SYSTEMATIC TRADING STRATEGY: THE BOND ULTIMATUM

Team: Capital Builders Group
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Investment Decision: Reallocated 40% ($115k) of Portfolio's fixed-income position to new holdings

INTRODUCTION:

Historically, the MSIF has maintained a fixed-income allocation of 30% of total capital, invested entirely in ICSH, an ultra-short duration holding effectively serving as the fund's liquidity. Our strategy specifically addresses this position, as it has not undergone detailed re-evaluation during our cohort's tenure. Given current macroeconomic conditions, particularly the likely appreciation of the long end of the yield curve over the next six months, revisiting our fixed-income exposure is both timely and strategically beneficial. Capturing the potential upside from yield curve normalization is a key objective of our proposed strategy.

TRADING STRATEGY DETAILS:

Our approach had two primary objectives: first, to preserve sufficient liquidity through a substantial holding in ICSH; second, to diversify the remaining allocation across a strategically designed "barbell" structure (a method popularized by BlackRock). We selected a cohort of 10 fixed-income ETFs, evenly divided between short-term and long-term maturities, and a pplied a custom optimization model under the following clearly defined parameters:

1. Maintain 30-60% of the current ~$300k ICSH allocation
2. Allocate 15-30% of the divested capital into long-term positions

Utilizing the probabilistic outcomes from the FedWatch tool, we calculated expected federal funds rates over the next five meetings and converted these into a monthly average expected rate, serving as a proxy for the risk-free rate. This proxy, combined with monthly mean returns derived from 10 years of historical adjusted-close pricing data for each ETF, formed the basis of our weighted objective function. Using Excel's solver, we minimized this function to identify an optimal allocation, resulting in 60% ICSH (ultra short-term), 10% IGSB (short-term), 18% SPLB (long-term) and 12% VCLT (long-term).

BACKTESTING PERFORMANCE:

The optimized allocation, representing a 70/30 split between short-term and long-term positions, demonstrates robust performance both historically and on a forecasted basis. Historical price analysis indicates the new allocation increases the portfolio's expected return by 1.14%, with only a modest beta increase of 0.07. Importantly, these positive results do not yet incorporate our hypothesized yield curve normalization scenario, which would further enhance the performance of our long-term positions.

While such normalization remains speculative, the likelihood of a downside scenario – involving reinversion of the yield curve combined with Federal Reserve rate hikes – is exceedingly low. Indeed, FedWatch has excluded such rate hike scenarios from its forecasts entirely. Consequently, our proposed strategy immediately achieves more efficient capital allocation, providing a compelling balance of modest upside potential and minimal downside risk.