



Economic Situation and Strategy

22 September 2023

Tactical allocation of the equity ratio: Between tree and bark

There are currently 1,000 reasons to be positive about stock markets. The peak of key interest rates globally has almost been reached. The anticipation of interest rates falling again (even if that could take some time) should fundamentally give stock markets a further boost, especially since profit expectations for 2024 and 2025 are quite positive. There is also much to suggest that the global economy will soon have reached its lower turning point; accordingly, the hope that the global economy will begin to recover - let's say in the next 12 months - should also have a positive effect on the price potential on the stock markets.

Stupidly, there are also a similar number of reasons for rather falling prices. This includes the plausible expectation that the quite positive profit expectations are over-ambitious and that a negative revision in the coming months and quarters is more than likely. The hope of falling interest rates and returns may also turn out to be deceptive once it becomes clear that if energy prices rise again, the decline in inflation will be more difficult than hoped.

Last but not least, there are also some more technical reasons for an upcoming correction. The (implied) volatilities in various indices are at extremely low levels, which can definitely be seen as a warning signal. Our in-house structural break indicator is also at an extremely low level. This can be seen as extreme calm and relaxation on the markets and initially sounds very good. However, if you consider that this indicator ultimately shows that investors are completely prepared for “business as usual”,

do not expect major upheavals and turbulence and are positioned accordingly, even smaller problems can lead to larger reactions on the markets.

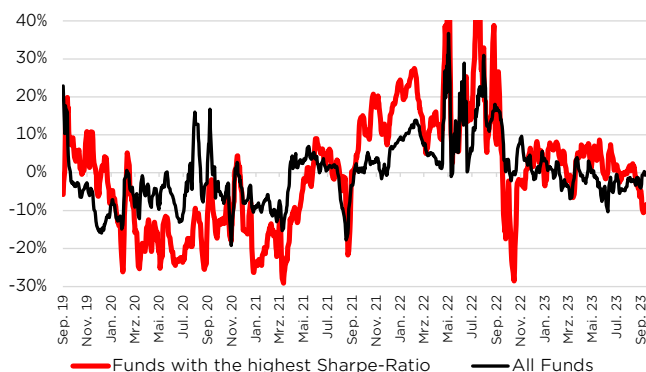
Nevertheless, it is not a good idea to offset the number of positive aspects with negative aspects. Asset management does not work like a tally list where you list the pros and cons. Ultimately, considerations and scenarios must also be supported by probabilities of occurrence in order to achieve valid results. And here, from our point of view, there is a lot to be said for leaning towards the positive perspective. However, it would be interesting to know whether we are alone in this consideration and positioning, or whether we are in good company here.

The funds that have been successful in the past are reducing their equity ratio

Our calculations suggest that with this slightly positive positioning, we at Warburg tend to represent a minority opinion. For the approximately 2,500 asset management funds that we evaluate, we come to the conclusion that, on average, these funds currently have an equity ratio that is extremely close to their respective historical averages. The funds that have been able to generate particularly good risk-adjusted returns in recent years have even reduced their equity allocation slightly in recent weeks, although this reduction has not been particularly large so far and is still within the usual fluctuations in tactical allocation. The equity ratios are not calculated using reports from the fund companies, because in many cases these are subject to a time delay. Instead, we analyze the price development of the funds and indirectly draw conclusions about the tactical allocation from the NAV trends. After all, the price development of a fund does not fall

from heaven, but is always the result of an investment in securities. The composition of these securities can be replicated indirectly using a mathematical procedure with a high degree of accuracy. It works as follows: An optimizer is “offered” a number of asset classes and markets with which he has to recreate the specific performance of a fund. This replication is subject to certain restrictions; for example, the sum of invested assets must not exceed 110% and the cash ratio must not exceed 30%. The task now is to reflect the actual development of a portfolio as best as possible by explaining the fund's performance over a period of, for example, 100 trading days, with as little deviation as possible through a suitable mix of assets and markets. This actually works extremely well in the vast majority of cases, but unfortunately it is comparatively computationally expensive. But if you don't shy away from this effort, you can get a fairly reliable picture of the tactical allocation of asset-managing funds almost in real time.

Equity quota of all asset-managing funds and the funds with the best Sharpe ratio in comparison to the long-term average



Now you could make it very easy for yourself and simply “recreate” the allocation of funds that were particularly good in the past. At times that would have worked very well. An example of this is the phase immediately before the Corona crisis on the stock markets in March 2020. At that time, the very good funds immediately before the collapse reduced their equity quota significantly more than the average of all funds. However, one should not believe that funds that have been particularly successful in the past generally have the license to outperform. This

can be shown quite well and clearly with the period immediately after the Corona crash. While the funds as a whole quickly settled back into an average equity ratio, the supposedly particularly “smart” funds were far too cautious for far too long. So there is no shame in being positioned differently than the funds that have historically delivered very good risk-adjusted returns. In addition, it is not the case that the funds that have received positive attention in the past represent a homogeneous set that is always positioned identically. Even though the majority of funds with a historically good risk-adjusted return have reduced their equity ratio, there are still many funds that have done the opposite. So we are not alone with our moderately optimistic attitude. For this reason, you shouldn't allow yourself to be guided too much by such evaluations - it's more about understanding fundamental trends in tactical allocation in order to then compare your own opinion with them and, if necessary, critically examine them. If there are good and valid reasons to deviate from the tactical mainstream, then there is nothing wrong with doing exactly that. That is the meaning of active management!

Good funds are more tactically active

There is still something that can be learned structurally from funds with historically good Sharpe ratios and therefore a good risk-adjusted return: As the graphic on the left shows, the successful funds are significantly more active in their tactics than the average. What is already visually striking can also be clearly understood statistically: the standard deviation of the deviation from stock-benchmark ratios for the historically particularly good funds is about twice as high as the average for all funds. So activity pays off - but of course only if you are mostly on the right side of your decisions. This is sometimes easier and sometimes harder. At the moment it is rather more difficult and we lack the confidence to position ourselves significantly more “aggressively” on the stock market. As the saying goes, you're a bit between tree and bark.

Dr. Christian Jasperneite

Market data

Stock markets	As of	Change versus				
	22.09.2023 08:15	15.09.2023 -1 week	21.08.2023 -1 month	21.06.2023 -3 months	21.09.2022 -1 year	30.12.2022 YTD
Dow Jones	34070	-1,6%	-1,1%	0,4%	12,9%	2,8%
S&P 500	4381	-1,6%	-0,4%	0,4%	15,6%	14,1%
Nasdaq	13224	-3,5%	-2,0%	-2,1%	17,9%	26,3%
DAX	15572	-2,0%	-0,2%	-2,8%	22,0%	11,8%
MDAX	26575	-2,7%	-1,6%	0,0%	11,2%	5,8%
TecDAX	3008	-3,3%	-1,5%	-4,5%	7,2%	3,0%
EuroStoxx50	4213	-1,9%	-0,3%	-2,5%	20,6%	11,0%
Stoxx 50	3956	-1,6%	1,6%	-0,3%	14,4%	8,3%
SMI (Swiss Market Index)	11085	-1,0%	2,2%	-0,8%	6,3%	3,3%
Nikkei 225	32571	-2,9%	3,2%	-3,0%	19,3%	24,8%
Brasilien BOVESPA	116145	-2,2%	1,5%	-3,6%	3,8%	5,8%
Russland RTS	988	-4,0%	-6,5%	-6,6%	-10,7%	1,8%
Indien BSE 30	66261	-2,3%	1,6%	4,3%	11,4%	8,9%
China CSI 300	3726	0,5%	-0,1%	-3,6%	-4,5%	-3,7%
MSCI Welt	2886	-2,5%	-0,8%	-1,4%	14,7%	10,9%
MSCI Emerging Markets	956	-2,9%	-0,4%	-4,8%	2,6%	0,0%
Bond markets						
Bund-Future	129,60	-71	-92	-382	-1160	-333
Bobl-Future	115,85	-40	86	1	-445	10
Schatz-Future	104,90	-11	1	-10	-217	-53
3 Monats Euribor	3,93	28	28	54	282	204
3M Euribor Future, Dec 2023	4,01	0	5	1	103	40
3 Monats \$ Libor	5,66	-1	2	12	205	89
Fed Funds Future, Dec 2023	5,44	1	0	16	126	79
10 year US Treasuries	4,50	17	15	78	99	66
10 year Bunds	2,74	9	6	31	85	18
10 year JGB	0,75	5	10	37	49	33
10 year Swiss Government	1,08	1	1	11	-22	-53
US Treas 10Y Performance	566,14	-1,2%	-0,8%	-5,2%	-4,4%	-2,4%
Bund 10Y Performance	529,98	-0,6%	-0,1%	-1,7%	-4,3%	0,9%
REX Performance Index	428,60	-0,6%	-0,5%	-1,1%	-3,7%	-0,9%
IBOXX AA, €	3,89	7	2	18	74	30
IBOXX BBB, €	4,71	6	2	11	38	1
ML US High Yield	8,82	21	5	16	5	-15
Convertible Bonds, Exane 25	6620	0,0%	0,0%	0,0%	3,0%	0,0%
Commodities						
MGBase Metal Index	378,94	-2,1%	0,9%	-2,4%	-0,7%	-9,4%
Crude oil Brent	93,70	-0,4%	10,9%	21,5%	4,3%	10,3%
Gold	1925,01	-0,2%	1,9%	-0,3%	15,4%	6,0%
Silver	23,32	0,6%	0,7%	2,5%	19,8%	-1,8%
Aluminium	2170,40	1,1%	3,6%	-0,5%	-0,3%	-7,6%
Copper	8129,75	-2,6%	-1,3%	-5,5%	4,9%	-2,8%
Iron ore	121,69	0,3%	14,3%	7,8%	23,4%	9,4%
Freight rates Baltic Dry Index	1569	13,6%	28,3%	37,9%	-10,1%	3,6%
Currencies						
EUR/ USD	1,0647	-0,1%	-2,4%	-2,5%	7,5%	-0,2%
EUR/ GBP	0,8669	0,7%	1,4%	0,8%	-0,6%	-2,3%
EUR/ JPY	157,76	0,2%	-0,9%	1,9%	10,6%	12,2%
EUR/ CHF	0,9632	0,8%	0,5%	-1,7%	0,9%	-2,2%
USD/ CNY	7,3036	0,3%	0,2%	1,7%	3,6%	5,8%
USD/ JPY	147,60	-0,2%	1,0%	4,0%	2,5%	12,6%
USD/ GBP	0,81	1,0%	3,7%	3,7%	-7,7%	-2,0%

Source: Refinitiv Datastream

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