Quant insight

18.01.2022

Factor Watch
– the US business cycle

- The weak economic data at the end of last week has had a material impact on the US growth outlook.

- Now-Casting’s tracking Qi GDP growth for the US has fallen to 1.9%. Their number is lower than peers like the Atlanta Fed’s GDPNow, but the profile is the same; & note the Citi Economic Data Surprise index has also turned negative.

- Qi looks at all factors in z-score terms & Friday’s Retail Sales / Industrial Production miss has prompted a sharp move lower. Growth had already slipped below trend but is now accelerating lower.

- Many economic forecasters have a growth slowdown pencilled in for 2022 but, for most, that’s a Q2 event. **The deceleration appears to be unfolding earlier & more aggressively**.

- At the same time the early 2022 bear move in bond markets has picked up renewed momentum. Qi had already flagged the significance of this, but now the move in 10y US real yields, from local low to recent high, is a 3 standard deviation event – chart overleaf. It is also the sixth biggest spike in real yields in z-score terms since 2009.

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- There is already a huge volume of analysis in mainstream media about this real rate move. Does it reflect an improving economic outlook, or a tightening of financial conditions? Are real yields the key determinant of speculative technology stocks & the broader Growth versus Value rotation?

- One observation to the first point. The graph above shows US inflation expectations in z-score terms. After the Q4'21 inflation shock, expectations have reverted close to trend. As always there is a level versus rate of change argument: real yields are still deeply negative. But, in impulse terms & on current patterns these charts err towards **tighter financial conditions into a slower economic cycle.**

- In terms of the implications for asset allocations, investors have two options. Read volumes of traditional research to reach a conclusion based exclusively on subjective opinions. Or, add Qi's machine-learning framework into your process to identify which stocks / sectors / assets have a positive relationship with real yields - independent of all other macro variables - versus those that suffer when real rates leg higher.

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Quant insight

Quant Insight Limited
42-46 Princelet Street
London E1 5LP
United Kingdom
Tel: +44 203 9941310
www.quant-insight.com