Best of the Cash and Equity Breed

By Didier Darcet
didier.darcet@
gavekal-intelligence-software.com

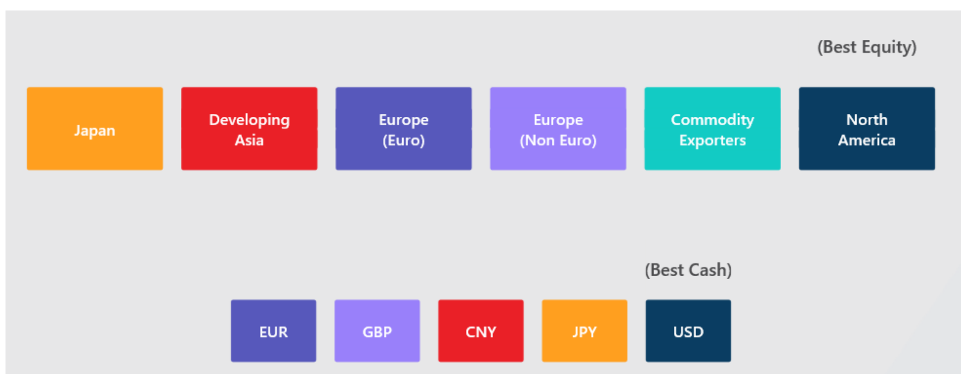
TrackMacro ™ is a software tool providing equity risk signals in 40 countries

Download TrackMacro for PC from the company website
Download TrackMacro for iPad from the App Store

A new version of TrackMacro will be launched in the coming weeks. The extended version includes a cash and equity tracker to dynamically select the best remunerating economic zones.

North America and the Commodity Exporters, for instance, were anticipated to be the best equity zones for May 2019, while USD and JPY, the best currencies to place cash. Japan was anticipated to be the worst market for equity risk and EUR the worst currency to deposit cash among the top five international currencies.

Fig 1. Equity risk and cash ranking – May 2109 – Extended TrackMacro



Source: TrackMacro by Gavekal Intelligence Software

The "Best Zone" approach is complementary to the one currently operated by TrackMacro:

(i) TrackMacro provides equity "risk on" and "risk off" signals in 40 countries based on macro data. The AI program analyses equity value for risk on a country by country basis, independently from one another.

(ii) "Best Zone" provides a ranking among zones and among countries within each zone in the global competition to attract international savings, based on *relative* attractiveness.

For the first time since launch on June 30, 2015, TrackMacro is now able to provide full equity/bond model portfolios with dynamic allocations across countries and between equities and bonds. All risk parameters are at the discretion of the user to run extended simulations.

The simplicity of the approach is as striking as its performance.

Global Competition to Attract Savings

Economic zones compete to attract the largest amount of capital, denominated in their own currency, whether it be in cash or risk assets. However, to succeed, they must also please investors.

From an investor's standpoint, the attractiveness of an economic zone resides in the proposed remuneration, for cash deposit on the one hand, and for risk assets on the other hand:

(i) The Monetary Front: Remuneration of cash, including the appreciation or depreciation of the currency, and the interest rate.

(ii) The Economic Front: Excess remuneration of risk assets, also named "risk premium", i.e. the return of risk assets minus cash rate.

Economic zones are however, facing a dilemma: they can rarely be competitive on both fronts. High interest rates and strong currencies favor cash lenders, but at the expense of cash borrowers such as local companies. A strong remuneration for "the rentier" is likely turn unfavorable to "the entrepreneur".

The situation today where the USA leads the financial world remuneration on both cash and risk is extremely rare and very informative on the balance of international financial power.

Arbitrage Opportunity for Flexible Investors

Multinationals benefit from a global tax competition across economic zones and countries. They tend to book their profits in the most attractive tax zones.

In a similar way, flexible investors can take advantage of the global competition to attract capital. They can simply place their cash in the best cash remunerating zone, and place their risk (the excess return of equities over cash) in the best risk remunerating zone.

How to Identify the Most Attractive Zones

A simple rule is to bet on the leading horses in a horse race, one hundred feet before the arrival. Economic, cultural, social and monetary policies tend to evolve at a slower pace than financial markets. An economic zone favoring "the rentier" (the cash and bond holder), such as China has been for many years, or Germany before the introduction of the Euro, is unlikely to change politics overnight.

The model we propose is to rank cash and risk remunerations on a 12 month-rolling basis and to follow the leaders. A cautious investor could simply avoid the losers; a more aggressive investor could concentrate its exposures on the top leaders.

Whatever the risk profile, the outcome is a significant alpha generation, decade after decade, for fifty years. The higher the exposure to the leaders, the higher the alpha.

Selecting the first tier, for instance, among major currencies, major economic zones, and countries within each zone has provided up to 9% alpha per year, as illustrated below.

Fig 2. "Best Zone" model- First tier selection- NAV

Source: Gavekal Intelligence Software

Conclusion

International investors should, in general, hedge the currency risk associated with international equities, unless very specific circumstances arise, such as the one present today for the USA. The cash required for international equity investment can be borrowed off-balance sheet through FX swaps. Cash, on the other hand, should be placed in the best cash remunerating zones.

The new TrackMacro provides information regarding the economic zones and the countries to place cash and to invest in equity risk with high statistical confidence.

The addition of the “Best Zone” model to the current, original TrackMacro model increases the alpha one step further. It further shows the ability of risk management models to control the value creation path, and to achieve higher returns by taking less risk.