

## **Qi Market Spotlight: Are we entering a zone of uncertainty for the Mag7?**

*Evidently, the S&P500 is the most concentrated in over 50yrs leaving positioning in secular themes i.e. Mag7 crowded*

*Qi has created a macro-relational model for the Mag7 12mth fwd PE multiple – currently trading above Qi model value at 33.8x vs. 31.5x*

*Setting aside earnings strength, the major upside drivers of the Mag7 12m fwd PE have been a deteriorating growth / inflation trade-off reflecting its secular, safer haven status; Mag7 benefits from weaker economic growth prospects / tighter FCIs*

*Can the growth / inflation trade-off dynamic change in favour of small caps if confidence in Fed cuts is now firmly established? Well, the Russell 2000 trades above Qi model value – the index needs both easing FCIs AND rising growth expectations over H2*

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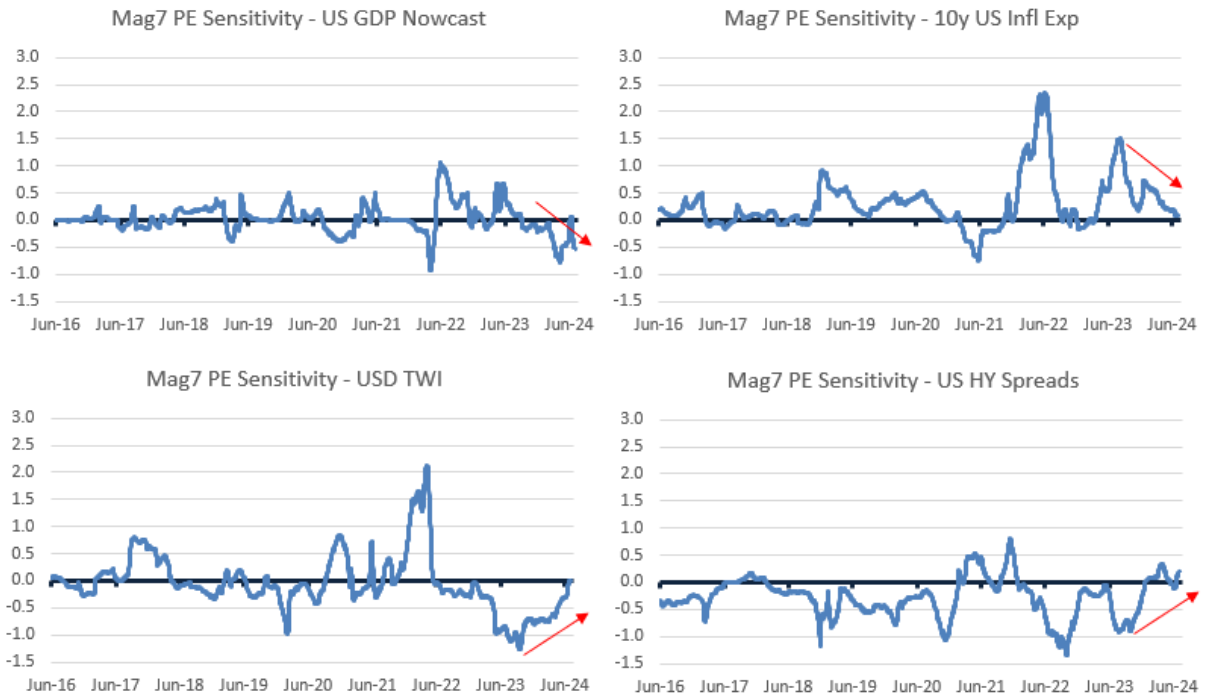
### **1. What are the macro drivers of the Mag7 12mth fwd PE?**

From a top-down perspective, the PE multiple is determined by the interplay between growth expectations, financial conditions and risk appetite – this is ideally suited for Qi's macro-relational analysis

**Since Q3 2023**, the Mag7 12mth fwd PE has exhibited the following macro sensitivities:

- An increasingly **negative** association with **US GDP growth expectations**, at long term range lows currently
- A **positive** but diminishing association with **10y inflation expectations**
- A diminishing negative association with the **US dollar**, and now **positive**
- A diminishing negative association with the **US HY credit spreads** and now **positive**
- A mild **positive** association with **10yr real yields**, currently negligible

See the charts below:



These associations reflect that the secular growth prospects / strong balance sheets of the Mag7 have been a safe haven as the debate on hard landing / soft landing and the accompanying focus on FCIs continued. In other words, Qi shows that any deterioration in the growth / inflation trade-off would favour the Mag7 12mth fwd PE – **scarcity of economic growth demands a premium for secular growth.**

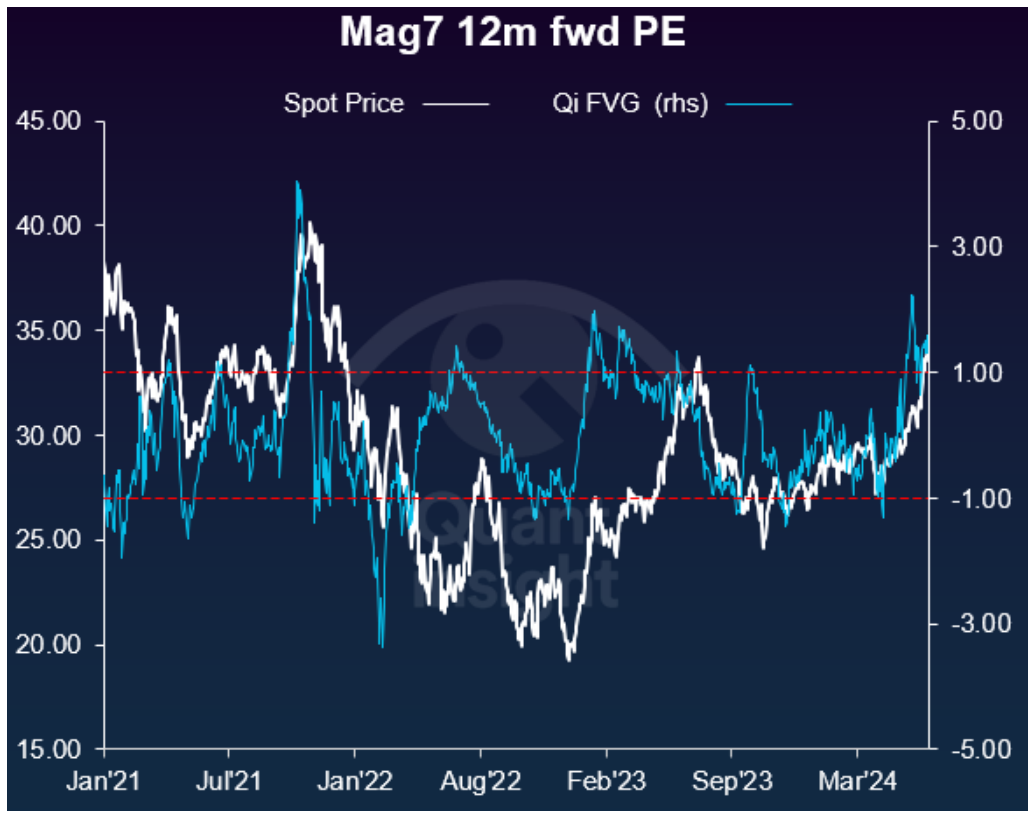
## 2. The Mag7 12mth fwd PE currently trades at a premium to Qi's macro-warranted model value

Today, the Mag7 12mth fwd PE is 32.9x:

- The FVG is **+0.86 sigma**, at the **upper end of the long term historical range**
- Qi model RSq has dipped below 65%, but is still fair well-explained by macro at 60% RSq
- Qi's **macro-warranted fair value PE is 31.4x**

See the charts below:





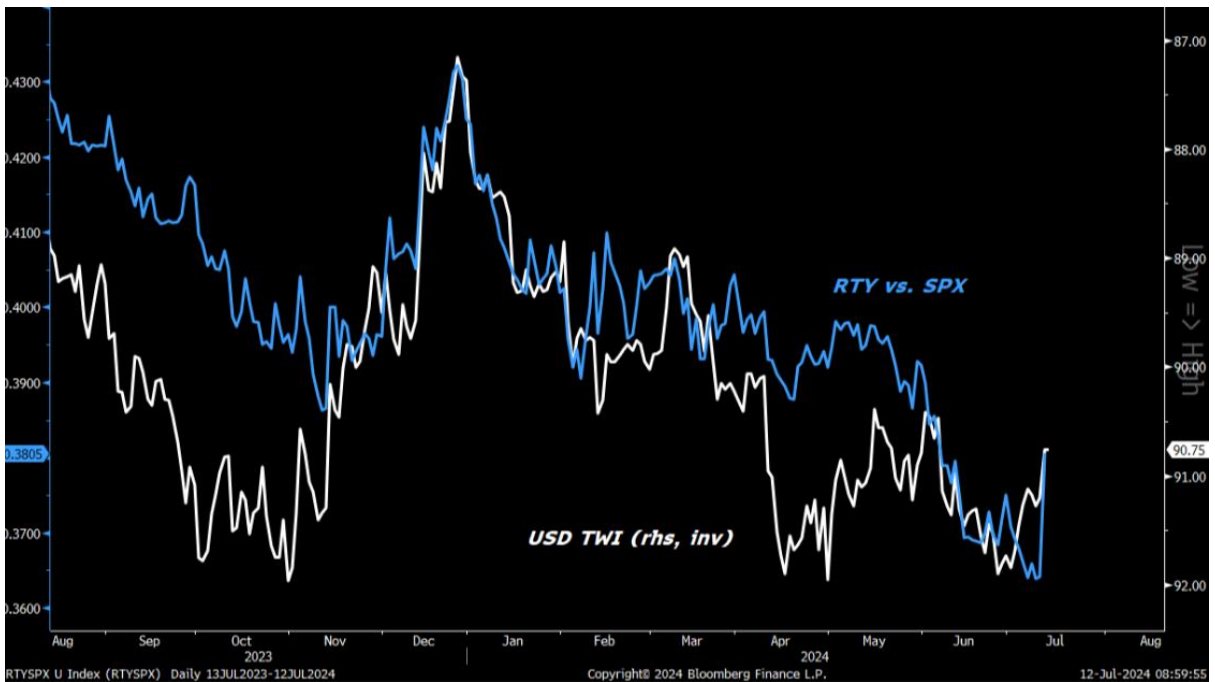
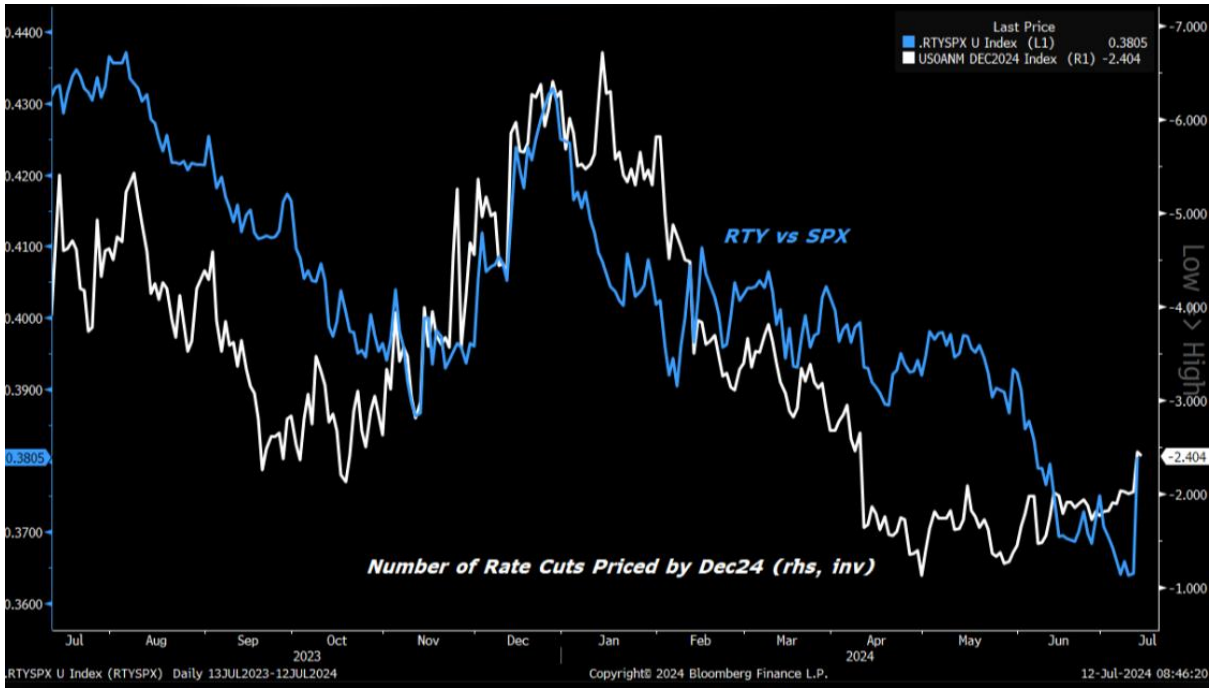
This **earnings season will be an important test** if investors are prepared to pay the same premium for this group relative to the rest of the market

**3. In contrast, Russell 2000 requires not only FCI easing but growth increasingly important – currently trading above Qi model value**

With attention post-CPI focused on market rotation, we note that **since early June, QQQ relative to IWM had rallied harder than Qi's macro model would have suggested** – that divergence has now closed:

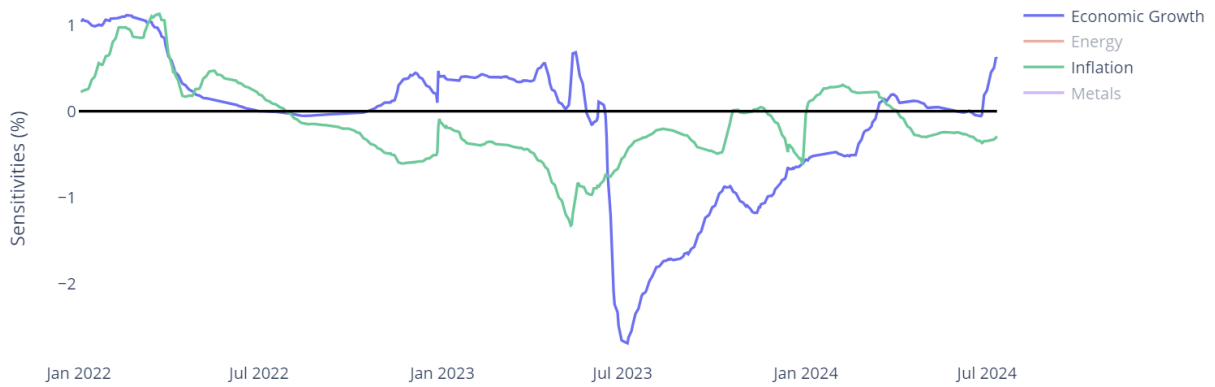


In contrast to the above, the **Russell 2000 is looking for an improving growth / inflation trade-off** – both with respect to its positive sensitivity to GDP growth expectations and negative sensitivity to inflation, real yields, credit spreads and the dollar i.e. the small cap outperformance trade lives in the soft landing scenario. Consider how **reliant Russell 2000** outperformance this year has been **on the pricing of rate cuts and a weaker dollar**:

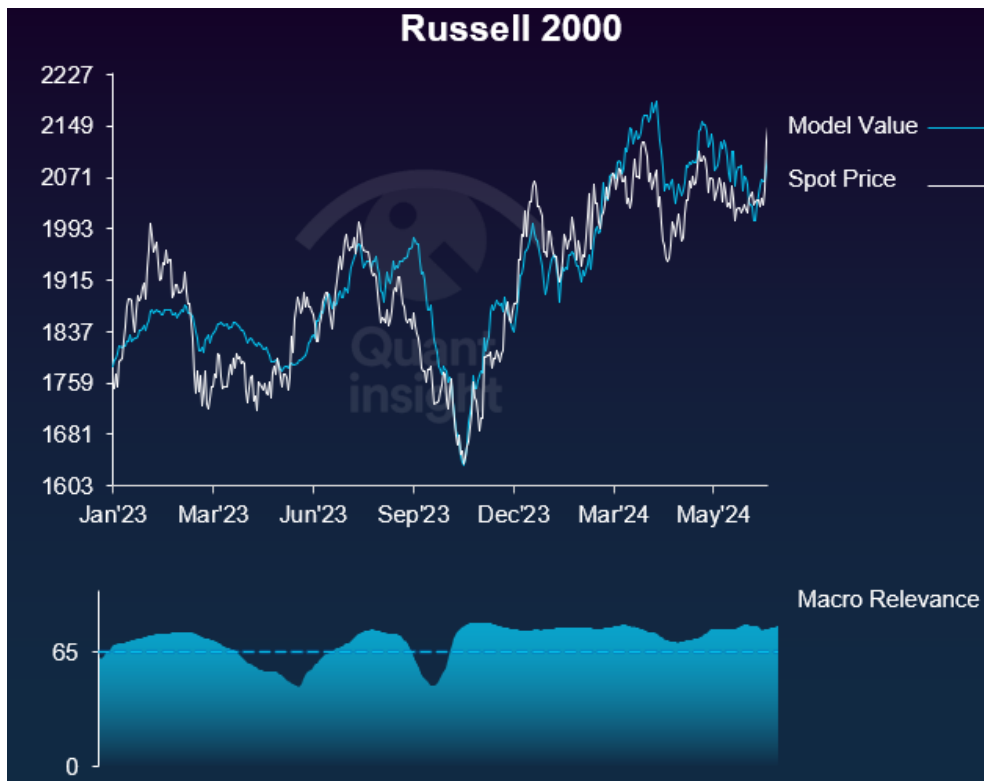


However, a focus on FCIs alone would be myopic – Qi’s model of IWM relative to SPY shows a rising focus on growth expectations. See the first chart below.

### IWM vs. SPY - Economic Fundamentals



Friday's rotation comes at an interesting juncture – the Citi US economic surprise index sits at close to long term range lows. It will not be straight forward - lingering evidence of weakening economic data, deteriorating pricing power, a poor China outlook and unemployment rolling over seem incompatible with a sustained value bounce. Further, Qi shows the **Russell 2000** trading **+0.4 sigma rich** to Qi model value currently.



It is fair to say that enactment of the tariffs proposed by Trump would likely boost stocks with domestic revenues and supply chains relative to internationally-exposed peers. However, data from here will be key for Russell 2000 outperformance e.g. this week's retail sales – the surprise hurdle is low but investors likely won't jump the gun without more evidence.

