Qi Market Spotlight: Where are we now?

In H1 exposure to risk was richly rewarded. ***July marked a turning point for markets and a regime change****.*

Since late June, through the Qi lens we have written on a number of warning signs and the shifting narrative*:*

- *Qi fair value gaps moving into rich territory SPY and crowded positions through July*
- *Qi model momentum for SPY waning with the macro drag rising despite all the excitement on Russell 2000 rotation*
- *Qi macro factor sensitivities showing signs of thinner air alongside a focus on good news is good news.*
- *Qi macro factor vol hitting multi-year lows in mid-July*

Sinister or Temporary Correction - little sign of macro panic under the hood*: Seasonality, crowding & levered positioning are likely just as much to blame as cyclicality/crisis concerns. Qi macro factor sensitivities have not lurched higher nor has RSq explanatory power across major assets collapsed - indicative of Mr. Market not fundamentally in panic mode on macro. The 1mth change in SPY factor vol has jumped aggressively but this is reflective of the move in VIX to its post Covid highs.*

It will likely remain choppy but historical precedents suggest support at the 200d MA on the S&P500 (~5000). *SPY's Qi macro model value is only ~3% away from where it has steadied previously, representing a 10% 4wk drop in Qi macro model value (assuming recession not imminent)*

Areas of value? *Seasonally, this is not the time to be a hero, but the Mag7 12mth fwd PE is now 27.5x vs. Qi's macro-warranted fair value of 31.6x - a 2 sigma discount on Qi FVG. A notable opportunity, so long as the immediate risk aversion stabilises.*

Warning 1: Qi Model FVG for SPY shifting from cheap to rich (2-July)

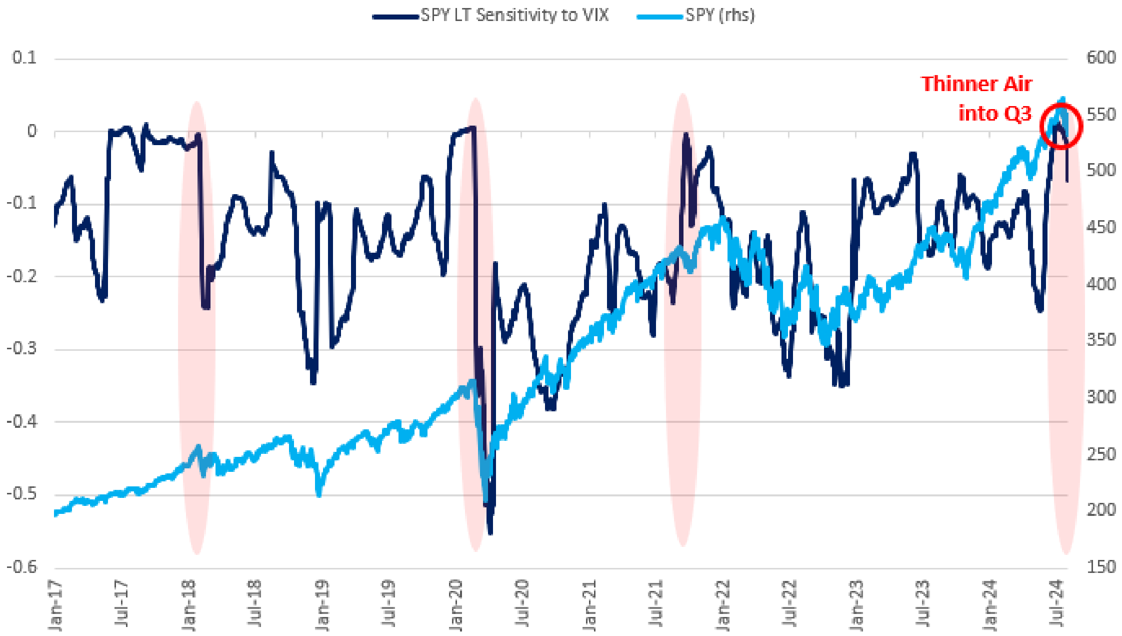
The S&P500 was trading **0.75 sigma cheap** to its Qi macro-warranted fair value at the trough of the last pullback **on 19-April**.

By **2-Jul, the index was trading 0.26 sigma rich**. The implication was that there was a greater **onus on Qi model momentum sustaining**.

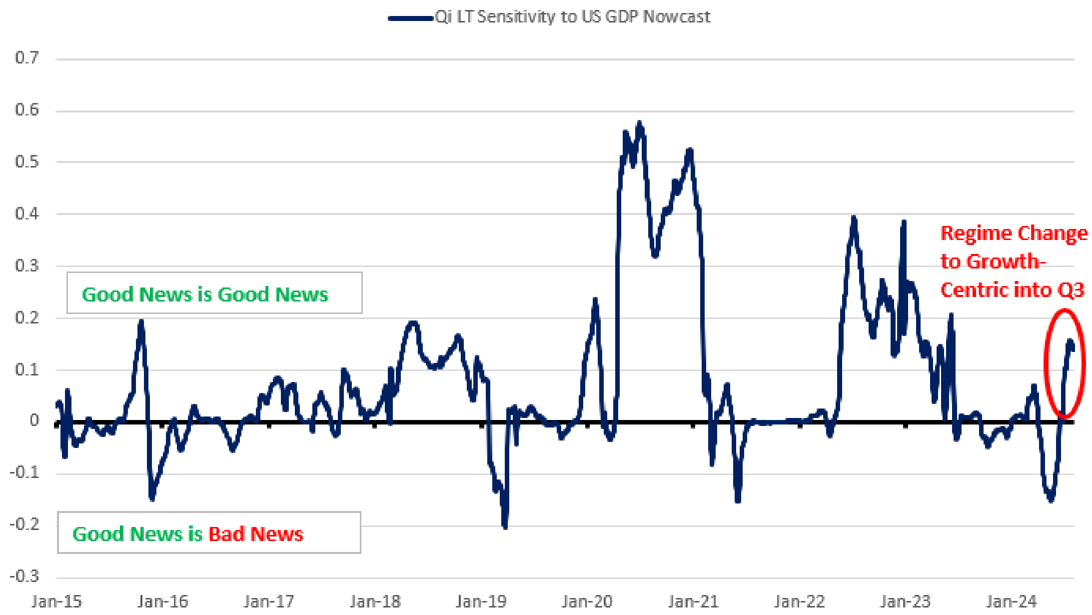
Warning 2: Qi Model Factor Sensitivities to SPY into thinner air (2-July)

In **early July**, we found it notable that the Qi long term model **sensitivity of the S&P500 to VIX edged slightly into positive territory**. This was a rare occurrence having occurred only in 3 periods previously since 2017. The norm is of course a large negative relationship. On these 3 occasions, when that sensitivity had peak and rolled over it was a sign of market caution.

Today that sensitivity is falling back into accustomed negative territory.



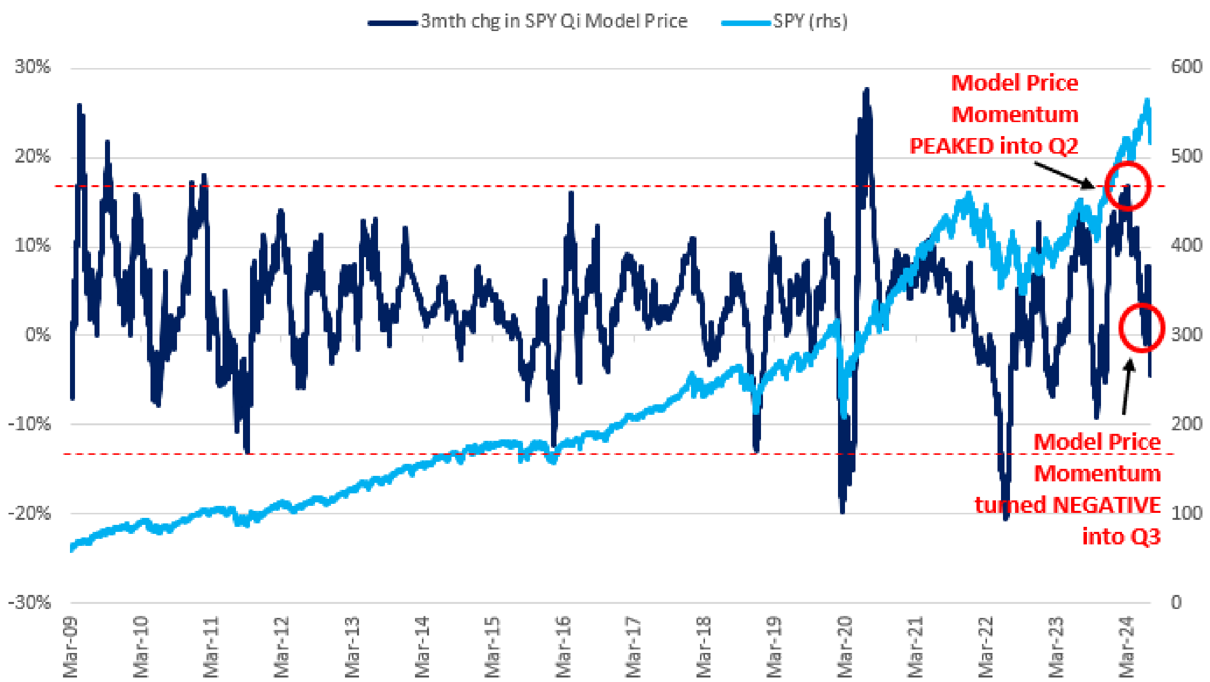
Secondly, we noted **in early July that Qi sensitivity to US GDP Nowcast had jumped into positive territory**. The norm is for risky assets to want higher growth expectations with the sensitivity remaining positive. However, since late summer 2023, that sensitivity had been more often than not negative as opposed to positive i.e. softer economic news was welcomed by the S&P500 that was pre-occupied with the Fed policy reaction function. That dynamic changed into Q3 and remains in force today.



Warning 3: Qi Model Momentum for SPY fading over Q2 and negative into Q3 (2-July)

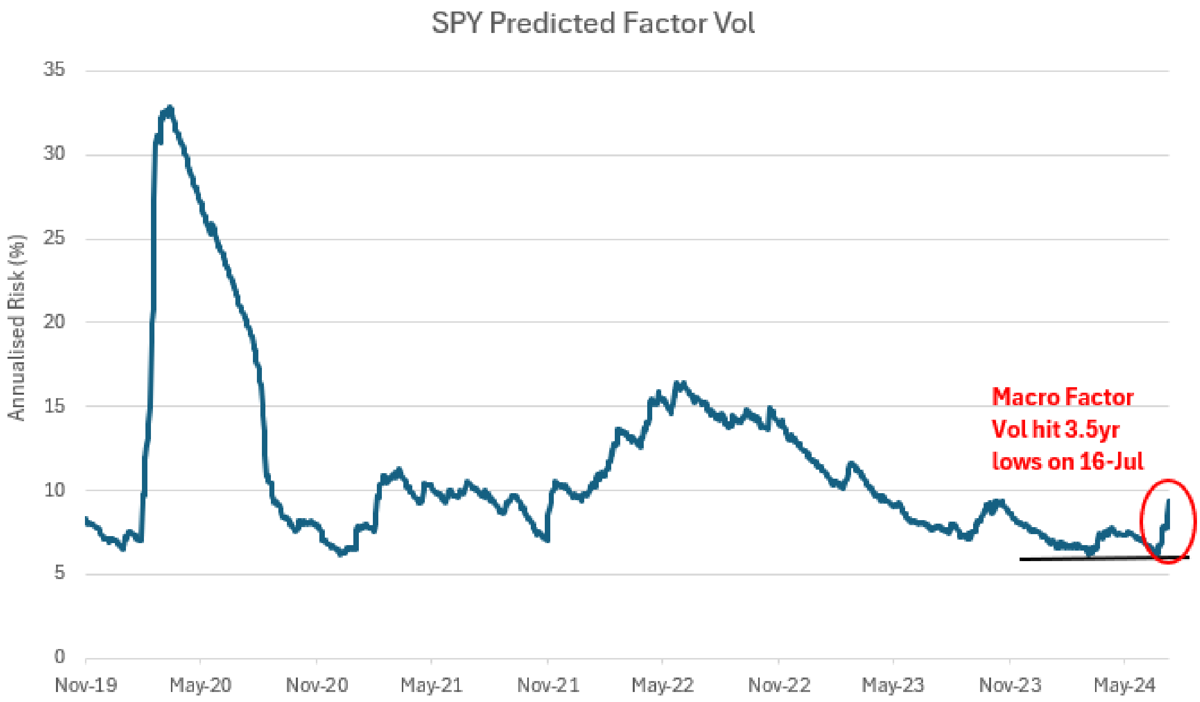
Fast forward to today and we can see that Qi **model price momentum** for the S&P500 (3mth change in Qi model value) **peaked into Q2** this year from long term range highs and has since **turned negative into Q3**

Today, with model value falling alongside spot, SPY today is still trading at +0.3 sigma rich!



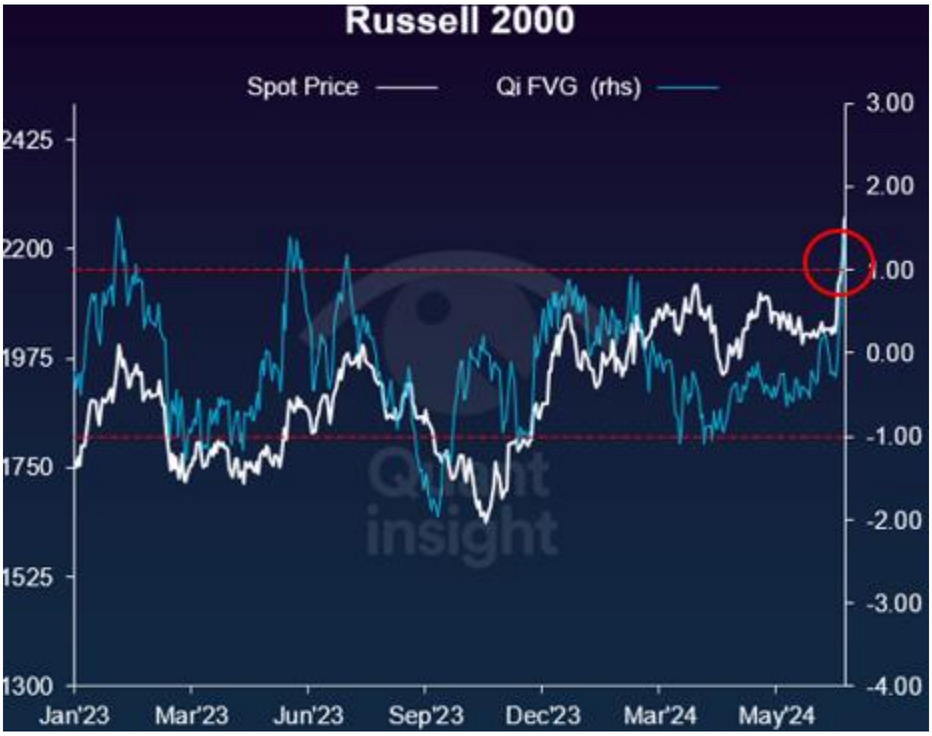
Warning 4: Qi Model Predicted SPY Factor Vol reaches multi-year low (16-July)

Through July, we noted that **Qi's risk model predicted factor vol for the S&P 500 had hit 3.5yr lows by mid-July**. With soft landing / disinflation tailwinds now well priced, and the geopolitical / growth uncertainty ahead, macro vol was more likely to be turning higher than lower from here.



Warning 5: Qi FVG of Crowded Positions (16-July)

By mid-July, whether we looked at the Mag7 12mth fwd PE, the GS most short rolling index or the Russell 2000, all traded at a significant premium to macro-warranted fair value! Indeed, in mid-July we said the RTY rally was more idiosyncratic reflecting positioning rather than supported by macro.



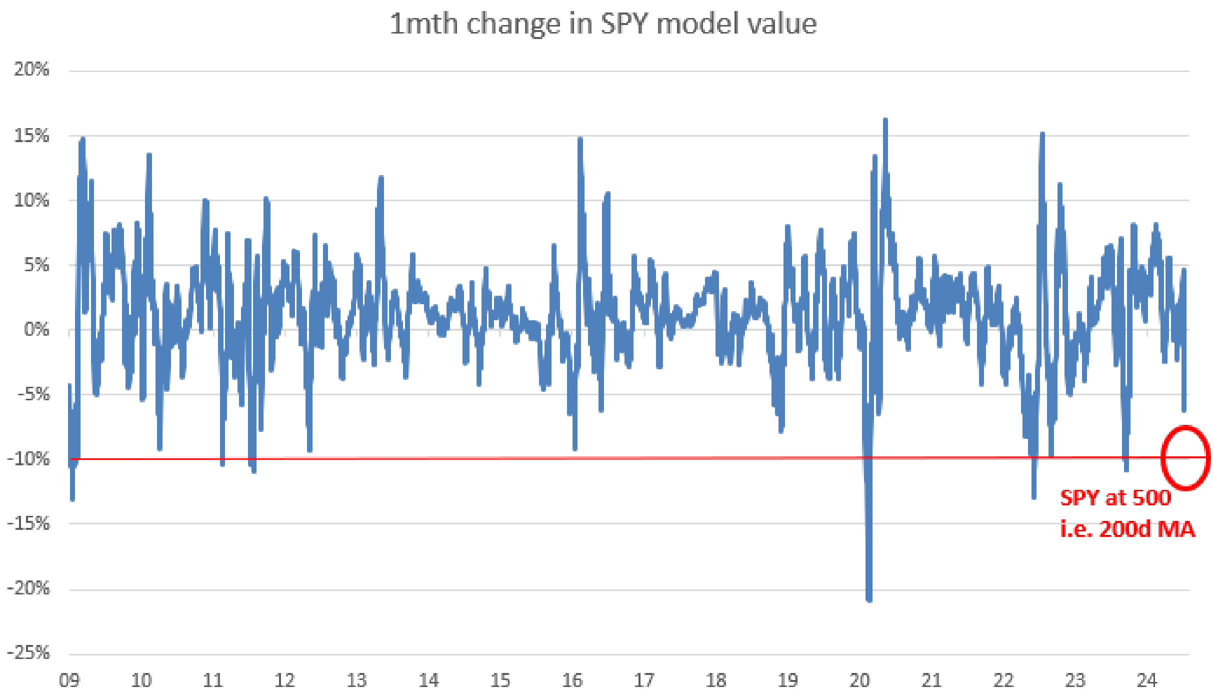
Today? The Mag7 12mth fwd PE trades at a 2.4 FVG discount to Qi model value, the GS most short index at -0.6 sigma, and the Russell 2000 at -0.1 sigma. So10% **cheap to model but the only notable move looks to be in the Mag7 through Qi's macro lens**.

So what to look for now?

***Have Model RSqs sharply collapsed indicating regime shock?* NO**, macro explanatory power has remained high across major assets through this correction. There is no sudden narrative shift other than recognition that growth is now the top driver rather than disinflation.

***Have Macro Factor Sensitivities jumped indicating a macro shock?* NO**, despite the evident stress across markets, the S&P500 macro beta impulse remained surprisingly subdued. No surprise to see factor sensitivities sharply rise to risk aversion measures. However, sensitivity to financial conditions have actually fallen over the last 4wks. With the index falling below its 50d MA but the impulse not jumping in response is notable – perhaps telling us positioning and seasonality is just as much a likely culprit here.

***Is model price momentum showing signs of troughing?* Closer to the zone**. SPY model price has fallen 6% over the last 4wks. Historically, the trough of the 4wk descent has not been worse than a 10% fall over a rolling 4wk period (outside of Covid). See the chart below. That would be at ~500 on SPY – the 200d MA



***If this is not sinister, where is there value?* Back to Mega-Cap Tech**? The Mag7 12mth fwd PE now trades at a 2.4 FVG discount to Qi model fair value – the 12mth fwd PE was ~2 sigma rich in rich in mid-July and now ~ 2 sigma cheap to model value today.