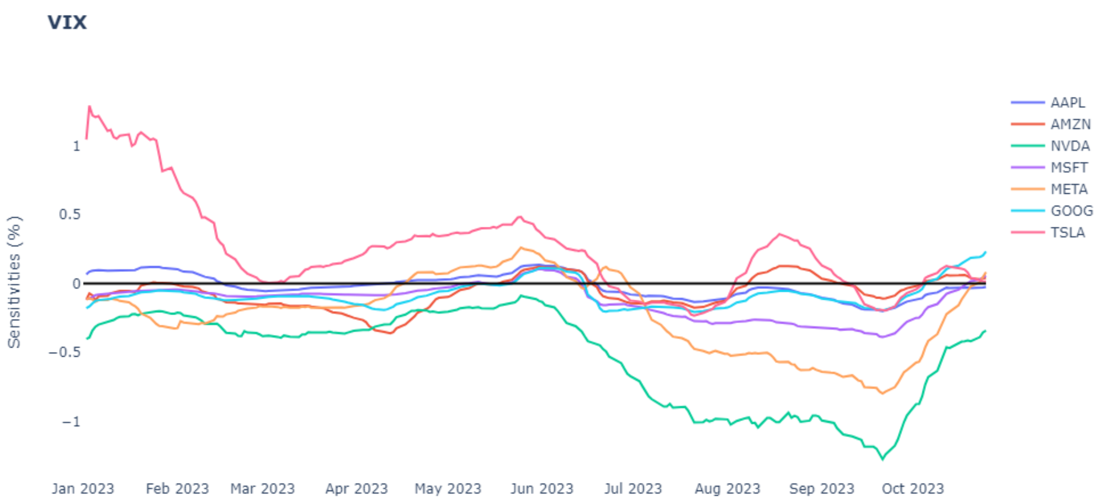
26.10.2023

Equities need a regime change?

Equity bulls need the "generals" to hold in. The Magnificent 7 are responsible for 2023's performance. Given poor breadth, if they roll over now there's a very real risk of a deeper correction.

Aside from the idea of AI as a genuine game changer, the obvious argument for the Magnificent Seven to retain a bid is their role as a comparative safe haven. Typically, they have strong balance sheets and wide moats in Buffett speak.

Qi can measure each of these seven stocks' sensitivity to VIX as a way to see if there's a regime change going on.



Ordinarily, all equities want healthy risk appetite (low VIX). If these mega cap tech stocks are going to start trading as **safe havens** during "risk off", we'd expect to see that sensitivity flip from a negative to positive relationship.

The chart above shows the percentage move in each of the Magnificent Seven for a one standard deviation shock higher in VIX, every other factor held constant.

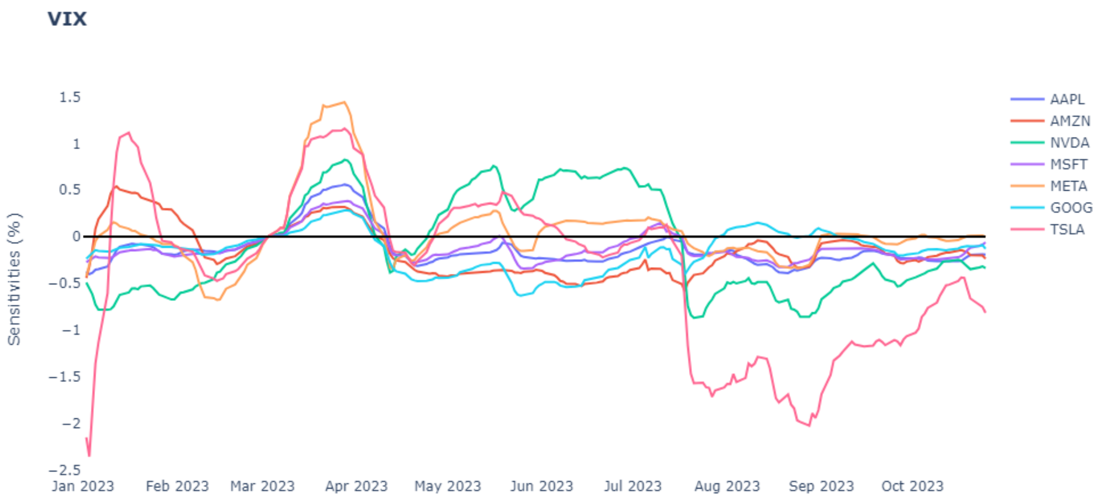
There is a uniform pattern where, since early October, these tech stocks have become less reliant on risk aversion metrics. In fact, most are now pretty **indifferent to whether VIX trades above or below 20.**

The two comparative outliers are:

- Nvidia is lagging but the direction of travel is the same.
- Google is leading and the relationship has turned positive. Higher VIX, all else equal, is now consistent with a higher stock price.

A couple of additional observations.

- risk aversion is not the key driver of these models currently. It varies by model but generally speaking the Magnificent Seven care a lot more about **rate volatility** and **inflation expectations** than what VIX is doing. That itself could of course be a good sign.
- the first chart above uses Qi's Long Term (rolling 1y look-back period) where model confidence numbers are generally high (only Nvidia is not in regime).
- but arguably the Short Term model with its 4 month history will be more timely in **capturing these changing sensitivity patterns.** The chart below runs the same exercise using our ST models.



For most stocks, sensitivity is negative and holding steady. **There are no signs of any regime shift yet.** Although once again, comparative indifference could be a healthy sign.

Tesla is the outlier this time. Both because it is more reliant on VIX staying low in absolute terms; but also because the pattern is becoming stronger - TSLA is **increasingly more vulnerable** to bouts of "risk off".

Having a real-time quantitative measure of how these market-leading stocks trade with VIX will be a critical metric to watch in the days and weeks ahead.

Quant Insight Limited, Dawson House, 5 Jewry Street, London, UK EC3N 2EX

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