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Predictive Analytics

Quantifying Fear & Greed
— Sandeep Tandon (Founder & CIO, quant Money Managers)

quant Mutual Fund's global outlook - Markets at an inflection

At quant, we have always believed that capitulative phases are great buying opportunities to create wealth as parabolic growth provides opportunities for asymmetric returns. The key is not to get carried away by the narrative surrounding the 'global investors' (net sellers of Indian equities) smarter than 'local investors'. Every Bull Run has new leaders and since April 2020 domestic retail investors have emerged as the new leaders as their convictions haven't capitulated despite sharp fall in the month of May and June 2022. Despite sell off in June higher than month of May and similarly sell off in May higher than March, none of the global volatility indices made new highs. Thus, the smart money was not worried and hence it can be said that, the selloff was led by weak hands and rising impact costs.

qGR's 'Behaviour Analysis' is always based on our capabilities of data analytics and demystification of delusions & illusions. These set of analytical tools help investors to cope with cognitive dissonance created by acknowledging that the global macros are deteriorating.

Despite our concern on Developed Markets (DMs) particularly US & Europe in the long run, the pessimism has spiked globally. quant Capitulation Indicator has also spiked and current readings are highest since the Covid Crash of March 2020.

Even quant 'Fear Indicator' has spiked and has registered highest ever reading since the Covid Crash 2020. If we dissect the reading into various components then we notice that the quant Fear Indicator for the stocks is higher than the Covid Crash reading. What is interesting is the quant Fear Indicator for the indices is still lower and thus shorting in individual stocks is on the higher side. Upon further analysis, the quant Fear Indicator for stocks is greater than that of the index, and therefore short positions in individual equities are quite elevated.

The recent collapse in Bitcoin prices is a representation of selling exhaustion and crypto currencies is the 'Market Implied' Global Risk Appetite indicator of the global markets. Consequently, we will see its impact cascading through other asset classes in the very near-term. Our 'Predictive Analytics' indicators endorse that the global financial markets are at the cusp of an inflection point. Further, our 'Predictive Analytics' tools foresee a decent reflex rally in global equities, crude oil (more in the near-term) and crypto currencies, along with decline in global volatility indices (in very near-term), base metals and U.S bond yields (in near-term). Our longer-term call remains elevated on both inflation and interest rates for DMs as they are in structural bull-run.

The world economic momentum has been declining for last many months and it slowed noticeably since the beginning of the month of May and we all witnessed its impact on global markets and steep corrections in global equities from the month of May onwards. The only exception was Japan and macro indicators now suggest that this positive effect is now petering out. The Central Bank accelerated tightening which will heap further misery on global activity in the long-term, but from the very near-term perspective; we have seen exhaustion in Risk Appetite and Liquidity will rise with a lag effect. Despite hue and cry about collapse in Global Liquidity, the current value of major global Central Banks' Liquidity stands at $28.6 trillion versus at the peak of March 2022 at $29.4 trillion. In the month of May, 2022, the DM Liquidity dropped by nearly $200 billion and Emerging Markets (EM) Liquidity expanded by $170 billion approximately. The Fed is leading this tightening cycle, draining $364 billion from markets in May, following the $250 billion in April and since the December 2021 peak, the Fed balance sheet has fallen by nearly 15%.

Crypto nears its medium-term bottom

At quant Global Research (qGR), the research wing of quant Mutual Fund, our focus is to draw inference from 'Market Implied' data as opposed to an assumptions based analysis. Crypto currencies are a perfect representation of market implied Risk Appetite. Thus, movements in this space have a substantial impact on Perceived Global Liquidity and Volatility.

The steep fall in crypto currencies that we are witnessing is a vivid indicator of collapsing Global Risk Appetite. Crypto currencies have an impact on global sentiments, especially among the young and savvy investor base as evidenced by the ongoing launches of ETFs dedicated to cryptos. Despite the nightmarish and massive losses of more than $2 trillion, our 'Predictive Analytics' indicators foresee a medium-term bottom. As an example, the quant Fear Indicator for bitcoin is now very close to its 2018 and 2020 bottom and the retesting of this level is a manifestation of a bottom in Global Risk Appetite from a medium-term perspective.

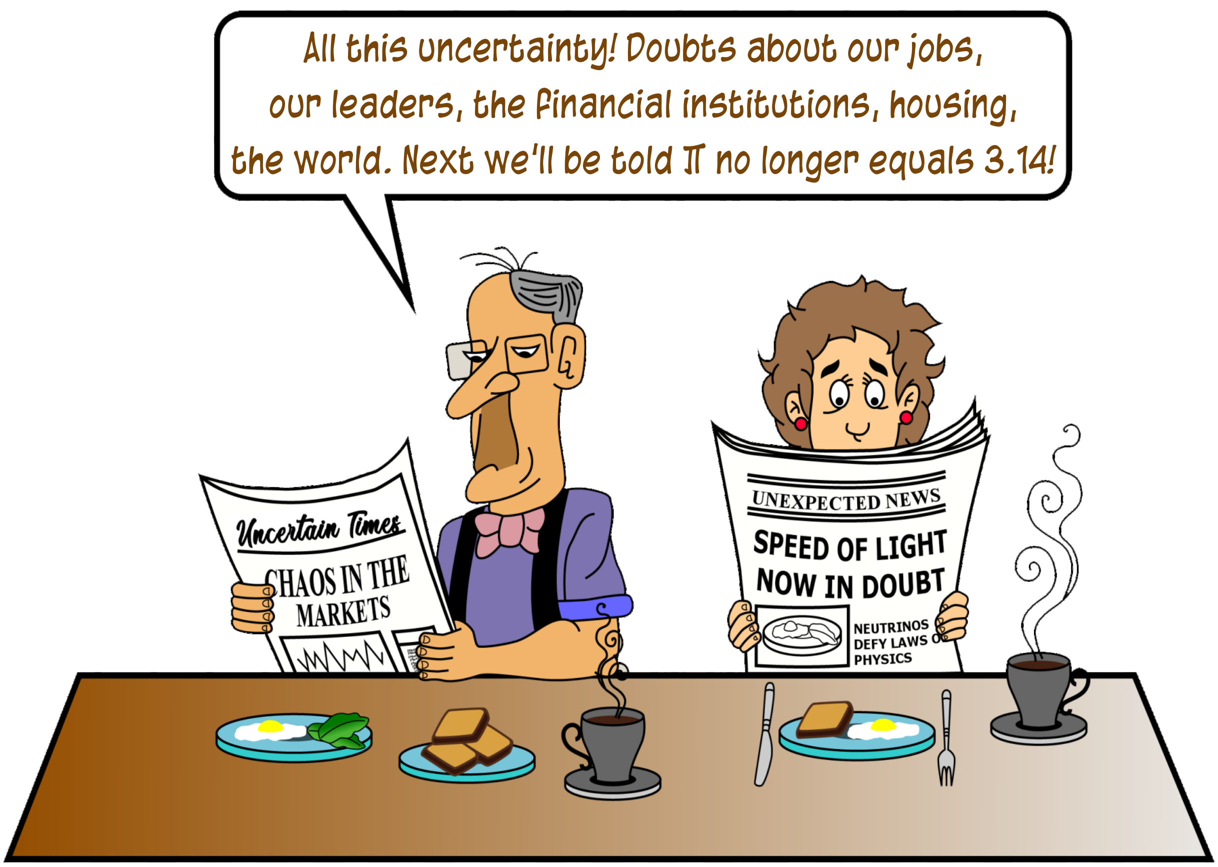
Even though many legendary investors are sharing a negative consensus on crypto currencies, our 'Predictive Analytics' foresee a medium-term bottom. Historically, a trading bottom in crypto occurs at least a few months ahead of a turn in the Global Liquidity cycle.

Global Macros - On the Brink of Long term sluggishness?

The balance sheet data from the Global Central Banks showcase that Global Liquidity is shrinking at a slightly quicker pace and the same is reflected in contraction of liquidity indicators. In the last few weeks, we saw a flurry of Central Bank activity via both scheduled and emergency meetings. It is now evident that policy tightening is being front-loaded in some quarters, as inflation becomes more entrenched and has spread beyond food and energy costs. Now, the next big worry is wage inflation!

After the 75bps hike by the Federal Reserve (FED) (and a further hike in July meet has been forecasted), the European Central Bank (ECB) surprised everyone with an unplanned meeting just days after its regular Governing Council meeting. The Bank of England also followed the FED and ECB with an expected and more cautious 25bps hike in its policy rate. The Swiss National Bank further surprised with a 50bps hike in interest rates, its first since 2007. The Bank of Japan (BoJ) left policy rates and quantitative measures unchanged at its monetary policy meet last week. Despite a rise in commodity prices which has resulted in inflation reaching the BoJ's long-term target of 2%, the BoJ believes that surging commodity prices in Japan is likely to decelerate in the near term. It's worth noting that BoJ liquidity growth has slowed sharply on a relative basis as the Japanese yen weakness is now a substantial concern.

Though the Fed rate hike dominates the global headlines, there are more shocks if someone studies the balance sheet data in detail. The FED balance sheet has dropped to $5.45 trillion from the peak $6.48 trillion recorded in mid-December. The pace of tightening is speeding up and current contractions of FED's balance sheet are way beyond previous periods of quantitative tightening going back multi-decades. FED's liquidity conditions are clearly already tightened significantly, yet the 'normalization' of its balance sheet is far from over. We expect FED to withdraw further $1-1.25 trillion in the current calendar year 2022.



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Currency Volatility – Near term exhaustion likely

Currency Volatility after bottoming out in September-October 2021 has gained momentum since Russia-Ukraine war. Now, synthetic currency indices are showing signs of exhaustion and currency pairs are showing signs of reversal. Thus, the implied volatility of Global currencies will cool off in the near term.

Our 'Predictive Analytics' model still endorses that Volatility Expansion Phase (VEP) would continue at least till calendar year 2023. Therefore, the currency volatility will spike significantly again in 2023.

The DXY (dollar index) picture is disturbing due to sudden collapse of Japanese Yen (JPY) against the U.S. dollar (USD), JPY being the currency of world's biggest credit nation and having 2nd highest weightage in DXY after Euro (EUR). But, upon further analyzing other synthetic currency indices and sentiments data, we conclude that the picture is not as awful as DXY depicts.

EMs to outperform DMs this decade – India biggest beneficiary

Despite the steep fall in global equities since the September – October highs, we see clear signs of a capitulative bottom in global equities. The quant Complacency Indicator for US equities has corrected sharply and its vulnerability has now reduced considerably in the near-term. While other global behavioral indicators viz. Risk Appetite and Risk Aversion are showcasing signs of a near-term bottom in terms of price behavior, time consolidation can last for few more weeks.

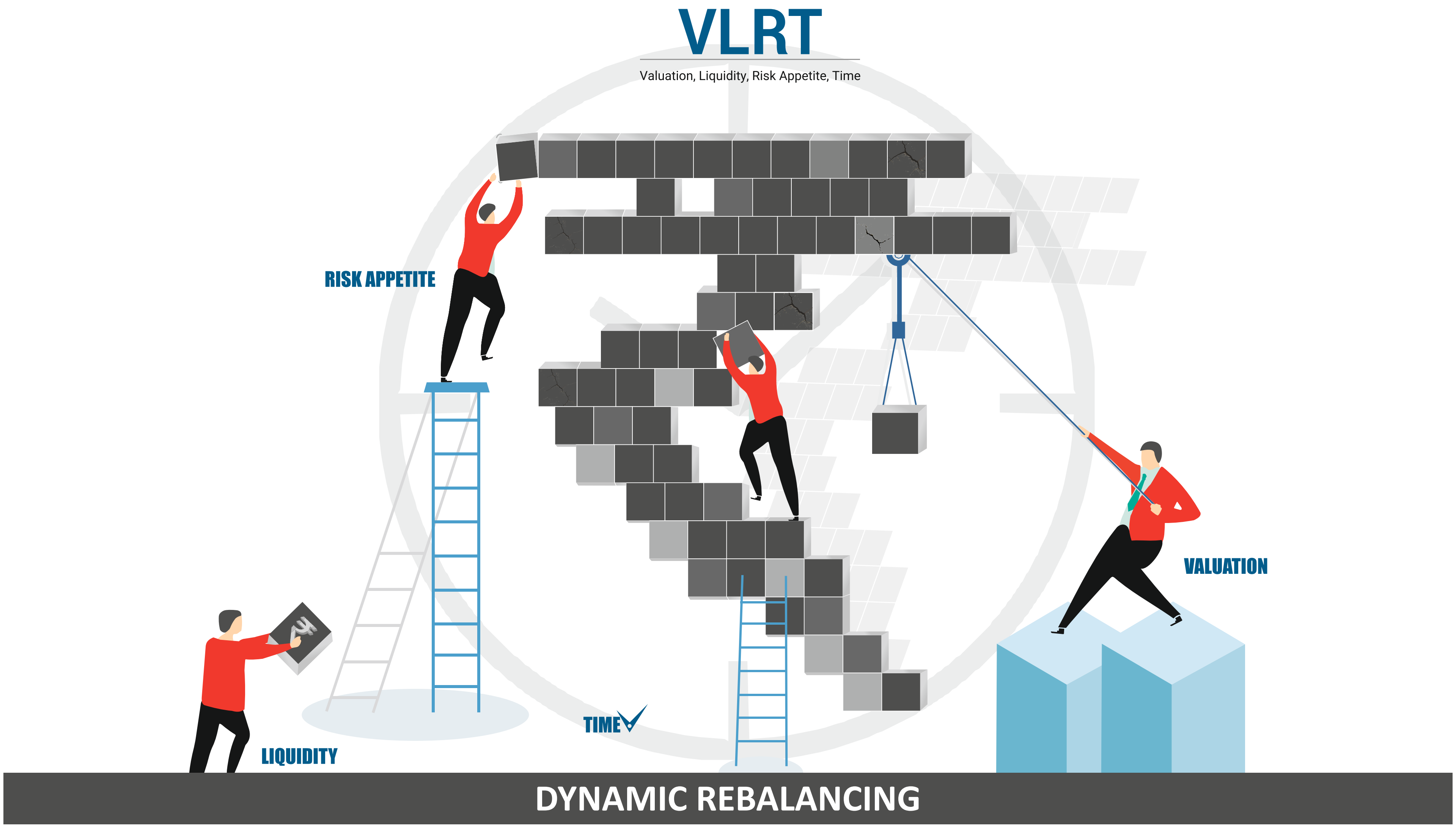
Global Liquidity and Risk Appetite Indicators were trading at higher levels in 2021 and thus euphoria was witnessed in Q4 of CY 2021 in growth sectors and most admired category stocks. However, of late, we have observed a sharp decline in their valuation multiples; particularly in DMs. Risk Appetite parameters have declined both in EMs & DMs on absolute basis, but on relative basis, Risk Appetite of EMs is rising accompanied by good Liquidity Indicators. It could therefore be said that, after witnessing one of the steepest fall in 'Money Flow' towards global equity as an asset class, Smart Money has trimmed its global equity exposure in U.S. And from medium to long term perspective, we believe that EMs have the potential to significantly outperform DMs. 'Money Flow Analytics' of EMs, in particular, of those to Asia reinforce this view. Asia within EMs and India within Asia is best placed to capitalize on the opportunities over the coming decade.

Our way forward – Guided by 'Predictive Analytics'

In summary, our 'Predictive Analytics' coupled with our VLRT framework (Valuation, Liquidity, Risk Appetite & Timing analytics) envisions a risk-on environment for global equities in the near-term. This will, in turn, have its own psychological impact on global financial markets. Notwithstanding the down-grades Indian market has received from eminent strategists coupled with quant Fear and quant Capitulative Indicator being at the highest level since 2020 Covid crash, clearly reflects the pessimism is peeking out from near-term perspective. Thus, we expect a fairly broad based rally.

Through our Risk Appetite indicators for India are still showing minor weaknesses but good Liquidity is rising, hence, a buy on dips strategy will remain very effective from both a medium and long-term standpoint.

Dynamic Money Management | VLRT framework



quant Mutual Fund

registered office: 6th floor, sea breeze building, appasaheb marathe marg, prabhadevi, mumbai - 400 025.

tel: +91 22 6295 5000 | phone/whatsapp: +91 9920 21 22 23 | help.mf@quant.in | communication@quant.in | www.quantmutual.com

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