1. The bull vs. bear case for risk rests on whether FCIs bite

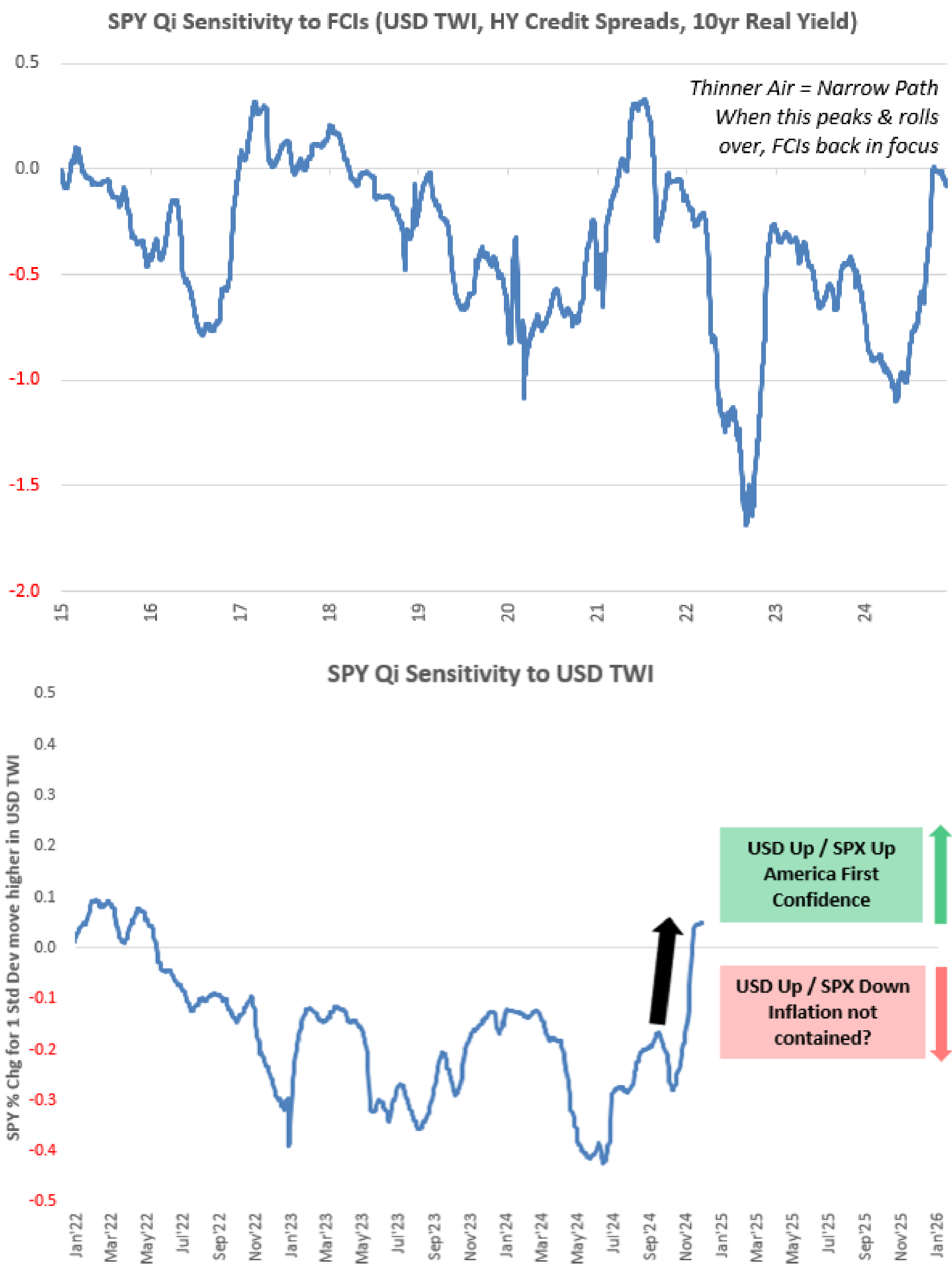
The bull case for risk is that positioning and sentiment have reset with the equity market weakness since the election. Alongside, Trump's tariff agenda might be less disruptive than feared. This pessimism is reflected in Qi's models through (1) macro explanatory power that has been fading over the last month given the regime uncertainty and (2) SPY reaching 0.75 sigma below Qi model price at the turn of the year – 1yr lows. Together with Qi's models showing bonds in oversold territory, there is enough for some risk respite.

The bear case for risk is that "hope" is not a strategy – Trump volatility keeps sentiment on the backfoot. Alongside, financial conditions are entering restrictive territory. The 6.2pt surge in ISM Services Prices is hinting at untamed inflation. IF financial conditions are entering restrictive territory, then this week's NFP data could prove important. Further, we may well be back to "good news is bad news".

One barometer for the bull vs. bear case is to track the relationship of risky assets to the dollar, real rates and credit spreads. By the turn of the year, we reached a point where this relationship was reaching the top of its historical range i.e. FCIs were deemed a non-issue (under the pretext of US Exceptionalism) - a back drop where the S&P500 was deemed strong enough to withstand a strong US dollar, positive real rates and no concerns on the credit cycle. But of course, in this region the air is thinner…see the first chart.

More simply we would argue that given the success of Trump's policy agenda will have a large bearing on the performance of US assets, it follows that the strength of a positive relationship between the dollar and S&P500 (i.e. both the Dollar AND Stocks move up) is a reflection of

confidence in Trump's domestic agenda / America First. If the tail risks e.g. inflation are not contained, FCIs will matter and we go back to a negative relationship - USD up / S&P500 down.



2. Value/Growth and Bond Yields – A regime shift

The last 2 years have cemented the outperformance of Growth Stocks over Value Stocks. Indeed, the outperformance of Growth over Value continues a trend that has been in place since the start of the last decade through the biggest bull market of our generation!

However, a clear message of the last 2 years is that the fundamental drivers of Growth vs Value has changed:

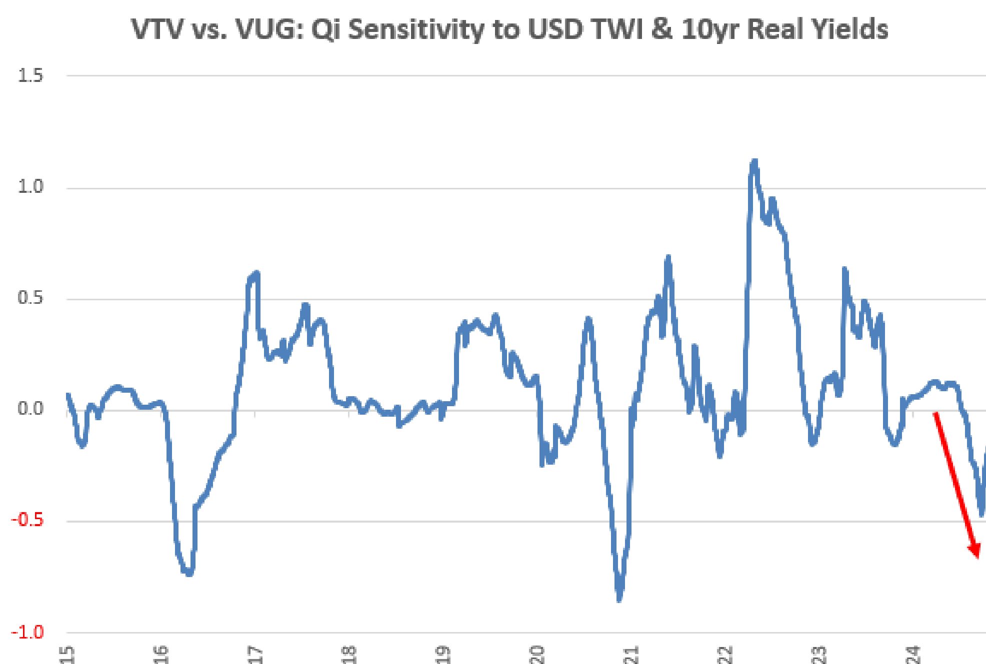
The last decade norm was that Growth tended to be "hope" and so was much more sensitive to the discount rate on terminal value - current ROI prospects were poor. Now Growth shows prospects of

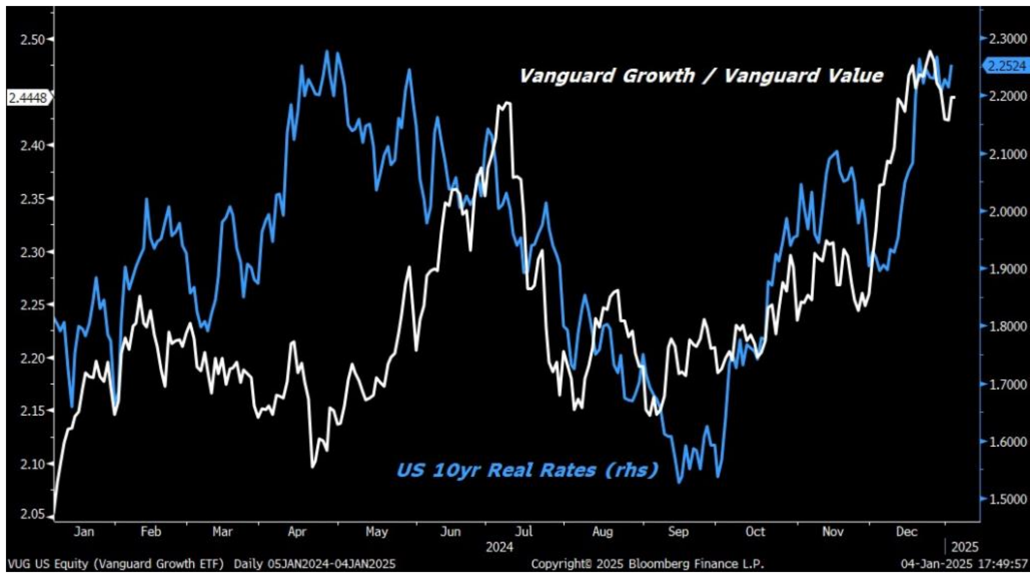
much higher current ROI. The superior performance of Growth over the last 2yrs was largely in recognition of this far superior earnings profile, fueled by the secular AI narrative.

Contrast this with Value – across the forest of investment projects, the lower return ones are more likely to fall in the value camp – a lower ROI requires a lower cost of capital associated with a weaker Dollar / lower rates.

Qi's models empirically concurs with this view. Over the last two years, for Value to outperform Growth, it was has wanted to see lower real rates and more recently a weaker Dollar. That's a change from the norms of the past decade where higher real rates implied higher economic confidence allowing respite for Value while tighter FCIs hurt Growth. The tables have turned.

Indeed, Qi's models send a further message. If we remain in a risk-on / strong $ backdrop, Growth will likely continue to outperform. After all, the S&P500 itself is now dominated by Growth stocks. A Value reversal is more likely in a risk-off backdrop where confidence on US asset reflation (higher USD / higher stocks) is fading.

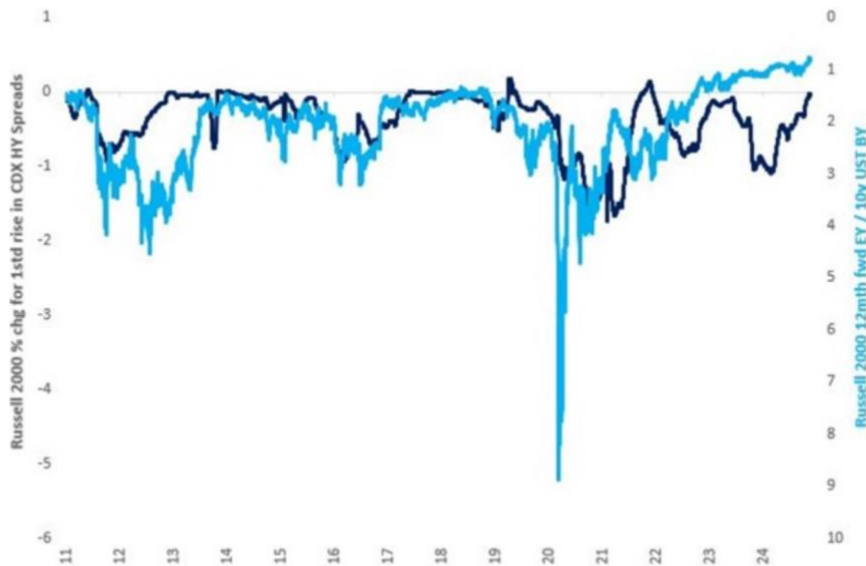




3. Small Caps – Similarly, the worrying indifference to credit spreads

Qi's lens on the Russell 2000 warns of the risk between expectations and reality – R2K factor sensitivity to HY credit spreads has dissipated to almost zero on our model. Ordinarily, there is a large negative relationship i.e. higher spreads, weaker small caps. Back in the Spring, CDX HY spreads hit 312bps vs. 295bps today. Over the same period, the Russell 2000 has rallied 20%.

Now the narrowing of sensitivities to zero has occurred in the past BUT the difference today is that credit spreads are back at their multi-year tights. The below chart shows that sensitivity since 2011 (dark blue). Alongside I show the ratio of the R2K 12mth fwd earnings yield / UST bond yield (light blue) – the message is the same – a "yellow" signal the easy money is over and those earnings expectations better start ramping up soon!



4. **HY credit - canary in the coalmine**

All that begs the question, what is the macro perspective on US credit? One interesting model is High Yield which now sits around 1 standard deviation rich versus Investment Grade. This is true looking at both HYG vs. LQD, and HYGH vs. LQDH - the equivalent ETFs that hedge interest rate exposure to provide a 'pure' credit play.

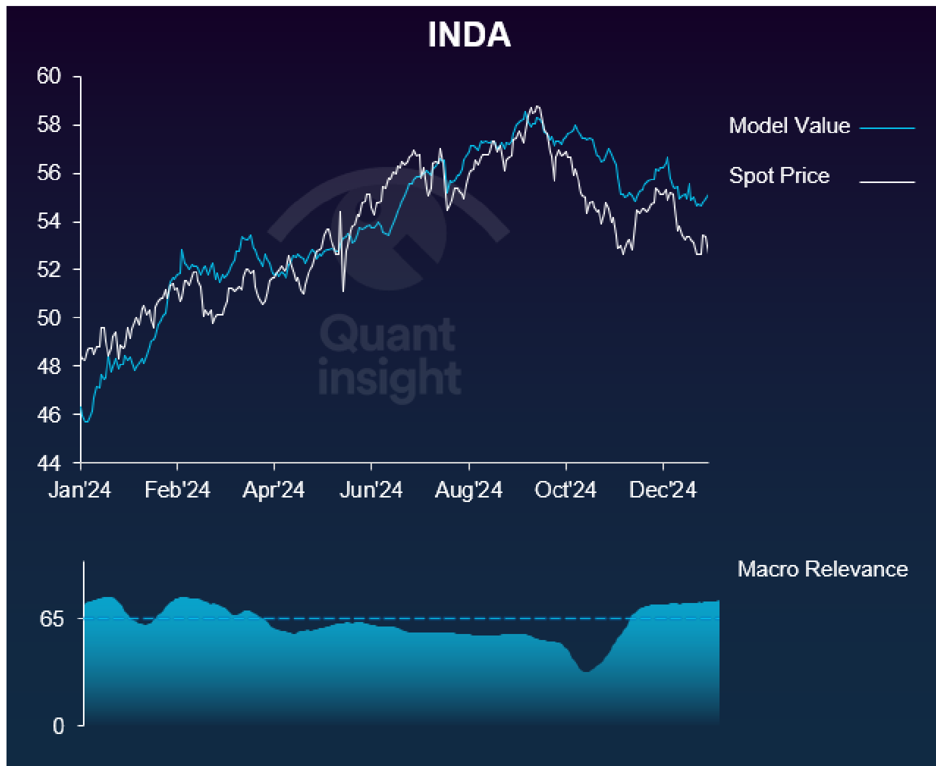
Over H2'24 macro momentum was trending higher, i.e. the macro environment supported HYG outperformance. That has stalled at the start of the new year - in effect the most recent HY outperformance is not justified by macro conditions.

To be clear, in outright terms US credit spreads do not screen as being rich or at risk. This is purely a relative value perspective. The fact that the signal is true for HYGH/LQDH though means it does not reflect IG's longer maturity profile during this back-up in rates. It is another yellow flag – this time that the credit profile of US HY is, in macro terms, starting to look somewhat extended.

5. **Time to re-visit India**

The shine has come off Indian equities of late. The NIFTY has fallen nearly 30% since its September high. The mainstream narrative is slower economic growth plus expensive valuations have hurt.

That sell-off has now gone too far according to Qi. While iShares MSCI India ETF INDA has continued to fall, Qi model value is showing tentative signs of stabilising.



The model moved back into regime mid-November &, right now, macro explains 76% of the variance in INDA. The regime is Goldilocks with a heavy emphasis on easy money conditions & healthy risk appetite.

This FVG back-tests well historically.

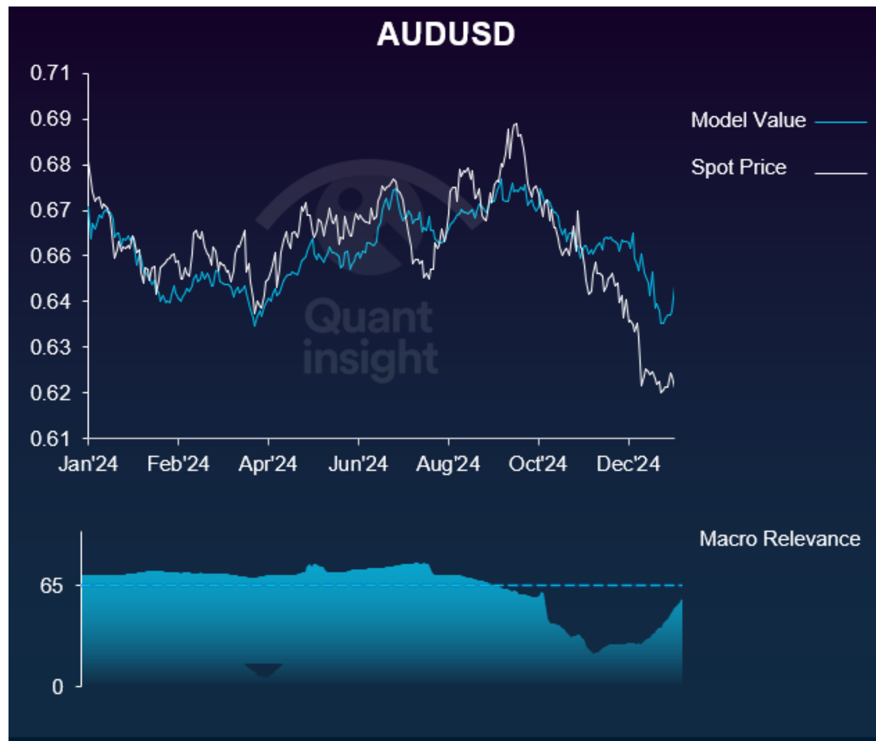
```
FVG_Back_Test(['INDA'],1.2,0.25,65,'2009-01-01','2025-01-06',['Long'],'Long Term')
```

✓ 3.4s

	Results
Hit Rate	78.571429
Avg. Rtrn	3.769683
Ann. Rtrn	62.762673
Median Rtrn	1.876716
Avg. Max Gain	5.018565
Avg. Max loss	-4.030740
Avg. Holding Period	19.142857
Median Holding Period	18.500000
No. of Trades	14.000000
Avg. Win	5.900906
Avg. Loss	-4.044802
Win/Loss	1.458886

6. RBA rate cut? Short AUD is not the right trade

Soft Australian CPI data has re-kindled hopes of an RBA rate cut next month and, in turn, weighed on the Aussie Dollar this week. But Qi suggests a lot of that news is already priced into several AUD crosses. Both AUDUSD and AUDJPY are more than one standard deviation cheap to macro conditions.



The interesting point is the macro profile. Aussie yields fell hard in November on soft inflation data and that dragged the Qi model value and spot FX lower. But Qi's macro-warranted model value hasn't fallen as much as people focused solely on the bond market would believe.

AUDUSD model value has already bounced; AUDJPY model value moved sideways in November rather than lower. Why? Because of the fall in VIX and risk aversion metrics was a positive for Aussie and that offset.

Rate differentials are always important for currencies, but they are not the only driver. Qi offers the wholistic macro picture. And, right now, both AUDUSD and AUDJPY screen as cheap even with yields falling and money markets moving to price in a 75% probability of an RBA rate cut on Feb 18th.

Aussie ASX 200 and iShares MSCI Australia (EWA) look more interesting on Qi – in line to slightly cheap to aggregate macro conditions.

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