**https://www.astoriaportadv.com**

# Astoria Portfolio Advisors' Macro Insights

- Investors are focusing (and wasting) too much time on **political rhetoric**. For equities, its all about **earnings growth** and more importantly, **their rate of change**.

- Positioning in US equities isn't nearly as attractive as it was years ago but there are pockets in global equities where **valuations are attractive** (select EM countries, Europe, Japan) and **sentiment is low**.

- China's credit driven expansion, loose financial conditions, weaker dollar, and overall lower rate environment provides a supportive backdrop for EM equities.

- It is important to keep in mind, however, that the **economy is late cycle as this is already the 3rd longest expansion since 1850**.

- US credit is the one area where **late cycle risks loom large**. You are not being compensated for the risk you take on owning HY credit. Fed tightening cycles have historically coincided with **credit spreads widening** and **valuations are already rich**. There is more value in Senior Loans, Preferreds, and MBS, the latter which has high sensitivity to a strong US housing market.

- With policy uncertainty spiking and growing geopolitical risks **gold remains attractive** particularly given its inherent **convexity** over bonds, dollar, or equity volatility.

- **The back end of the US curve likely will be capped around 3.50% because of the generational search for income globally** along with the emotional scars of two 50% drawdowns in equities over the past 15 years. One way to get materially higher rates is to get clarity on fiscal stimulus, tax cuts and other Trump polices which would boost growth and bring long rates higher. However, the probability of any significant policy being implemented this year is low.

# Astoria Portfolio Advisors' Macro Insights

- For much of the post credit crisis period where markets were driven by **secular stagnation fears**, investors piled into curve, roll down and yield trades given growth was perceived to be low. The amount of capital tied to short equity volatility trades in particular is exceptionally high and alarming. Investors should be concerned with these strategies given the **inherent linkage between volatility and liquidity**, particularly *if* there is an **aggressive rate hike cycle**.

- The softness in US economic data, lower inflation expectations, and Trump's rhetoric on the dollar are all catalysts for weaker dollar in 2017. For our International Equity exposure, we prefer a combination of hedge and unhedged **strategies given timing** dollar moves can be quite difficult and cumbersome for tax sensitive investors.

- Banks weren't able to build net interest margins in a low rate, flat curve environment where there was **little organic growth demand** and **muted inflation**. Banks sold off in April because of the rate move and the rotation into growth stocks but in an environment of higher growth, higher inflation with potentially less regulation, banks are well positioned given their **greater margin of safety**.

- The current setup of **lower cross asset correlations**, **higher sector dispersion, loose financial conditions, and better economic growth** provides an attractive setup for **active management**. However, active management of low cost, passive strategies is the **sweet spot**.

- The focus on low fees is a good thing. Its quite simple -> **high fees erode investor returns**. However, don't just buy a passive ETF because it has low management fees. It's significantly more important to focus on the index methodology.

- The tremendous focus and resources dedicated to delivering short term alpha is **leaving** opportunities for **investors to capture long term returns**. At Astoria Portfolio Advisors, we are **positioned** to capture **long term returns**.

# Financial Markets have Witnessed Extraordinary Changes over the Past Decade. 2007 was Characterized by…

### Active Management

- Stock picking in vogue
- Block trading
- Mutual Funds > ETFs

### High Fees, High Returns

- Alpha was more prolific
- Less emphasis on beta management
- Focus on high returns with less emphasis on risk management

### Higher Growth, Higher Rates, Greater Dispersion

- Better environment for active management

### Opaque Investments

- Emphasis for illiquidity premium
- CDOs, OTC, & synthetics in vogue
- Excessive leverage
- HF lockups

Source: Astoria Portfolio Advisors LLC

# While 2017 is Characterized by…

### Beta

- Passive investing in vogue.  ETFs > MFs
- Vanguard Total Market Index Fund largest in the world
- Electronic Trading

### Low Fees, "*Low Returns*"

- Alpha harder to achieve
- Focus on risk adjusted returns
- Very few want to pay alpha prices for beta type returns

### Secular stagnation fears

- Low growth, low volatility, low yield
- Poor environment for active management
- Carry, roll down, and yield strategies dominate

### Transparency

- Rules based investing
- Emphasis on liquid strategies
- Artificial Investing, Big data
- Preference for systematic strategies

Source:  Astoria Portfolio Advisors LLC

# What's Driving These Changes? Natural Evolution of Markets but the Great Recession & ETFs have had a Profound Impact.

## The Great Recession was a generational event …

- 40% SPX decline
- 8 million jobs lost
- $10 trillion USD of wealth depleted
- 2 wall street firms collapsed
- 465 US banks go bankrupt
- Low savings
- Excess leverage

## which led to enormous policy action…

- Unprecedented amounts of QE globally.
- US bond yields go to multi century lows
- Central Banks in Europe & Japan purchase majority of their bond markets
- Japan substantial holder of equity market
- Negative deposit rates

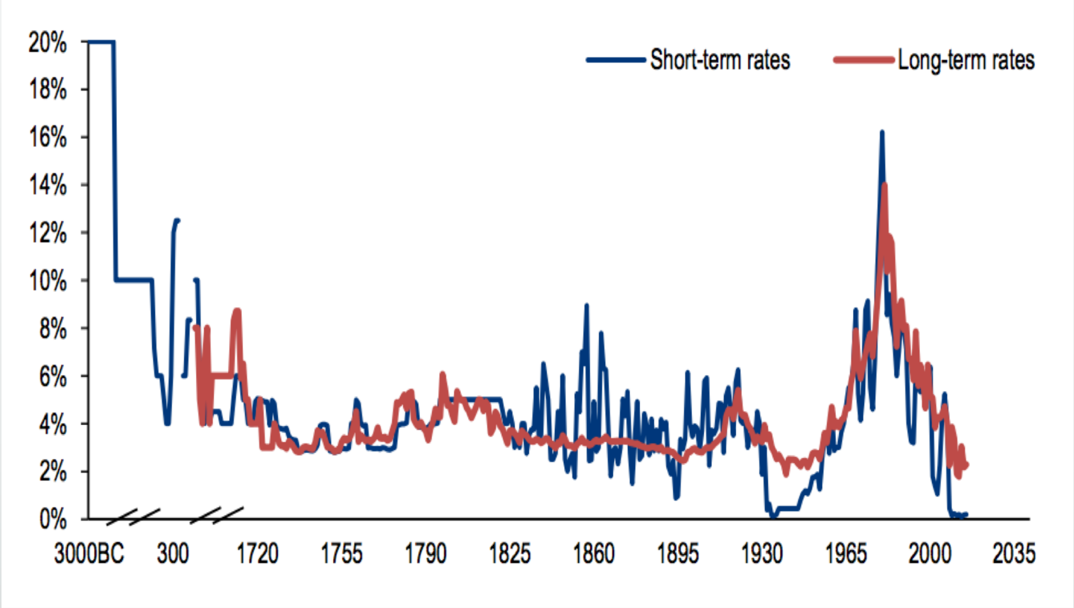
## which had *some* unintended consequences.

- Post QE, secular stagnation fears dominate which led to investors positioning for yield and not growth
- The most hated bull market ensues but yet very few participate and benefit from it

Source: Astoria Portfolio Advisors LLC

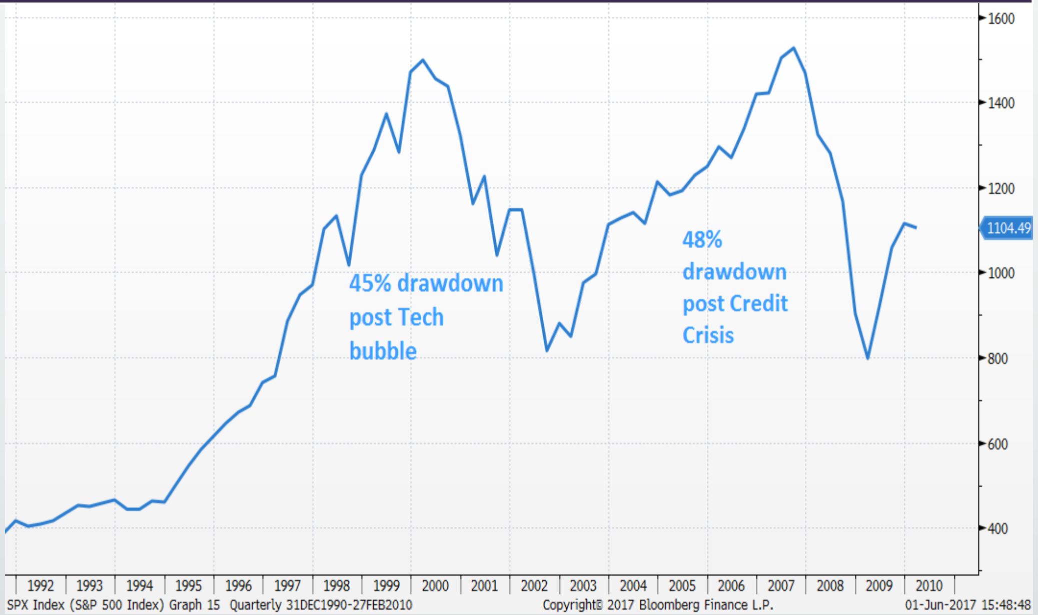
# Secular Stagnation Fears Dominated Post Credit Crisis.

## QE Suppressed Bond Yields to Multi Century Lows!




Sources: Bank of England, Global Financial Data, Homer & Sylla "A History of Interest Rates.

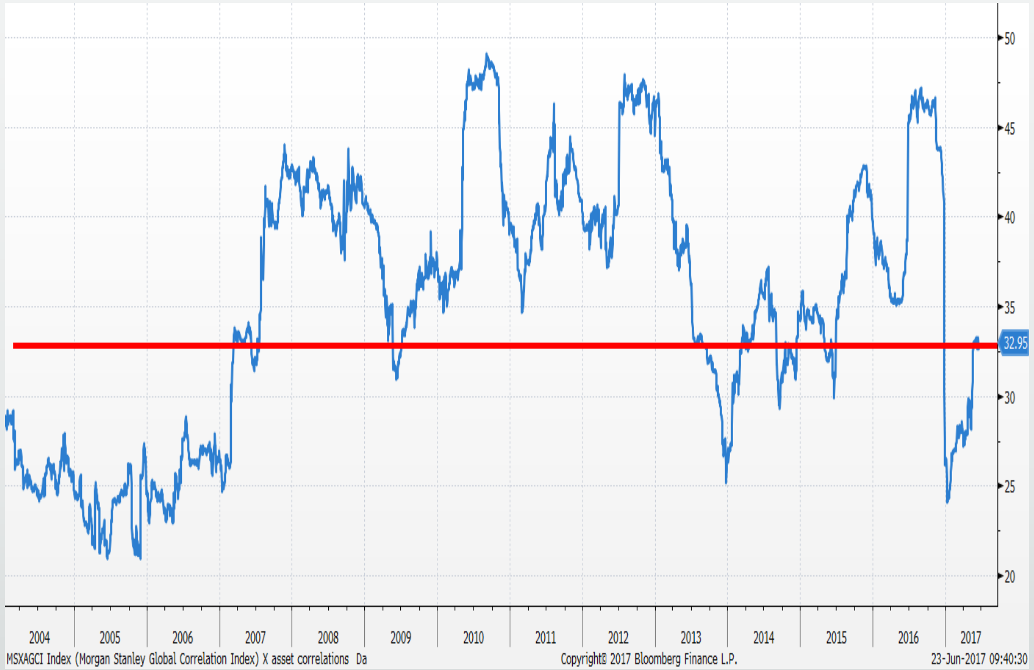
## The Emotional Scars of Two Near 50% Drawdowns in US Equities and QE help to Create Preference for Yield Instead of Growth.




Source: Bloomberg, Astoria Portfolio Advisors LLC

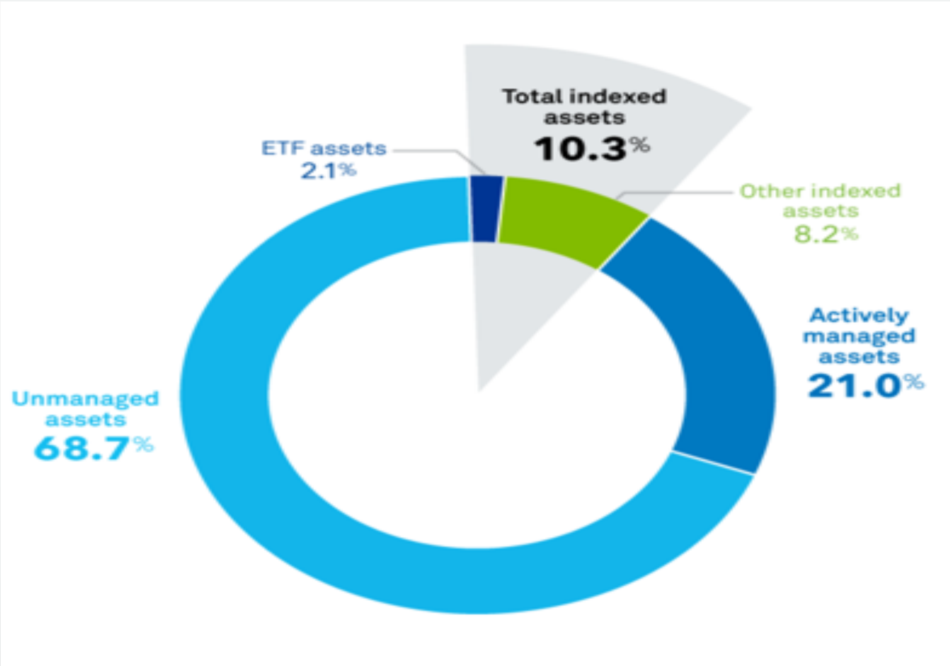
# There is a Bubble in Passive Strategies? Really? It's Only 10% of the Global Stock/Bond Market.

## Cross Asset Correlations are at Attractive Levels for Alpha Generation Even with the Rise we Have Seen in 2017.




Sources: Bloomberg, Morgan Stanley, Astoria Portfolio Advisors LLC

## Index Funds Represent Only 10% of Global Stocks and Bonds and About a Third of Managed Assets Overall.




Source: Blackrock estimates based on Mckinsey, Markit, Simfund, and Broadridge data as of 12/31/16

# Despite the Influx into Passive Strategies, the Current Environment for Active Management and Alpha Generation is Attractive.

**Given where we are in the economic cycle, active management is as important as ever.**

**Lower cross asset correlations**

**Higher growth, Higher rates**

**Transition away from Monetary Policy. Fed begins a tightening cycle.**

**Alpha generation?**

Cross asset correlations fall significantly immediately after Trump's election

US Inflation expectations bottomed in Q1 2016.

US rates bottomed in the summer of 2016.

Monetary policy has ended in the US and the market is shifting towards potentially less taxes, less regulation, etc. Fed wants to hike rates.

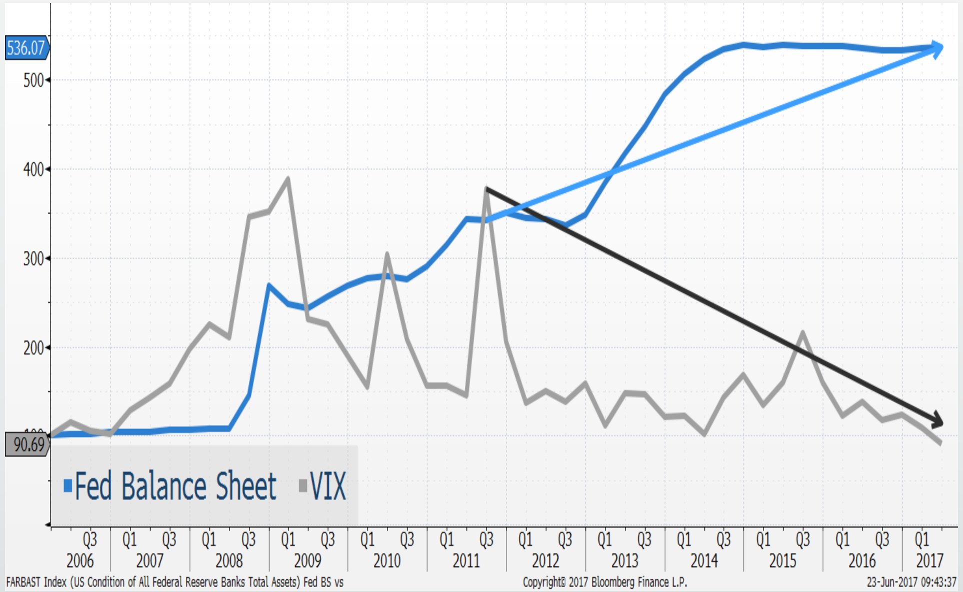
Source: Astoria Portfolio Advisors LLC

# Investors Need to be Mindful of the Direct Linkage Between Liquidity and Volatility, Particularly as the Fed Embarks on a Tightening Cycle.

## Short Equity Volatility Strategies have Never been as Extreme.   This is Concerning.


Sources: Bloomberg, Astoria Portfolio Advisors LLC

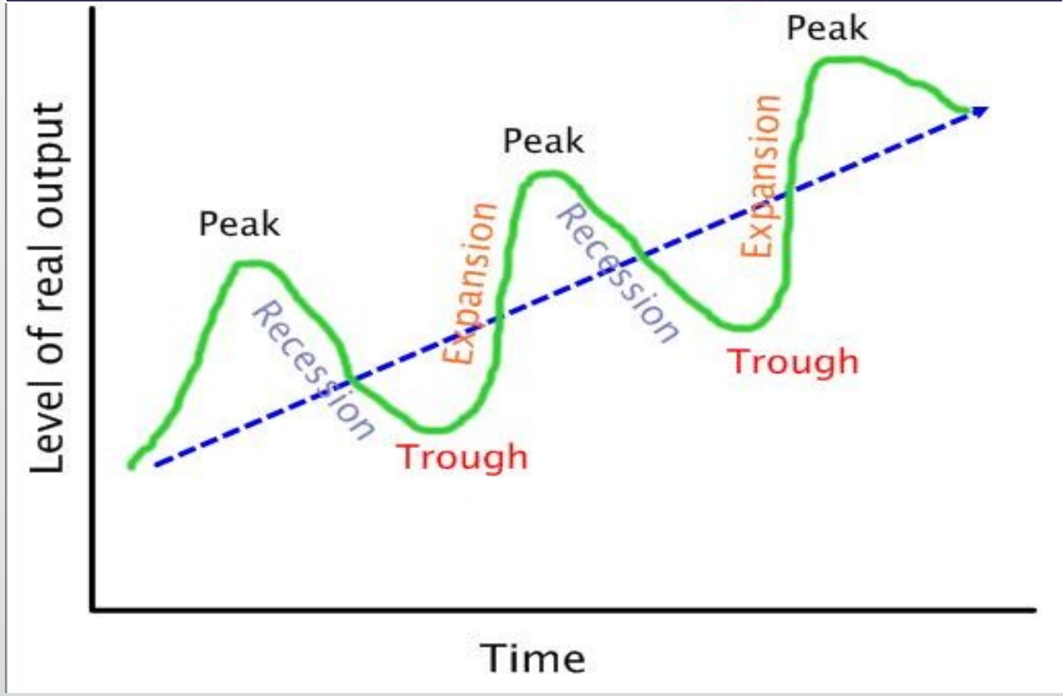
## Fed Balance Sheet is Inversely Correlated with Volatility.




Sources: Bloomberg, Astoria Portfolio Advisors LLC

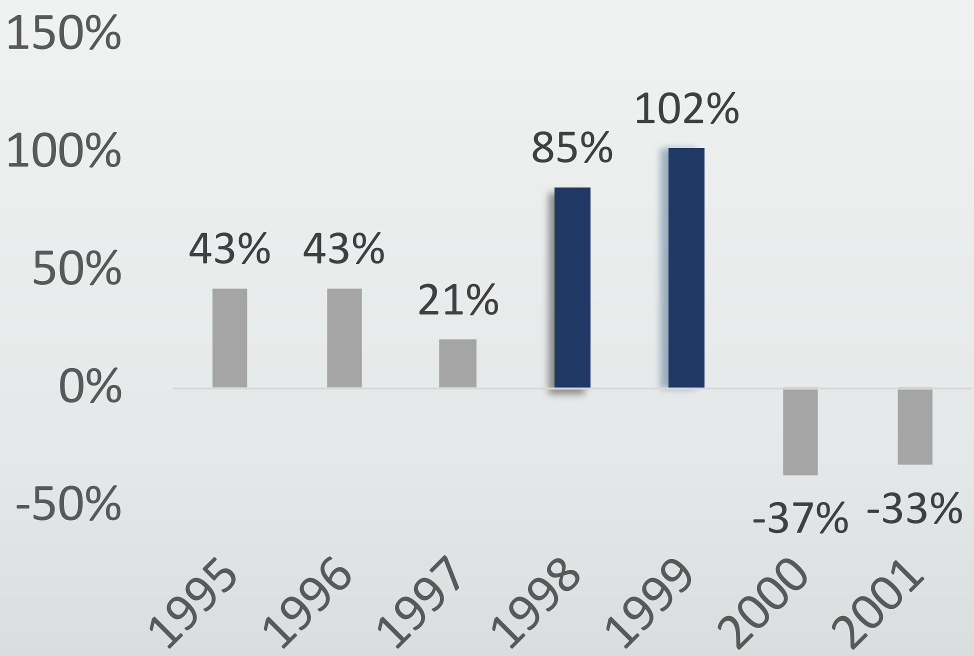
# Late Cycle Does not Mean it's the End of the Cycle. Sometimes the Best Returns Come at the End when Investors go 'all in'.

**We are in the Later Stages of the Business Cycle.**




Sources: http://welkerswikinomics.com

Remember when NASDAQ Stocks Rallied 187% in 1998 & 1999 Years After People Warned the Bubble Would Pop?



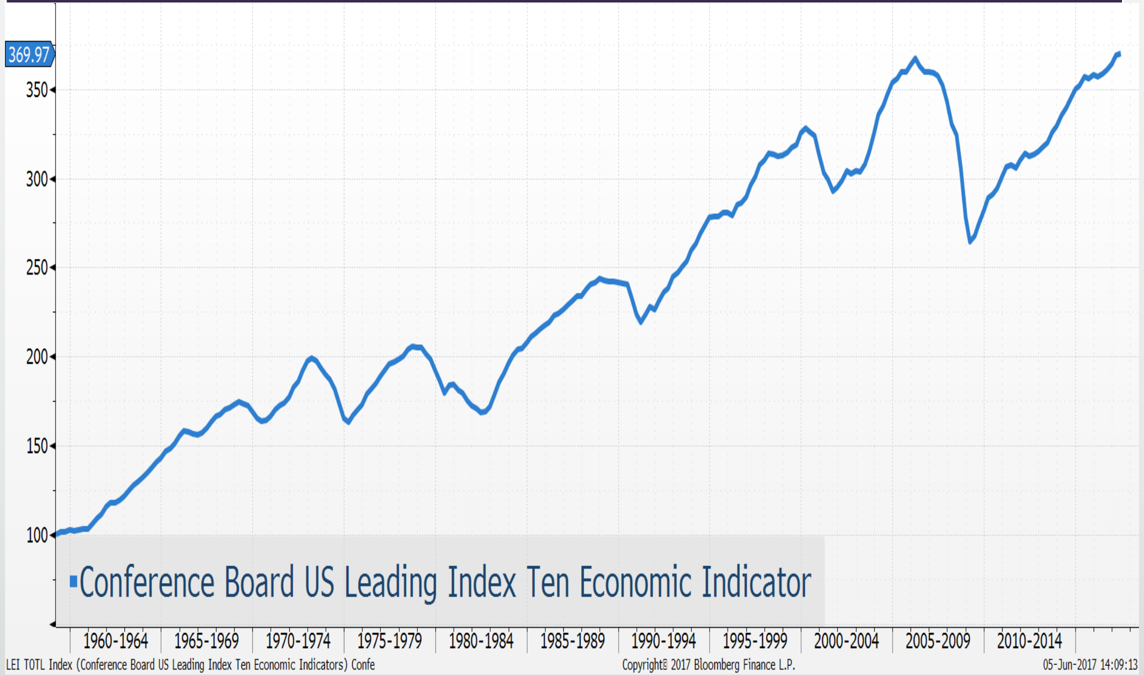

Source: Bloomberg, Astoria Portfolio Advisors LLC

# Equities Remain Attractive in the Context of Loose Financial Conditions, Low Interest Rates, and a Supportive Economic Backdrop.

## Chicago Fed National Financial Conditions Index is Near 20 Year Lows!


Sources: Bloomberg, Chicago Fed, Astoria Portfolio Advisors LLC

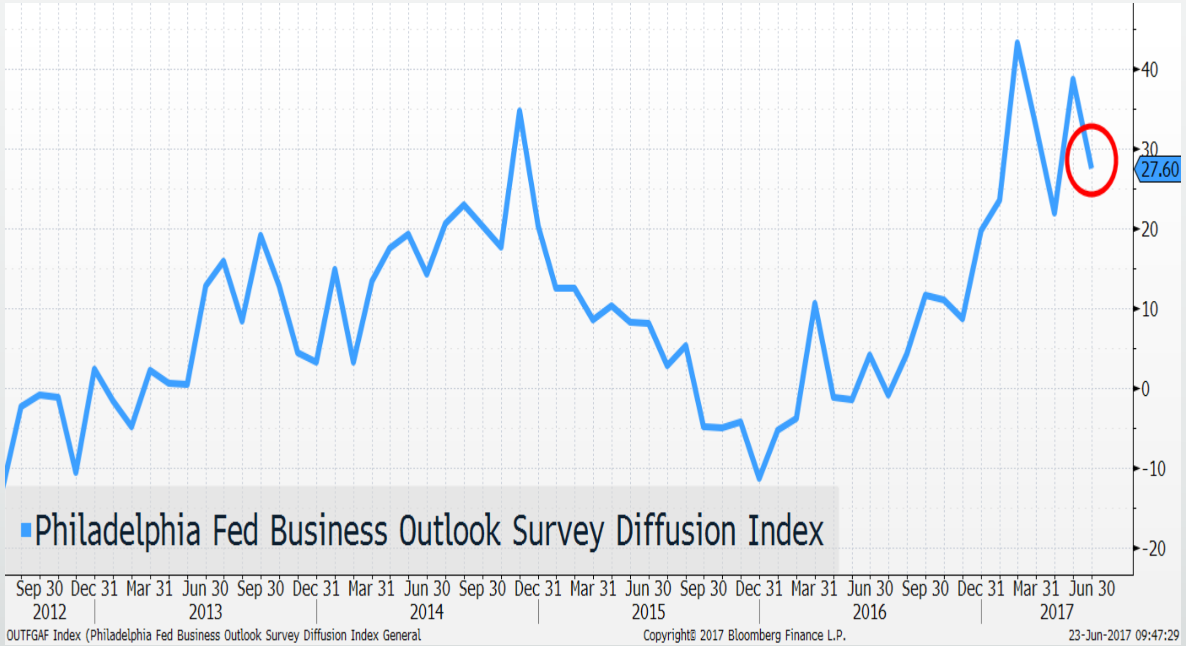
## Conference Board LEI is at 57 Year Highs!




Source: Bloomberg , Conference Board, Astoria Portfolio Advisors LLC

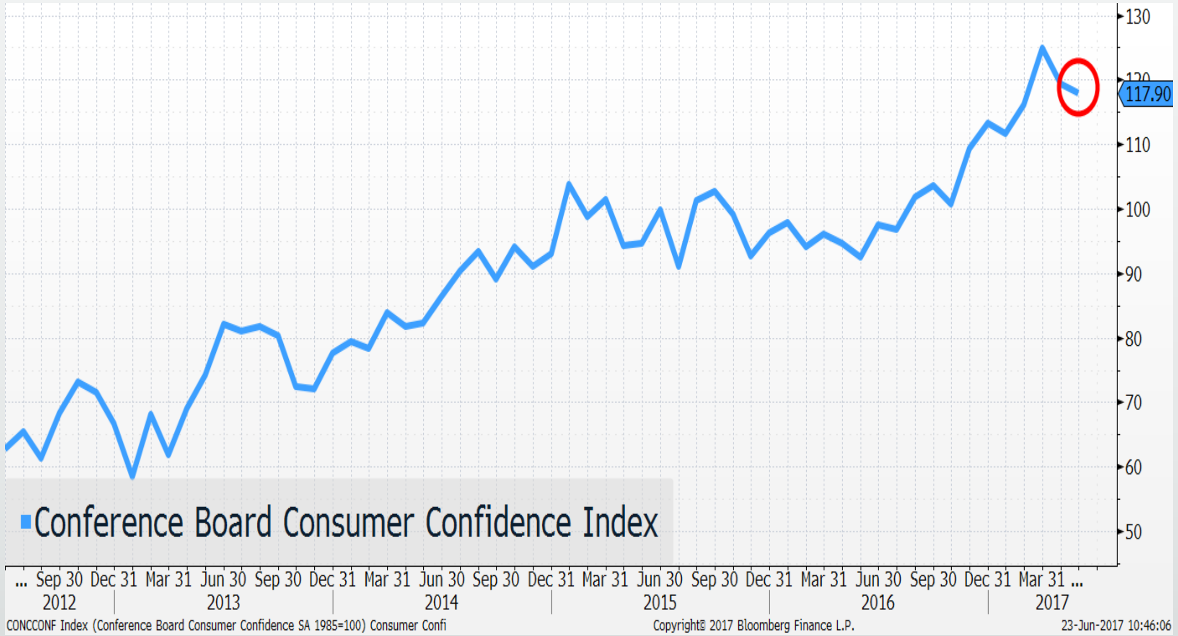
# Economic Outlook is Positive.

## Philly Fed Business Outlook Survey Diffusion Index is at 4 Year Highs.




Sources: Bloomberg, Philadelphia Fed, Astoria Portfolio Advisors LLC

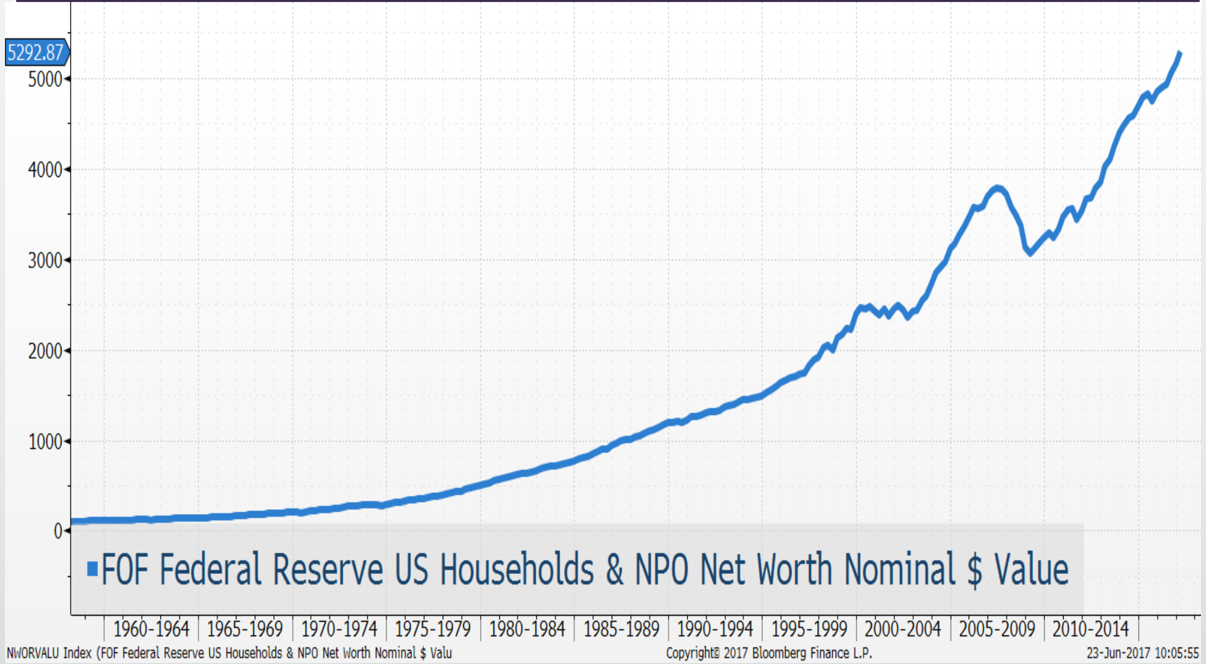
## Consumer Confidence is at 5 Year Highs.




Source: Conference Board, Astoria Portfolio Advisors LLC

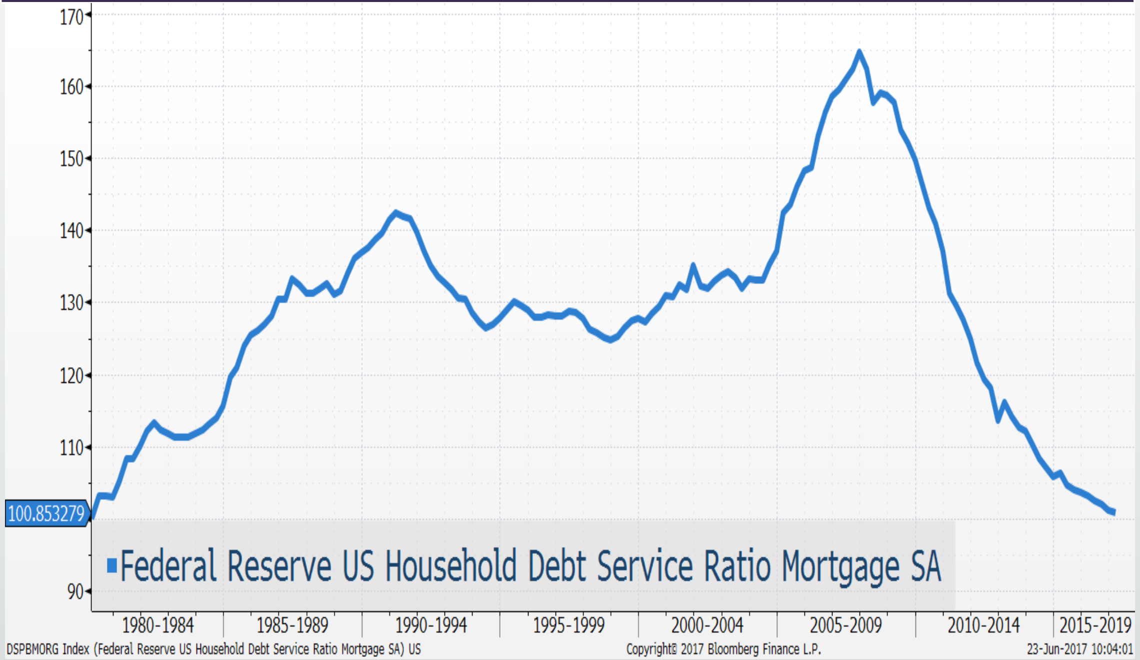
# US Households are in Excellent Shape.

## US Household Assets and Non Profit Organization Net Worth is at 57 Year Highs!




Sources: Federal Reserve, Astoria Portfolio Advisors LLC

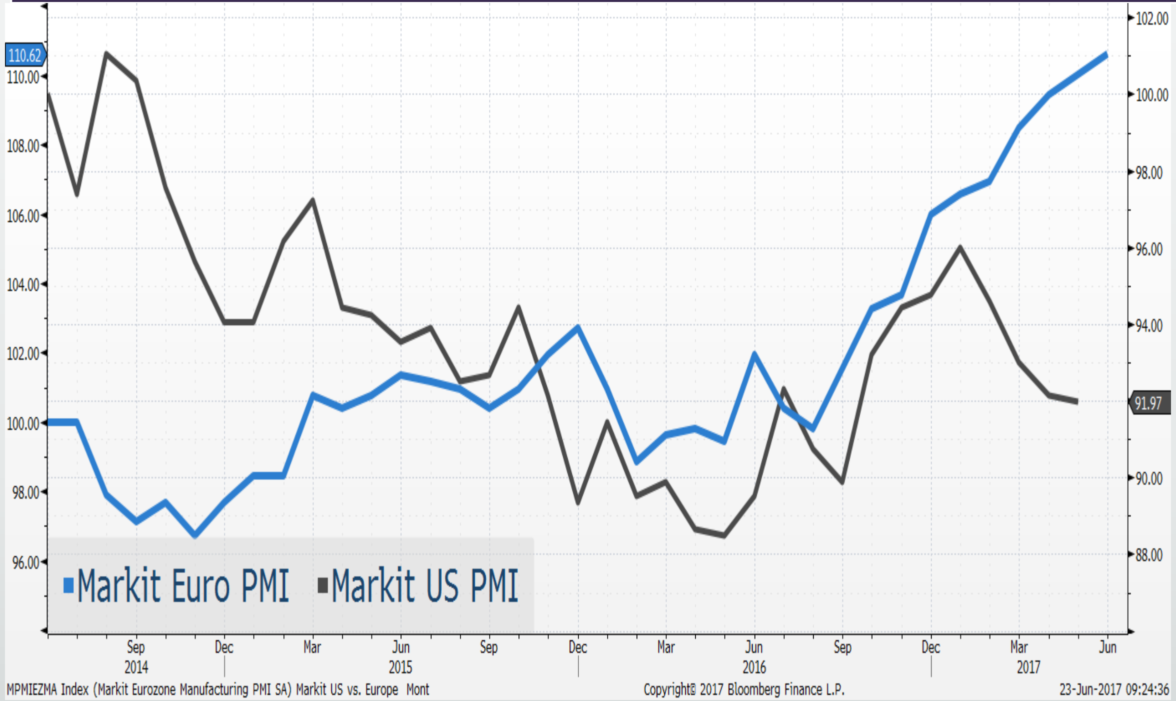
## US Household Debt Service Ratio is at 37 Year Lows!




Sources: Federal Reserve, Astoria Portfolio Advisors LLC

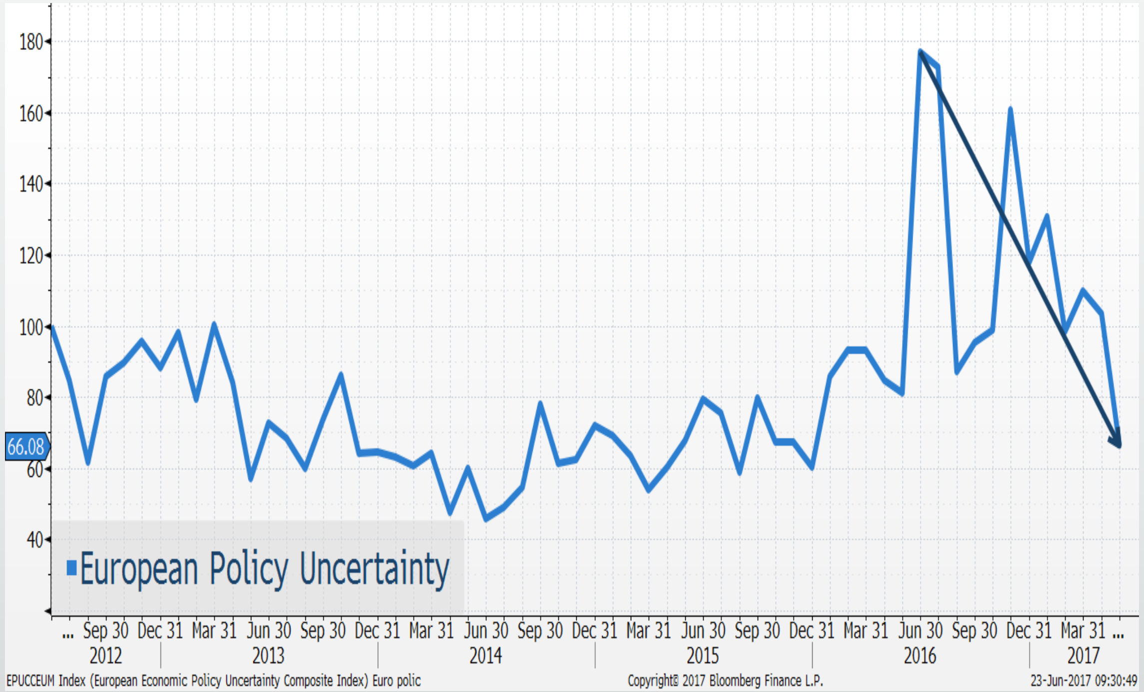
# Why the Strong Inflows into Europe? (1) Better Macro Data (2) Better Earnings and (3) Lower Policy Uncertainty.

## The Rate of Change in European PMI's is Higher than the US.




Sources: Bloomberg, Markit, Astoria Portfolio Advisors LLC

## European Policy Uncertainty has Declined Significantly Post French Elections



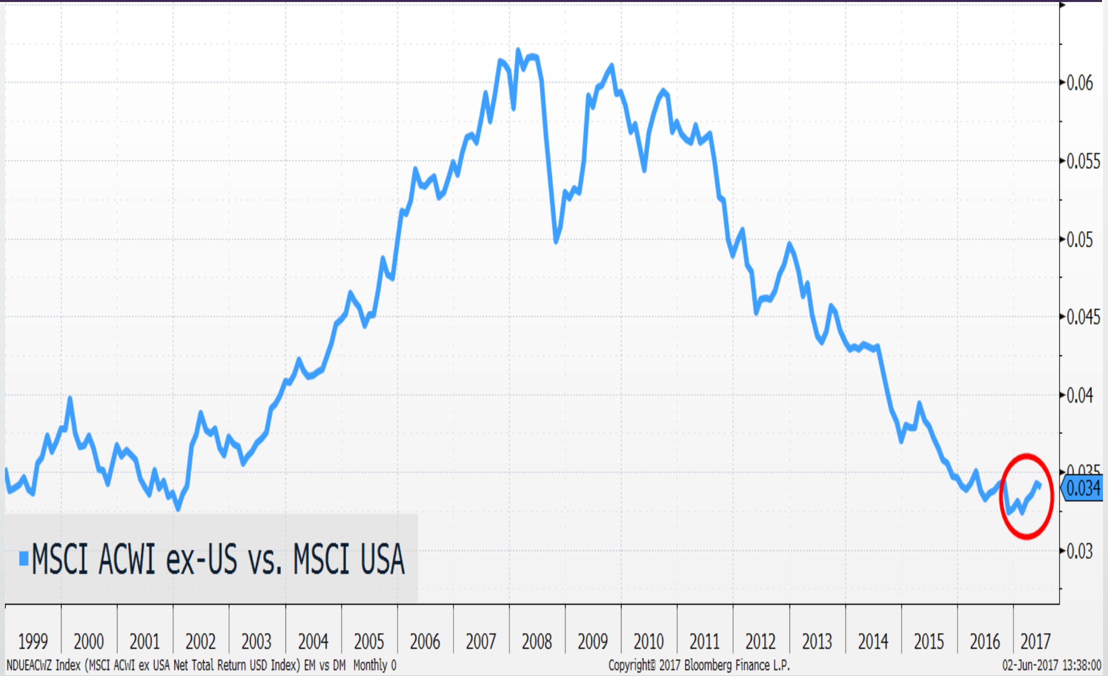

Source: Bloomberg, Baker, Bloom, and Davis, Astoria Portfolio Advisors LLC

# Investors are Focusing on the Reversal of the Trump Trade. However, the Bigger Story in '17 is the Global Earnings Recovery and the Change in Market Leadership.

## Rest of World Equities have Outperformed US Equities in 2017.

- Changes in market leadership often times go unnoticed.
- Nearly every global equity market produced positive returns in Q1.
- RoW equities are 2017's market leaders. Select YTD Returns: ASE Index (Greek) +28%, BKNFRR Index (Frontier) +19%, MXEF Index (EM Equity) +18%, WTEHIT Index (Europe Hedged) + 14%, S&P 500 +10%.

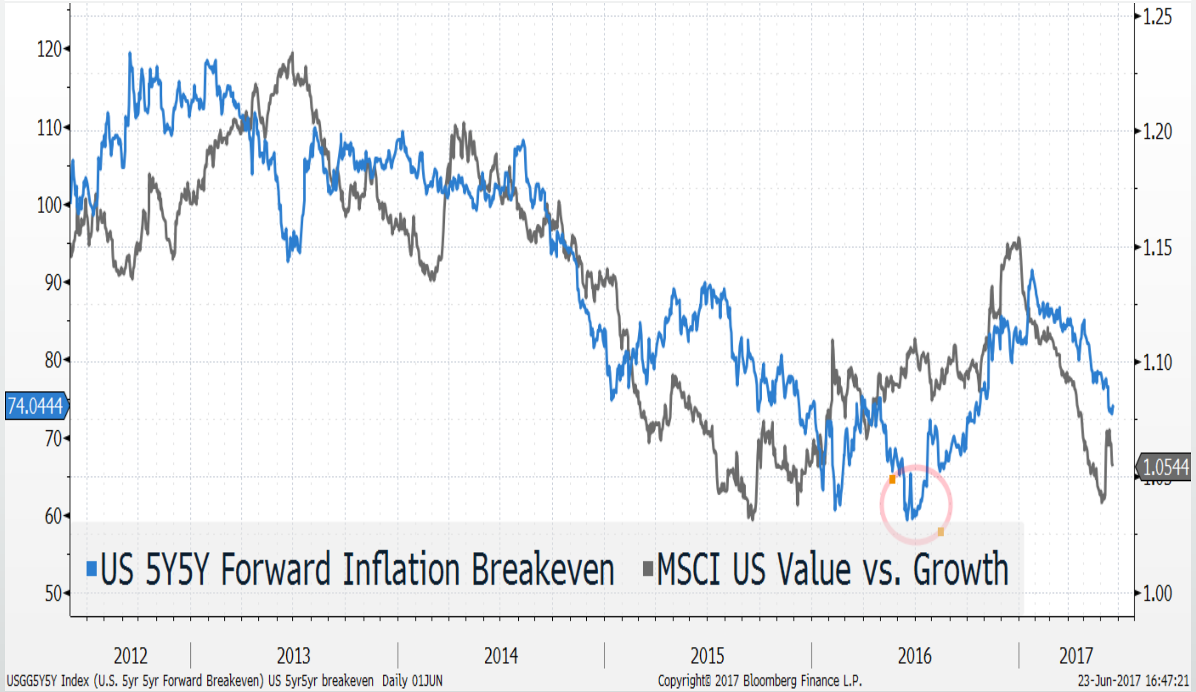
## After 7 Years of US' Relative Outperformance vs. the Rest of the World, Overseas Markets are This Year's Leaders




Source: Bloomberg, MSCI, Astoria Portfolio Advisors LLC

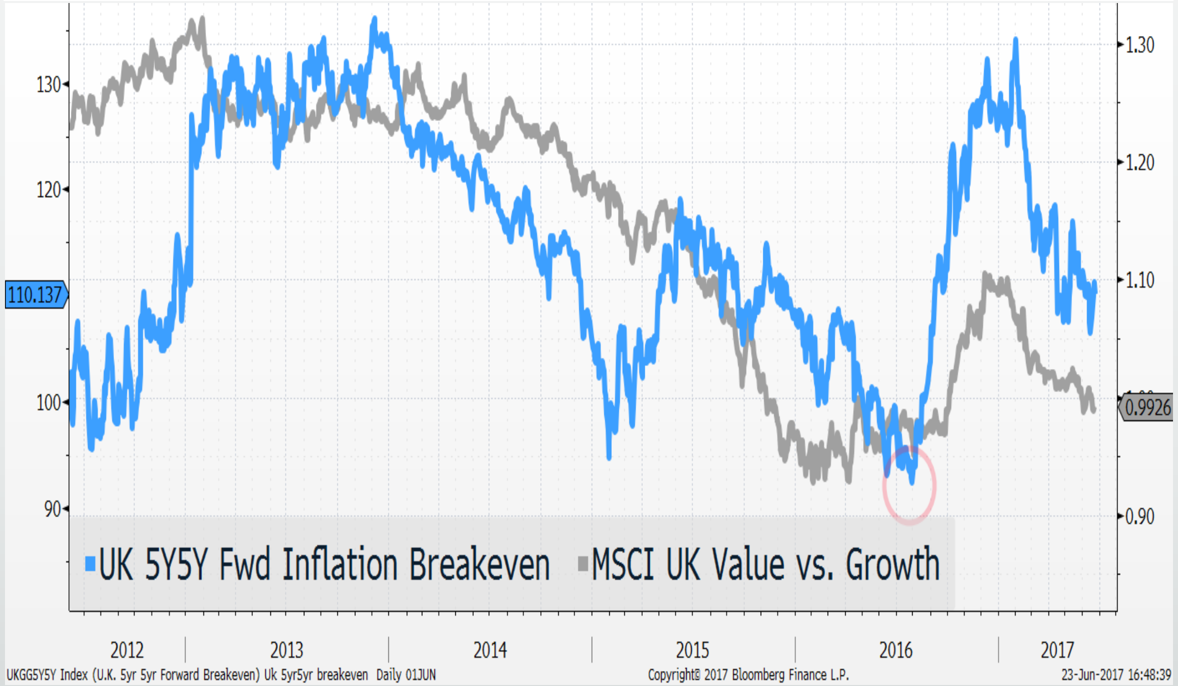
# The Decline in Inflation Expectations and Massive Rotation into Growth Stocks…..

## US Inflation Expectations troughed in Q1 '16 Post the Oil/Cyclical Recession of '15.




Sources: Bloomberg, MSCI, Astoria Portfolio Advisors LLC

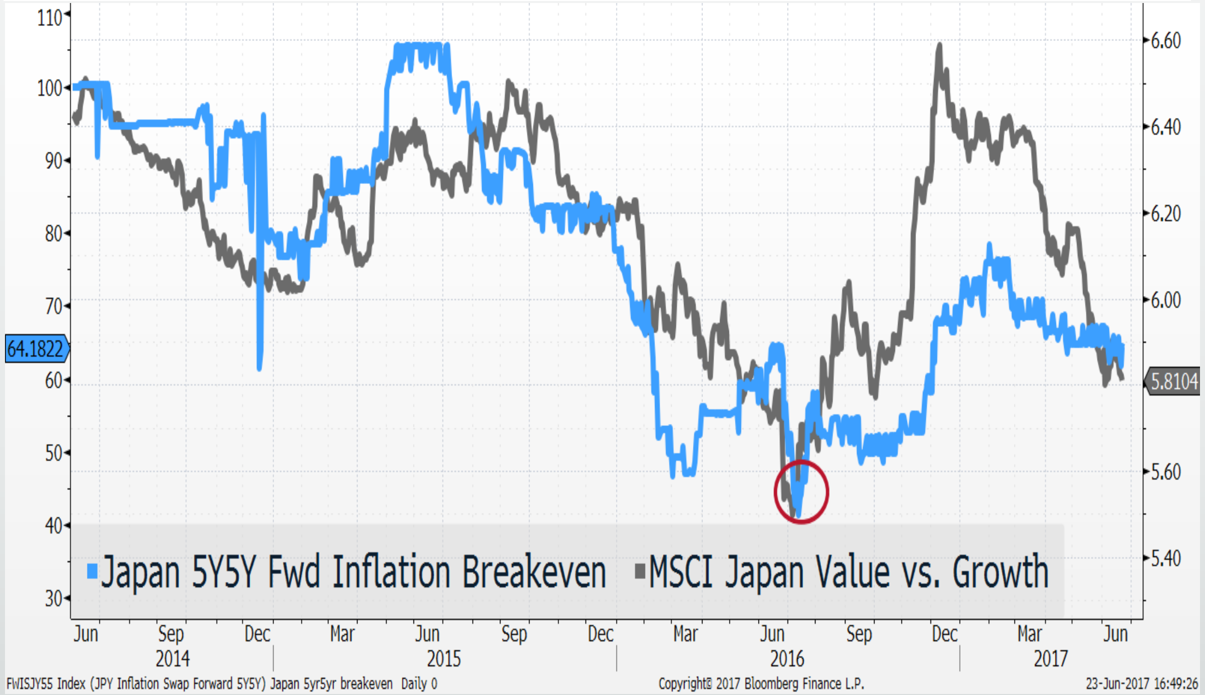
## UK Inflation Expectations Bottomed in July '16 Following Brexit.




Source: Bloomberg, MSCI, Astoria Portfolio Advisors LLC

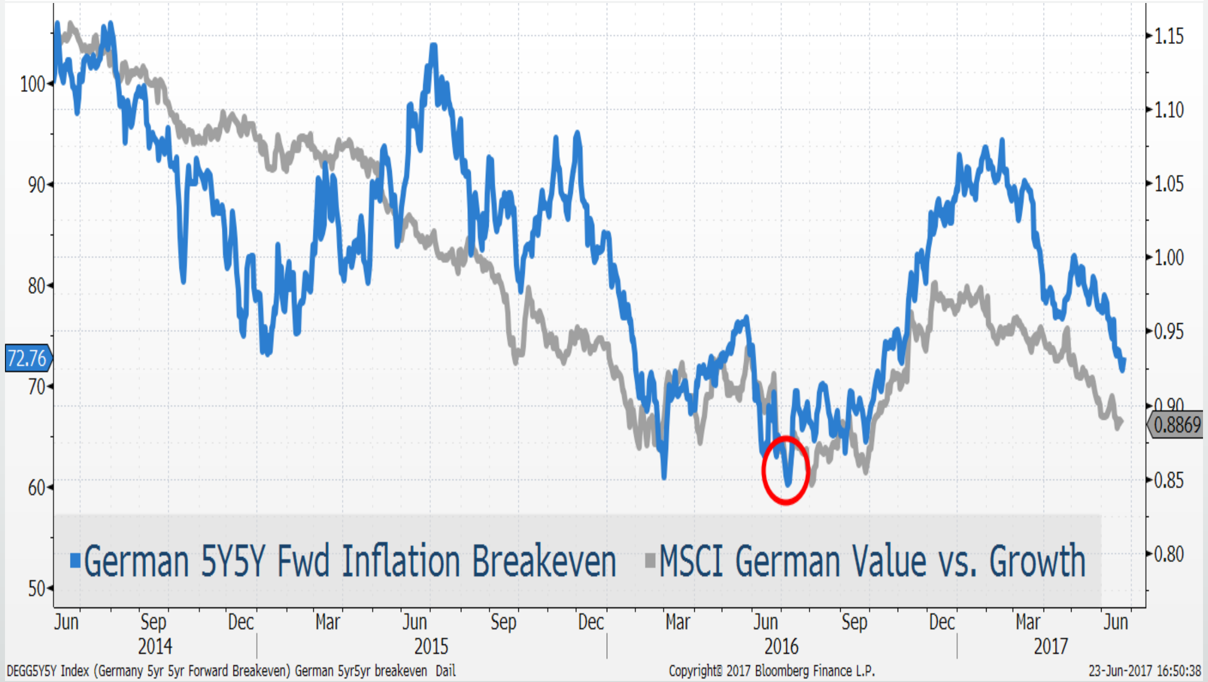
# …is Giving an Opportunity to Pick up Cheap Value Stocks on a Global Basis.

## Japan Inflation Expectations bottomed July ‘16 Following Brexit.




Sources: Bloomberg, MSCI, Astoria Portfolio Advisors LLC

## German Inflation Expectations Bottomed in July ‘16 Following Brexit.




Source: Bloomberg, MSCI, Astoria Portfolio Advisors LLC

# Importance of Using Game Theory.

| Common Misconceptions | Reality |
| --- | --- |
| "Investors should buy and hold." | Really? You would have experienced two 50% drawdowns since 2000. Given where we are in the economic cycle, active management is critical. |
| "We are living in a low growth world" | Ok, fine. But as an equity shareholder you should care about earnings growth and hence price appreciation. |
| "We are living in a low return world" | What on earth are they talking about? The S&P 500 has tripled since 2009, is up 60% in the past 4 years, and is +9% YTD. |
| "Yield, carry, and roll down strategies are attractive in this environment" | I certainly understand carry and roll down strategies which extract risk premia in asset classes where there are structurally inefficiencies but the yield trade has massively underperformed being long equity risk in this cycle. |

# What are we Concerned About?

## Risks

- Flattening yield curve potentially signaling a deflationary scare which equities markets aren't picking up
- Fed unwinding their balance sheet.
- Continued political gridlock causing additional weakness in inflation expectations, weaker dollar, flatter curves, etc.
- Central banks have $19 trillion of debt, up from $3 trillion in 2000.
- HY credit valuations are expensive and search for yield trade has forced inexperienced investors into this complex and highly illiquid asset class.

## Risks

- Japan and Europe owning a substantial portion of local equity and bond market. It is never a good thing when 1 investor owns an outsized portion of any market.
- Commodities rolling over.  Noble Group (Asian commodity supply chain manager) stock has fallen 87% YTD.
- Global Trade has recently rolled over.
- There is a tremendous amount of money linked to short volatility strategies. Although volatility remains depressed, the risk is being pushed to the tails.

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