

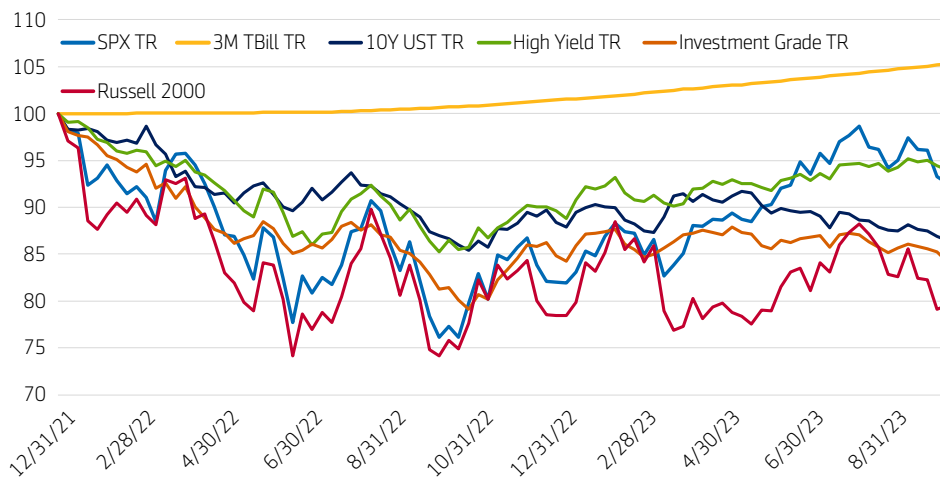
AEGON INSIGHTS

Regime investing: Defense wins championships

With autumn upon us, not only do the leaves start turning but it also means we are in the throes of American football season. Given the continued Fed regime of monetary tightening, we find the old football axiom “defense wins championships” quite apropos for strategic asset allocation.

Since the Fed signaled back in December 2021 its intention to finally begin tightening monetary policy, owning risk has been an uphill battle. As illustrated in the chart below, the ultra-short duration “risk-free” T-Bills have been the best-performing asset, even more so on a risk-adjusted basis.¹

Exhibit 1: Asset Class Returns - 12/31/2021 - 9/29/2023



Source: Bloomberg

We believe this defensive tilt will likely continue to outperform until a genuine pivot to a rate-cutting regime is clearly signaled (note: a pause is not a pivot). Why? Cash rates north of 5% not only represent a steep hurdle rate both for risk assets and capital investment, but also sharply increase the cost of debt financing. This is not a big surprise as it is exactly what restrictive monetary policy sets out to accomplish and why it is so successful in slowing down the economy and taking the froth out of asset prices. Small-cap equities are one of the asset classes most affected by this policy and hence it is no surprise that it has been one of the biggest underperformers.



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Frank Rybinski, CFA, is head of macro strategy responsible for guiding the firm's global macroeconomic view as it pertains to tactical and strategic asset allocation. This includes analysis of the economy, interest rates, and the relative value between asset classes. In this capacity, Frank frequently appears in leading financial media outlets like Bloomberg, CNBC, Fox Business and the Wall Street Journal. Prior to his current role, Frank was a credit strategist for UBS Investment Bank. Prior to that, he worked as an analyst for ZT Zurich Trust in Zurich, Switzerland. Frank began his career as a trader for Spear, Leeds & Kellogg and held a similar position at The Royal Bank of Scotland. He has been in the industry since 1996 and started with the firm in 2008. Frank received his BA in economics from Boston College. He is a CFA® charterholder.

¹Risk-free refers to an asset (such as Treasuries) where the return of principal is, in theory, guaranteed. US Treasuries are often perceived as “risk-free” because they are backed by the full faith and credit of the US government. All investments contain risk and may lose value.

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While defense has clearly been the bias in this regime, it doesn't mean you can't make money owning risk—just that your timing needs to be more precise since you are swimming upstream. This brings up an important differentiation: strategy versus tactics. While strategy is the over-arching construct or scaffolding used in identifying the optimal risk tilt and inter-market allocation for the current regime, tactics focus on the ability to maximize intra-market discrepancies and nuances. Case in point: While cash has been the best asset class in this regime, one could still make money by correctly reading the episodic sentiment shifts and technical tea leaves of specific markets and timing actions accordingly. Metaphorically, strategy is like a supertanker, while tactics more resemble a cigarette boat. Our cheeky metaphors aside, we'll close with a quote from Sun Tzu's seminal treatise "The Art of War":

“Strategy without tactics is the slowest route to victory.

Tactics without strategy is the noise before defeat.”

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