

06.03.2024

Qi Market Pulse: Vol Check

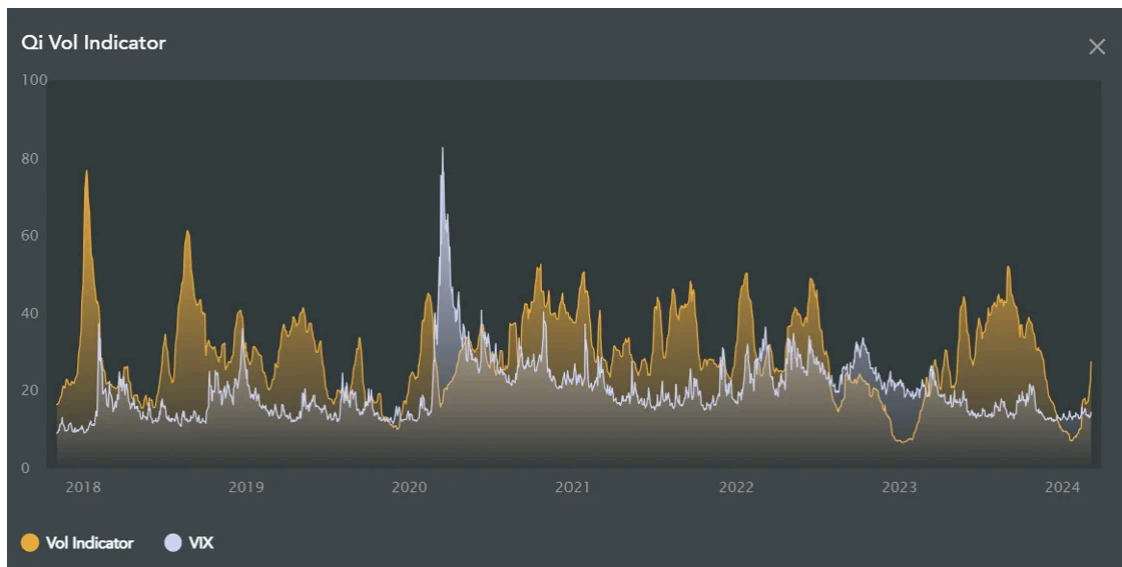
Qi is capturing some clues suggesting equity markets could be on the cusp of a potential regime shift. Is complacency about to give way to risk aversion?

Clue 1: Qi's Vol Indicator has jumped 20 points higher in the last month. 2023 was a tricky year for this alternative fear gauge but, over history, it has provided an early flag for several big "risk off" moves.

Clue 2: The acceleration in S&P 500 Qi sensitivity to risk aversion rose to multi-year highs into mid-February, as VIX descended below 13. This augurs caution.

Clue 3: Subsequently the S&P500 Qi sensitivity to risk aversion turned positive at the start of March. Again, this augurs caution.

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This [report](#) details the underlying construction but, in short, we use our model confidence metrics for six global benchmarks across equity, bond & currency markets.

High model confidence means macro factors are driving price action. When we see a sharp fall in model confidence that means the asset in question is experiencing a regime shift. It has moved from a stable macro regime to being driven by non-macro factors.

Often these are more transient factors like sentiment & positioning which are prone to sharper swings & hence greater volatility. Hence **spikes in our Vol Indicator should be viewed as a potential flag for a volatility event.**

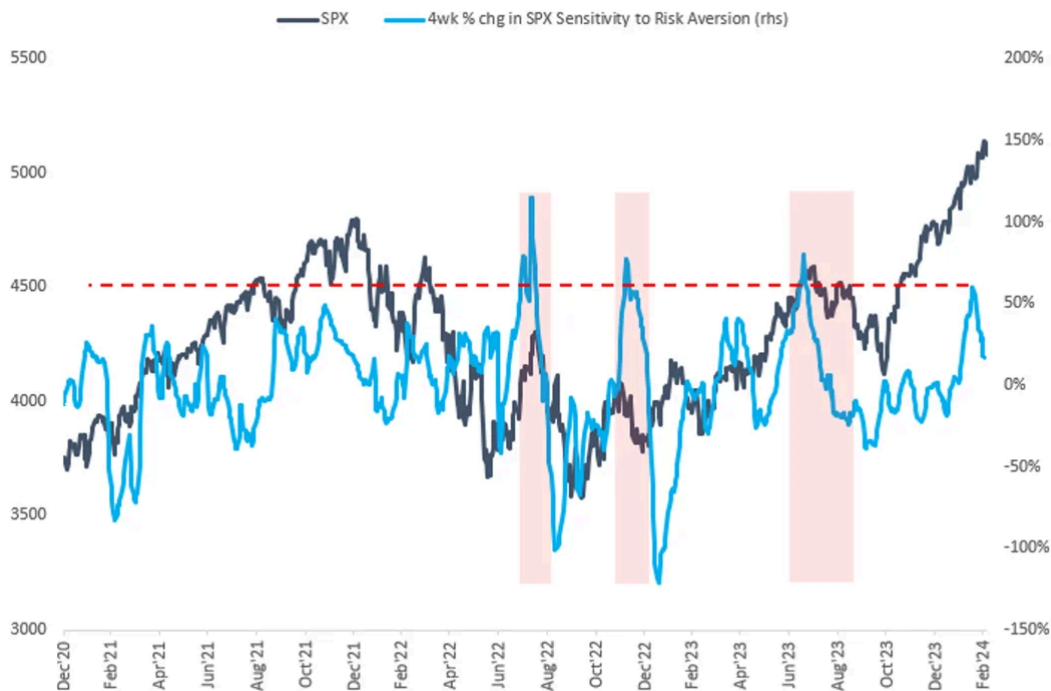
Breaking the Vol Index down we see that model confidence for 10y US & European yields, plus USDJPY & EURUSD are either flat or rising. The models where confidence is falling, & hence

causing the spike in our Vol Indicator, come from the equity side.

Qi's Short Term model confidence for the S&P500 has fallen 32% over the last 2 weeks; for the Euro Stoxx 600 it's down 34%. Not a component but note NASDAQ ST model confidence has fallen 55% in the last fortnight!

At a minimum, we can observe that our Short Term models, which have done such a good job of defining equity indices over recent months, are experiencing a sharp regime shift. But there are other straws in the wind too.

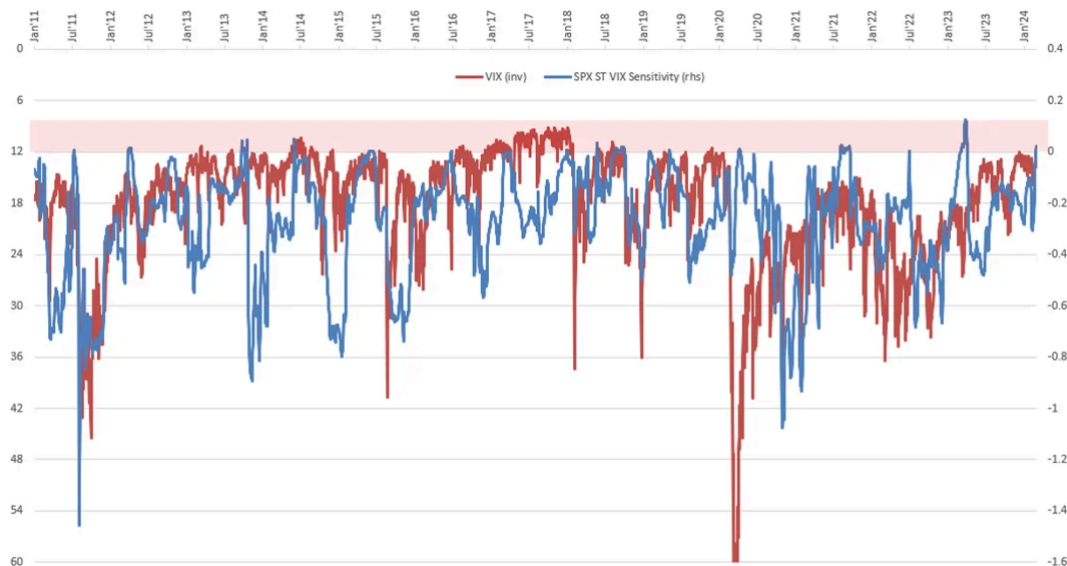
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Reliance on low equity volatility rises as Momentum becomes a tour de force. However, as this reaches close to multi-year highs, the premise presumably is that everyone is close to “all in” on the prevailing narrative.

That sensitivity has started to roll-over from levels similar to what we saw in July 2023, December 2022 and August 2022. We mark those periods below in the chart overlaying SPX Index with its beta impulse to risk aversion.

Clue 3: Subsequently the S&P500 Qi sensitivity to risk aversion turned positive at the start of March. Again, this augurs caution.



This would strike any investor as unusual. Indeed, it is a rare occurrence as the chart above shows. What Qi is picking up on is that while VIX saw its low in mid-December, the S&P500 continued to make gains since. Evidently, when the VIX is low and range-bound, minor gains have not perturbed risky assets. However, does a positive sensitivity reflect a peak in sentiment?

There are only 16 events since 2011 when this has been seen on Qi's models: The first chart overlays the VIX with SPX sensitivity to VIX. See the table below which lists the dates that sensitivity first turned positive.

The average 3mth change in VIX is positive and SPX mildly negative. However, the hit ratio in that outcome is mixed. What we can say is that those dates where VIX saw a subsequent firm move higher occurred when the drop in Qi's macro explanatory power of the S&P500 was particularly sharp i.e. it became harder for Qi to explain the macro forces in play. Into the 1-March, Qi SPX model RSq has fallen 15% over the last 1mth.

SPX Sensitivity to VIX first turning +ve	VIX 3mth Fwd Chg	SPX 3mth Fwd % Chg	SPX RSq 1mth Chg into Trigger
11-Jul-11	17.8	-12.4%	17.0
28-Mar-12	4.0	-5.2%	-25.8
24-Sep-13	-1.0	7.7%	5.2
02-Jun-14	0.4	4.1%	-36.5
03-Jun-15	17.7	-9.5%	-23.2
24-Jun-16	-13.5	6.2%	-15.4
31-Mar-17	-1.2	2.6%	55.3
01-Jan-18	10.1	-2.2%	-38.4
24-May-18	-0.1	4.7%	-20.6
24-Sep-18	23.9	-19.5%	-0.8
01-Feb-19	-3.3	8.8%	-32.8
09-May-19	-2.2	2.3%	-1.5
09-Aug-21	-0.2	6.0%	-11.8
30-Jun-22	3.9	-3.8%	0.3
03-Mar-23	-2.8	5.9%	-10.9
01-Mar-24	?	?	-15.0
Average Chg	3.6	-0.3%	-9.7
Average when VIX went up	11.1	-6.9%	-15.3
Average when VIX went down	-3.0	5.5%	-4.1
% times VIX up / SPX down	47%	40%	

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