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EDITO

Antifragile

The month of January was rich in extra-financial events of an unpredictable nature with a potentially high impact for investors: escalation between the United States and Iran, the spread of the coronavirus, President Trump's attempted impeachment, the terrorist attack in London, not to mention increased tensions in Libya, Syria and the Sahel. This succession of events is an opportunity to recall **the concept of antifragility** developed by Nassim Nicholas Taleb in his book "Antifragile". Antifragility is the property of a system that becomes stronger when it is exposed to shocks of different kinds. Thus, antifragility goes well beyond robustness (ability to withstand shock).

Over the past decade, **portfolio robustness has been provided by central banks**. By drastically lowering their key rates and injecting record amounts of liquidity, the diversified equity/bond portfolio has been relatively robust thanks to the very good decorrelation between the two major asset classes. The very strong convexity during the QE phases may have resembled a form of antifragility. However, previous episodes of monetary tightening and attempts to normalize have shown the fragility of the global economy and financial markets. On the one hand, the global economy cannot yet perform beyond its potential growth rate without monetary support. On the other hand, investors persist in highly defensive asset allocation choices and investment themes.

The end-of-cycle thesis favors a quality bias and a reduction in risk. A mature cycle means that imbalances have accumulated (unemployment rate at its lowest point, debt ratio at its highest point, looming overcapacities, decline in the corporate margin rate), the growth/inflation mix is deteriorating, and volatility and the corporate default rate are rising. Financial assets have reached an evaluation peak. **This scenario will become critical** as monetary and credit conditions tighten. The search for antifragility for the investor will then result in a strong disinvestment with **a preference for cash**. The monetary stimulus given in 2019 makes it possible to envisage **a temporary resetting of the cycle**, with a steepening of the yield curve, a reduction in the probability of recession and a resumption of risk.

The Course of Empire : Destruction, Thomas Cole (1836)
New-York Gallery of the Fine Arts

This thesis is fueled by an exceptional alignment: macro and corporate earnings recovery, abundant liquidity, monetary and fiscal support, US election year, and significant potential for rebalancing flows between bonds and equities. The realization of this scenario will be an important test of the adaptive nature of an investment strategy. Investors' consensus positioning is always overexposed to defensive themes. **Adaptability** means a reallocation towards more cyclical themes (emerging markets, Europe) and more sensitive to the rise in long-term interest rates (Japan, value style, commodities).

In the longer term, **the passive 60/40 portfolio** (equities and bonds) is likely to enter a sustainable cycle of mediocre or even negative performance, due to **the unprecedented combination of record valuations** of equities and government bonds. Over the past century, such a combination has always coincided with the 60/40 portfolio's entry into a bear cycle. The antidote is **active diversification, the search for alternative sources of return and the ability to be contrarian**. This is undoubtedly what will characterize an antifragile portfolio. The action of central banks is currently preventing investors from making such choices, which may be a trap at some point. Nevertheless, we must be prepared for a change in the rules of the game.

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