



Is Past Performance a Guarantee of Future Results?



Andres Salmanca
Data Analyst
Insigneo



Mauricio Viaud
PM and Senior Investment Strategist
Insigneo



Is Past Performance a Guarantee of Future Results?

Cash is king. This is a phrase that we have been hearing in the media for a while, especially given the currently high level of short-term interest rates. As a result, many investors have chosen to exit the markets and increase their allocations to cash in their portfolios. But is cash really king? It goes without saying that a reasonable allocation to cash is a prudent measure in most portfolios. However, a problem emerges when investors seek allocations to cash in an overwhelming manner, reaping potential benefits in the short term, but leaving their portfolios exposed to missing market rallies over the long term.

Over the past 18 months, markets experienced the most aggressive rate hike cycle of the last 40 years. From March 2022 to July 2023, the Fed Funds Rate rose from a mere 0.25% to 5.50%. This took a big toll on Fixed Income investors, represented by the Bloomberg US Aggregate Index, which is on track to post double-digit losses over a three-year period after dropping

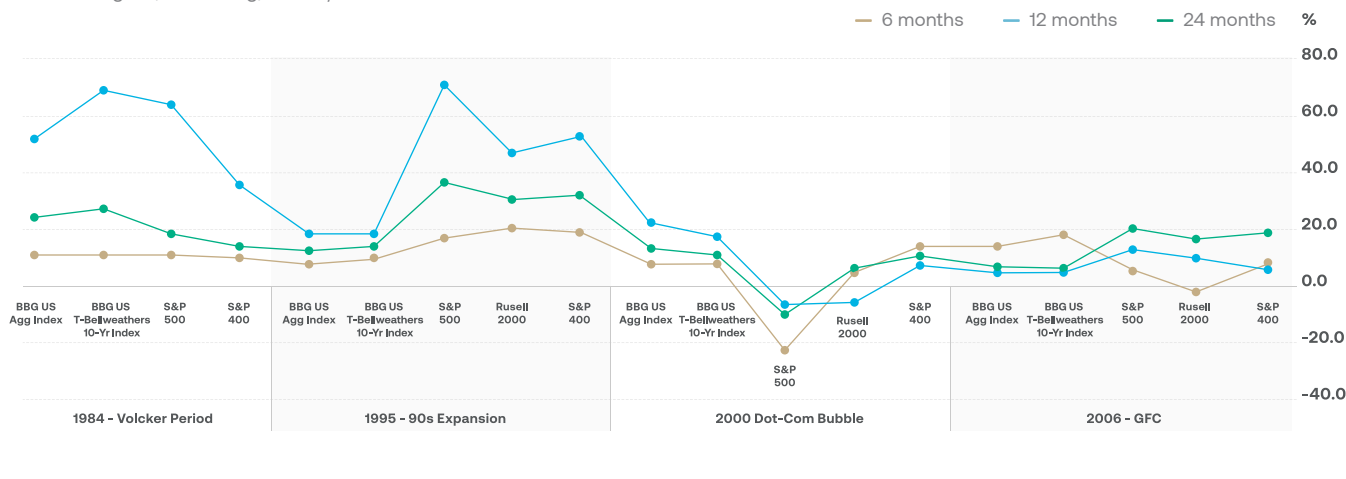
12.9% from December 2020 to November 2023.

While the long-term macroeconomic outlook remains challenging, history gives investors reasons to be optimistic. Over the last 40 years, both corporate and sovereign bonds have performed well after Fed rate hike pauses. For the following analysis, we used the Bloomberg US Aggregate Index to represent Core Bonds, the Bloomberg US Corporate Bond Index for Investment Grade Corporate Debt, the Bloomberg US Corporate High Yield Bond Index for High Yield Corporate Debt, the Bloomberg US Mortgage-Backed Securities Index for MBS investments, and the Bloomberg US Treasury Bellweathers 10 Year Index for Treasuries as market proxies. If we take a quick glimpse into how these indexes performed after Fed rate pauses since 1984, we see that, on average, Fixed Income has returned 7.54% over the next 6 months, 12.22% over the next 12 months, and 23.25% over the next 24 months. Bearing in mind that this is a very broad analysis, it nonetheless allows us to get an idea of what has happened within the Fixed Income realm.

Along the same lines, let us look at the performance

History As Our Teacher: Historical Performance of Various Assets through 6, 12, and 24 Months After the Last Rate Hike in a Monetary Tightening Cycle.

Source: Insigneo, Bloomberg, as of 12/23



of U.S. equities over the same period, using the S&P 500 as a proxy for large cap stocks, the S&P 400 for mid cap, and the Russell 2000 for small cap. Since 1984, equities have traded higher an average of 7.84% in the 6 months following the last rate hike, 13.54%, over the following 12 months, and 27.08% over the following 24 months.

Fed Rates Cycles

However, let us do a more detailed analysis of each Fed cycle so that we can compare the current market situation to previous ones. Starting with the early 1980s, with Paul Volcker as Fed president, the US economy was experiencing what came to be known as the “Great Inflation”. The Fed’s target rate was at 14% at the beginning of 1980, reaching 20% by the end of 1981, and later stabilizing below 10% after November 1984. For purposes of this study, we consider the Fed pause as the last interest rate hike of this period, which happened in August 1984. Looking at the performance of the indices, Fixed Income returned 11.36% over the following 6 months, 26.28% over the

following 12 months and 56.47% over the following 24 months, with Treasuries posting an astonishing 69.67% return over that 24-month period. It is important to note that during this cycle, 10-year treasury yields were above 12%. At the same time, U.S. Equities posted gains of approximately 11%, 16%, and 50% over the following 6-, 12-, and 24-month periods, respectively.

After the Volcker period, Alan Greenspan took over as Fed Chair in August of 1987 and carried on a moderate hiking cycle to fight inflation. On September 4, 1987, the Fed Funds rate saw its last hike just a few weeks before the Black Monday stock market crash. Looking at the performance of the indices, Fixed Income returned 9.93% over the following 6 months, 13.74% over the following 12 months and 25.53% over the following 24 months. Not surprisingly, equities underperformed in the months following the 1987 crash, retreating nearly 17% over the following 6 months, ending down 12.5% the following 12 months, but turning positive over the following 24 months with returns near 10.5%. After a short period of cuts following the Black Monday crash, the Fed started a

new hiking cycle to fight inflation, which ended on February 24, 1989. At that point, the Fed decided that monetary policy was in line with expectations and the United States entered an eight-month recession known as the Gulf War Recession. Looking at the performance of the indices, Fixed Income returned 8.25% over the 6 months following the last hike, 9.30% over the following 12 months and 21.60% over the following 24 months, with High Yield heavily underperforming the market. Over this period, equities posted returns of approximately 20%, 10.5%, and 20% for the subsequent 6-, 12-, and 24 months after February of that year.

After this short recession, the United States underwent an expansion period for a few years, seeing GDP rise as much as 4% in 1994. This economic expansion pushed prices and inflation higher, which led the Fed to raise interest rates to maintain sustainable economic growth. Shockingly, the Fed Funds rate almost doubled in one year, going from 3.25% to 6% by February 1995. Looking at the performance of the indices, Fixed Income returned 8.59% over the following 6 months, 13.48% over the following 12 months and 21.01% over the following 24 months. At the same time, U.S. equities posted gains of 18.5% over the subsequent 6 months following the last hike, 32.9% over 12 months, and an astounding 56.8% over the following 24 months. The 90s expansion came to an end with the Dot-Com Bubble at the completion of the decade. With the Nasdaq index growing 400% from 1995 to 2000, the Fed stepped in to control inflation by raising rates from June 1999 to May 2000. Looking at the performance of the indices, Fixed Income returned 5.16% over the following 6 months, 10.99% over the following 12 months, and 18.16% over the following 24 months. During this period, equities experienced volatile returns which is understandable in light of the expansion and eventual bursting of the Dot-Com Bubble. In fact, equities declined nearly 4% in the 6 months following the last rate hike in May of 2000, rose 2% in the following 12 months, and post-

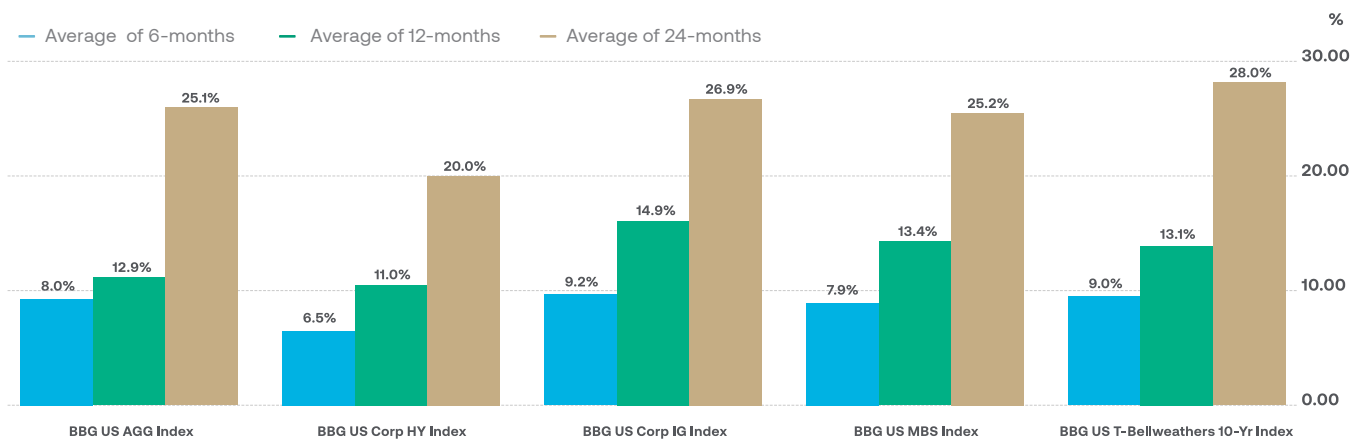
ed a decline of 1.42% over the following 24 months. Due to the Dot-Com Bubble burst, the Fed dropped the reference rate from 6.5% to 1.0% in two years to boost the country's economic recovery after the eight-month recession produced by the stock market meltdown. The US economy experienced a strong recovery underpinned by low interest rates which pushed GDP growth up to 3.9% during 2004 and 2005. Led by Greenspan and Ben Bernanke, the Fed took a similar approach to the one observed during the Dot-Com bubble to tame inflation, raising rates from June 2004 until June 2006. Looking at the performance of the indices, Fixed Income returned 6.04% for the following 6 months, 7.15% for the following 12 months, and 13.07% for the following 24 months. Equities posted positive returns of 9.3%, 8.5%, and 4.05% over the 6-, 12-, and 24-month periods following the last rate hike of this cycle.

Finally, after cutting rates to almost 0% following the Housing Market Crash of 2008, the Fed kept rates abnormally low for a period of seven years. However, on December 17, 2015, the Fed started a new moderate hiking cycle under Janet Yellen's administration, ending on December 20, 2018, under Jerome Powell's administration, as the economy showed signs of recovery. Looking at the performance of the indices over this period, Fixed Income returned 7.50% for the following 6 months, 10.57% for the following 12 months and 19.22% for the following 24 months. Equities registered meaningful gains over the same period, seeing the averages rise 17.8%, 27.7%, and close to 50% over the subsequent 6-, 12-, and 24 months following the last rate hike in this cycle.

If we observe the average return of the different Fixed Income indices over the last 40 years, the US Treasury 10 Year Notes outperformed nearly every other index in this asset class, regardless of the nature of the Fed cycle. Even if we remove Volcker's period, where treasuries saw a 24-month return of 69.67%, 10 Year Treasuries still outperformed every

Average Index Return After a Fed Pause

Source: Insigneo, Bloomberg, as of 12/23



other index during the first 6 months after a pause in rate hikes, seeing an average return of 8.8%. Additionally, US Treasuries were only outperformed by IG Corporate Bonds over the 24-month period. For the 12-month period, Treasuries’ average performance was below MBS and IG Corp Bonds returns.

On the other hand, High-Yield bonds, on average, have underperformed the rest of the group in every period after a Fed Pause. While, in theory, High-Yield bonds are the securities with more room for recovery once rate cuts begin, in practice, these investments need the right backdrop to outperform. To this point, High-Yield bonds outperformed Fixed Income indices during the 1995 cycle, amid economic growth and rate hikes that were designed to control inflation. During other Fed cycles, the US economy has faced the prospect of recessions or market downturns that affected High Yield issuers with weak credit fundamentals. In other words, if rate cuts are implemented for the wrong reasons, High Yield Corporate Bonds tend to underperform. Finally, IG Corporate Bonds, Core Bonds and MBS have registered in-line performance during different market cycles, with IG issuers outperforming every other index in the 12-month period after the pause.

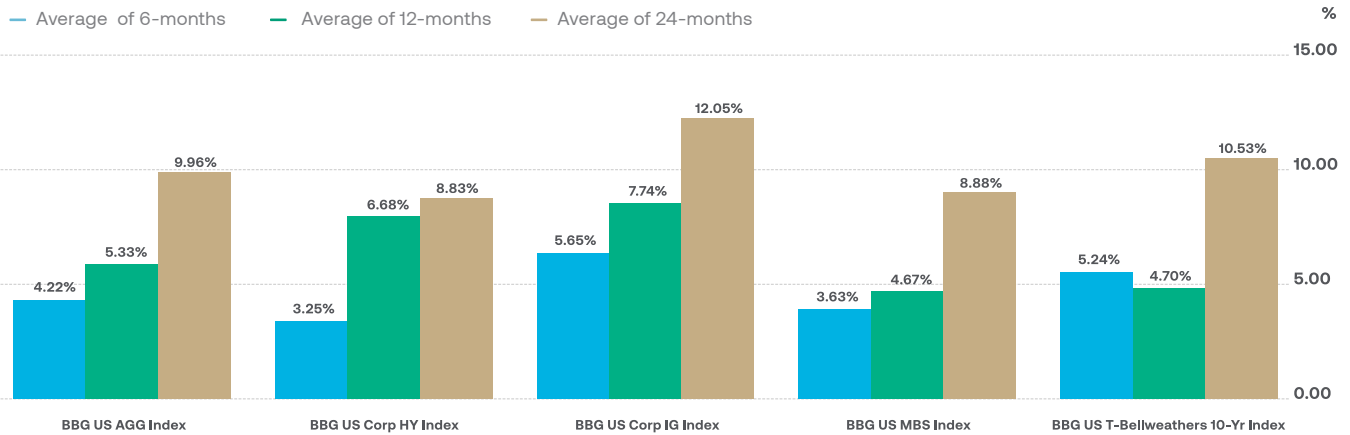
Looking at equities, on average, this asset class has returned approximately 8%, 13.5% and 27% in the 6-, 12-, and 24-month periods following the last hike in a Fed’s hiking cycle. On a market cap basis, although small-cap stocks tend to lead the way in the initial 6 months after the last hike, large-cap and mid-cap stocks tend to take the reins in the subsequent 12- and 24-month periods. Large and mid-cap stocks averaged approximately 15% and 20% returns in the 12 months following the last hike, and 32% and 30% in the subsequent 24 months. Small Cap stocks averaged 11.5% and 20% over these two time periods.

Excess Cash Return

While cash has worked as a safe haven for investors over the past 12 months, it is important to keep in mind that Fixed Income has outperformed cash alternatives over the last 30 years. If we use the Bloomberg US Treasury Bills 1-3 Month Index as a proxy for cash alternatives and compare this index’s returns to the other Fixed Income indices used for this analysis, on average, we have seen that Fixed Income has exhibited an excess return after the last

Average Index Excess Cash Return after Fed Pause

Source: Insigneo, Bloomberg, as of 12/23



rate hike of 4.40% in the following 6 months, 5.82% in the following 12 months and 10.05% in the following 24 months. Staying on the sidelines with too much cash on hand may reduce portfolio risk over the short-term, but it could also likely lead to missed potential opportunities of market rebounds. While it is challenging to compare today's economic backdrop to the periods previously described, history has shown us that we don't necessarily need to be bullish on the economy to generate returns. Staying invested for the long-term is the key to investment success. ■

House Views Matrix

	TACTICAL (UP TO 3 MONTHS)	CYCLICAL (UP TO 12 MONTHS)
Global Asset Allocation		
Equities	NEUTRAL	NEUTRAL
Fixed Income	OVERWEIGHT	OVERWEIGHT
Cash	UNDERWEIGHT	NEUTRAL
Regional Breakdown		
US Equities ¹	OVERWEIGHT	OVERWEIGHT
European Equities	NEUTRAL	NEUTRAL
Japanese Equities	OVERWEIGHT	OVERWEIGHT
Emerging Market Equities	NEUTRAL	UNDERWEIGHT
Chinese Equities	NEUTRAL	UNDERWEIGHT
US Treasuries ²	OVERWEIGHT	OVERWEIGHT
Investment Grade Fixed Income	NEUTRAL	NEUTRAL
High Yield Fixed Income	NEUTRAL	UNDERWEIGHT
Emerging Market Sovereign	OVERWEIGHT	NEUTRAL
US Dollar	NEUTRAL	OVERWEIGHT
Energy ³	OVERWEIGHT	NEUTRAL
Precious Metals	UNDERWEIGHT	OVERWEIGHT

¹Relative to global equities in USD

²Relative to aggregate fixed income markets in USD

³Relative to an overall commodity allocation

Important Legal disclaimer

Insigneo Financial Group, LLC comprises a number of operating businesses engaged in the offering of brokerage and advisory products and services in various jurisdictions, principally in Latin America. Brokerage products and services are offered through Insigneo International Financial Services, LLC, headquartered in Puerto Rico, and through Insigneo Securities, LLC, headquartered in Miami. Both are members of the Financial Industry Regulatory Authority (FINRA) and Securities Investors Protection Corporation (SIPC) <https://www.sipc.org/>. Investment advisory products and services are offered through Insigneo Advisory Services, LLC, an investment adviser registered with the Securities and Exchange Commission. In Uruguay, advisory services are offered through Insigneo International Asesores de Inversion Uruguay, SA, Insigneo Asesores de Inversion Latam, SRL, and Insigneo Asesores de Inversion de Uruguay, SRL, in Argentina through Insigneo Argentina, SAU, and in Chile through Insigneo Asesorías Financieras, SPA. Collectively, these eight operating businesses make up the Insigneo Financial Group. To learn more about the Broker Dealers including their conflicts of interest and compensation practices, please go to <https://insigneo.com/disclosures/> or via www.finra.org. To learn about Insigneo Advisory Services, LLC and any conflicts related to its advisory services, please see its Form ADV and brochure which can be found at Investment Advisor Public Disclosure website <https://adviserinfo.sec.gov/>.

FOR AFFILIATES LOCATED IN CHILE

Insigneo Asesorías Financieras SPA se encuentra inscrito en Chile, en el Registro de Prestadores de Servicios Financieros de la Comisión para el Mercado Financiero. Este informe fue efectuado por área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, en base a la información disponible a la fecha de emisión de este. Para evitar cualquier conflicto de interés, Insigneo Securities LLC dispone que ningún integrante del equipo de Research & Strategy tenga su remuneración asociada directa o indirectamente con una recomendación o reporte específico o con el resultado de una cartera.

Aunque los antecedentes sobre los cuales ha sido elaborado este informe fueron obtenidos de fuentes consideradas confiables, no podemos garantizar la completa exactitud e integridad de estos, no asumiendo responsabilidad alguna al respecto Insigneo Securities LLC, Insigneo Asesorías Financieras SPA ni ninguna de sus empresas relacionadas. Este material está destinado únicamente a facilitar el debate general y no pretende ser fuente de ninguna recomendación específica para una persona concreta. Por favor, consulte con su ejecutivo de cuentas o con su asesor financiero si alguna de las recomendaciones específicas que se hacen en este documento es adecuada para usted. Este documento no constituye una oferta o solicitud de compra o venta de ningún valor en ninguna jurisdicción en la que dicha oferta o solicitud no esté autorizada o a ninguna persona a la que sea ilegal hacer dicha oferta o solicitud. Las inversiones en cuentas de corretaje y de asesoramiento de inversiones están sujetas al riesgo de mercado, incluida la pérdida de capital.

La información base del presente informe puede sufrir cambios, no teniendo Insigneo Securities LLC ni Insigneo Asesorías Financieras SPA la obligación de actualizar el presente informe ni de comunicar a sus destinatarios sobre la ocurrencia de tales cambios. Cualquier opinión, expresión, estimación y/o recomendación contenida en este informe constituyen el juicio o visión de área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, a la fecha de su publicación y pueden ser modificadas sin previo aviso.

FOR AFFILIATES LOCATED IN URUGUAY

En Uruguay, los valores están siendo ofrecidos en forma privada de acuerdo al artículo 2 de la ley 18.627 y sus modificaciones. Los valores no han sido ni serán registrados ante el Banco Central del Uruguay para oferta pública.

FOR AFFILIATES LOCATED IN ARGENTINA

Insigneo Argentina S.A.U. Agente Asesor Global de Inversión se encuentra registrado bajo el N° 1053 de la Comisión Nacional de Valores (CNV) e inscripto ante la Inspección General de Justicia (IGJ) bajo el N° 12.278 del Libro 90, Tomo -, de Sociedades por Acciones. Este informe fue efectuado por área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, en base a la información disponible a la fecha de su emisión. Para evitar cualquier conflicto de interés, Insigneo Securities LLC dispone que ningún integrante del equipo de Research & Strategy tenga su remuneración asociada directa o indirectamente con una recomendación o reporte específico o con el resultado de una cartera. Aunque los antecedentes sobre los cuales ha sido elaborado este informe fueron obtenidos de fuentes consideradas confiables, no podemos garantizar la completa exactitud e integridad de estos, no asumiendo responsabilidad alguna al respecto Insigneo Securities LLC, Insigneo Argentina S.A.U. ni ninguna de sus empresas relacionadas. La información base del presente informe puede sufrir cambios, no teniendo Insigneo Argentina S.A.U. la obligación de actualizar el presente informe ni de comunicar a sus destinatarios sobre la ocurrencia de tales cambios.

Este material está destinado únicamente a facilitar el debate general y no pretende ser fuente de ninguna recomendación específica para una persona concreta. Por favor, consulte con su ejecutivo de cuentas o con su asesor financiero si alguna de las recomendaciones específicas que se hacen en este documento es adecuada para usted. Este documento no constituye una oferta, recomendación o solicitud de compra o venta de ningún valor negociable en ninguna jurisdicción en la que dicha oferta o solicitud no esté autorizada o a ninguna persona a la que sea ilegal hacer dicha oferta o solicitud. Las inversiones en valores negociables están sujetas al riesgo de mercado, incluida la pérdida parcial o total del capital invertido. Cualquier opinión, expresión, estimación y/o recomendación contenida en este informe constituyen el juicio o visión de área de Research & Strategy de Insigneo Securities LLC, o sus proveedores, a la fecha de su publicación y pueden ser modificadas sin previo aviso.