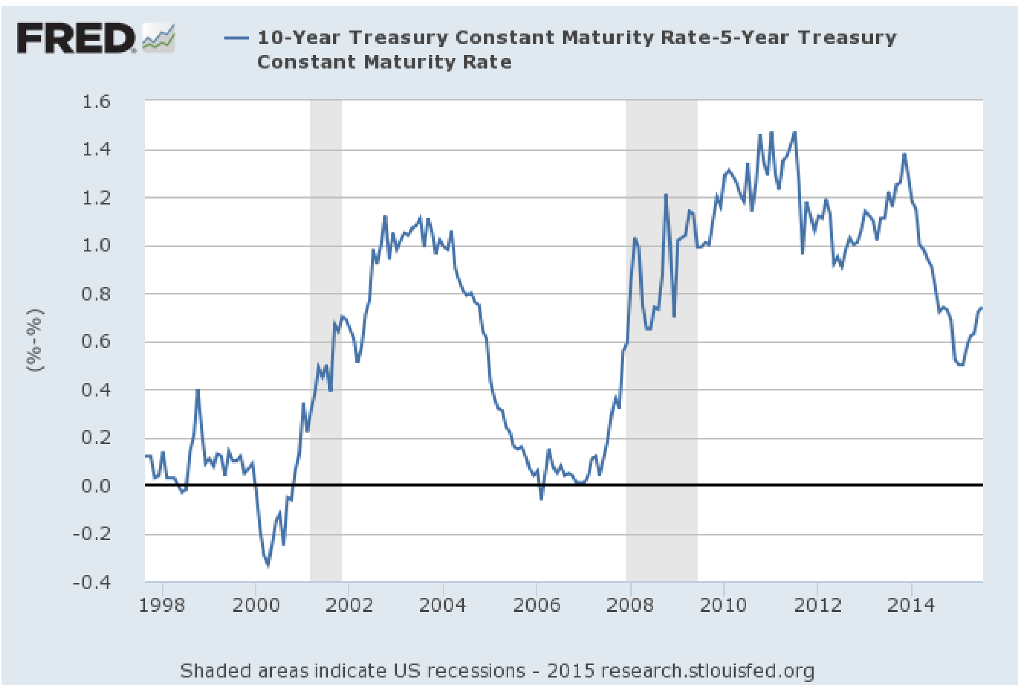
Alhambra Investment Partners

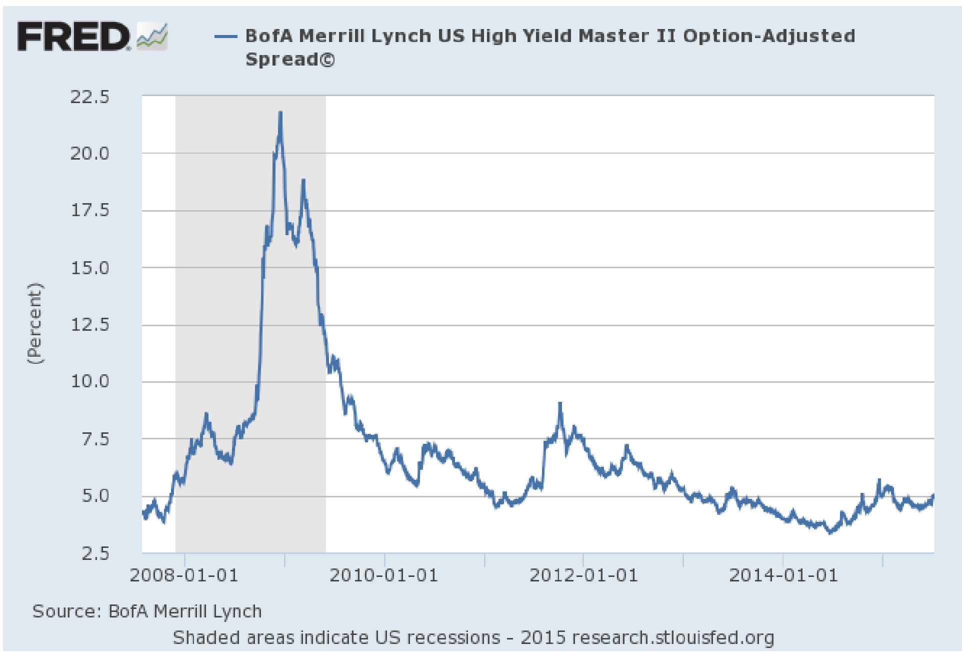
GLOBAL ASSET ALLOCATION UPDATE

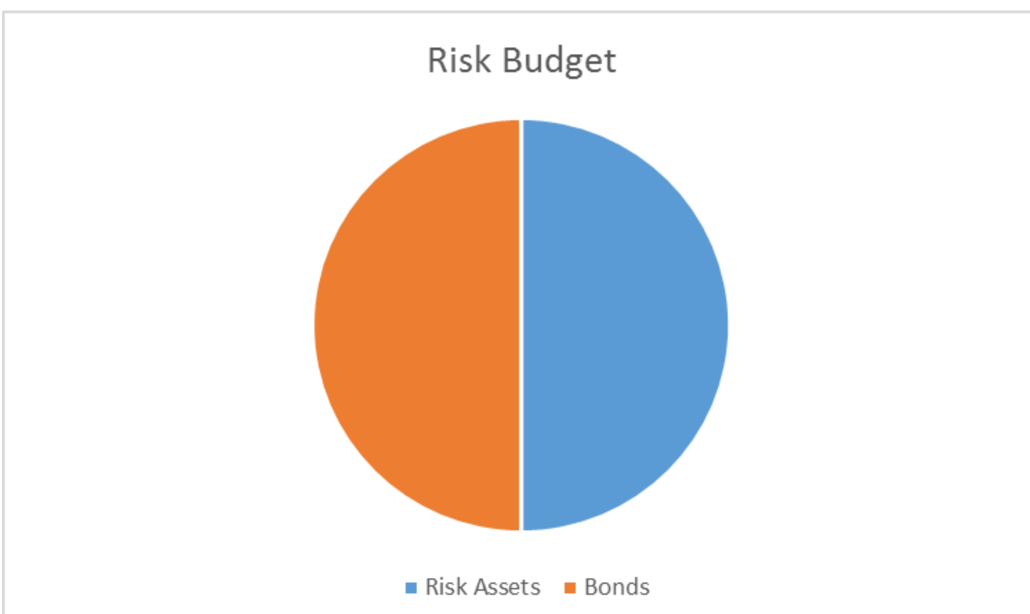
There is no change to our risk budget this month. For the moderate risk investor, the allocation between risk assets and bonds stays at 50/50 versus the benchmark of 60/40. The yield curve continues to steepen in what looks more and more like a plea from the market for more Fed easing (QE4 anyone?); the curve is steepening because short term rates are falling faster than long term rates. As I've said before, the yield curve is not offering the guidance it has in the past since we never reached a flat or inverted curve in this cycle. Of course, that assumes this cycle is coming to an end, a conclusion that is impossible to reach right now – although it is looking more and more likely.



The call this month on our risk budget is the toughest one I've had to make in a very long time. With the yield curve steepening, credit spreads widening and well past their nadir and the long term momentum breakdown in the S&P 500, it would be really easy to take our allocation down another notch.

Credit spreads resumed widening this month, especially over the last two weeks. They did not, however, widen enough to trigger a secondary sell signal. This might be a timing issue as our model only produces monthly buy or sell signals and the widening of spreads accelerated in the first week of July. It is quite tempting to ignore the model and make an allocation shift anyway but then what would be the use of having a model if one doesn't have the discipline to follow it? So, since the model didn't signal a change at the end of the month, I won't make a change. I would also note – again - that the current widening of spreads is across the credit spectrum all the way out to AAA. I find it hard to believe that won't have an impact on the economy but I'll wait for more evidence.





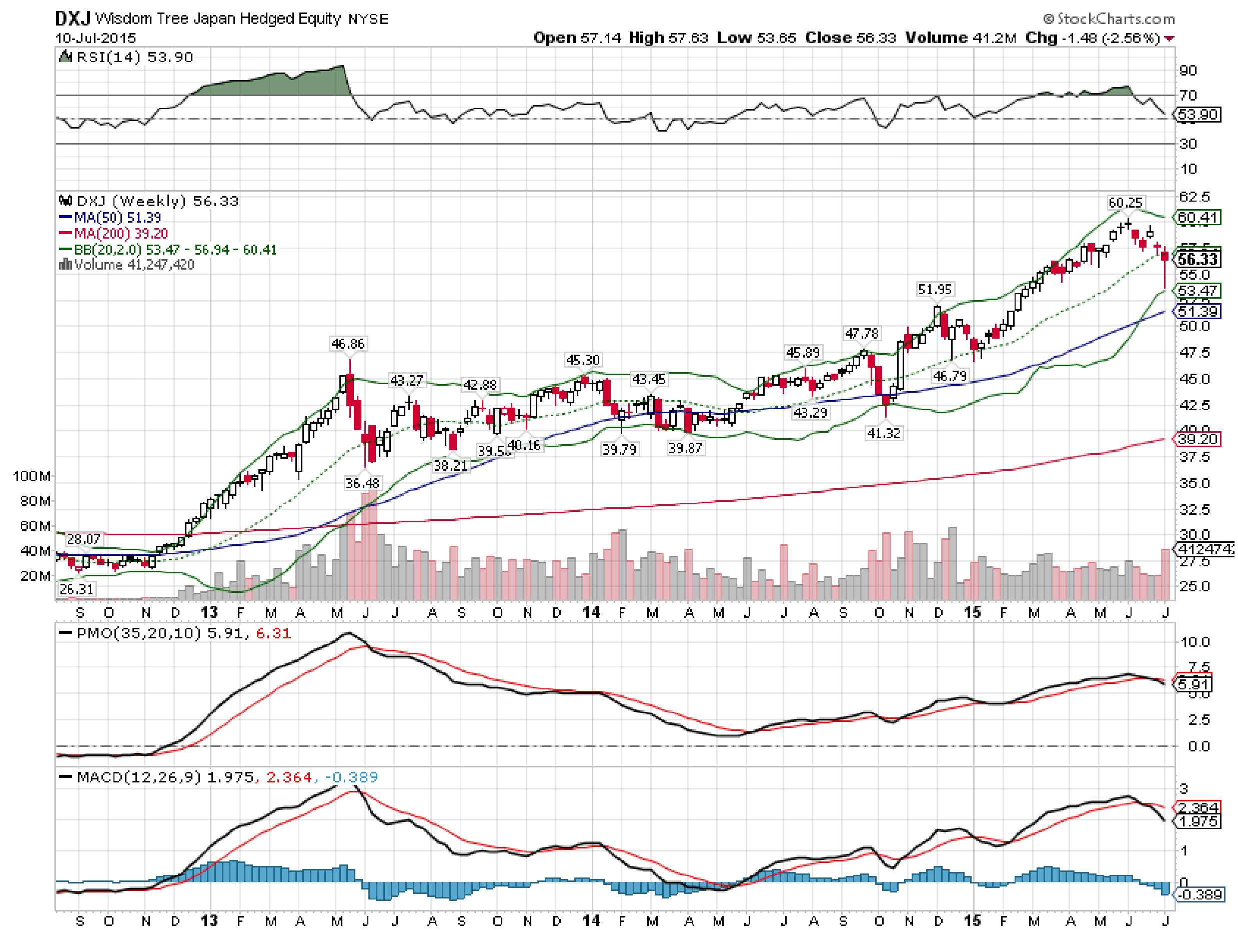
The trend for international versus US large cap continued to correct on the month but EAFE is still outperforming YTD and I will maintain the overweight to international. I find it notable that the US Dollar has not been more of a beneficiary of the turmoil in Europe and China the last few weeks. That gives me some comfort that once the stock market correction has run its course, international will again outperform. Certainly though this trend bears watching closely. At its nadir last week it appeared more like the long term trend of US outperforming was reasserting itself. By the end of the week though, the intermediate term trend resumed with EFA outperforming strongly. Weekly momentum of the trend is still positive.

Our overweight to Asia also took a bit of a beating the last few weeks but, like the EFA/SPY trend, the end of the week rally saved the trend. The intermediate term trend is intact with Asia still rising. The outperformance of Asia versus the EAFE index itself is less convincing technically and needs to hold support near current levels.


AAXJ iShares MSCI All Country Asia ex Japan Index Fund Nasdaq GM
© StockCharts.com
10-Jul-2015
Open 61.54 High 62.15 Low 58.08 Close 61.12 Volume 14.2M Chg -2.36 (-3.72%)
RSI(14) 38.36
AAXJ (Weekly) 61.12
MA(50) 63.19
MA(200) 56.66
BB(20,2.0) 60.15 - 64.98 - 69.80
Volume 14,165,829
PMO(35,20,10) 1.34, 2.06
MACD(12,26,9) 0.134, 0.803, -0.669

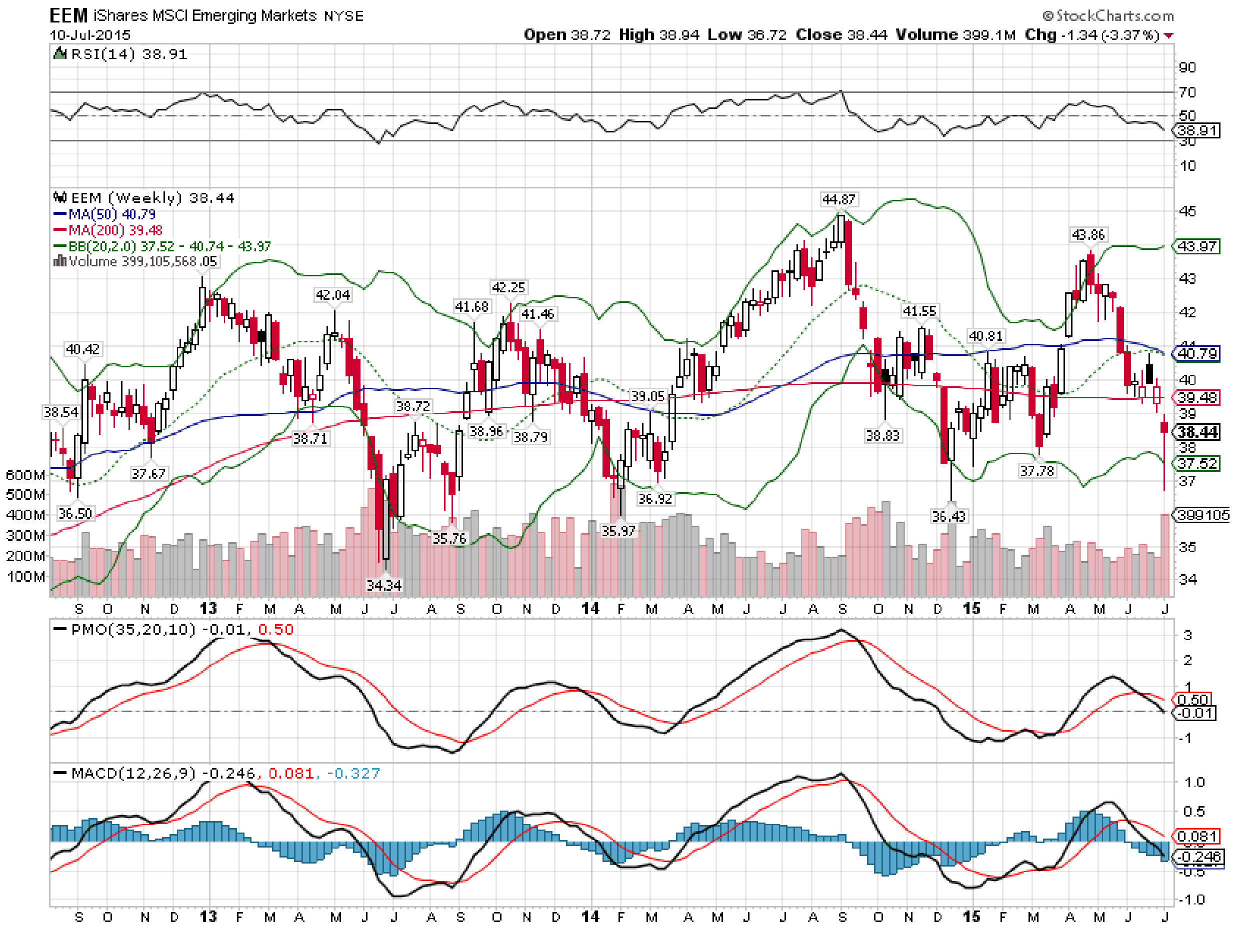

AAXJ:EFA iShares MSCI All Country Asia ex Japan Index Fund/iShares MSCI EAFE Index Fund Nasdaq GM/NYSE
© StockCharts.com
10-Jul-2015
Open 0.957 High 0.967 Low 0.903 Close 0.951 Volume 0 Chg -0.042 (-4.20%)
RSI(14) 36.86
AAXJ:EFA (Weekly) 0.951
MA(50) 1.001
MA(200) 1.015
BB(20,2.0) 0.952 - 1.000 - 1.049
Volume 0
PMO(35,20,10) 0.06, 0.72
MACD(12,26,9) -0.007, 0.000, -0.007

Japan is correcting along with other Asian markets but it remains my favorite long term investment. There may be a bit more correction coming but unless the uptrend is broken I will maintain the position we've held now for almost 3 years. I am shifting new positions (and in some tax deferred accounts) to the unhedged version (EWJ). The Yen has shown some strength recently and I think the depreciation is largely over.



For more aggressive investors I continue to favor unhedged Europe over the Euro hedged version. We still don't know what will become of Greece in the next few days and weeks but I continue to believe that whatever the resolution, it will be positive for the Euro. If Greece leaves the Euro it is a better currency. Right now, it appears the price for staying in will be quite high – more IMF style tax hikes and spending cuts – and if the Greeks accept them, it will be seen as a positive for the message it sends about fiscal discipline.

Emerging markets have also corrected but held at the bottom of the now years old channel:



I am maintaining the position in Emerging Europe as the trend versus broad emerging markets is intact:

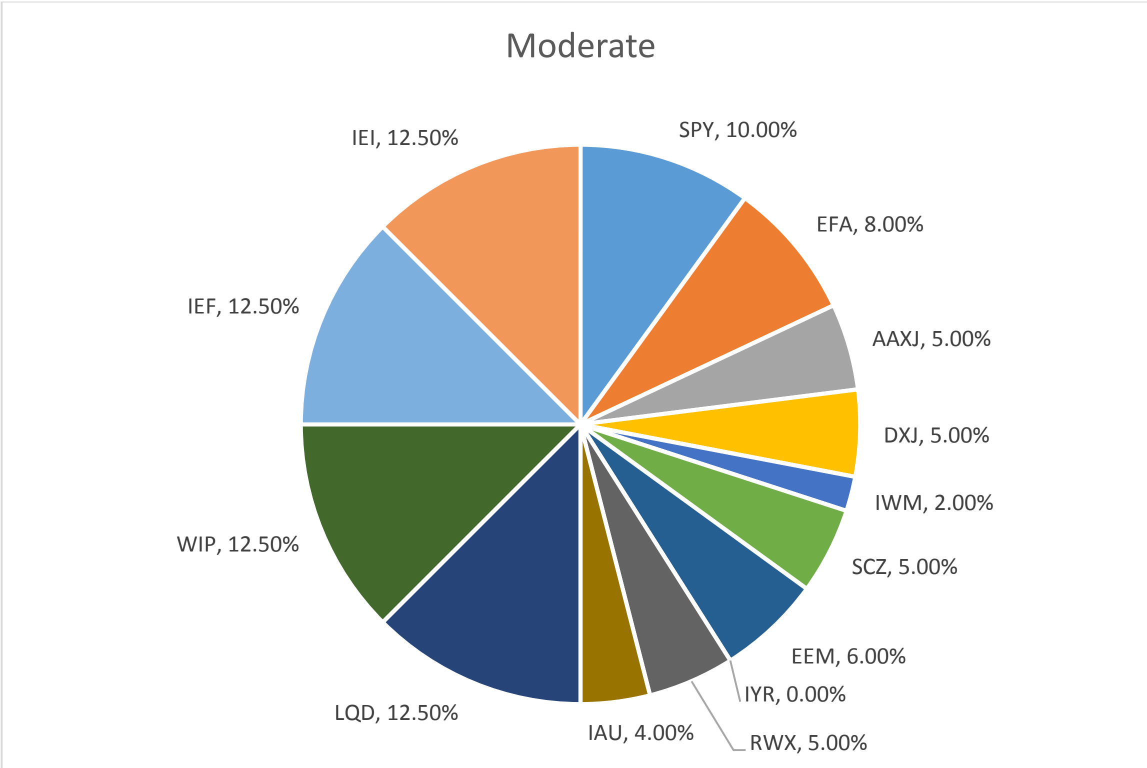
The gold position has essentially done nothing since the last update. That's a bit disappointing considering all the global market turmoil at the moment but it really is about the dollar which has gotten at least a small bid recently, though for dollar bulls it must be a bit disappointing. It would be unusual for the dollar rally to fail after such a short – albeit sharp – run higher but the lack of follow-through is certainly curious. If the dollar resumes its uptrend, I might dump the gold position but for now it is a solid hold.

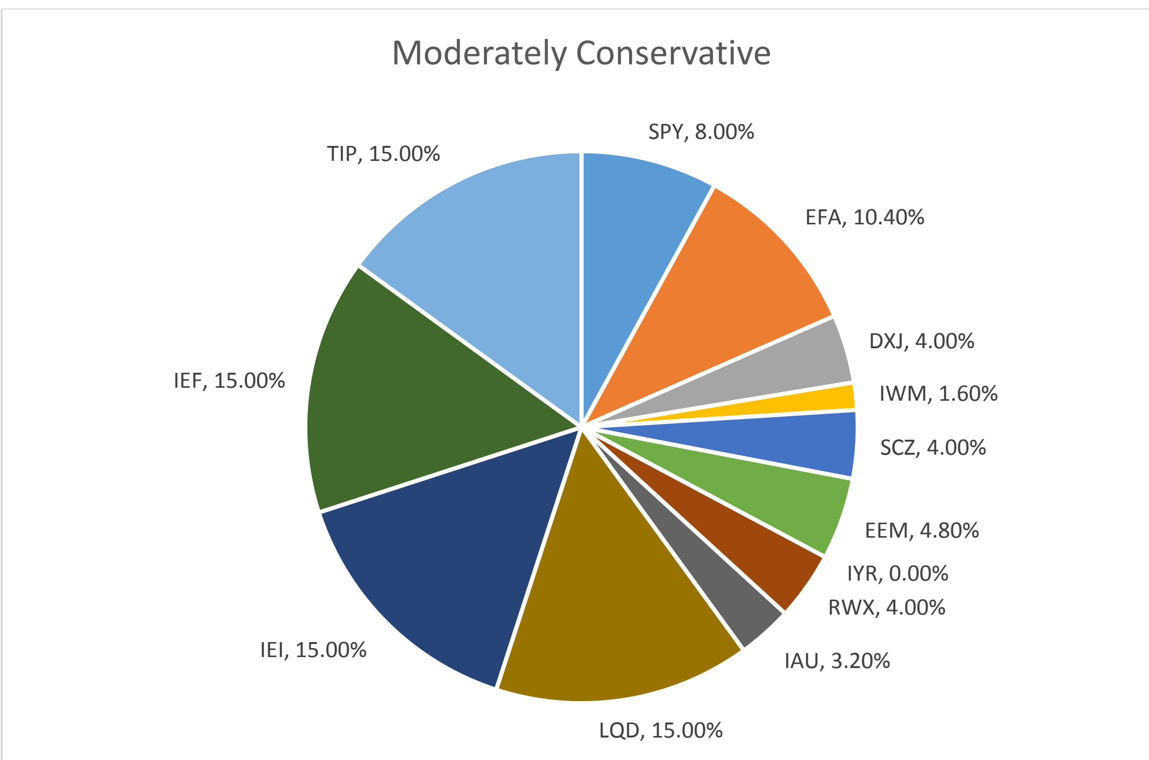

IAU iShares COMEX Gold Trust NYSE
© StockCharts.com
10-Jul-2015
Open 11.26 High 11.35 Low 11.10 Close 11.24 Volume 11.9M Chg -0.03 (-0.27%)
RSI(14) 42.11
IAU (Weekly) 11.24
MA(50) 11.74
MA(200) 13.92
BB(20,2.0) 11.13 - 11.48 - 11.84
Volume 11,856,824
PMO(35,20,10) -1.26, -1.18
MACD(12,26,9) -0.124, -0.109, -0.015

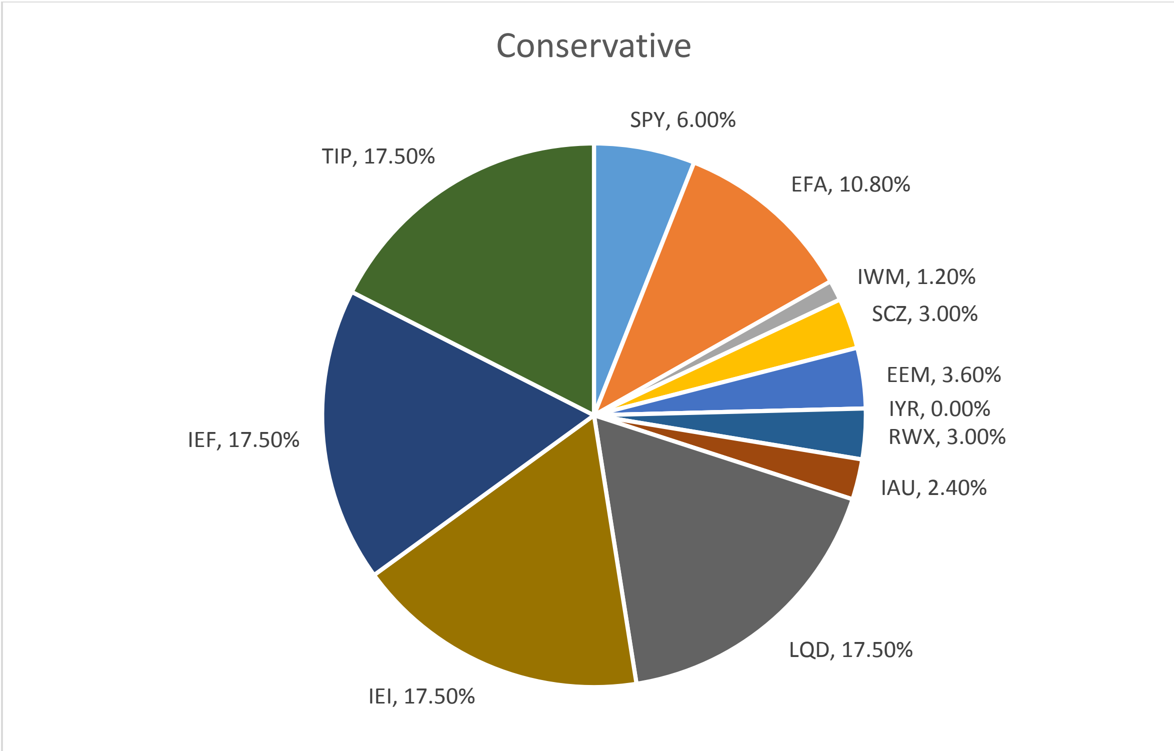

$XEU Euro - Philadelphia INDX
© StockCharts.com
10-Jul-2015
Open 111.85 High 112.08 Low 111.20 Close 111.60 Chg +1.28 (+1.16%)
RSI(14) 50.68
$XEU (Daily) 111.60
MA(50) 111.84
MA(200) 116.20
BB(20,2.0) 109.65 - 111.89 - 114.12
Volume undef
PMO(35,20,10) -0.04, 0.17
MACD(12,26,9) -0.291, -0.121, -0.170

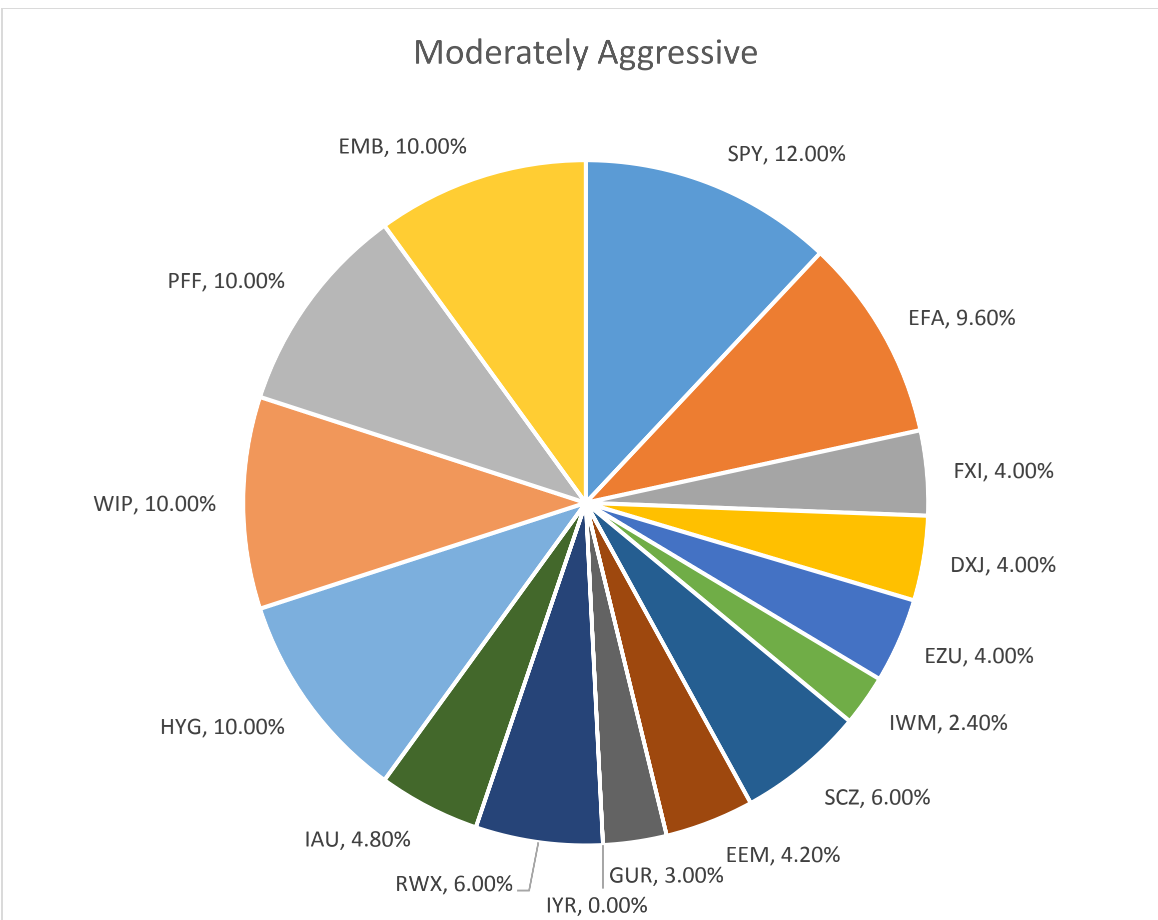
There are no changes to my discretionary global asset allocation this month. Most of the emerging trends I've been tracking and acting on have come under pressure the last month but overall I'm comfortable with the allocation. The hardest part of the portfolio to allocate is, not surprisingly, the bond portion but as I said above, the decisions this month are the most difficult in a long time. The stock portion is at least a little easier to deal with knowing that stocks are generally overvalued. But I don't share the bond bubble views of a lot of my fellow asset allocators. Based on expected growth and inflation – to the extent those things can be estimated – the nominal 10 year Treasury note yield is right about where it should be and maybe even a little high depending on how pessimistic one wants to be about future growth. The real challenge in bonds is choosing between the various sectors. In the corporate space, junk has outperformed high quality bonds recently but not for the usual reason. Generally, junk outperforms on the way up, coming out of recession. Now junk is outperforming high grade corporates as both are losing ground to Treasuries. In any case, I think high quality will win that battle as junk will, as usual, get clobbered when the next recession does arrive (whenever that is). But with high grade corporates generally taking it on the chin the last few weeks it is certainly tempting to just toss the corporates and go all Treasuries.

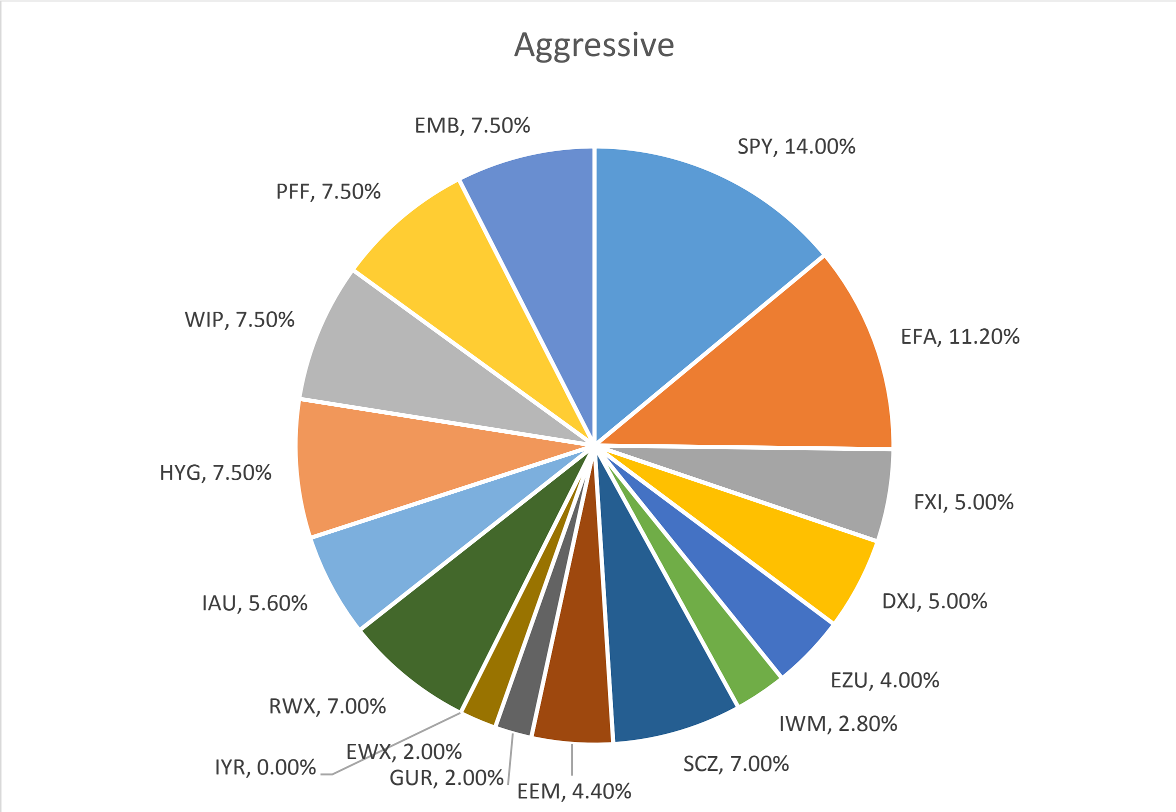
Note: There is a new section after the pie charts looking at asset allocation through the lens of momentum.






Conservative
SPY, 6.00%
EFA, 10.80%
IWM, 1.20%
SCZ, 3.00%
EEM, 3.60%
IYR, 0.00%
RWX, 3.00%
IAU, 2.40%
LQD, 17.50%
IEI, 17.50%
IEF, 17.50%
TIP, 17.50%


Moderately Aggressive
SPY, 12.00%
EFA, 9.60%
FXI, 4.00%
DXJ, 4.00%
EZU, 4.00%
IWM, 2.40%
SCZ, 6.00%
EEM, 4.20%
GUR, 3.00%
IYR, 0.00%
RWX, 6.00%
IAU, 4.80%
HYG, 10.00%
WIP, 10.00%
PFF, 10.00%
EMB, 10.00%



Momentum Asset Allocation

I also run two asset allocation models (one aggressive, one more moderate) based on momentum that ignores all the fundamental and economic information in favor of just allocating to the asset classes that are exhibiting momentum. It is an interesting check on the discretionary portfolio and provides additional information but it can also be run as a standalone strategy. The model rebalances monthly based on three month returns and some risk control measures and the model has historically performed amazingly well. It is, however, an active strategy and not particularly tax efficient. As such it is more appropriate for tax deferred accounts. Call me if you want more information. Here's where that model stands as of the end of the week:

Aggressive Version:

50% EFA

50% EWJ

Moderate Version:

25% SPY

25% IWM

25% SCZ

25% SHY

Note: This is where the model was at the end of last week however, the model only adjusts allocation monthly and last week was not the week for adjustment.

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"Wealth preservation and accumulation through thoughtful investing."

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