



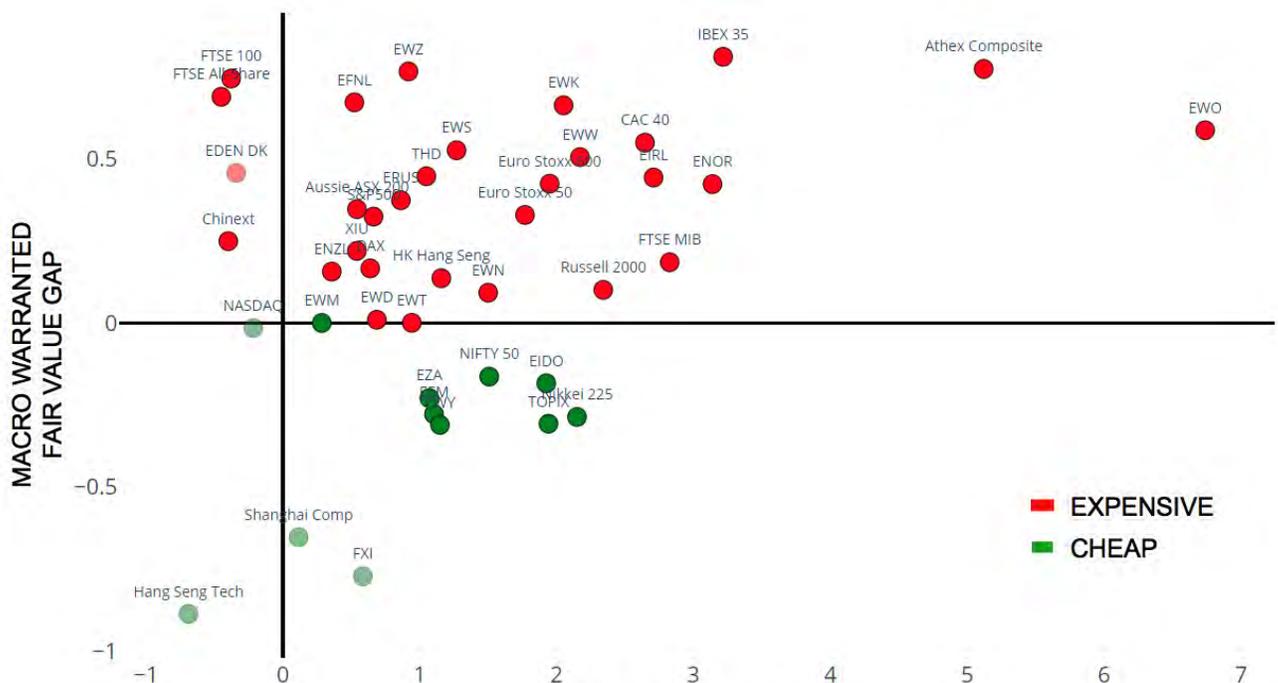
Qi Macroscope

7 May 2021

Nations love inflation, until they dont

While equity investors were put on their heels by US Treasury Secretary Yellen's mere utterance of a possible future rate hike, at the moment inflation is the friend and positive macro driver of most global equity markets, according to **Quant Insight (Qi)** data tracking the influence of macro drivers on asset prices. Yellen later backtracked but her comment still sent shockwaves through global financial markets, especially after recent PMI data pointing to bottlenecks in supply chains and upward pressure on inflation.

Qi data indicate that some global equity markets benefit more from inflation than others with smaller markets in Europe such as **Austria, Greece, Norway, Spain** and **Italy** getting the biggest tailwind from rising inflation expectations. On broader macro valuation terms there is a distinct East-West divide as US and European equity markets look consistently expensive while markets cheap to macro are generally in Asia, with **Japan** (both the Nikkei and TOPIX indices), **Indonesia, Korea, India** and **Emerging Markets** both attractively valued and benefitting from inflation.



But inflation can be a fickle driver and, if persistent, can flip from a positive macro influence to a negative one. “There will be a point at which inflation becomes a headwind. That’s when we see markets worrying about margin compression at companies and possible earlier monetary policy responses by central banks” says Huw Roberts, Head of Analytics at Quant Insight. “We’re watching Qi data to spot when the wind shifts.”

Japan-US Momentum Trade

As noted above, Japanese equities get a boost from rising inflation expectations. But a Qi model tracking the fair value gap between Japan’s **Nikkei 225** and the **S&P 500** opened at the end of April which investors may want to monitor. With the recent sell-off in US equities and Japan equities remaining stable, though, that gap has been closing.

While investors interested in this trade would not be catching it at the absolute low in valuation, there may be a benefit to that. The latest price action has established a turn in the trend and has triggered a momentum “buy” signal on Qi’s newly launched **Retina** signals service, which aligns macro valuations with price trend and momentum dynamics.

Getting Tactical in Tech

The recent underperformance of Tech to the broader US equity market may offer an interesting tactical trade opportunity at least up until the June 16 FOMC meeting. In particular, Qi’s relative value model comparing a large-cap technology index tracker, XLK, versus the S&P 500 index tracker SPY, is at a fair value gap of 3.2%. The model confidence has dropped, however, in recent days just below Qi’s threshold for considering the model to be in a macro regime, i.e. driven by macro factors. This means investor sentiment and rotation trade positioning may be in the driver’s seat at the moment.

But stay tuned. This trade thrives in a defensive environment, when inflation expectations and commodities are falling, real rates decline and credit spreads widen. The better-than-expected jobless claims data in the US on May 6 suggests the reflation trade continues, but investors attempting to peer around the next corner might keep this trade in mind for a time when they feel the reflation trade is due for a consolidation.

Global markets this week – Top macro drivers

Qi Model	Valuation Gap %	Model Confidence %	1 mth Change Model Confidence %	Driver 1	Driver 2	Driver 3
<u>S&P500</u>	2.07	85	-9	Corporate Credit	Inflation	Eurozone Confidence
<u>NASDAQ</u>	-0.11	21	-2	Corporate Credit	Economic Growth	Energy
<u>Euro Stoxx 600</u>	2.57	93	-3	Inflation	Corporate Credit	Economic Growth
<u>Shanghai Comp</u>	-2.16	31	-22	Economic Growth	USD Liquidity	CB QT Expectations
<u>EURUSD</u>	-0.19	50	-21	Infl. Diff.	CB QT Expectations Ccy2	Rate Diff.
<u>USDJPY</u>	1.67	74	10	CB QT Expectations Ccy1	China / EM Stress	Eurozone Confidence
<u>AUDUSD</u>	-0.26	44	-40	Infl. Diff.	Risk Aversion	Economic Growth Ccy2
<u>Gold</u>	0.76	90	1	CB QT Expectations	Inflation	Global Yield
<u>Silver</u>	0.99	35	-22	Economic Growth	Global Yield	CB QT Expectations
<u>WTI</u>	1.36	91	-2	Corporate Credit	Global Yield	Economic Growth

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Overview

Mixed messages

Falling real yields suggest the bond market is signalling peak economic growth. But the commodity market is shouting loudly that inflation is the number one threat. For now, equity markets seem to be listening to commodities rather than bonds. Hence the cyclical versus tech split in performance this week

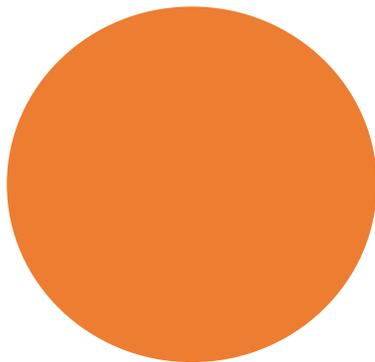
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Equity Indices

Global equity indices & inflation

This latest pullback in US equities has seen Industrials move to being 5.8% cheap versus Utilities. That's a one year low for the Qi Fair Value Gap

[5 May 2021](#)



Equities

Nikkei 225 vs S&P500

Falling real yields suggest the bond market is signalling peak economic growth. But the commodity market is shouting loudly that inflation is the number one threat. For now, equity markets seem to be listening to commodities rather than bonds. Hence the cyclical versus tech split in performance this week

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