White Paper – September 2022

Avoid macro "landmines"

How stock pickers can outperform tighter financial conditions

Summary

- Tighter financial conditions are a significant headwind for equities into year-end.
- How can equity managers try to insulate themselves from macro shocks like wider credit spreads & higher real yields?
- Qi factor sensitivities identify the stocks which are most vulnerable to tighter financial conditions, versus the ones that are comparatively resilient.
- In the 3weeks since the summer rally peaked & reversed lower, Qi's pick of resilient stocks **outperformed the most vulnerable by 7%** & the **S&P500 by 3%.**

Measuring Macro.

The summer rally in US equity markets saw the S&P500 peak on Aug 16th at 4,325. Thereafter, the Fed pushed back against the idea of a dovish policy pivot & financial conditions tightened sharply.

Two of the dominant drivers of that FCI tightening was a 94bp widening in US High Yield credit spreads & a 42bp increase in 10y US real yields. By close of business September 5th, the S&P500 was 9.0% lower.

To demonstrate Qi's ability to help stock-pickers understand the macro headwinds they face, we ran the following exercise.

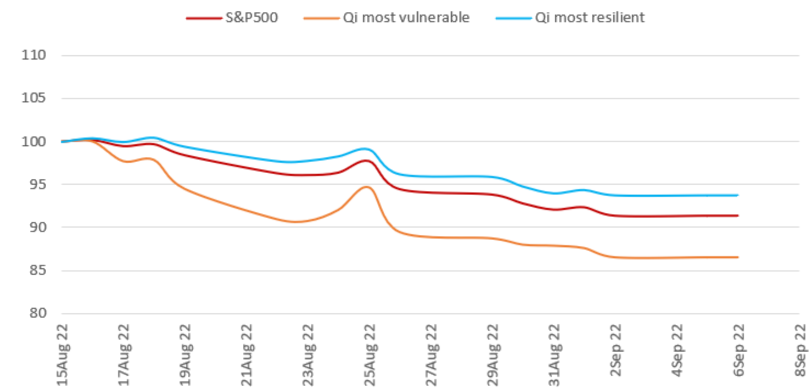
Using data from Aug 15th, the eve of the summer high, we filtered the entire S&P500 for those stocks in macro regimes (defined by model confidence of 65% or more).

We then screened for sensitivity to two factors - US High Yield credit & 10y US Real Yields. The 10 stocks with the greatest negative sensitivity (i.e. most dependent on low real yields & tight credit spreads) became the "*Qi most vulnerable*" basket.

In contrast, the 10 with smaller sensitivities (i.e. were less reliant on easy financial conditions) make up the "*Qi most resilient*" basket. Both baskets consist of 10 equally weighted stocks.

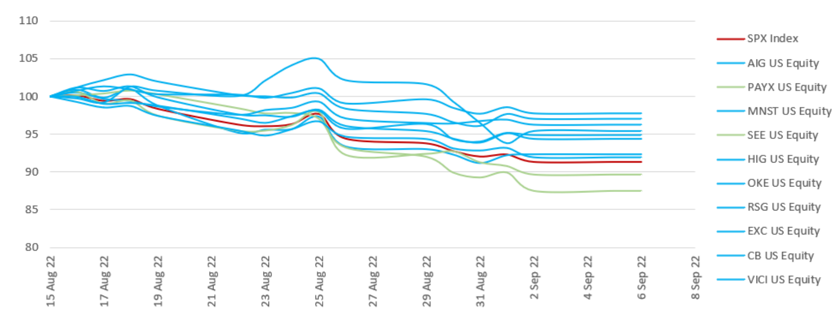
Results

While the S&P500 fell 9.0% between Aug 15th & Sep 5th, the **"*Qi most resilient* stocks" only fell 6.0%** while the **"*Qi most vulnerable*" fell 13.0%.**

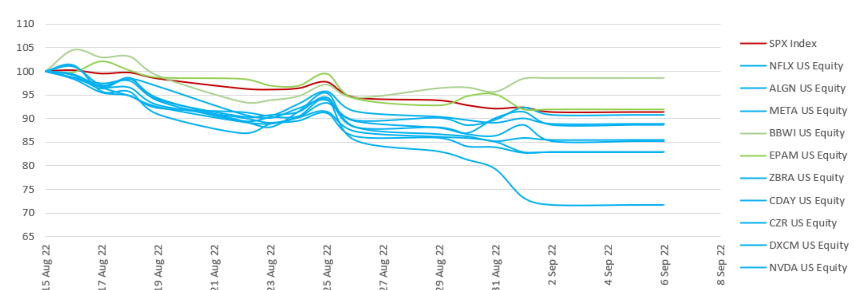


Break-down

Amongst the "*Qi most resilient names*", eight outperformed the S&P500 over the last 3 weeks, & two underperformed. Paychex (PAYX) & Sealed Air Corp (SEE) were the laggards.



It's the same with "*Qi most vulnerable*" names. All bar two (EPAM, Bath & Body Works) fell more than the broad index.



Conclusion

These are macro markets. Only by measuring your macro exposures can equity managers start the process of managing all the risks from inflation, Central Bank policy tightening, stagflation versus recession etc.

Qi **quantifies the independent sensitivity** of any stock, ETF, sector or index to a wide range of macro factors.

These are the building blocks that enable users to build an accurate picture of the risks they are running. From there, the Qi framework allows you to run stress tests, shift allocations to reflect the tail risks they are most worried about.