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## Goldilocks or Bust

The tug of war between **Goldilocks or Bust** remains the dominant narrative for global investors. This week Goldilocks has enjoyed a boost but, away from short term news flow, what's the cross asset picture of macro conditions and what's being priced?

- **Credit looks Goldilocks biggest cheerleader.** And therefore most vulnerable if Payrolls print soft and recession fears escalate.
- **European sector rotation plays** offer opportunities for hard and soft landing proponents alike.

The soft landing narrative has had good news this week - signs of a softening in the robust US labour market; no fiscal bazooka but incremental policy easing in China; bond yields reverse lower pulling the Dollar down.

But the dilemma facing investors remains sharply unchanged - Goldilocks or Bust is alive and well. And it's at times like these that all market participants, not just contrarians, should consider their tail risks. While Goldilocks prevails today, what are markets pricing in terms of recession risk?

The Watchlist below is not exhaustive but includes a number of securities across asset classes that would typically be viewed as cyclical in nature. So which markets are pricing the Goldilocks scenario, and which are pricing elevated fears of a hard landing?

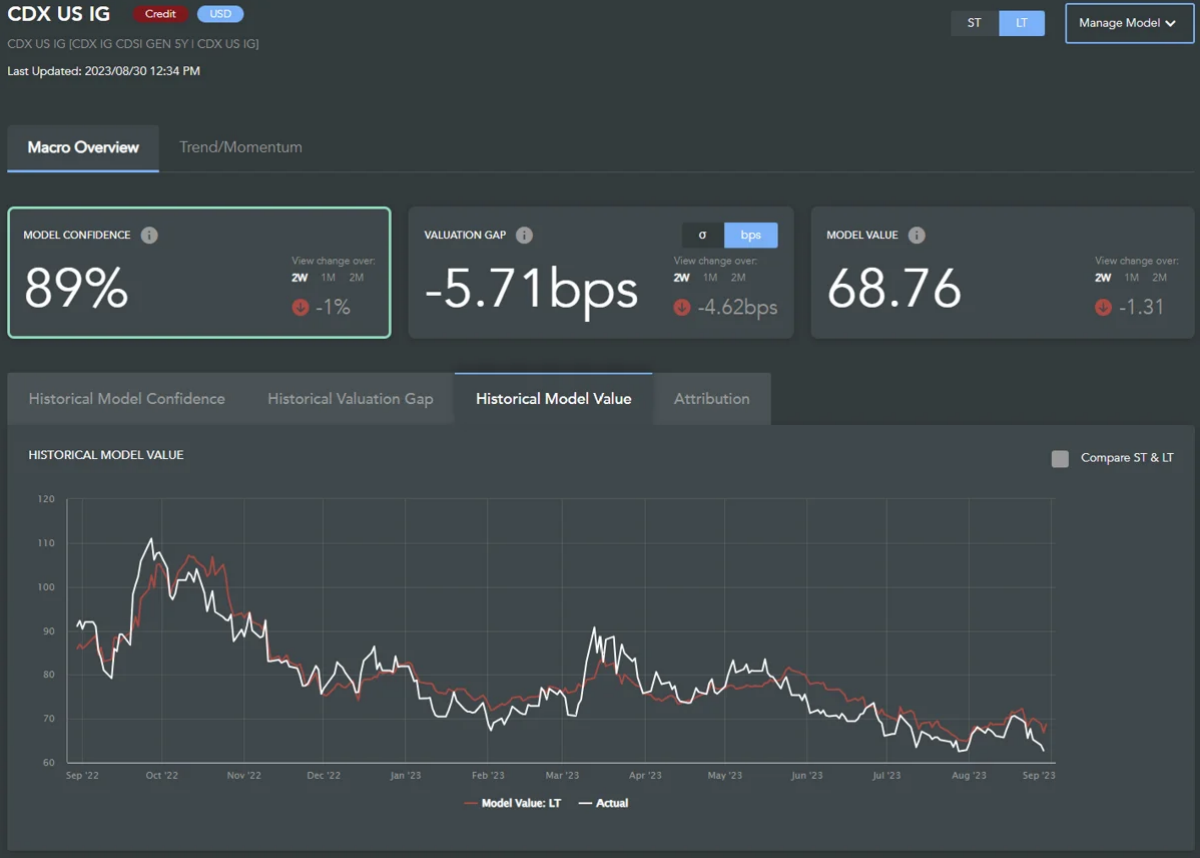
Model Name ▲	ST/LT ▲	Asset Class ▲	Confidence(%) ▲	Val Gap	Val Gap (σ) ▲	
<a href="#">CDX US IG</a>	LT	Credit	89%	-410....	-0.67	
<a href="#">IWM</a>	LT	ETFs	77%	-2.65%	-0.65	
<a href="#">iTRAXX EU IG</a>	LT	Credit	95%	-336....	-0.44	
<a href="#">iTRAXX EU HY</a>	LT	Credit	94%	-120...	-0.39	
<a href="#">German 10Y Bund</a>	LT	Rates	55%	-7.25...	-0.36	
<a href="#">CDX US HY</a>	LT	Credit	86%	-918....	-0.32	
<a href="#">Copper</a>	LT	Commodities	71%	-1.41%	-0.31	
<a href="#">SOXX</a>	LT	ETFs	88%	-3.18%	-0.30	
<a href="#">EWJ</a>	LT	ETFs	96%	-1.14%	-0.26	
<a href="#">UST TIPS 10y Breakeven</a>	LT	Rates	59%	-1.78...	-0.25	
<a href="#">QQQ</a>	LT	ETFs	90%	-2.37%	-0.24	
<a href="#">SPY</a>	LT	ETFs	93%	-1.13%	-0.24	
<a href="#">SCZ</a>	LT	ETFs	95%	-0.58%	-0.21	
<a href="#">EZU</a>	LT	ETFs	97%	-0.48%	-0.10	
<a href="#">AUDJPY</a>	LT	FX	75%	-0.17%	-0.07	
<a href="#">UST 10Y Note</a>	LT	Rates	85%	-1.06...	-0.04	
<a href="#">FXI</a>	LT	ETFs	83%	-0.04%	-0.01	
<a href="#">EURUSD</a>	LT	FX	88%	0.15%	0.09	
<a href="#">XLF vs. XLU</a>	LT	ETFs	57%	0.63%	0.13	
<a href="#">XLP vs. XLY</a>	LT	ETFs	72%	1.37%	0.14	
<a href="#">STS vs. STR</a>	LT	ETFs	91%	2.30%	0.44	
<a href="#">SX7P vs. SX6P</a>	LT	Equity	61%	2.63%	0.44	
<a href="#">USDJPY</a>	LT	FX	89%	1.95%	0.59	
<a href="#">USD 2Y10Y Spr</a>	LT	Rates	60%	10.3...	0.64	
<a href="#">IGV vs. SOXX</a>	LT	ETFs	68%	2.13%	0.85	
<a href="#">USDSEK</a>	LT	FX	62%	2.00%	0.98	
<a href="#">SXDP vs. SXAP</a>	LT	Equity	49%	5.70%	1.08	

- The clear standout is **credit**. Whether US or European, whether Investment Grade or High Yield, spreads screen as too tight on Qi's models. The Fair Value Gaps are modest (around half a standard deviation only) but macro explanatory power is high and the message is unequivocal - **credit is not priced for any uptick in recession fears**. US Investment Grade credit spread model shown below.
- Elsewhere in Fixed Income, government bond yields - both nominal & breakevens - are in line with macro conditions.

- The equity picture is mixed, but overall global equities are largely bang in line with aggregate macro conditions. The biggest valuation outliers both appear in Europe.
- If you're team Goldilocks European Autos look a cheap cyclical play versus their defensive Health Care peers - SXDP is nearly 6.0% rich to [SXAP](#).
- If you fear a recession, European Banks are 2.6% rich to Utilities [SX7P vs. SX6P](#).
- US equity indices are all modestly cheap to overall macro conditions but [IWM](#) is the only one with any meaningful valuation gap. Given the higher proportion of unprofitable companies more sensitive to interest rates, it is no surprise to see the Russell 2000 screens as 2.7% below macro-warranted fair value. Even more noticeable, **macro momentum is turning up for SPY, QQQ and IWM.**
- The FX market seems biased to trading defensively with the Dollar somewhat rich; most notably [USDSEK](#) which we use as a proxy for high beta Europe & market fears around the housing sector.

Again, this is not a definitive list of cyclical assets. Our [Recession Watch](#) is available off-the shelf, or create your own [customised Watchlist](#) in the Qi portal and, with one easy eyeball, you have the ability to quickly monitor where markets are pricing Goldilocks and where a potential Bust is gaining traction.

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