
Flexible Allocation: Environment and Portfolio Positioning

Ken Raguse, CFA, Portfolio Manager

Steve Wachtel, CFA, Portfolio Manager

Tim Ruiz, Portfolio Manager

Environment

- After moving significantly higher for two consecutive months, equity markets reversed course in December, with the S&P 500 falling 5.77%
 - The yield on 10-Year US Treasuries rose 27 basis points to 3.88%, contributing to the 0.45% decline in the Bloomberg U.S. Aggregate Bond Index

 - **Economy** – slowdown occurring / mild recession most likely
 - Inflation: continued to decline from peak levels
 - Reflected in November and December CPI report
 - Federal Reserve: slowed the pace of rate hikes to 50 basis points in December
 - Additional rate hikes are likely to be limited, with the pace possibly slowing to 0.25% and a pause coming sooner rather than later
 - How quickly will they pivot if inflation slows further and/or economy weakens significantly?
 - Economic data generally weaker
 - Real GDP should be positive for Q4 but growth is expected to slow, and could turn negative, in 2023
 - Most employment indicators remain healthy, although there are signs of a modest slowdown in some areas
 - Earnings estimates have been declining and corporate profits may turn down in the fourth quarter or early in 2023
 - Globally, China reversed their zero-covid policy and economic activity is expected to strengthen, while Europe has stabilized and may be able to avoid a recession

 - **Market Trend** – pulled back in December
 - Longer term support levels in place
 - Significant \$ remain on the sidelines

 - **Valuation** – attractive (especially certain segments)
-

Portfolio Positioning

- SSI's disciplined process and "constrained" approach helped Flexible Allocation portfolios limit drawdowns
- Although markets pulled back in December, the investment environment has become more constructive over the last couple months
 - Portfolio is no longer defensively positioned
 - Equity allocations remain steady and close to relevant benchmarks
- **Equity** portfolio generated returns similar to the S&P 500
 - Reduced energy position (XLE), which helped returns throughout 2022
 - Increased international equity position (VXUS / HEFA)
- **Fixed Income** portfolio held up relatively well, outperforming the Bloomberg Aggregate Bond Index
 - Given the highly volatile rate environment, we continue to focus on fixed income securities with limited interest rate sensitivity
 - Outlook for fixed income has improved significantly with mid-to-high single digits available across many fixed income market segments
- **Alternatives** outperformed the remainder of the portfolio
 - Convertibles offer attractive risk/reward - opportunity for upside participation combined with the potential for downside protection
- If the environment continues to improve, the portfolio will be adjusted to further capitalize on opportunities and participate in market upside

© 2023 SSI Investment Management LLC

SSI Investment Management LLC believes all the information contained in the report to be accurate but we do not guarantee its accuracy. The analyst(s) principally responsible for the preparation of this research report certify that the views expressed in this research report accurately reflect his/ her (their) personal views about the subject security (ies) or issuer(s) and that his/ her (their) compensation was not, is not, or will not be directly or indirectly related to the specific recommendations or views contained in this research report. None of the information reported or opinions expressed constitute a solicitation of the purchase or sale of securities or any commodities.

SSI operated under the name of SSI Investment Management, Inc. (1/1/1973-4/30/2019) and as of 5/1/2019 operates as SSI Investment Management LLC