Qi MacroVantage

MacroVantage scans all asset classes globally, looking for timely observations from Qi's AI driven framework.

Where an asset price has become divorced from macro fundamentals and offers a potential trade opportunity; where factor leadership may be changing or regimes shifting; employing Qi factor sensitivities to run scenario analysis on critical themes.

Topical, timely, machine-driven signals and observations.

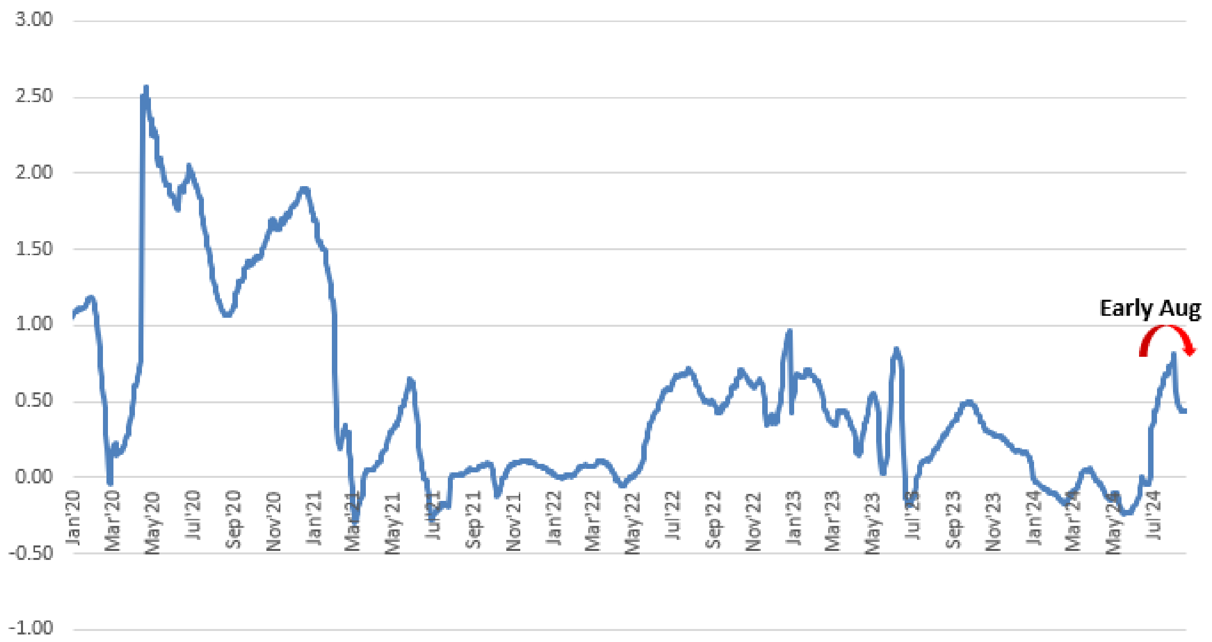
---

1. ***We remain in a growth-focused regime BUT sensitivity to GDP growth has dissipated from the panic highs at the start of the month***

On August 6th we wrote that the sharp risky asset pullback we had seen was likely temporary rather than sinister (*Qi Market Spotlight: Where are we now?)*. From Qi's perspective, there was little sign of macro panic under the hood – macro explanatory power across major assets remained well-explained and macro factor sensitivities did not suddenly lurch higher – the mantra "good news is goods news" was already well-recognised by Qi's models since early July. In turn, the SPY model price subsequently troughed and regained momentum in the aftermath of the deleveraging event.

What is interesting today is that while the regime remains firmly growth focussed (as evidenced by a shift in equity price / bond yield correlations to positive), that **sensitivity to growth seems to have peaked for now i.e. there appears to be more faith in the durability of the US economy** (recent micro / macro data has of course helped) – see the chart below. At the same time, SPY negative sensitivity to real yields and inflation expectations have been dissipating…in other words **less panic**.

Less panic may well mean more room for Fed. The presumption is that Chair Powell will reiterate in his Friday Jackson Hole speech that the Fed is close to cutting, is more comfortable with the inflation trajectory, now has more focus on the labour market, and is prepared to act swiftly. Taken together with less concerns on growth and weakness in the dollar (a broad support for SPY), risk sentiment likely has still some room to recover.



SPY Qi Sensitivity to GDP
3.00
2.50
2.00
1.50
1.00
0.50
0.00
-0.50
-1.00
Jan'20
Mar'20
May'20
Jul'20
Sep'20
Nov'20
Jan'21
Mar'21
May'21
Jul'21
Sep'21
Nov'21
Jan'22
Mar'22
May'22
Jul'22
Sep'22
Nov'22
Jan'23
Mar'23
May'23
Jul'23
Sep'23
Nov'23
Jan'24
Mar'24
May'24
Jul'24
Early Aug

2. Winners & Losers from the Dollar Meltdown

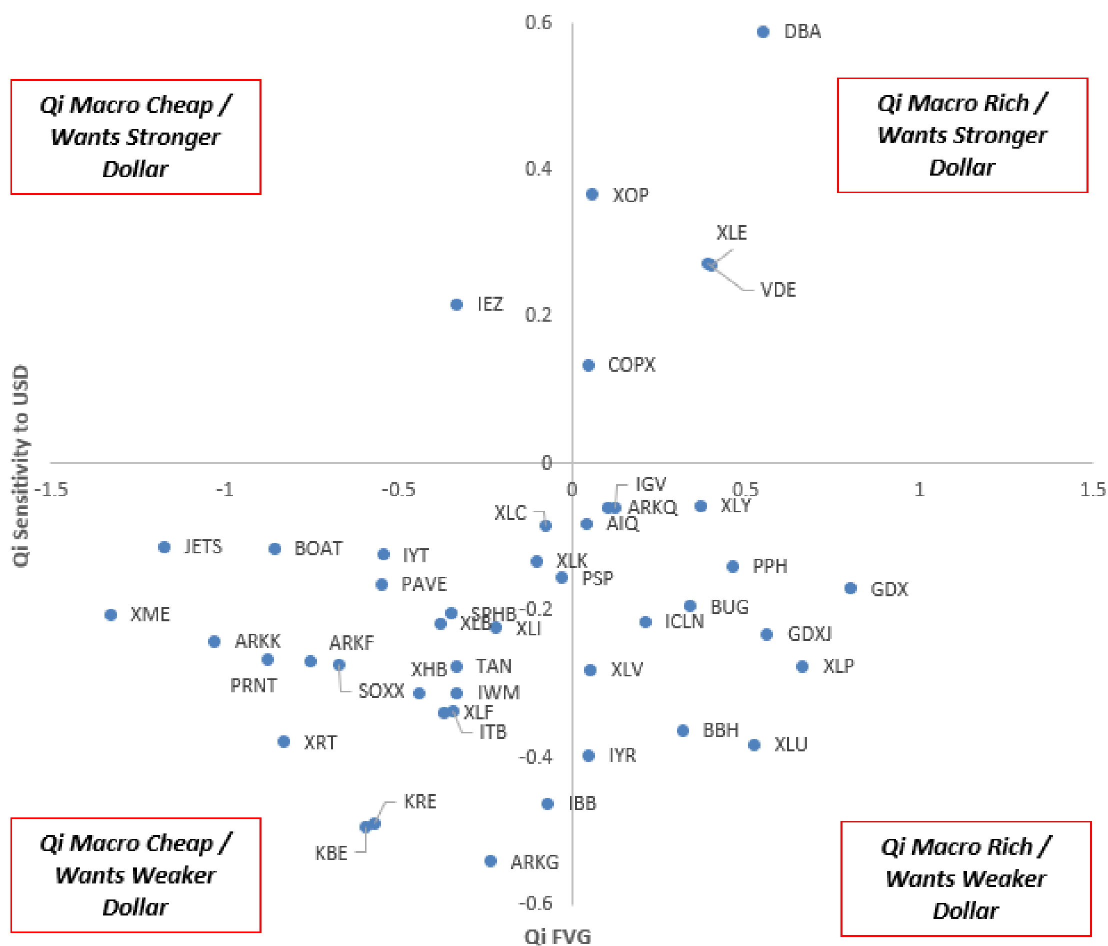
The dollar meltdown has been the key theme for the week – maybe the dollar does not like either presidential candidate! But by far the biggest driver has been the sharp re-pricing in Fed Funds to now 4 cuts by year end but also reflecting the carry unwinding we have seen. Jackson Hole commentary is clearly important for the next mark-to-market move in the dollar.

However, with the above in mind, it is instructive to compare the Qi FVGs of the major equity ETFs with their sensitivity to the dollar – see the below quadrant chart.

We can make a couple of observations:

1/ **No surprise that most sectors want a weaker dollar** – the biggest beneficiaries of a weaker dollar are both banks, retail and homebuilders at the value end of the spectrum and more speculative ARKG and IBB. In contrast, the energy sector would relatively benefit if we see dollar strength

2/ Those **sectors that are trading cheapest to Qi macro fair value are cyclicals**: miners (XME), global airlines (JETS), global shipping (BOAT), speculative tech (ARKK), retail (XRT) and regional banks (KRE). However, it is retail and banks that have both valuation merit and most sensitive if we see the dollar weaken further.



3. *The Dollar is priced for a dovish Powell*

Qi's macro snapshot of US Dollar G10 fx crosses is shown below. Two main observations:

- Macro matters – model confidence is high indicating macro conditions are a critical driver of price action.
- The Dollar is uniformly cheap to its peers. Every Dollar cross is at least 0.5 sigma cheap to model value. The book-ends are the two G3 majors with USDJPY 1 sigma cheap and EURUSD 1.5 sigma rich to aggregate macro conditions.

Model Name	ST/LT	Asset Class	Confidence(%)	Val Gap	Val Gap (σ)
USDJPY	LT	FX	69%	-3.72%	-1.04
USDSEK	LT	FX	65%	-1.72%	-0.82
USDCHF	LT	FX	84%	-1.42%	-0.63
USDCAD	LT	FX	57%	-0.59%	-0.56
USDNOK	LT	FX	56%	-1.07%	-0.51
NZDUSD	LT	FX	65%	0.84%	0.51
GBPUSD	LT	FX	74%	0.71%	0.72
AUDUSD	LT	FX	72%	1.00%	0.76
EURUSD	LT	FX	70%	1.30%	1.48

Qi clients will have already received mid-week updates about EURUSD – contact Qi sales to enquire. These are extended levels in Qi Fair Value Gaps that are rarely seen.

Our back tests and 1y correlation stats suggest the risk-reward is not great for chasing further Euro upside. Macro momentum (i.e. Qi model value), however, is trending higher. Waiting for this to peak is *the* critical catalyst before calling a top.

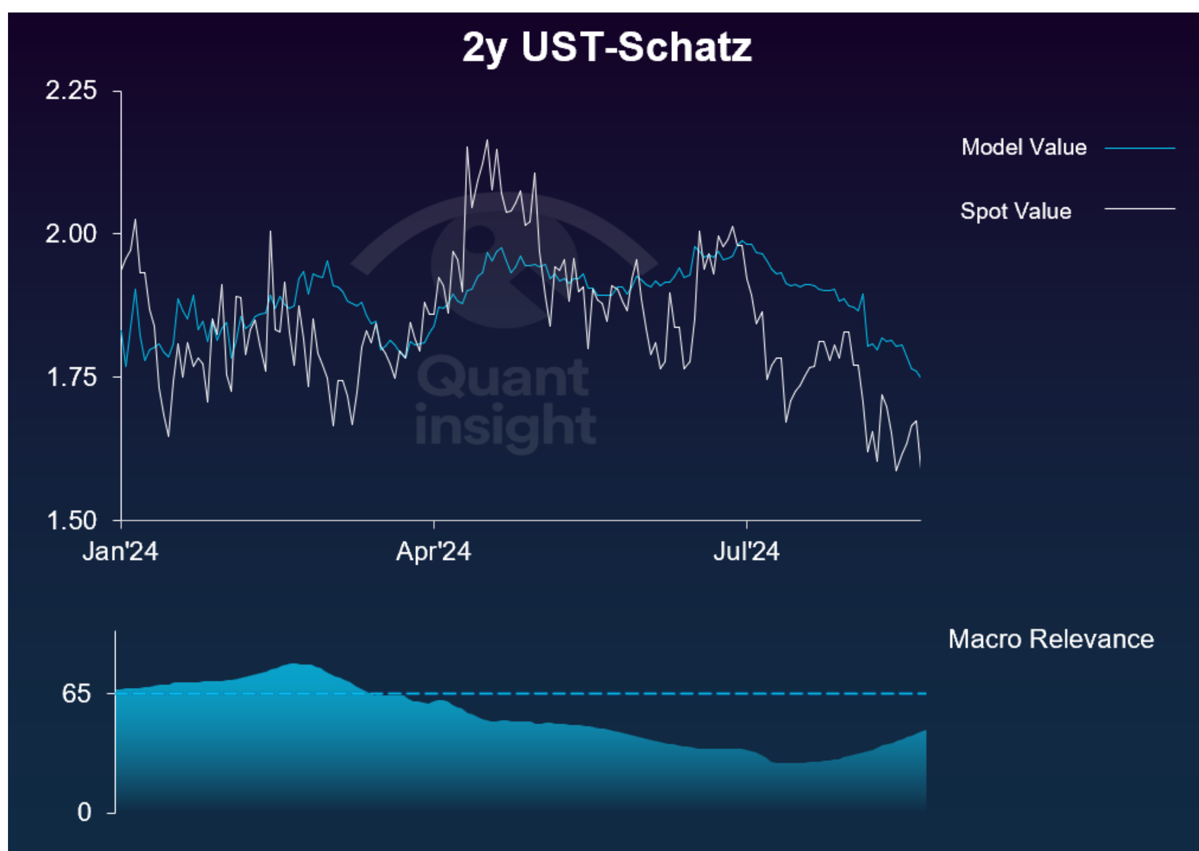
Finally, given the importance of interest rate differentials in the EURUSD model, the following bond market observation will only add to the sense the recent Fed re-pricing is starting to look somewhat stretched. Put another way, the onus is on Powell to deliver even more of a dovish surprise to maintain the current momentum.

4.) **It's not just equities and the Dollar. Bond markets expect a dovish Jackson Hole too.**

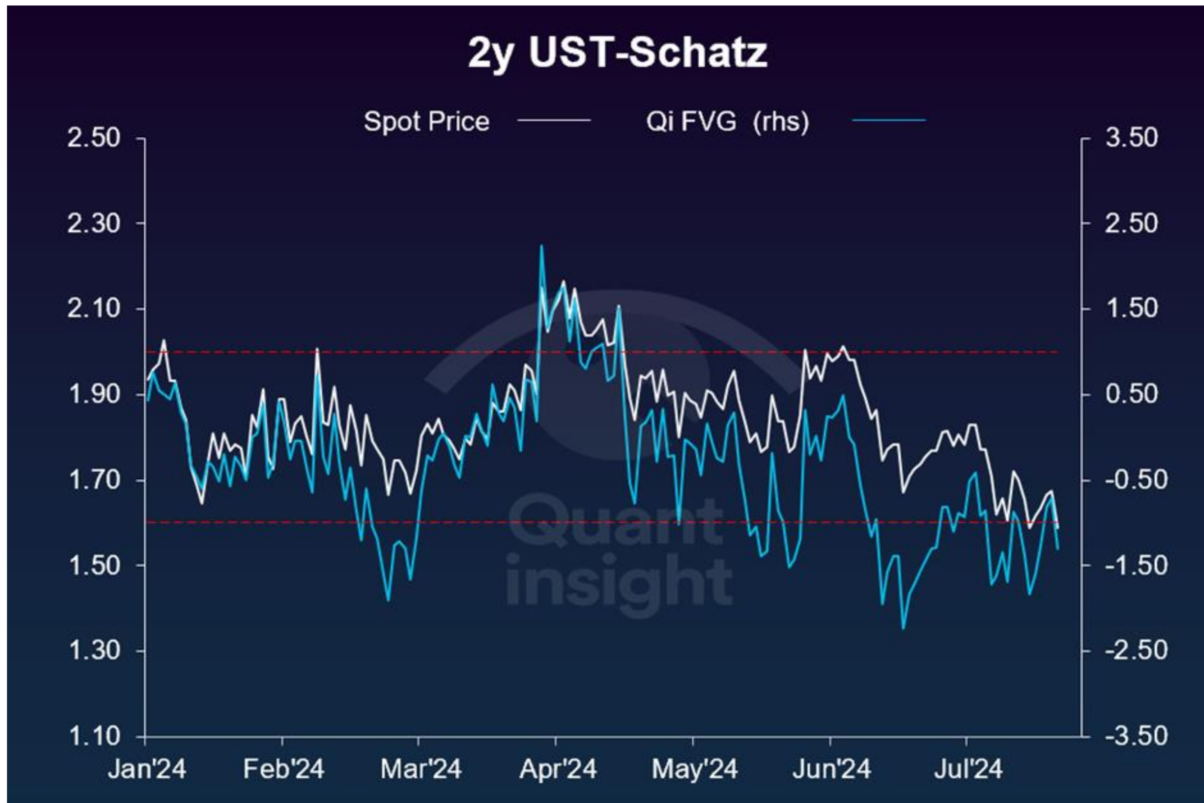
It is worth noting the degree of re-pricing in the front end of the US Treasury market. 2y UST yields are back below 4%; so already 1250-150bp through the official Fed Funds Target Rate.

And this has been a US-led move: US 2y Note yields spread to German Schatz yields has narrowed 20bp in August. Qi shows that spread is now 1 sigma (16bp) below model value.

Macro's explanatory power fell in q2 and remains below our 65% threshold but appears to be making a comeback. Yes, model value is falling – macro conditions point to lower US yields relative to German yields. But the market appears to have moved too-far-too-fast.



Moreover, Qi's Fair Value Gap has done a good job of capturing the local highs and lows in the cross-market spread itself in 2024. Once again, the risk-reward for chasing further UST outperformance (&, by implication, Dollar downside) is not great here.

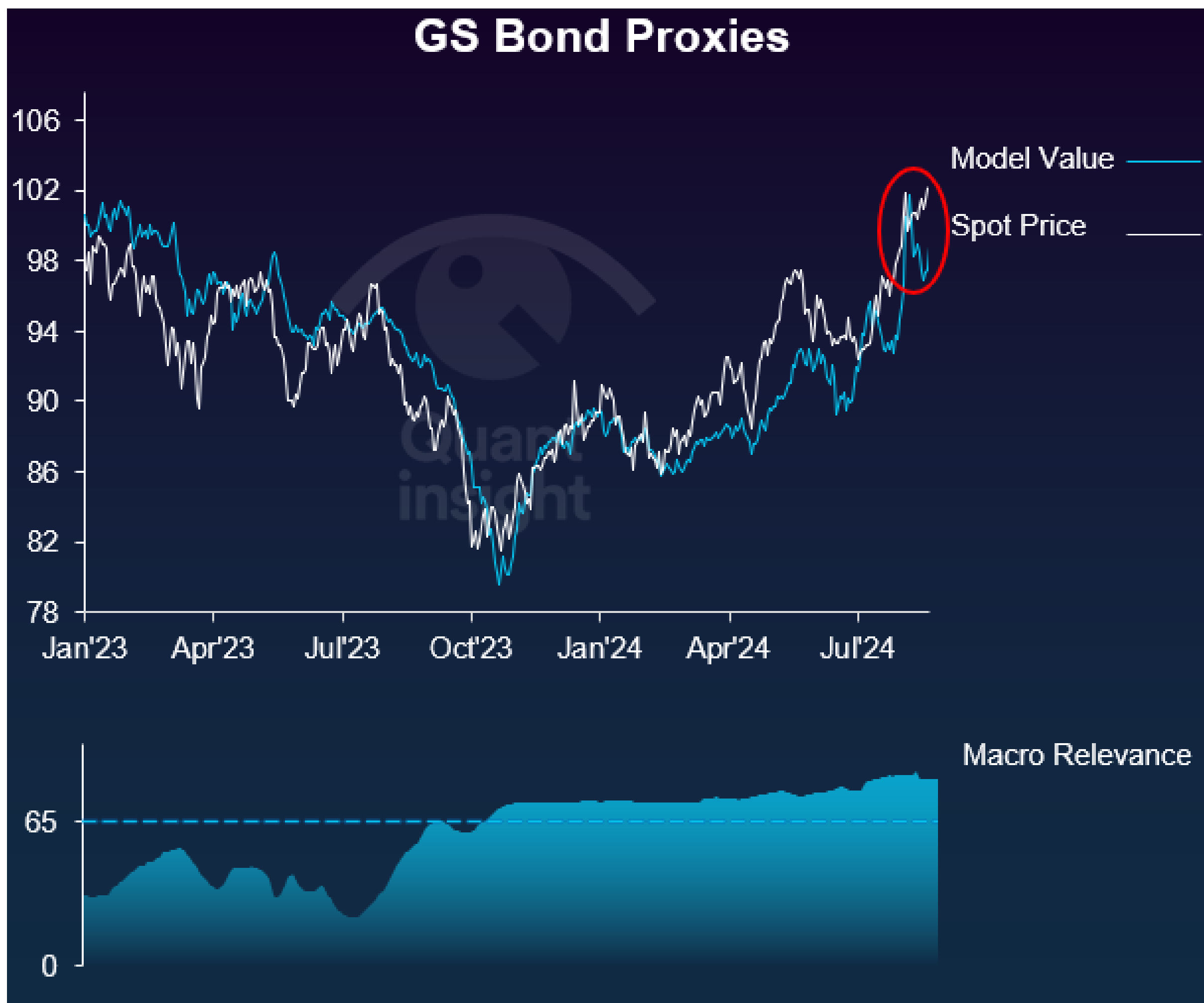


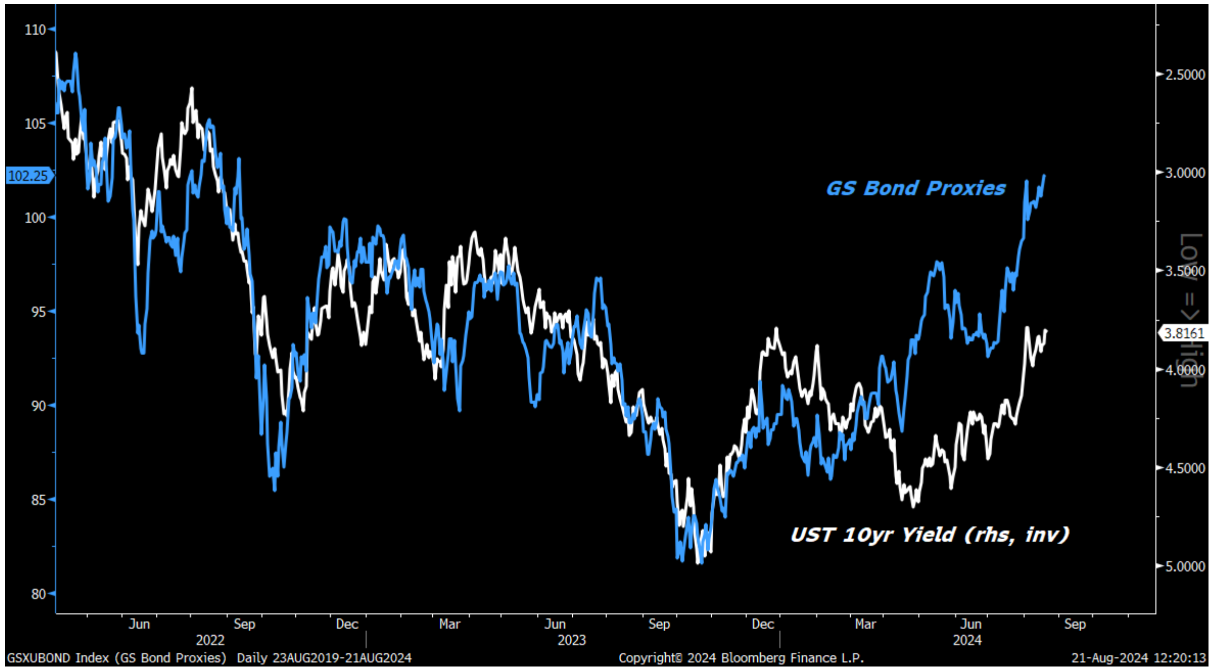
5. Bond proxy sectors too excited on growth slowdown and ahead of Jackson Hole?

Screening across sectors, the sectors making new highs in this rally include Utilities and Staples. However, these sectors are now both trading at the rich end of the sector valuation spectrum, at +0.5 and +0.7 sigma respectively.

This can perhaps be best visualised by the GS bond proxies basket which is dominated by these sectors. The first charts below shows the recent divergence between the recent higher spot price and lower Qi model value – currently the basket is trading at ~+1 sigma.

The second chart shows the simply overlay of this basket vs. 10y yields (inverted). **With the basket making new 1yr highs but 10yr yields not making new 1yr lows, it appears bond proxy sectors may have become too excited ahead of Jackson Hole**.




GS Bond Proxies
UST 10yr Yield (rhs, inv)
GSXUBOND Index (GS Bond Proxies) Daily 23AUG2019-21AUG2024
Copyright© 2024 Bloomberg Finance L.P.
21-Aug-2024 12:20:13

6. ***XLE vs XME: Energy vs Miners***

- Energy is trading 1.2 standard deviations or ~5% rich to miners
- Key positive drivers for this cross are higher real rates, higher inflation, higher dollar and higher credit spreads
- So easier financial conditions should drive this cross lower
- A more actively dovish FED (perhaps signalled at Jackson Hole) could be the catalyst here