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.

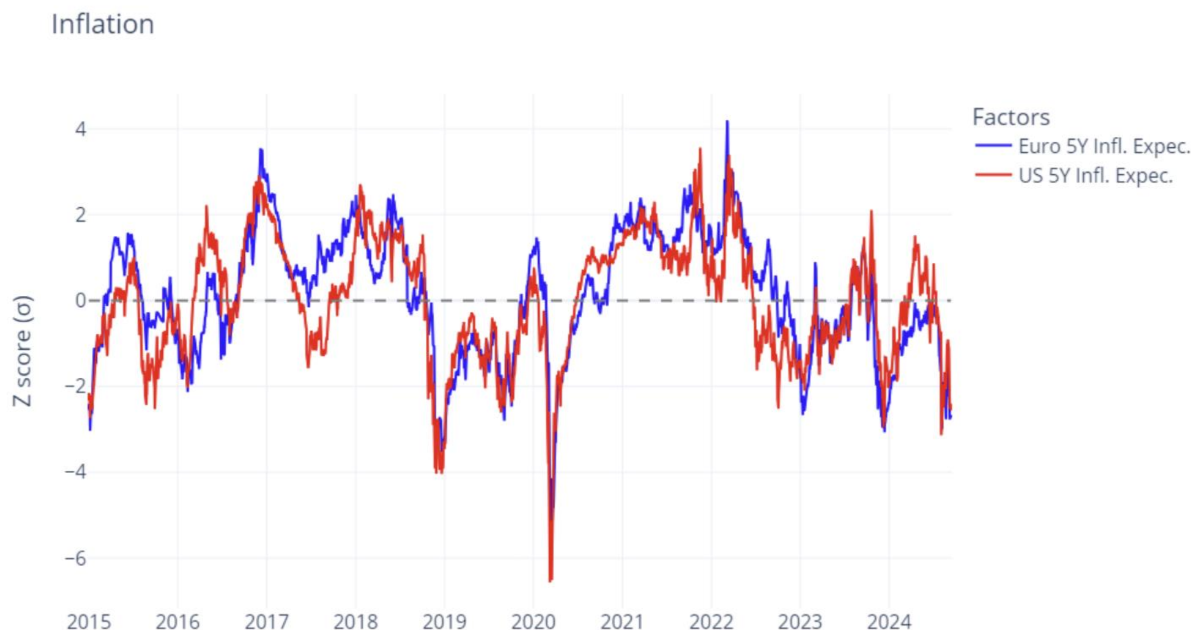
Topical, timely, machine-driven signals and observations.

1.) <u>The inflation battle is over. Disinflation is the new enemy?</u>

Prior to yesterday's CPI report, inflation expectations were making new local lows. Even after the core print, 10y US TIP break-evens are flirting with 2%. On Qi, both US & European inflation swaps in z-score terms are around 2.5 standard deviations below trend. Outside of Covid, these are rarified levels.

Commodity markets are a big part of this move. WTI is also 2.5 standard deviations below trend on Qi. Iron Ore sits 2 sigma below trend. That, in turn, could suggest this is less a recession signal for Western economies than an indication that China is exporting deflation.

That debate will rage amongst economists. The message from Qi is simply this – a lot of disinflation news is priced into the market, which begs the questions which areas of the market are leading or lagging this move?

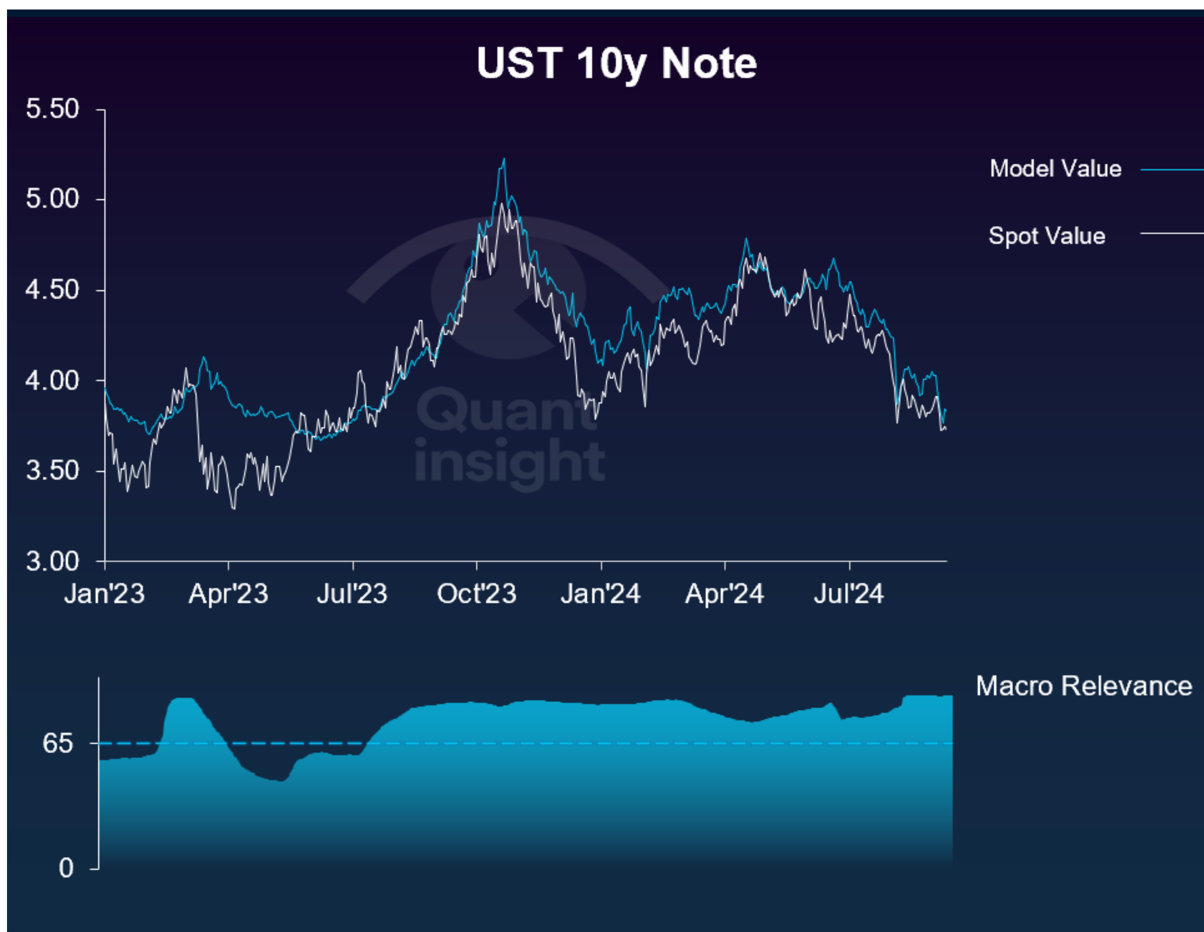


2.) **Recession? Buy bonds??**

Qi's model for 10y UST yields has 90% confidence. Unsurprisingly, bond yields are hostage to the broad macro-economic environment. Current patterns suggest 10s should yield around 3.84%. That suggests the bond market has rallied around 17bp too far versus prevailing macro conditions.

To be fair, there is a clear downward trend. Macro momentum has been pointing to lower yields, primarily thanks to falling energy prices, inflation expectations plus its role as a safe haven captured via strong negative sensitivity to VIX.

It's just that, at these levels, the market has moved ahead of things. From a risk-reward perspective, USTs aren't a great recession hedge at these levels. It's a similar but slightly less extended picture with 10y Bunds which sit 9bp too low versus Qi model value.



3.) Cheap inflation hedges

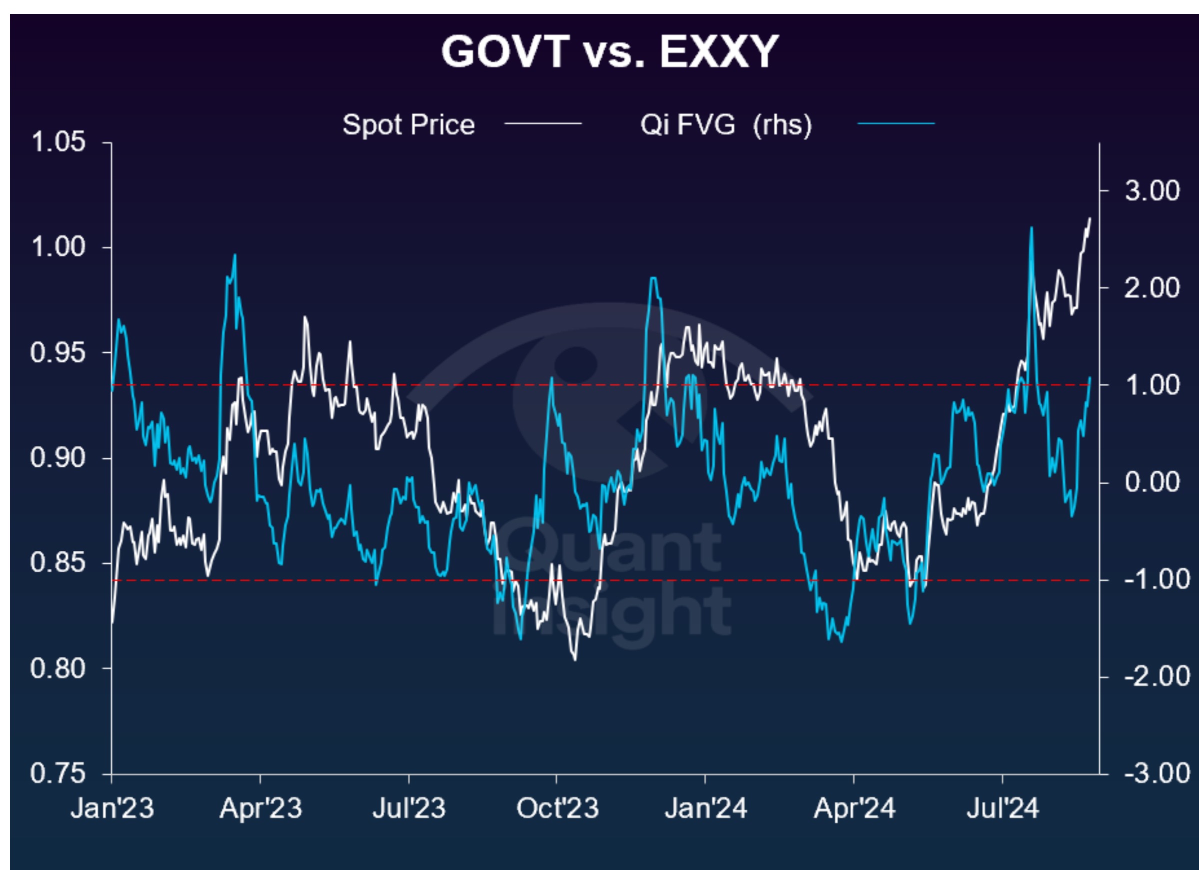
GOVT is the iShares ETF providing exposure to US Treasury bonds. EXXY is their Diversified Commodity Swap ETF which includes energy, base & precious metals plus agricultural commodities.

Qi models the RV between the two funds. Once again, model confidence is high and stable. Macro matters. As above, macro momentum had been firmly behind the disinflation narrative. Qi model value rose 17% in the June-Aug period: weak economic growth and spates of risk aversion drove UST outperformance versus commodities.

But Qi's macro-warranted model value peaked at the end of August and is now off almost 2%. And that has opened up a 1 std dev (4.6%) Fair Value Gap and a potential bearish divergence pattern.

Momentum players and recessionistas will dismiss this as simply a pause that refreshes the primary trend. For others, the conclusion is the market is starting to offer nice entry levels to hard assets or inflation hedges.

The strong correlation between the spot RV and Qi's FVG over the last 18months offers some support for the idea that, more recently, these ETFs have mean reverted back towards Qi fair value.

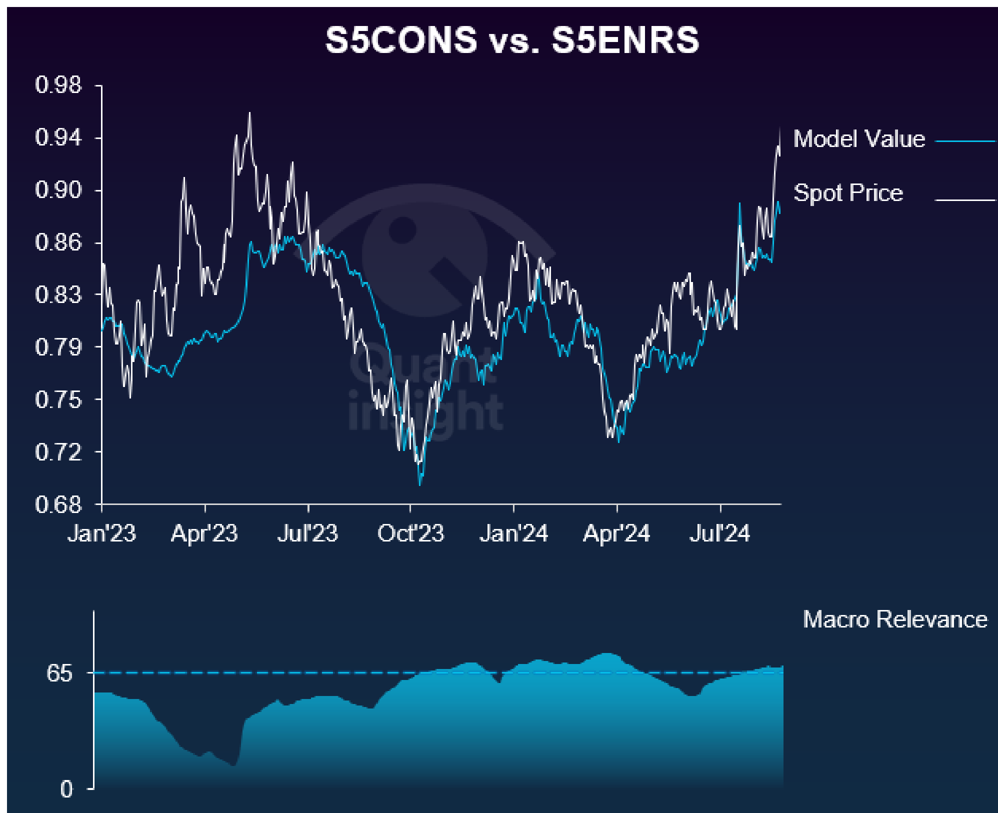


4.) Defensives vs. Commodity Equities – the book-end relative performance is becoming stretched

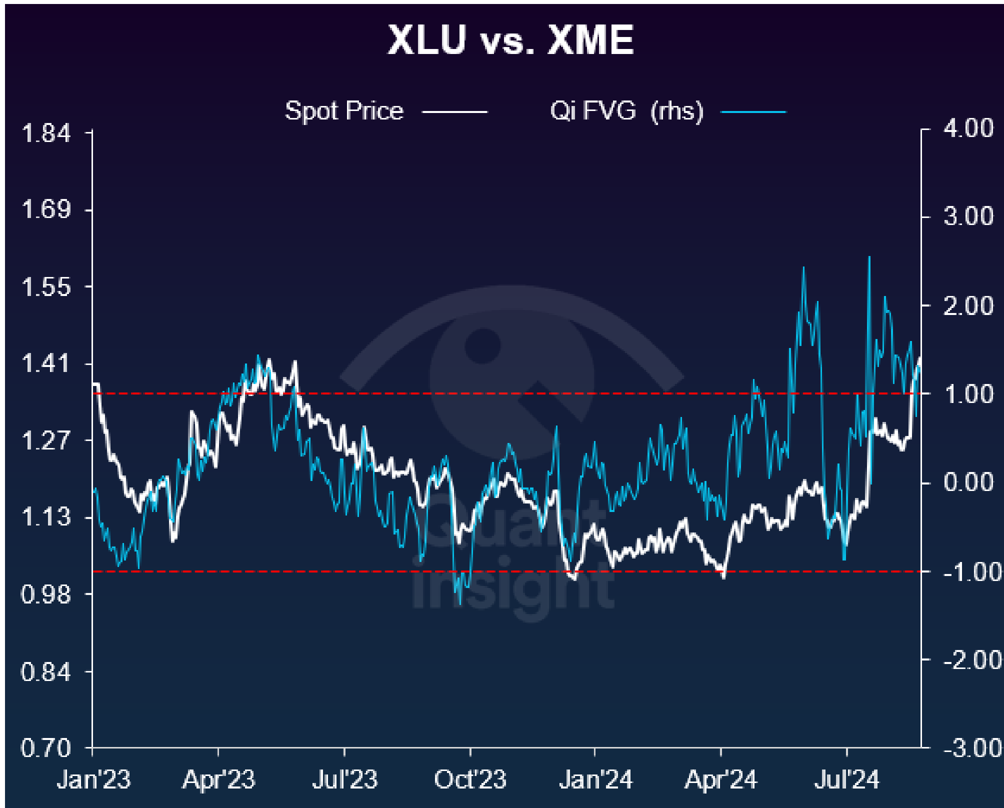
Uncertainty on the economic outlook has seen Treasury yields fall in 7 of the last 8 sessions and crude approach 3yr lows. As discussed above, this in turn has pulled inflation expectations to new lows, piling pressure on energy companies. Meanwhile in China, SHPROP is making new lows. All of this is happening in a backdrop of uncertainty around the Fed policy and a range of outcomes on the US election.

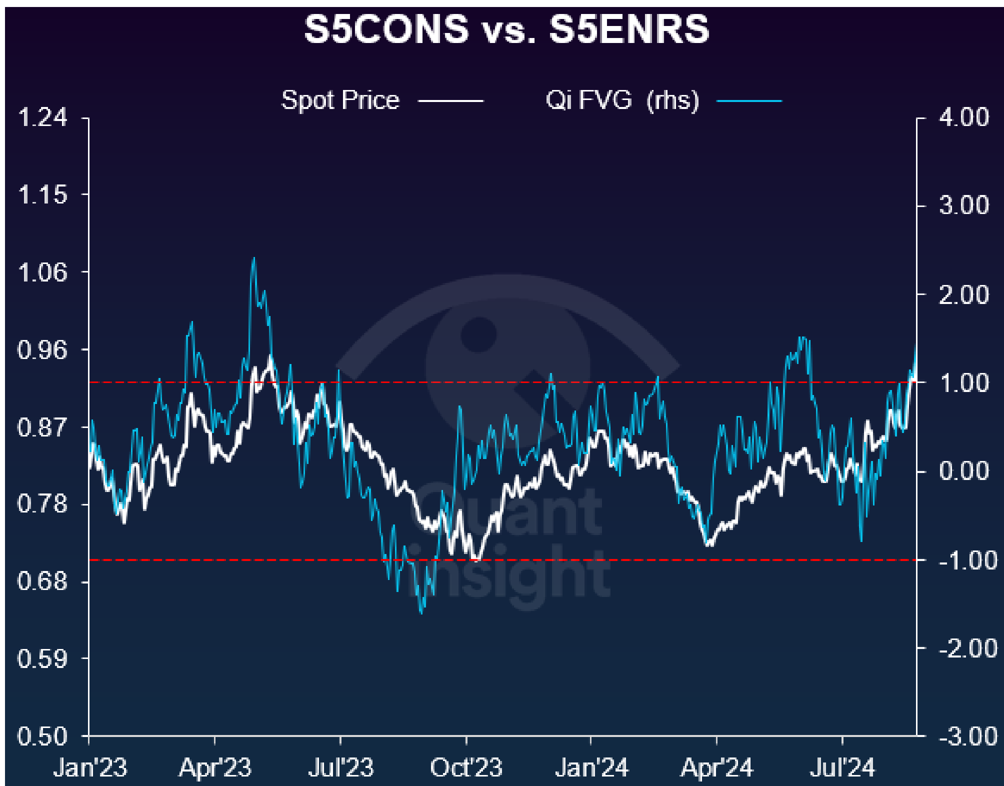
In equity space, these fears may be best characterized by the book-ends in terms of sector performers since the 16th July S&P500 peak – Utilities / Staples vs. Energy / Metals & Mining.

Below we show XLU vs. XME and S5CONS vs. S5ENRS through the lens of Qi's model value. Over the last month, the spot price of these RV pairs have accelerated higher in contrast to a more subdued model value. Both models are comfortably in a macro-driven regime, i.e. RSq > 65%



This over-extension is reflected in an FVG in these RV pairs at the upper end of their recent historical ranges.


XLU vs. XME
Spot Price
Qi FVG (rhs)
1.84
1.69
1.55
1.41
1.27
1.13
0.98
0.84
0.70
4.00
3.00
2.00
1.00
0.00
-1.00
-2.00
-3.00
Jan'23
Apr'23
Jul'23
Oct'23
Jan'24
Apr'24
Jul'24


S5CONS vs. S5ENRS
Spot Price
Qi FVG (rhs)
1.24
1.15
1.06
0.96
0.87
0.78
0.68
0.59
0.50
4.00
3.00
2.00
1.00
0.00
-1.00
-2.00
-3.00
Jan'23
Apr'23
Jul'23
Oct'23
Jan'24
Apr'24
Jul'24

Has the elastic been stretched further historically? Yes, but with oil at 3yr lows and the sharp cut in positioning, we wonder of the possibility of a crude short squeeze. Backtests show a 66% win hit ratio fading XLU vs. XME here.

5.) **XLF macro beta impulse to credit rising**

Earlier this week we noted that until recently XLF had demonstrated confidence in the credit cycle. HY credit spreads had not returned back to their tights but XLF until very recently was at ATHs. The easing in financial conditions have been at the epicentre of the XLF rally. However, with the balance of risks now tilting to the degree of slowdown, we note that sensitivity to credit spreads is starting to accelerate on Qi's ST model, where macro explanatory power is high at 69%