A Nuanced Macroeconomic Approach to Investing

[The crunching and evaluating of statistics can lead to vastly different outcomes depending on one's mindset, approach, or biases coming into the equation. When the equation is determining the health and direction of the economy, the task encompasses a great deal of complexity, ambiguity, and noise to shift through. Learning how asset managers distill economic data into informed courses of action is an important topic for investors to be aware of.

When the economy and markets are clearly surging, defensive investment strategies may not be popular but when we are in the inevitable cyclical or disruptive periods of uncertainty or at inflection points of change, it may be prudent to diversify into more risk managed strategies that focus on the macroeconomic forces that drive the everchanging dynamics of the markets.

To learn more about macro investing, we reached out to **Bryan Novak**, CEO of Astor Investment Management – a Chicago-based investment advisor focused on tactical macroeconomics-based asset allocation – that constructs risk-managed portfolios across separately managed accounts, mutual funds, and model delivery arrangements, including their flagship Astor Dynamic Allocation Strategy and their Astor Active Income Strategy. Astor gathers and assesses economic data for a comprehensive view of the relative strength or weakness of the U.S. economy and to generate a singular proprietary economic indicator - The Astor Economic Index® – which provides a roadmap for market exposure. We asked them questions to better understand how they keep their finger on the pulse of the economy and translate economic information into investing insights.]

Hortz: ***How did you arrive at your decision to focus your investment strategy on a purely top-down tactical macroeconomic approach? Can you share what informed and led you to this investment methodology?***

Novak: The decision to focus on a top-down macroeconomic approach is based on the observation that macroeconomics matter most for risk aware investors. So, what does this mean? Equity markets are a positively sloped asset class over the long haul. But they do experience periods of substantial underperformance of the long-term average return, and even bouts of large drawdowns. Some of these drawdowns approach wealth destroying levels.

What our research, in building this approach, found was that these large drawdown periods are almost always accompanied by weak, deteriorating macro-economic conditions. And since Astor started this over two decades ago, we have continued to observe this fact. Our models were built to ascertain trends in the meaningful data points that provide a true, measurable direction in the macro-economy.

This approach was validated in real time by the 2007-2008 Global Financial Crisis, which was a shock to risk assets. Astor was well positioned, as the crisis had been preceded by a weakening in economic data. The opposite also holds true. When the equity markets struggle against a backdrop of stable macro conditions, we have found that these tend to resolve much easier.

The decision of what portion of your portfolio to have in equities or bonds is far more meaningful in a top-down analysis than a bottom up, stock by stock approach to the average investor, and that decision is highly influenced by the macroeconomic outlook. As a result, understanding macroeconomic developments and their relevance for asset allocation is where we spend our time.

Hortz: ***How would you compare and contrast your macroeconomic investment strategy versus other tactical or macro managers? How does your Astor Economic Index further differentiate you?***

Novak: Tactical is a particular mindset in investing, with a major focus of the approach on risk management. Tactical investing relies on signals to make adjustments. These either come from market/asset class price movements or from fundamental data. Either way, there needs to be some measurables that a.) equate to a discernable trend and b.) have a trigger point of adjustment.

Our approach varies substantially compared to market price influenced tactical managers. Markets and the macro economy tend to move together over a business cycle, but in the short term there is a lower correlation. Market-price based indicators are susceptible to whipsaw impacts from directionless or volatile markets that are noisy. While slower to move, macro-based tactical strategies are much less susceptible to noisy market whipsaw impacts in the short term.

We are data driven and allow systematic models to guide our decision making wherever possible. The end result of our research process is called the **Astor Economic Index®** which is our proprietary reading of the U.S. economy and the cornerstone of our investment process. Unlike some tactical investors whose investing framework may change rapidly, we let the data and facts come to us, and apply a rigorous, nuanced, and validated approach.

Hortz: ***Can you further explain in more detail your view of "Nowcasting" versus traditional "Forecasting"? How does that distinctive perspective inform or guide your analysis of economic data?***

Novak: Forecasting recessions is something of a paradox. If, for example, we could predict recessions in advance with any reliability, policymakers could act to prevent them, and recessions would never occur. This example illustrates the difficulty of forecasting economic trends far in advance.

Instead, we do what is called "nowcasting", which takes the data as we have it today, and aggregate it to form a composite picture of the economy right now. Unlike those who are laser focused on specific sectors or factors, like the labor market, we believe that this differentiated approach lets us see the forest, rather than just the trees.

We monitor and evaluate this data on regular intervals. By continuously obtaining these aggregate, composite views, we can also evaluate the trend to get an informed perspective on where the economy may be going.

Hortz: ***How do you apply your investment methodology to your tactical unconstrained Astor Income Strategy? Do you look for or read economic data differently for the fixed-income versus the equity markets?***

Novak: Our approach to fixed-income investing in our income strategy retains the same fundamental beliefs as in equity asset allocation. Specifically, we think that economic data is the most important north star when choosing a fixed income allocation.

We adjust fixed income by using two levers: credit and duration. As the economy strengthens, we seek greater yield in lower credit sectors, and seek refuge in government securities during worse times. As inflation increases and monetary policy tightens, we look to shorter duration or floating rate exposure, and extend duration when the economy softens or monetary policy looks set to soften.

While equities tend to get the "press" of tactical or asset allocation shifts, the last few years proved meaningful in making tactical shifts WITHIN the fixed income asset class as well. Duration exposure was probably the #1 influence on fixed incomes portfolio returns in 2022-2023. It also had meaningful impacts on balanced asset allocation portfolios where fixed income makes up a substantial share.

Hortz: ***What does your research and Astor Economic Index say about the equity and bond markets right now in early 2024? What areas are you focusing on in your asset allocation decisions?***

Novak: Our data continued to show that the economy was healthy throughout 2023, a time during which the broad consensus was for an imminent recession and Fed rate cuts. As a result, we entered 2024 with a moderate exposure to equities and the bulk of our fixed income in short duration and high yield credit.

We believe that the risk-reward of longer duration assets is now more balanced than before – that is, we think that markets are more accurately pricing Fed policy, and thus long duration fixed income is less rich than it has been in the past year.

We see a cooling economy, but with no imminent recession. We continue to think that inflation will come slowly back towards target, but with considerable volatility. We are highly focused in finding differentiated sources of income for our fixed income allocation, as well as spreading risk in our equity allocation. Here is our recently published economic update for 2024 to share some of our current research and perspectives.

Hortz: ***What are your thoughts on how financial advisors, RIAs, and institutional asset allocators can employ your investment approach in their client portfolios?***

Novak: We suggest that the right way to think about Astor strategies in a portfolio context is the rudder of a ship. The core, strategic exposure of the portfolio sets the course or direction, but the strategy will adjust the rudder depending on the prevailing macro-economic winds. The overall direction remains, but the adjustment the Astor strategies can make are designed to lessen the impact of adverse market conditions related to changes in the macro-cycles.

Dynamic Allocation like ours pairs with a multitude of core portfolio exposures. It begins with a balanced risk outlook (approximately 55/45 equity/non-equity). The majority of client portfolios fall in the balanced risk to moderate risk categories. Starting with this outlook, the strategy complements static or strategically positioned portfolios in this category very well. For higher risk profile clients, the strategy can be a risk-aware tool to pair back equity exposure when economic cycles appear to be changing or markets appear richly valued. For low-risk clients, a modest allocation to this strategy can provide investors with mindful access to market risk that can be reduced should conditions warrant.

Active Income has historically provided returns in line with core bond exposure (as measured by the Bloomberg U.S. Aggregate Bond Index), with lower volatility. However, in recent years when adverse moves in interest rates have created chaos for fixed income, the strategy was able to substantially mitigate losses and volatility caused by excessive duration risk. The risk and return characteristics of the strategy provide it with the ability to be a core complement for portfolios allocated predominantly to fixed income, as well as portfolios with balanced allocation (equity/fixed income).

Hortz: ***Are there any particular issues that your investment strategies can help advisors address right now?***

Novak: With inflation and interest rate direction still up for debate, many investors are looking for guidance and an active eye on the key factors that will determine fixed income returns - duration and credit. Active Income focuses squarely on these two factors, having made substantial adjustments to interest rate exposure over recent years to help manage exposure through rising rates. With short rates likely peaking for this cycle, the next move is most likely down. However, inflation remains above the Fed's target, complicating rate cut expectations and the magnitude of these cuts in 2024.

As to equity market returns and the economy**,** markets continue to print new highs even as the outlook for rates is uncertain. There are certainly concentrated segments that have benefited the most, like large cap tech and AI-focused plays. While the economy is stable, there have been some perceived signs of softening, such as recent labor market data. This is directly related to the consumer strength that has no doubt carried the economy. Any potential threat to this arena has to be taken seriously. Our strategies are squarely focused on the data we think matters to this dynamic, and the economy overall.

other information are in the prospectus, which can be obtained through https://astorim.com/strategies/. Please read the prospectus carefully before you invest. Investing involves risk including the possible loss of principal.

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