LV RAG

Daily Risk Appetite Gauge

Equity Index Futures Trading Recommendations

16th September 2024

"SELL Case Brewing (WATCH & WAIT - for now)"

Email: info@longvieweconomics.com

Trading Recommendation ('1 – 2' week equity index trading recommendation)

- WATCH & WAIT (for now).

Rationale

"We are at a point where you might say, 'I could go either way — 25 or 50,' but I think the risk management has shifted to the labor market and favors doing 50," he said.

Source: WSJ, 12th September, "The Fed's Rate-Cut Dilemma: Start Big or Small?" Nick Timiraos, Sept. 12, 2024 (available HERE)

US equity markets rallied across the board on Friday, with all of the major 28 indices we track closing higher on the session. That was led by 'higher beta' indices, including the mid-caps (e.g. S&P400: +1.7%); small caps (e.g. Russell 2000: +2.5% & S&P600: +2.5%); and growth sensitive stocks (e.g. the Philly SOX: +1.7%). Many of those key indices are now finely poised at the top of their recent pennant formations (see FIGs 1a – 1c). Elsewhere on Friday the US dollar was weak (e.g. DXY: -0.3%); gold made a new record high (+0.8%); and HY credit spreads tightened further (e.g. see FIG 1f).

All of which is consistent with **growing expectations that the Fed will cut rates by 50bps this Wednesday**. Of note, the rates market had initially dialled back expectations for a 50bps cut last week (following the stronger than expected CPI report). After Thursday's WSJ article (by Nick Timiraos*, see quote above), though, the probability of 50bps has shifted back into focus. With that, the rates market is fully priced for a 25bps cut (with a 50% chance of a 50bps cut); US 1 & 2 year Treasury yields closed at new YTD lows on Friday (FIG 1d); while the yield curve has continued to steepen (i.e. '2s10s', see FIG 1e).

Given the rally in equities/key risk assets, **short term models have moved higher (with some starting to generate SELL signals)**. In particular, our risk appetite scoring system, and combined 'RAG 1 plus 2' model, have turned SELL overnight (see FIGs 2 & 2a); technical scoring systems for the S&P500, NASDAQ100, and Philly SOX are close to their SELL thresholds (see FIGs 2b & 2c); while put to call indicators are also approaching SELL (FIGs 2d & 2e). Other models are also close to SELL (e.g. see FIG 2f), while some are still mid-range (e.g. see FIG 2g).

With those models **not yet generating a clear SELL message**, there's a risk that equities squeeze higher in the near term, probably into the Fed meeting. Equity markets are therefore poised, in our view, to follow the usual 'buy the rumour, sell the fact' price pattern (i.e. rally in anticipation of a 50bps rate cut, and then selling off once it's announced). In that respect the SELL case for equities is brewing. For now, therefore, the risk reward favours WATCHing & WAITing.

Kind regards,

The team @ Longview Economics

*NB Timiraos is widely regarded as a 'mouthpiece' for the Fed, who often use his articles to signal their intentions to the market.

FIG 1: S&P500 futures 10-day tick chart shown with overnight price action

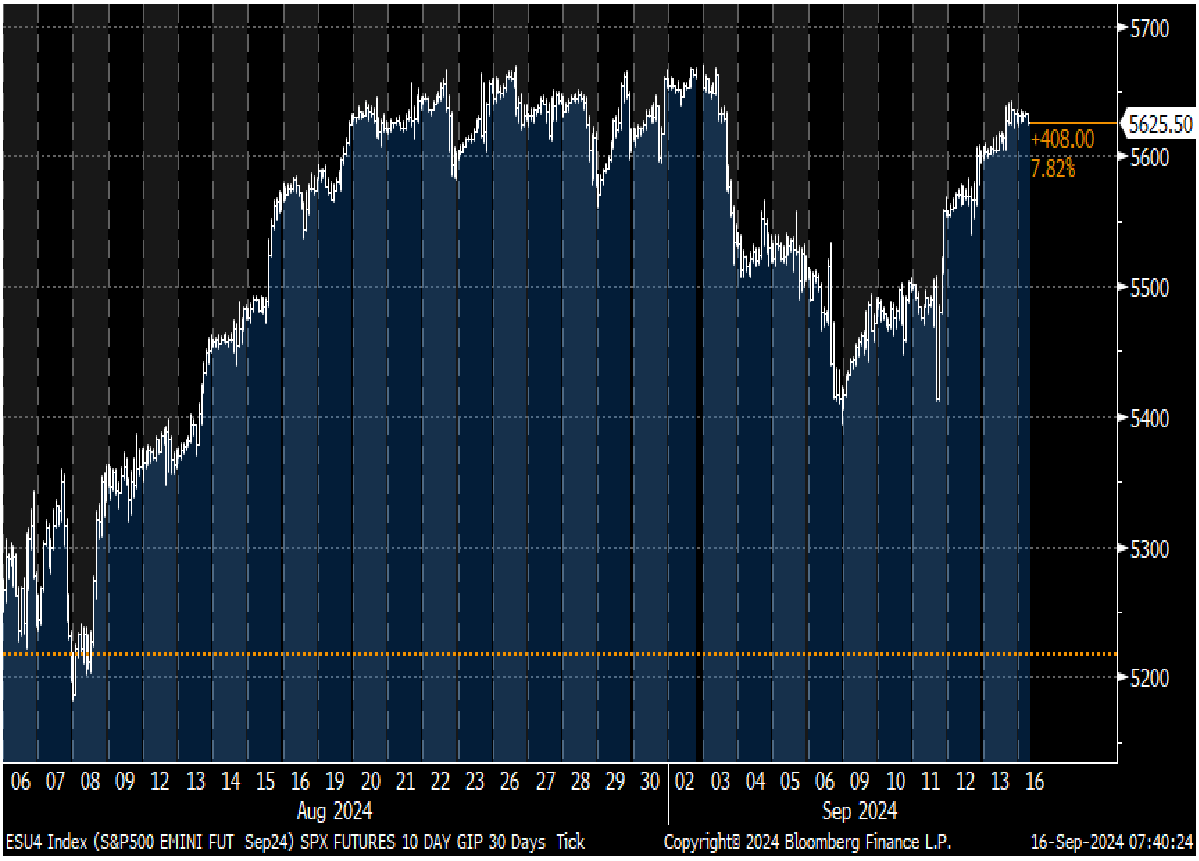


FIG 1a: S&P500 futures candlestick shown with its 50 & 200 day moving averages

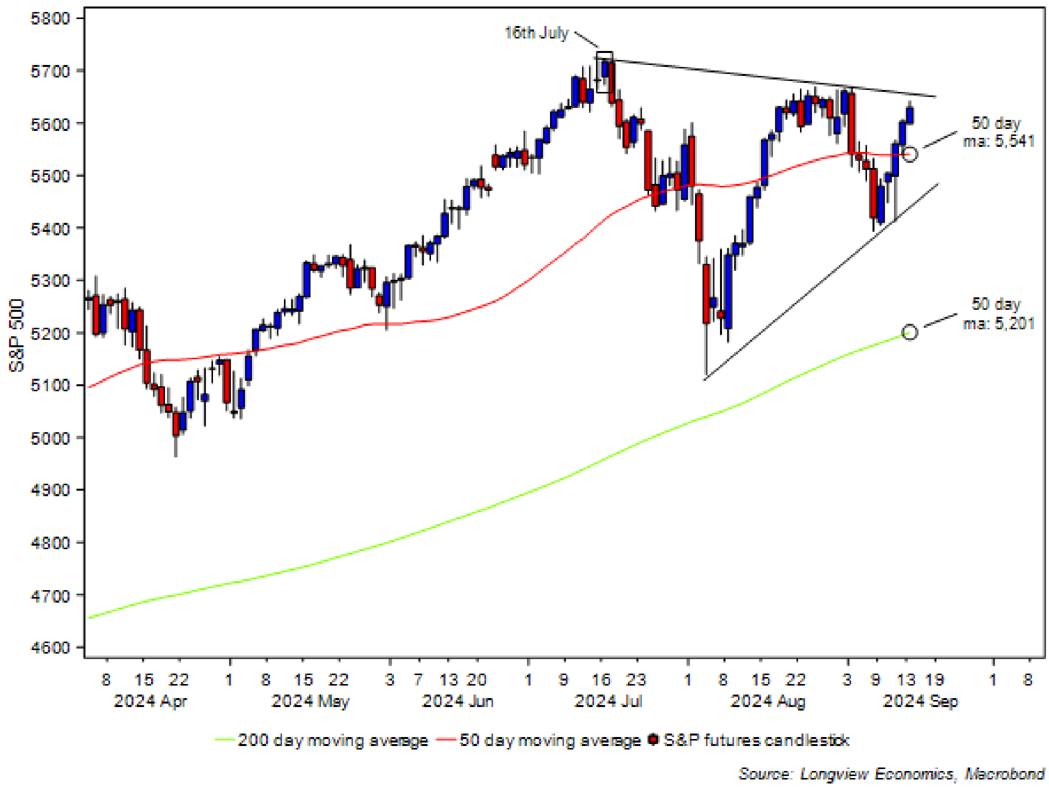


FIG 1b: NASDAQ100 futures shown with 50 & 200 day moving averages

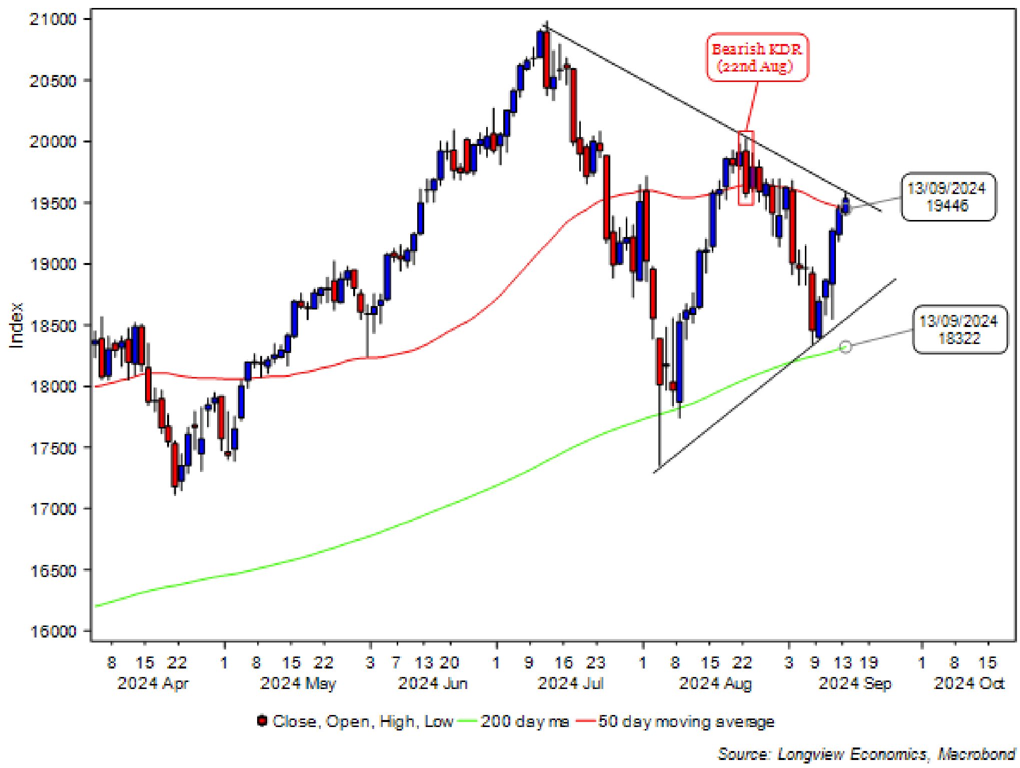


FIG 1c: Philly SOX index candlestick chart shown with key moving averages

FIG 1d: US 1 & 2 year Treasury yields (%)

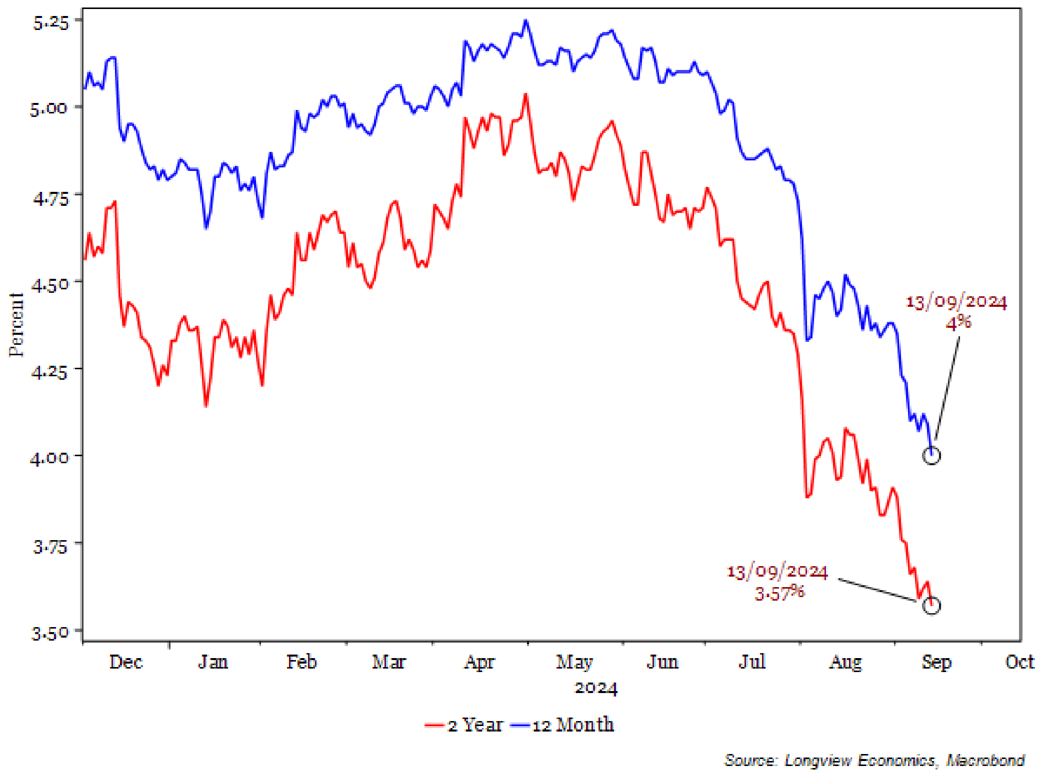


FIG 1e: US yield curve (10 year yield less 2 year, pp.)

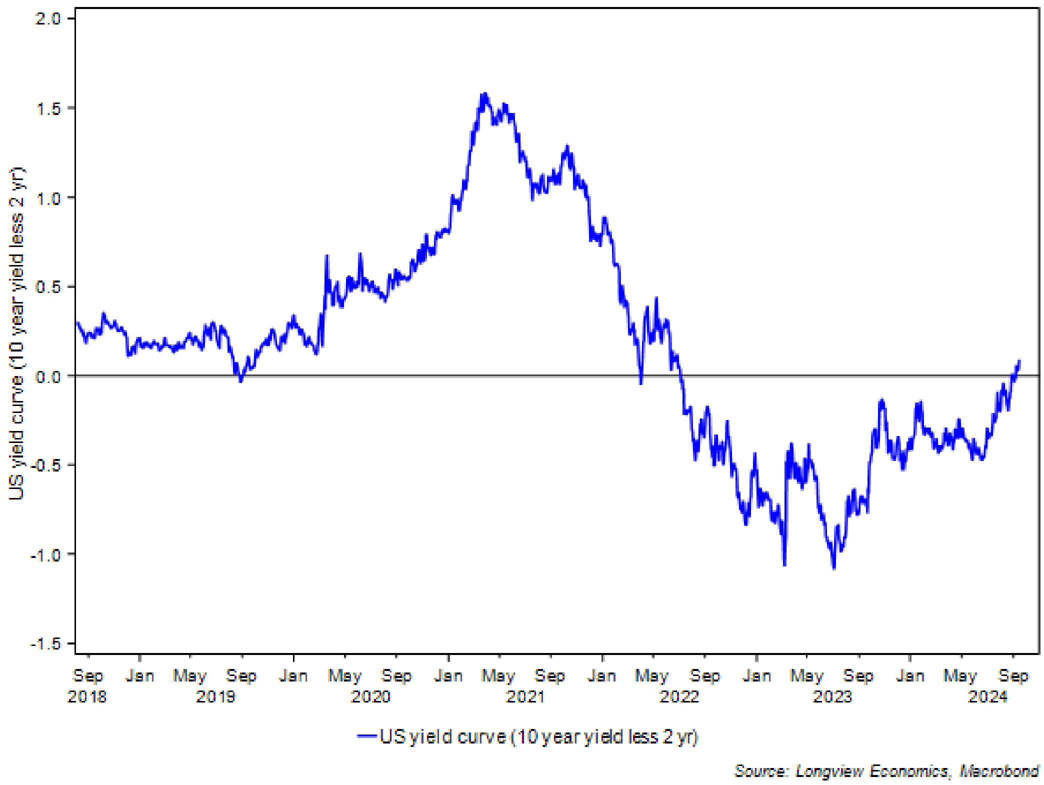
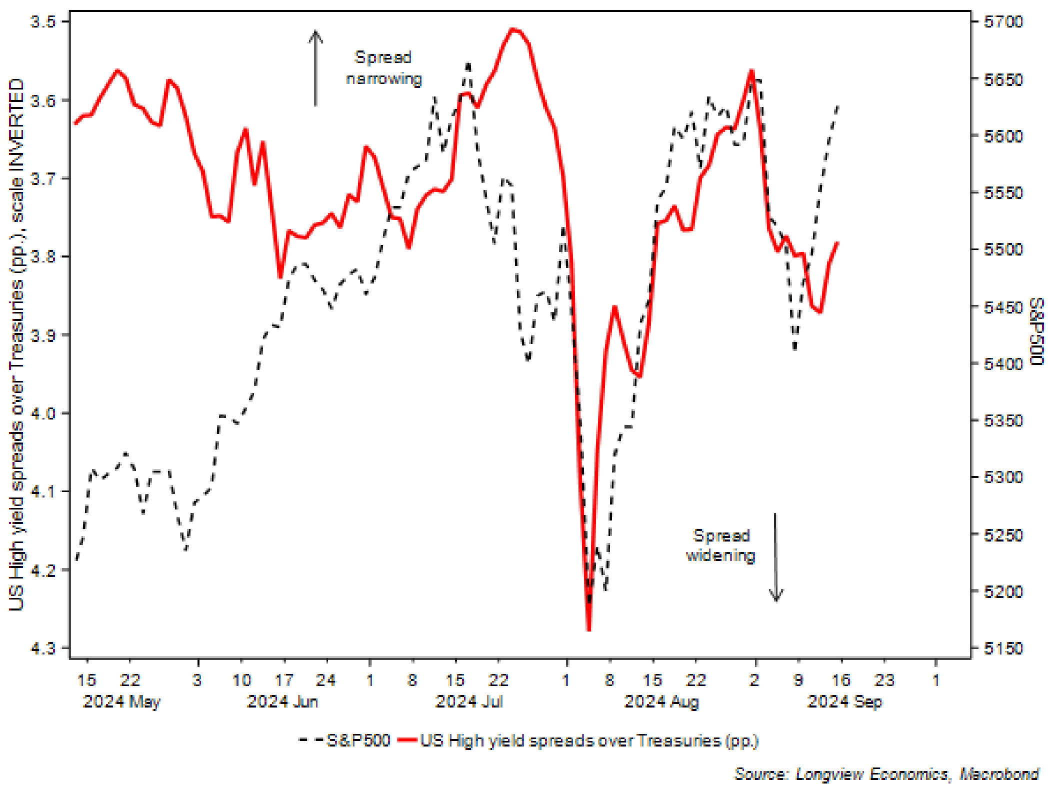


FIG 1f: US high yield corporate bond spreads (bps, NB scale INVERTED) vs. S&P500



Short term market timing models are starting to generate SELL signals….

FIG 2: Longview short term **'risk appetite'** scoring system vs. S&P500

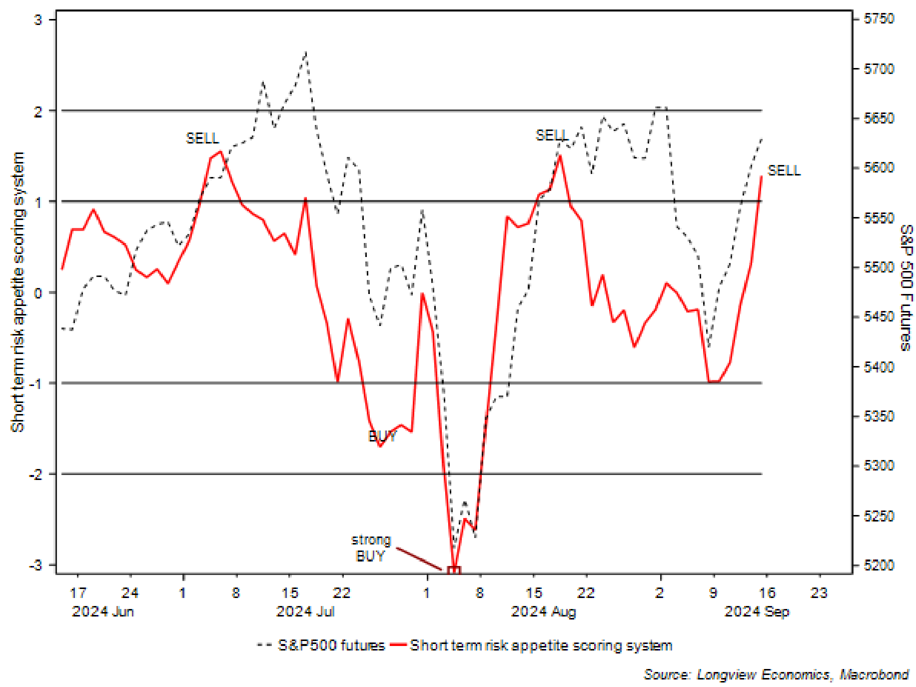


FIG 2a: Longview combined key **'risk appetite'** models (RAG1 + RAG2) vs. S&P500

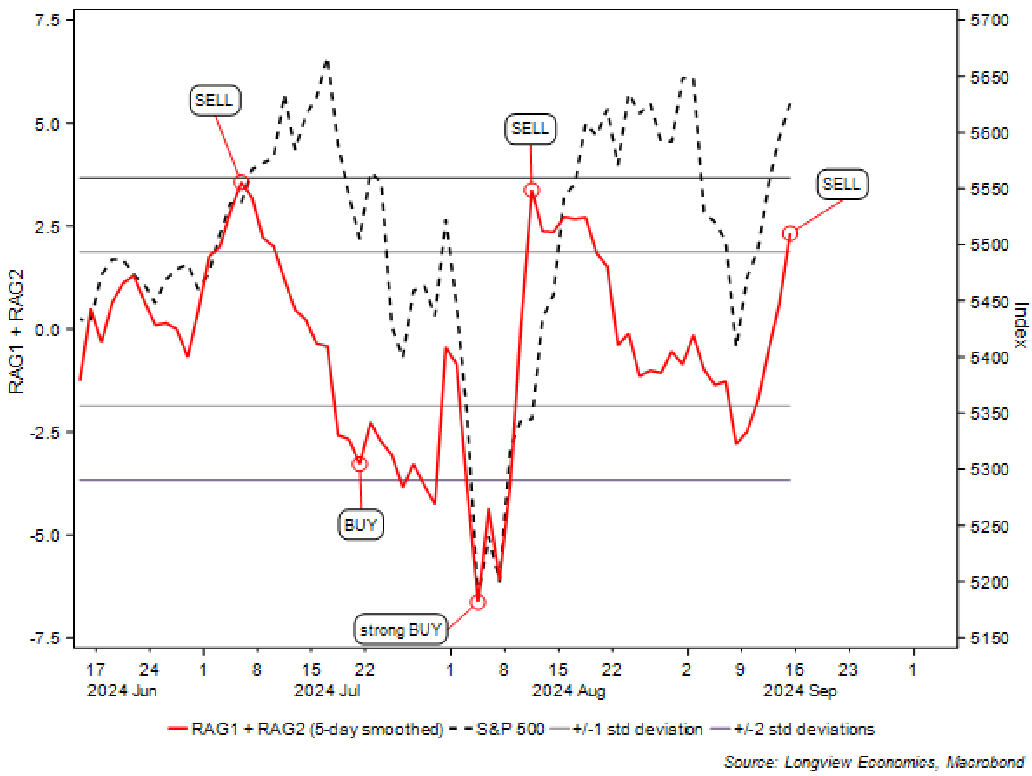


FIG 2b: Longview S&P500 short term **'technical'** scoring system vs. S&P500 futures

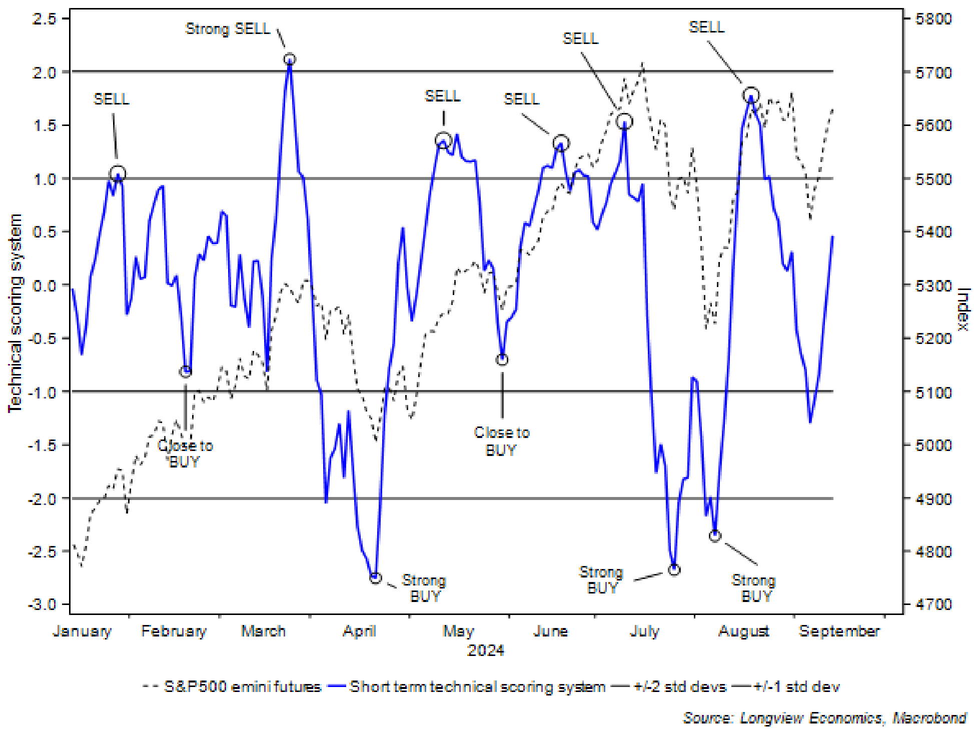


FIG 2c: Longview NASDAQ100 & Philly SOX short term **'technical'** scoring system vs. NASDAQ100 futures

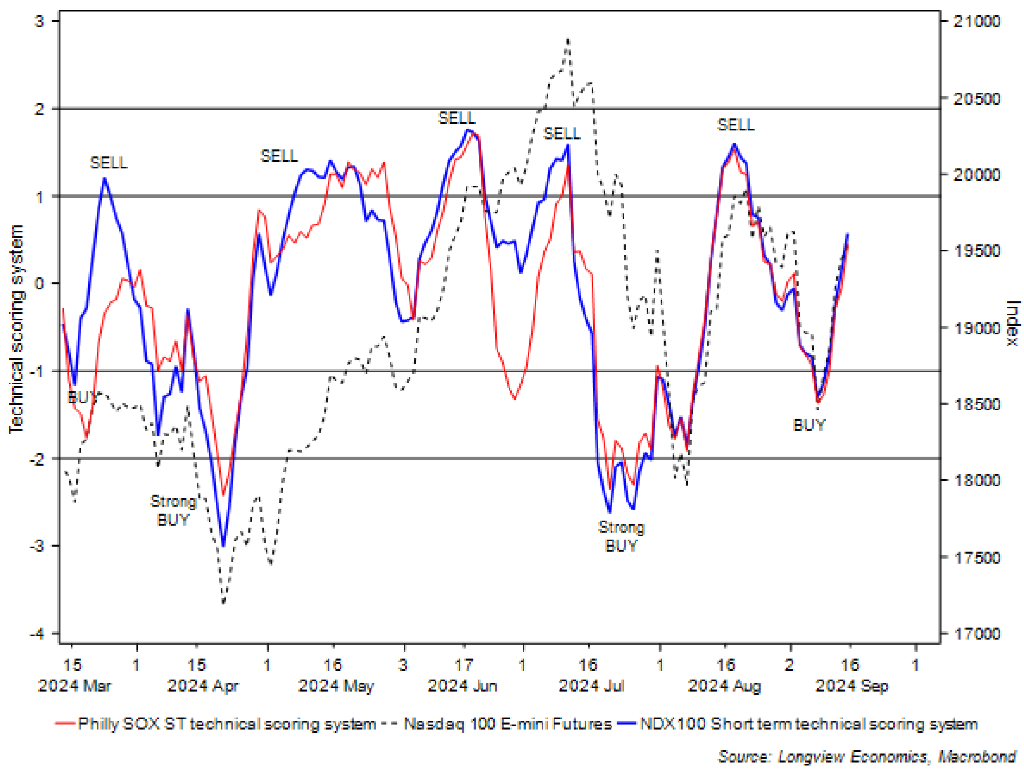
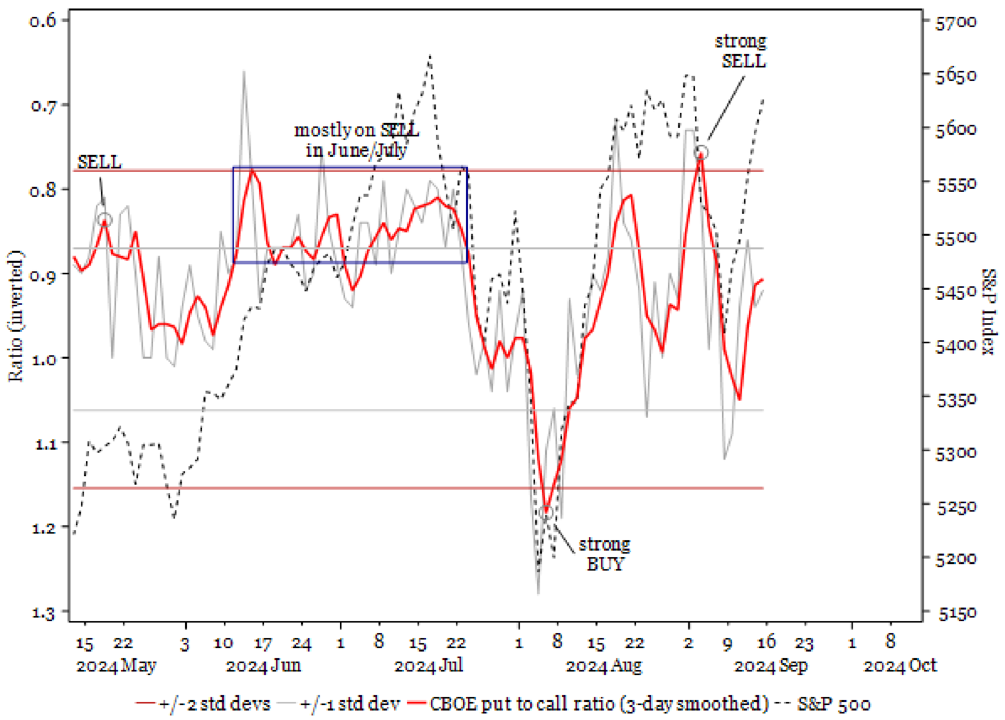
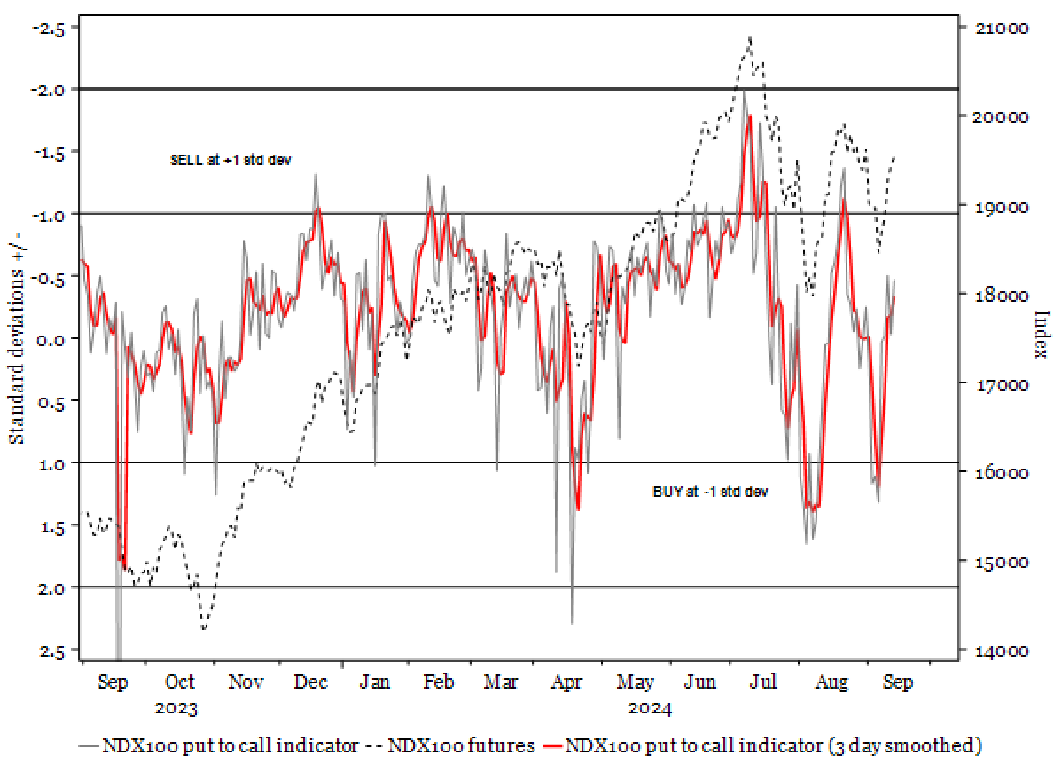


FIG 2d: CBOE put to call ratio (1 & 3 day smoothed with standard deviation bands) vs. S&P500



Source: Longview Economics, Macrobond

FIG 2e: NDX100 put to call indicator (1 & 3 day smoothed) vs. NDX100



Source: Longview Economics, Macrobond

FIG 2f: Average short term 14d RSIs of US industry groups (i.e. all 24) vs. S&P500

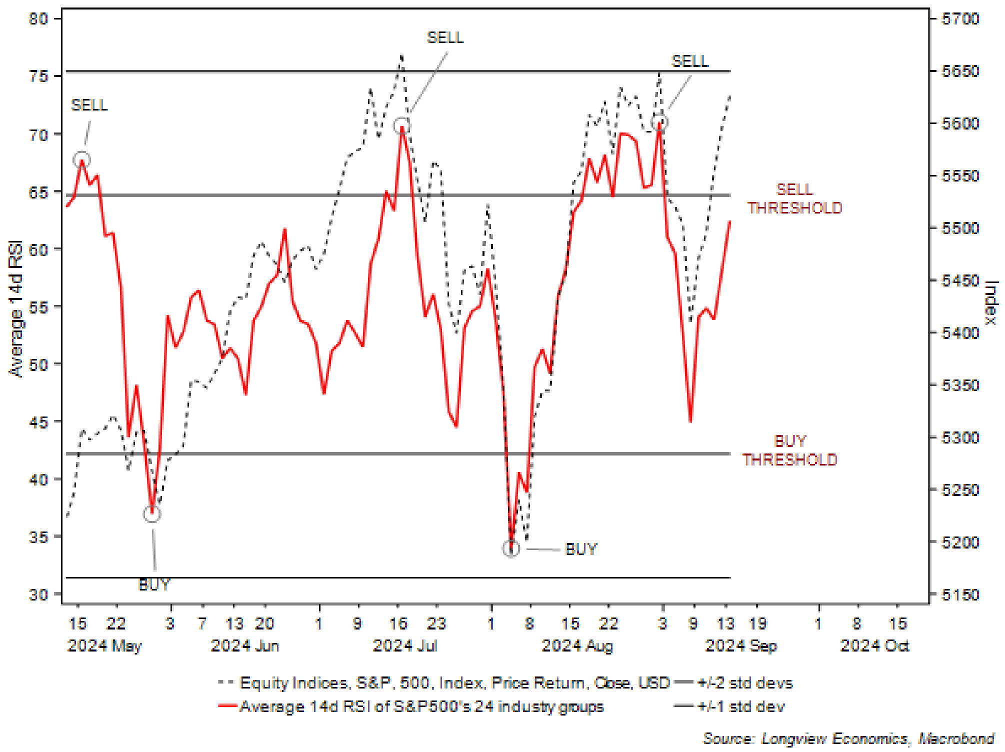
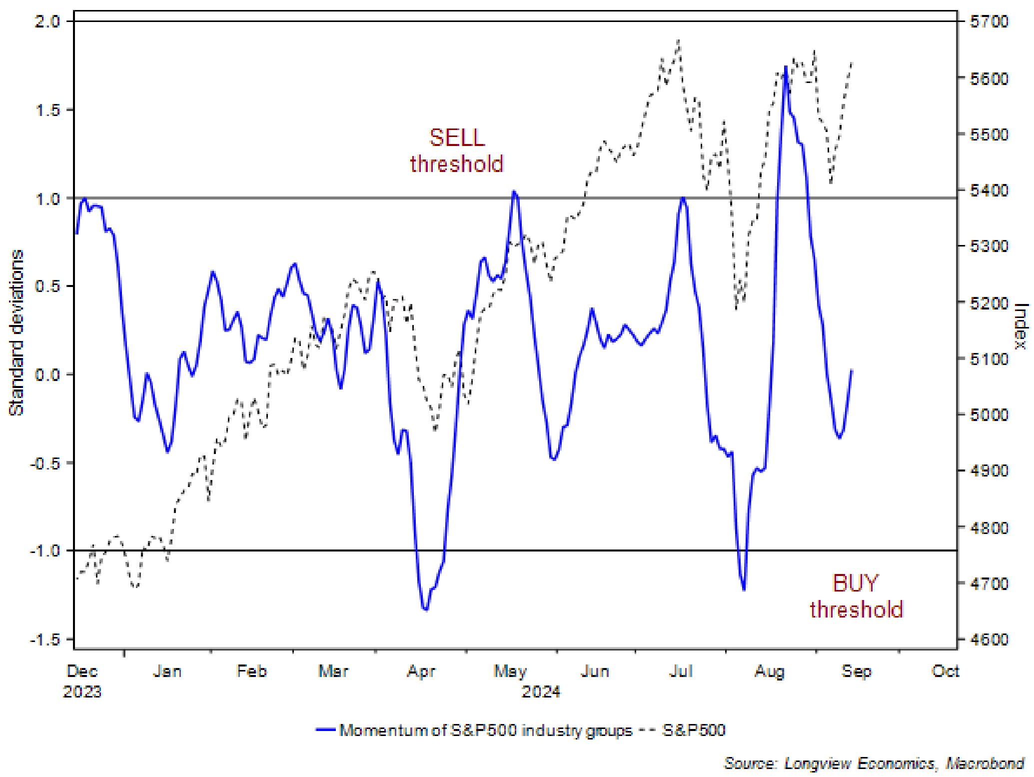


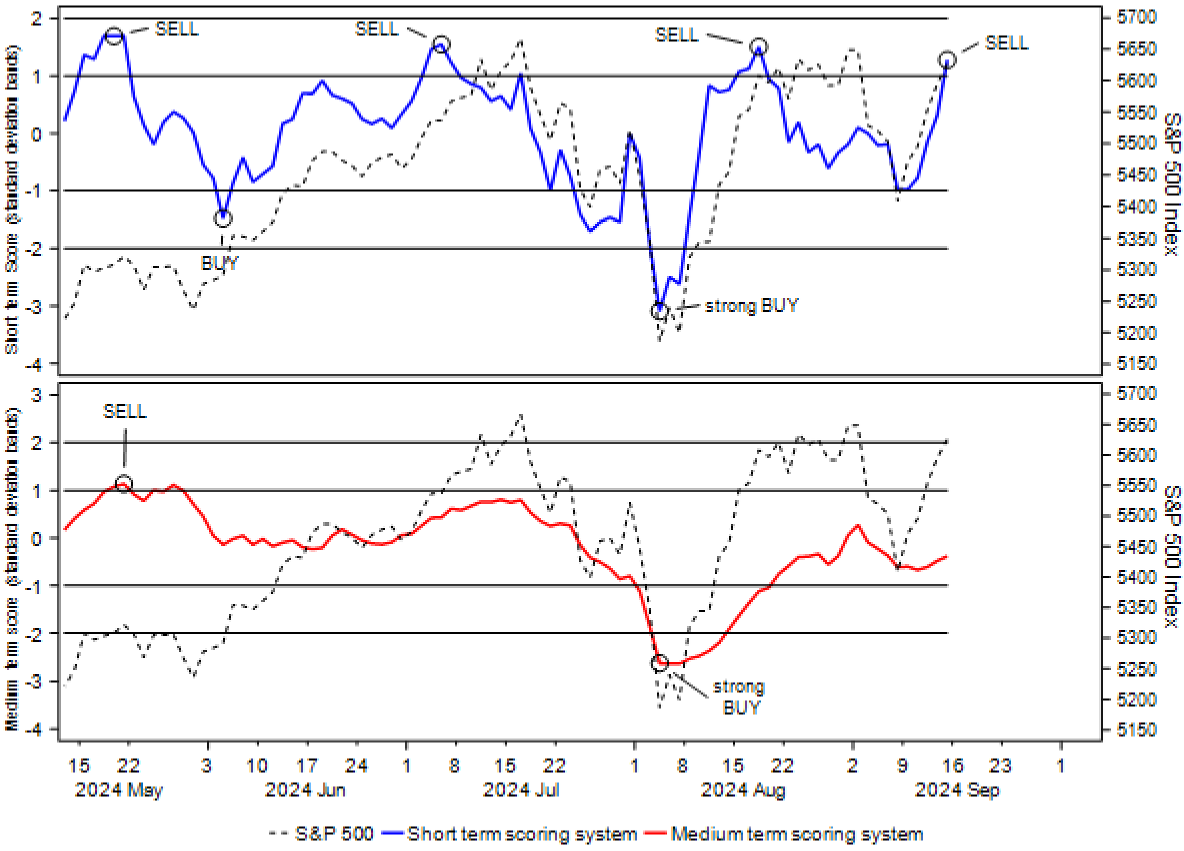
FIG 2g: Momentum of US industry groups (i.e. all 24, scored and aggregated) vs. S&P500



Key Longview Scoring Systems (chart below):

Short term (1 – 2 week) scoring system: **SELL**
Medium term (1 – 4 month) scoring system: **NEUTRAL**

FIG A: Longview short and medium term scoring systems vs. S&P500



Source: Longview Economics, Macrobond

Key macro data/events

Key data today include: UK Rightmove house prices (Sept, 12am); Italian core CPI (Aug, 9am); Eurozone trade balance & labour costs (Jul/Q2, 10am); US Empire manufacturing (Sept, 1:30pm); Canadian existing home sales (Aug, 2pm).

Key events today include: Speeches by the ECB's Guindos at event VII Foro Banca (9:10am), Lane at European Investment Bank Chief Economists' meeting (1pm) & Panetta in Rome; market holidays in various APAC countries (e.g. China, Hong Kong, Japan etc.) on account of Mid-Autumn Festival (Mon – Wed).

Key earnings today include: N/A

Definitions & other matters:

RAG = Risk Appetite Gauge

The 'Daily Risk Appetite Gauge' publication is designed to generate '1 to 2' week trading recommendations on equity indices. For trading recommendations on currencies, rates, bonds and other assets, pls see Macro-TAA trade publications.

For a medium-term recommendation please see our '1 – 4' month tactical market views which are updated at the start of each month in our Tactical Equity Asset Allocation publication (as well as occasional ad-hoc intra month Tactical Alerts). The latest update was published last week (5th September 2024). If you are not on the distribution list and would like to receive these reports pls email info@longvieweconomics.com.

1 – 2 Week View on Risk

16th September 2024

Longview Economics
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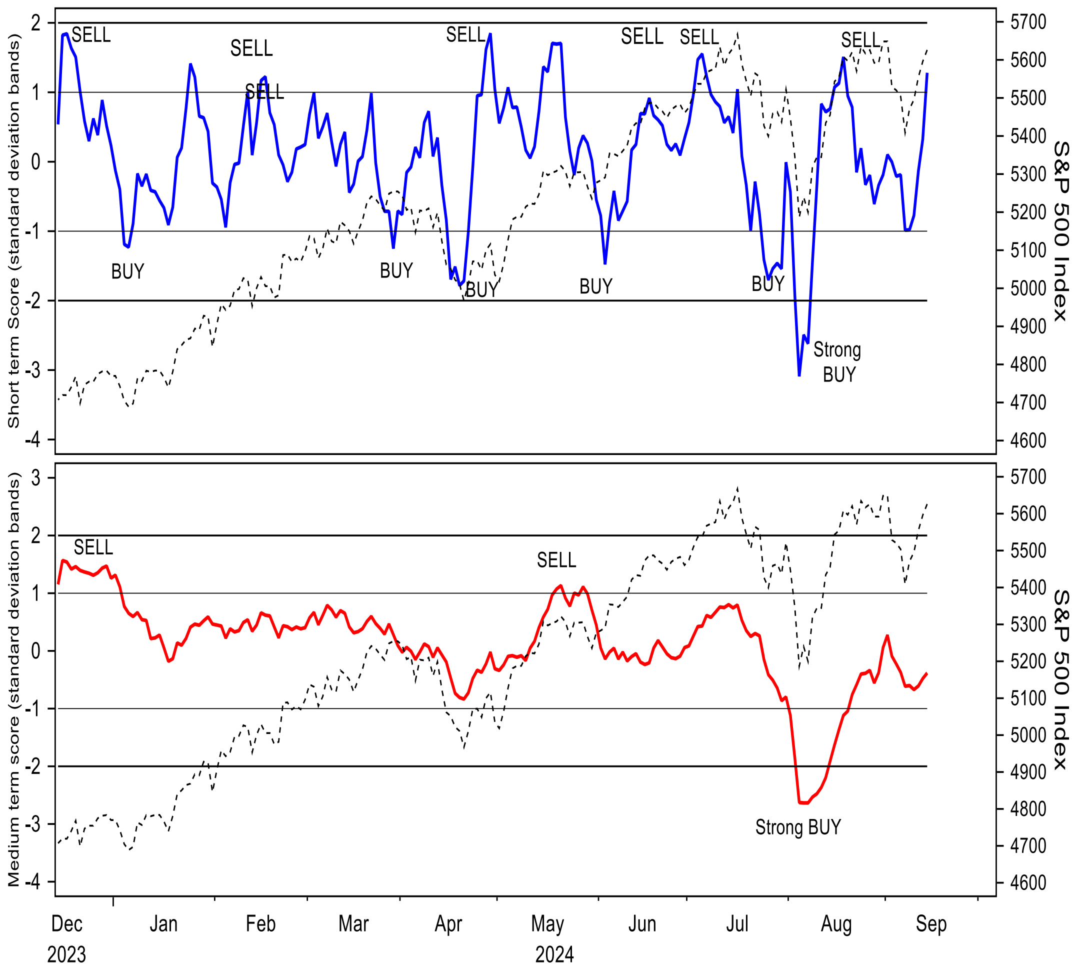
Section 1: Longview Scoring Systems (short & medium term*)

Fig 1: Longview 'short term' and 'medium term' scoring systems



Short term scoring system is on SELL

Medium term scoring system is NEUTRAL

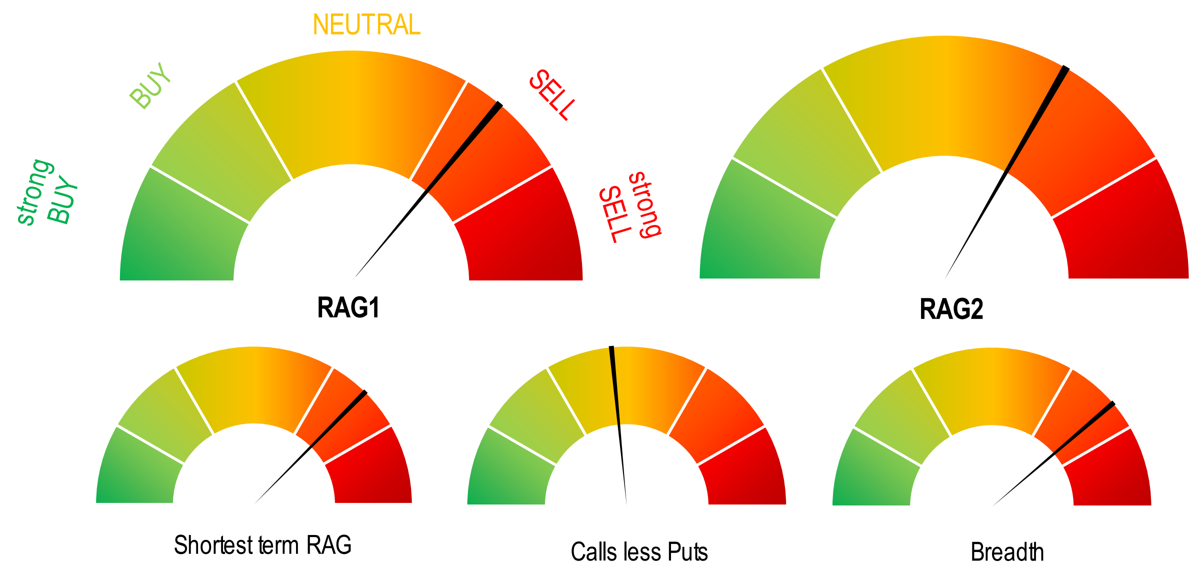
Source: Longview Economics, Macrobond

*NB short term is 1 – 2 weeks; medium term is 1 – 4 months

Important disclosures are included at the end of this report
For explanations of indicators please see page 10

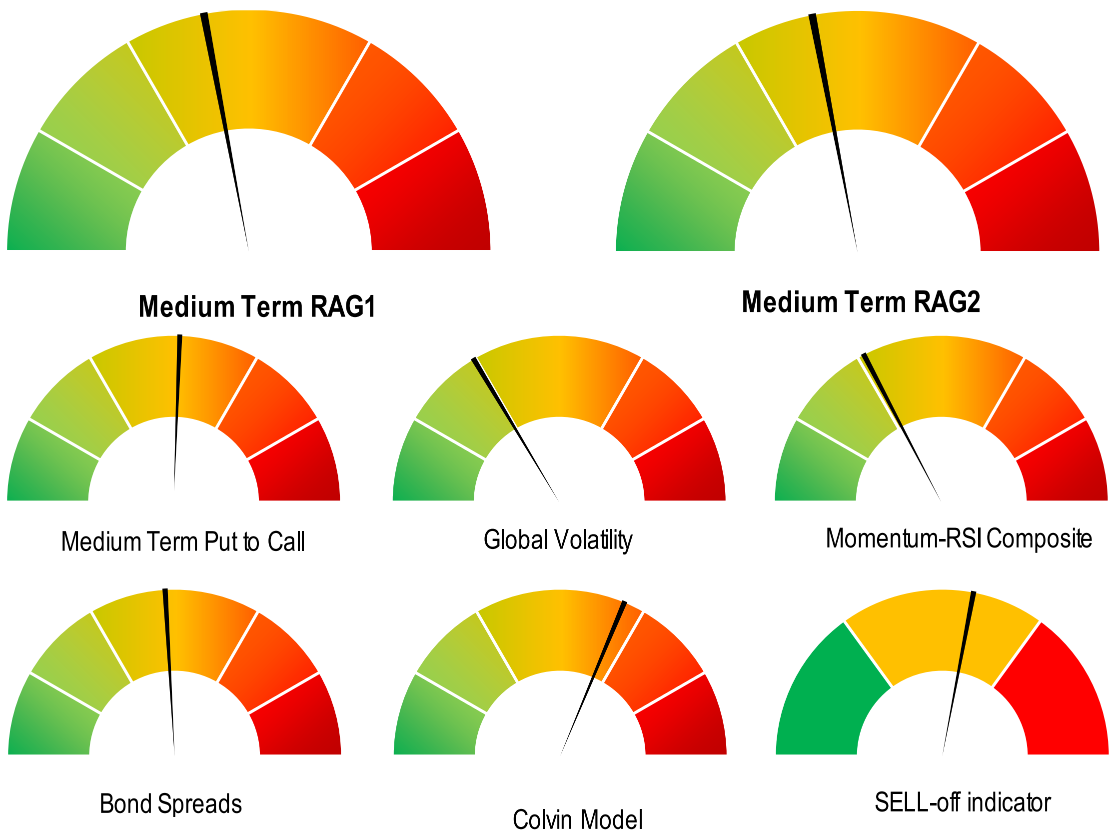
Section 1a: Summary of indicator signals**

Fig 1a: Short term models – shown as gauges using standard deviation bands



Source: *Longview Economics*

Fig 1b: Medium term models – shown as gauges using standard deviation bands



Source: *Longview Economics*
**The gauges are a pictorial representation of the strength of the current BUY, SELL or NEUTRAL signal of each indicator

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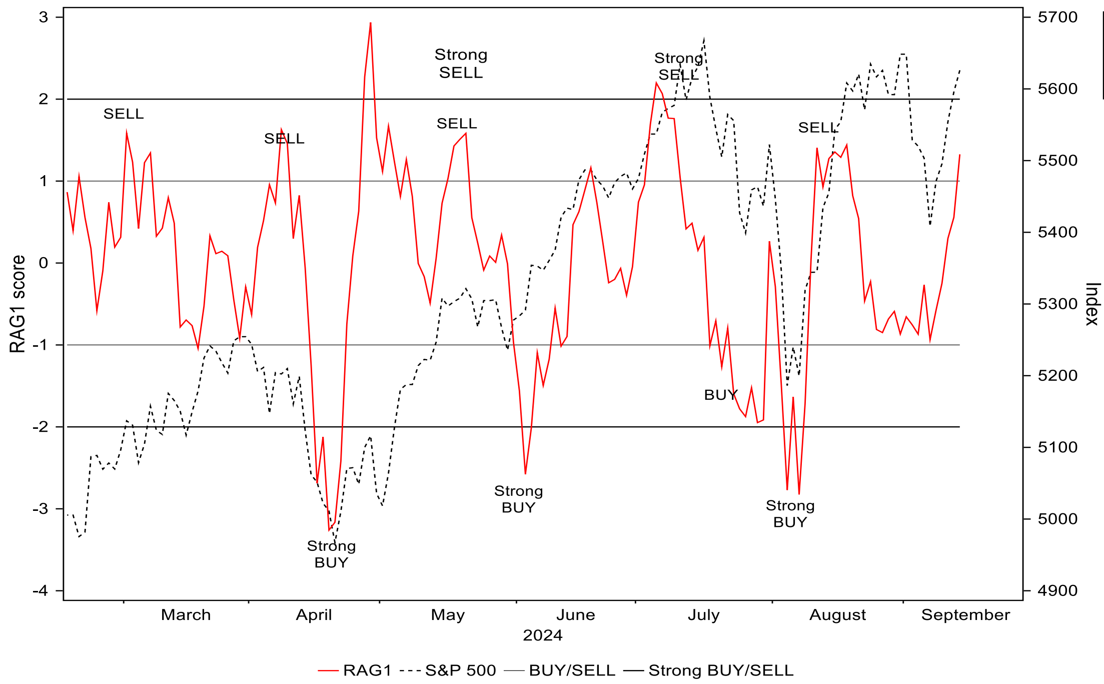
Section 2: Short term (1 – 2 week) trading models

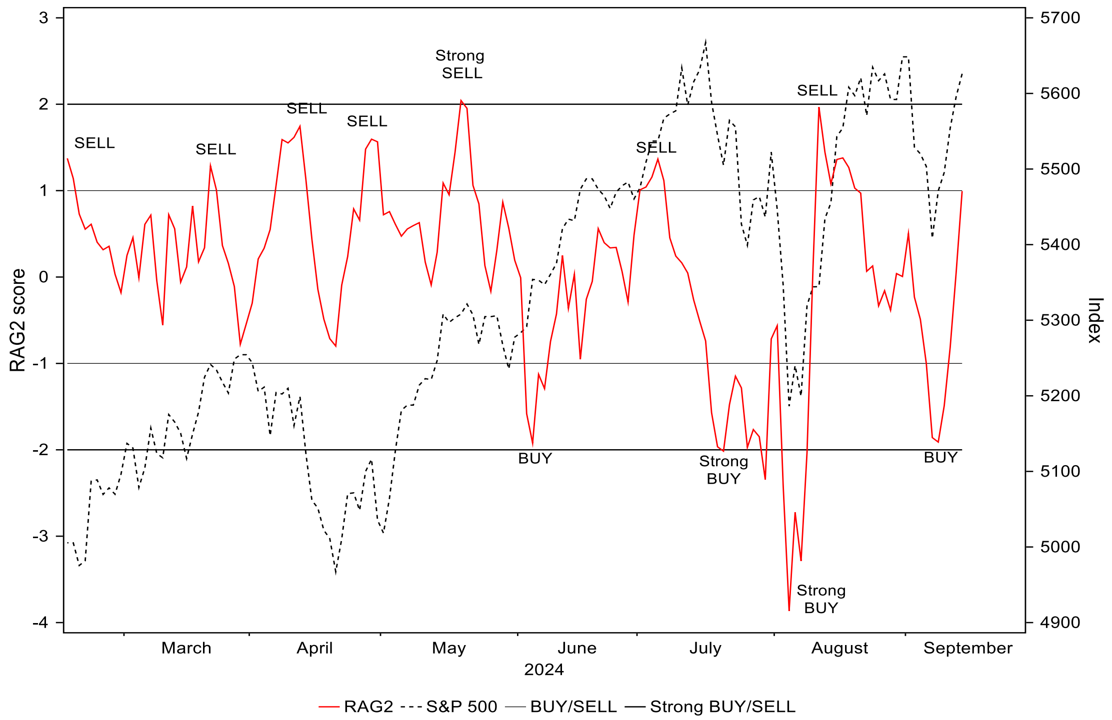
Fig 2a: RAG 1 vs. S&P 500



Source: Longview Economics, Macrobond

RAG1 is on SELL

Fig 2b: RAG 2 vs. S&P 500

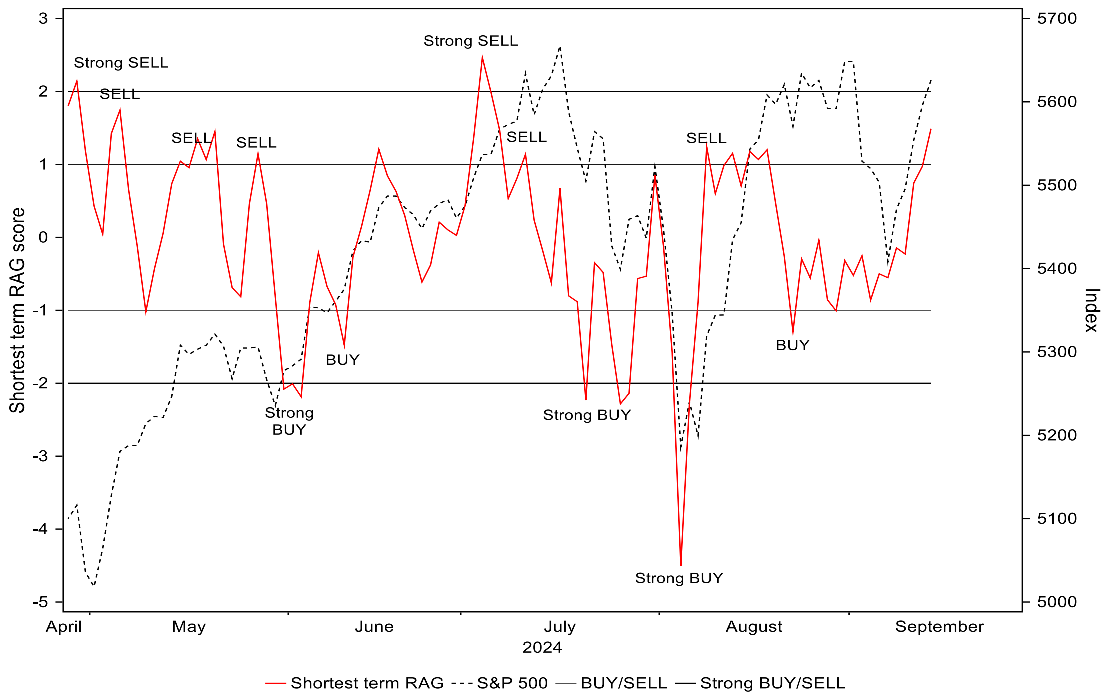


Source: Longview Economics, Macrobond

RAG2 is NEUTRAL

For explanations of indicators please see page 10

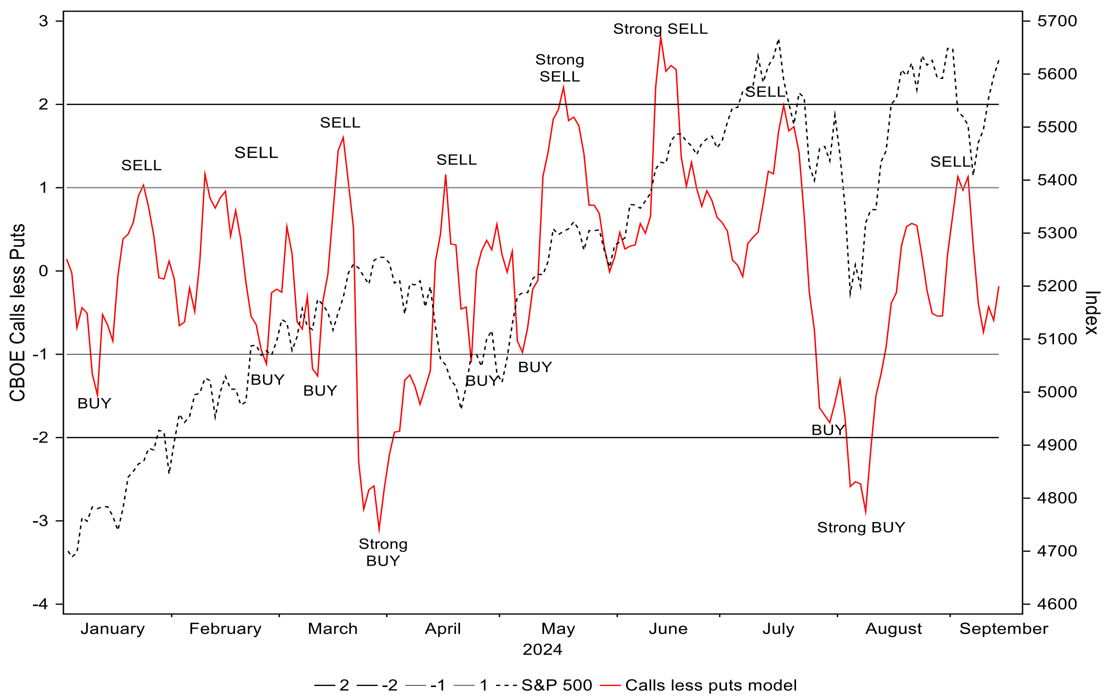
Fig 2c: Shortest term RAG (i.e. using a 3 day moving average) vs. S&P 500



Source: Longview Economics, Macrobond

Shortest term RAG is on SELL

Fig 2d: CBOE calls less puts (5 day moving average) vs. S&P500

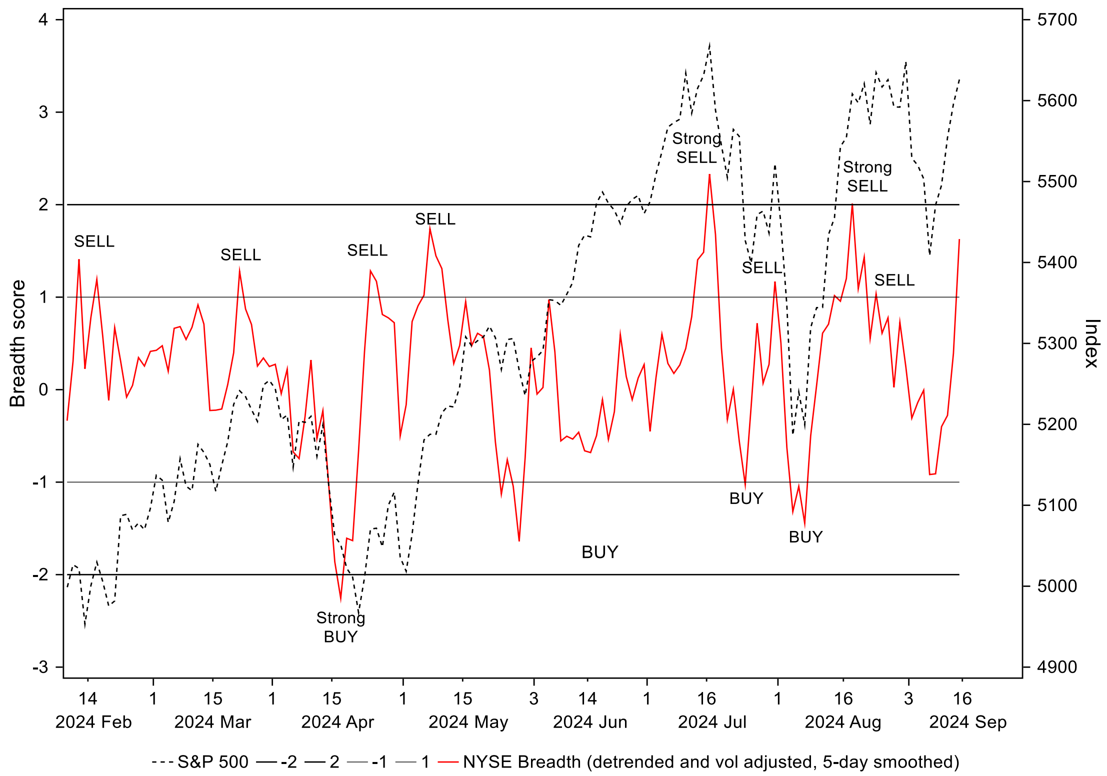


Source: Longview Economics, Macrobond

Calls less puts model is NEUTRAL

For explanations of indicators please see page 10

Fig 2e: Advancers less decliners (NYSE) – 5 day moving average vs. S&P 500



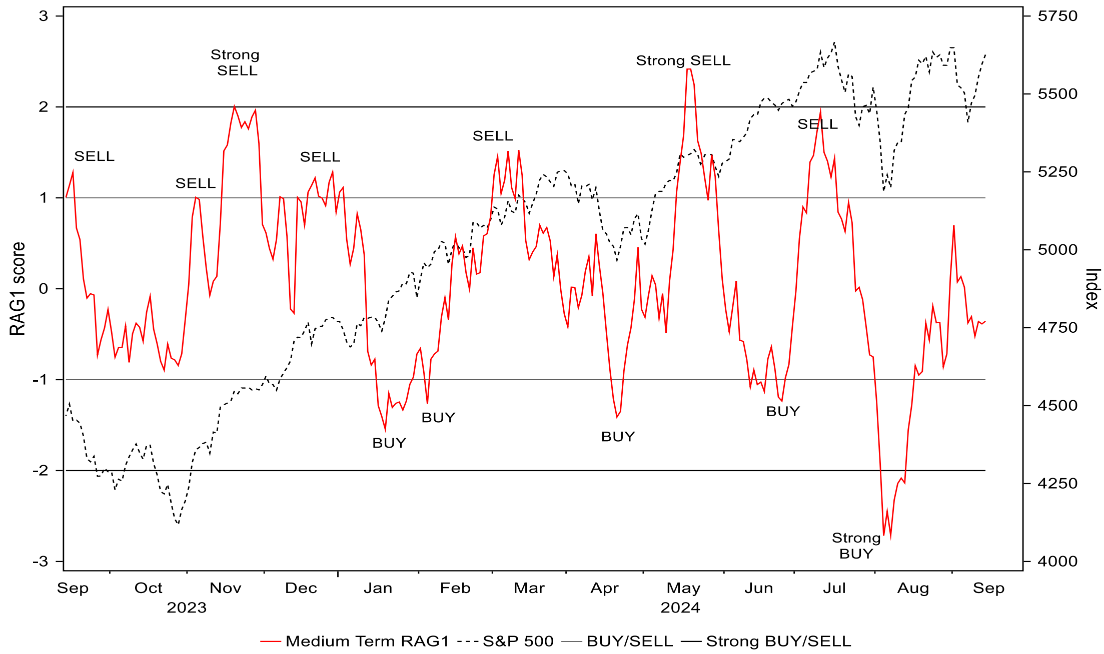
Source: Longview Economics, Macrobond

The breadth model is on SELL

For explanations of indicators please see page 10

Section 3: Medium term (1 – 2 month) outlook

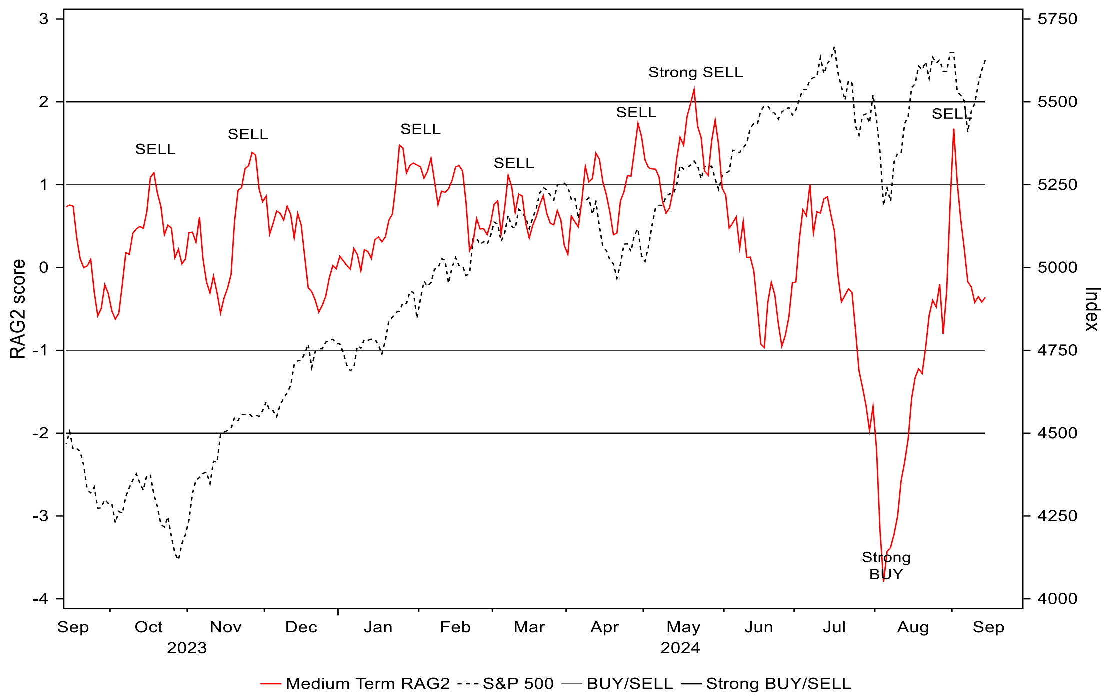
Fig 3a: Medium term RAG1 (1 – 2 month view) vs. S&P 500



Medium term RAG1 is NEUTRAL

Source: Longview Economics, Macrobond

Fig 3b: Medium term RAG2 (1 – 2 month view) vs. S&P 500



Medium term RAG2 is NEUTRAL

Source: Longview Economics, Macrobond

For explanations of indicators please see page 10

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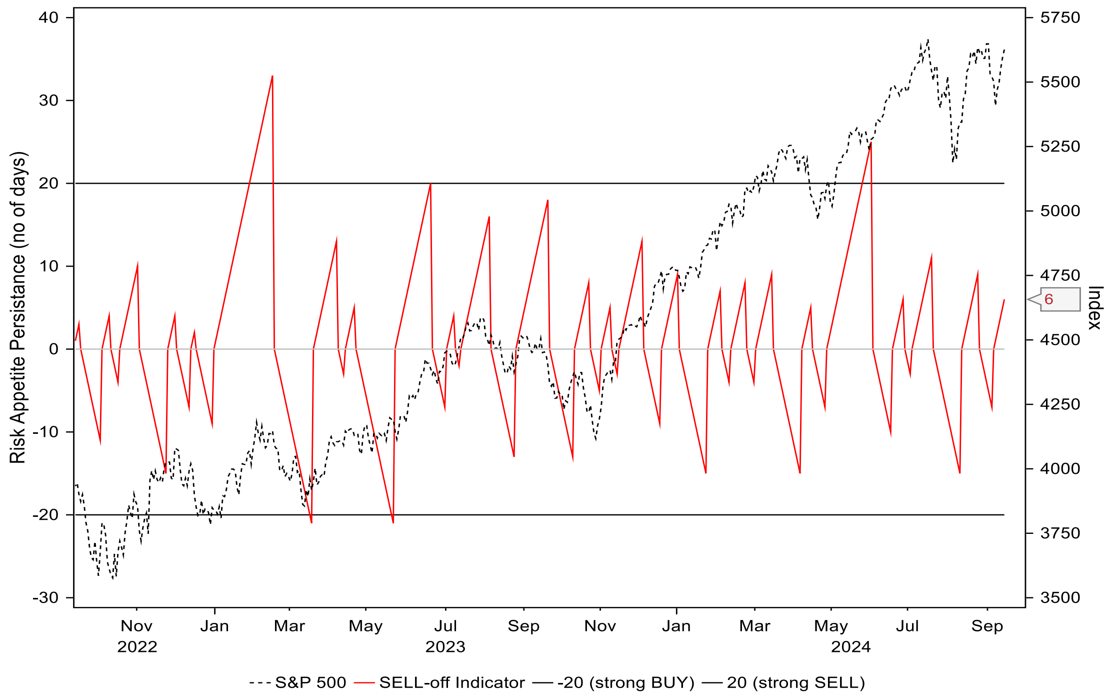
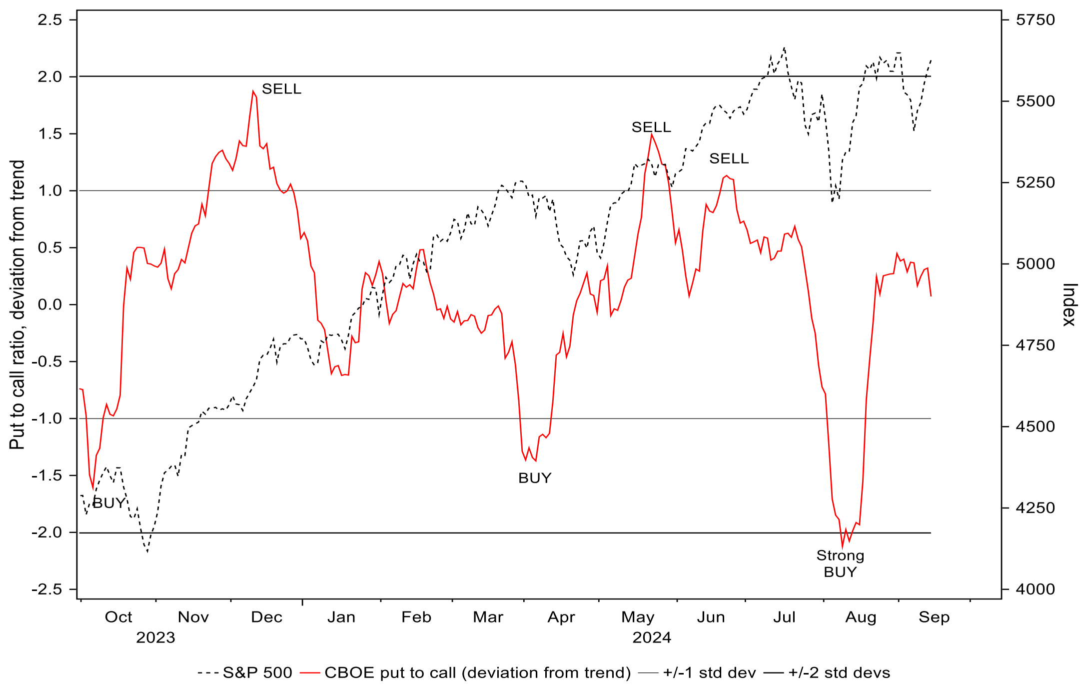
Fig 3c: SELL-off indicator (shown vs. S&P500)



Source: Longview Economics, Macrobond

The SELL-off indicator is NEUTRAL

Fig 3d: CBOE put to call trend deviation model vs. S&P500

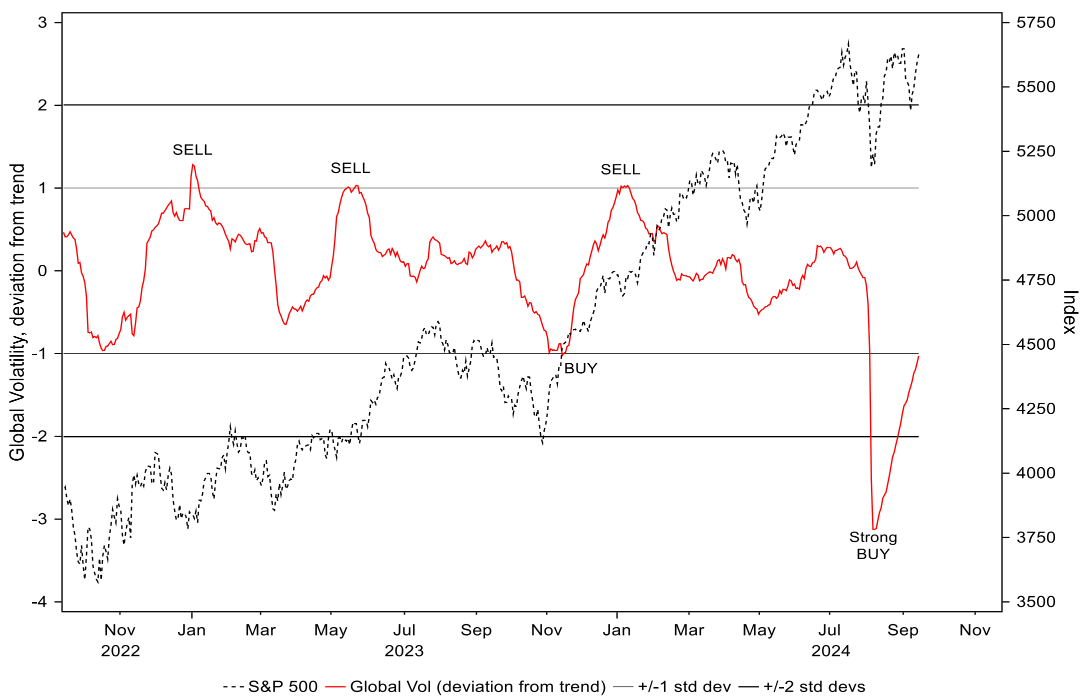


Source: Longview Economics, Macrobond

Medium term put to call model is NEUTRAL

For explanations of indicators please see page 10

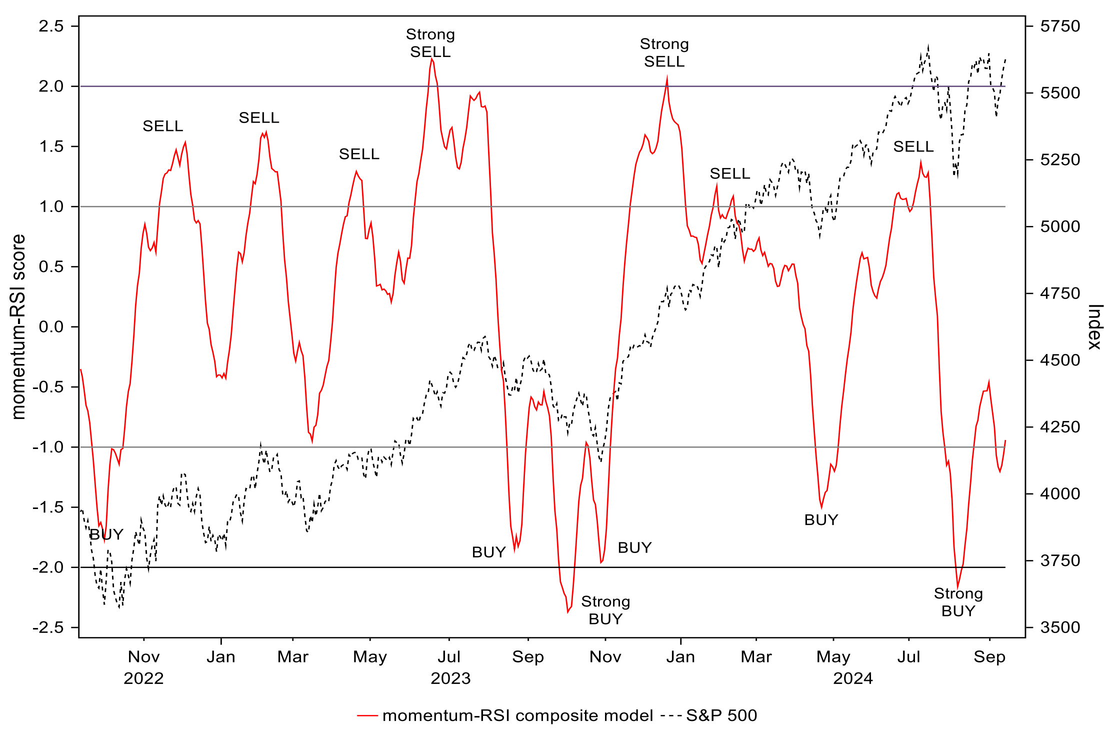
Fig 3e: Global volatility (deviation from trend) model vs. S&P500



Source: Longview Economics, Macrobond

Global volatility indicator is on BUY

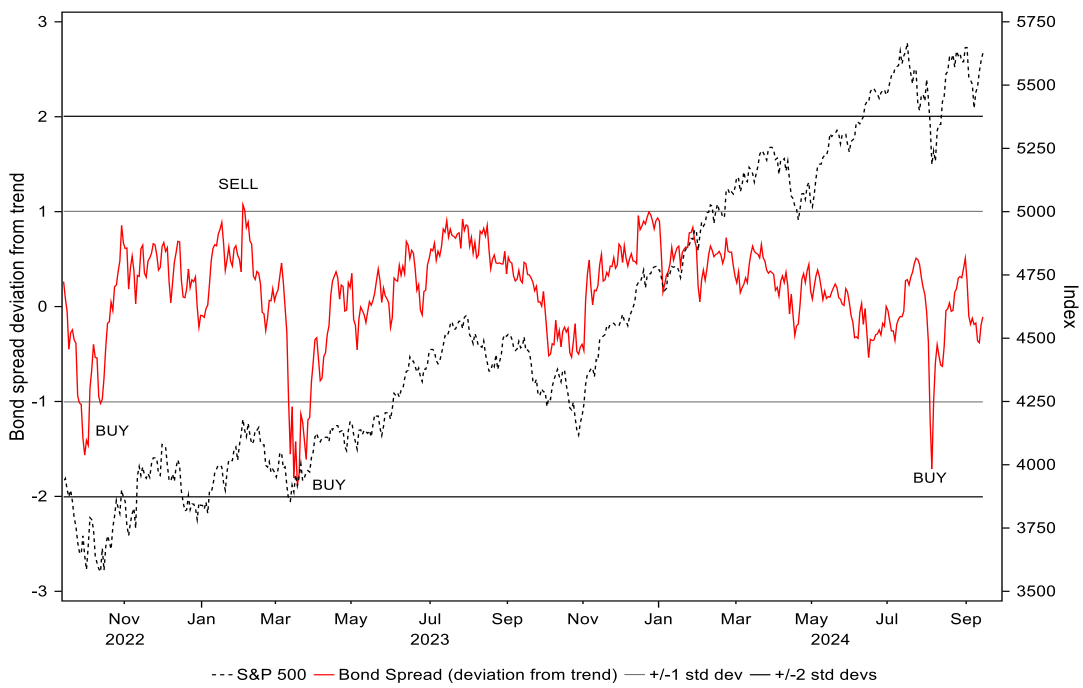
Fig 3f: Longview Momentum-RSI composite model vs. S&P 500



Source: Longview Economics, Macrobond

US momentum RSI composite model is NEUTRAL

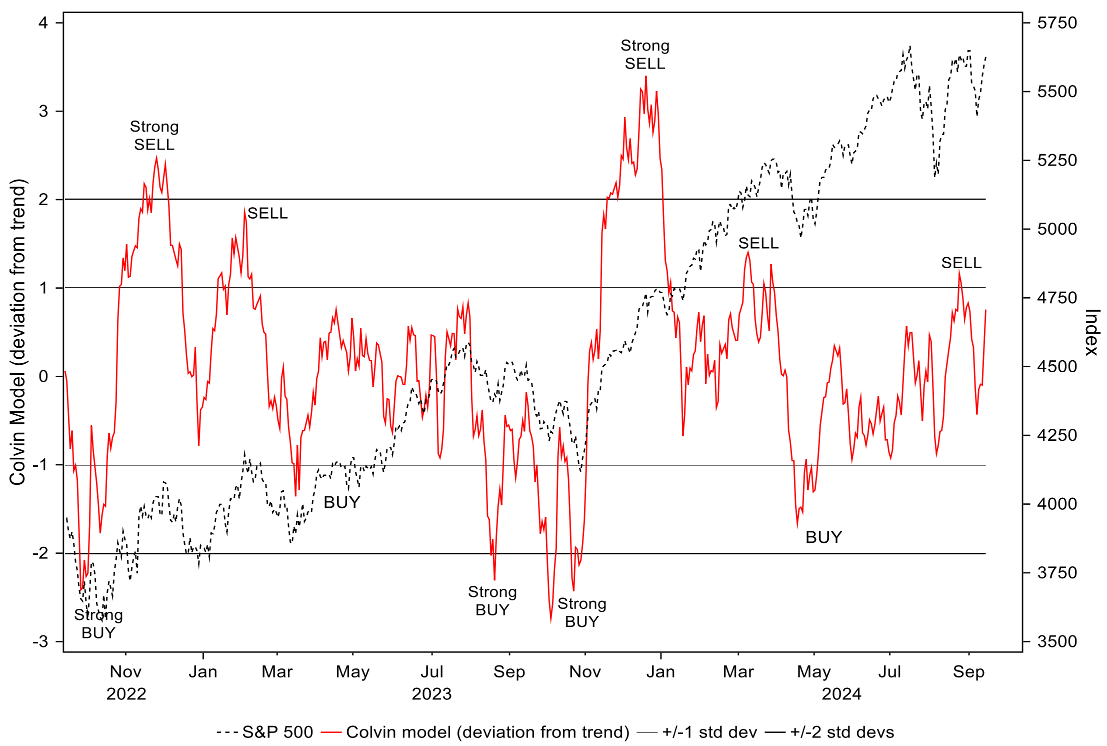
Fig 3g: High yield corporate bond spreads deviation from trend model vs. S&P500



Source: Longview Economics, Macrobond

High yield corporate bond spreads model is NEUTRAL

Fig 3h: Colvin model (deviation from trend) vs. S&P500



Source: Longview Economics, Macrobond

Colvin model – is NEUTRAL

For explanations of indicators please see page 10

Appendix: Model Explanations

Model 2a-b: Short term RAG1 & RAG2 (risk appetite gauge)
RAG1&2 each draw upon the volatility and price movement of approximately 70 financial instruments each day. By plotting risk curves we derive the risk appetite of the investment community as a whole on any and every day's trading in financial markets.

Model 2c: Shortest term RAG
This RAG model is a shorter term moving average risk appetite model than model 2a. By being shorter term in nature it helps to more accurately time the entry day for a specific trade.

Model 3a – 3b: Medium term RAGs
This is a medium term version of the risk appetite models. This is designed to forecast the direction of equity markets on a 1 – 2 month timeframe.

Model 3c: SELL-off indicator
The SELL-off indicator measures the number of days our RAG system has been on a SELL signal (i.e. as a positive number) and the number of days which it has been on a BUY signal (negative reading). When the indicator moves above +20 (i.e. risk appetite has been persistently high for a long period of time) this indicator warns of a potential sell-off in equity markets (and other risky assets). Most major SELL-offs in equity markets in recent years have been accompanied/foreshadowed by a reading of over +20.

Model 3d: CBOE put to call (deviation from trend model)
This model measures movements in the put to call ratio from its medium term moving average trend line. A sharp move higher (lower) in the put to call ratio indicates heightened levels of fear (complacency) and is used as a contrarian indicator. NB Given that the absolute put to call ratio has historically undergone long term structural trends, a deviation from trend model correlates more closely with medium term trends in equities.

Model 3e: Global volatility (deviation from trend model)
The (underlying) global volatility indicator measures the degree of complacency in financial prices. It achieves this by measuring short term realised volatility in over 150 financial assets from around the globe and across the asset class spectrum. A low reading indicates that only a low level of risk is priced into financial markets (and vice versa). Given, though, that volatility is an asymmetric measure of risk we use a deviation from trend version – which correlates more closely with trends in equities.

Model 3f: Momentum Model
Based on the rate of acceleration (or deceleration) of the momentum of the convergence (or divergence) of a short and a long term moving average of the equity or other price index. The concept is equally applicable to any financial market and the signals are particularly pertinent at extremes.

Model 3g: High yield corporate bond spreads (deviation from trend model)
This model measures movements in the spread of high yield corporate bonds over US Treasury yields from its moving average trend line. Given that the spread is an asymmetric measure of risk we use a deviation from trend version – which correlates more closely with trends in equities.

Model 3h: Colvin model
The Colvin model measures global market breadth i.e. the strength of the advance (or decline) in global risk asset prices. Extreme deviations from trend reflect rapid advances/declines in asset prices thereby leading to and generating overbought/oversold signals.

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