



# Quantitative Signals on Major Market Moves

## **Monthly Market Alert**

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March 3, 2017

*Extracts from the original document*

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This document provides the outputs of highly complex and extraordinarily powerful data-mining and artificial intelligence tools applied to macroeconomic, financial and market variables.

These outputs are Early Warning Signals (EWS) on large reversal in market prices (upwards as well as downwards) over a short-term horizon (1, 2 and 3 to 6 months ahead) and the tools include an estimation of cyclically-influenced Fair Values (i.e. market prices that would be fully consistent with the traditional set of economic and cyclical determinants of fair values).

*Results presented here are directly the outputs of the quantitative models and we do not tamper with them. However, we note that a couple of markets show probability indexes very close to the thresholds that would imply a different signal (double signal or no signal). We are therefore more cautious on these, and we highlight them with a \* in the table opposite.*

**Written on March 3, 2017 with data up to March 1, 2017.**

## Key messages – March 2017

### Retrospective outlook

Good predictive power on bonds

### Short term neutral signals

Profit-taking and political risk induce “wait and see” mood

### Less pronounced equity trend

Muted US equity, Euro Zone markets catch-up

### Govies differentiation

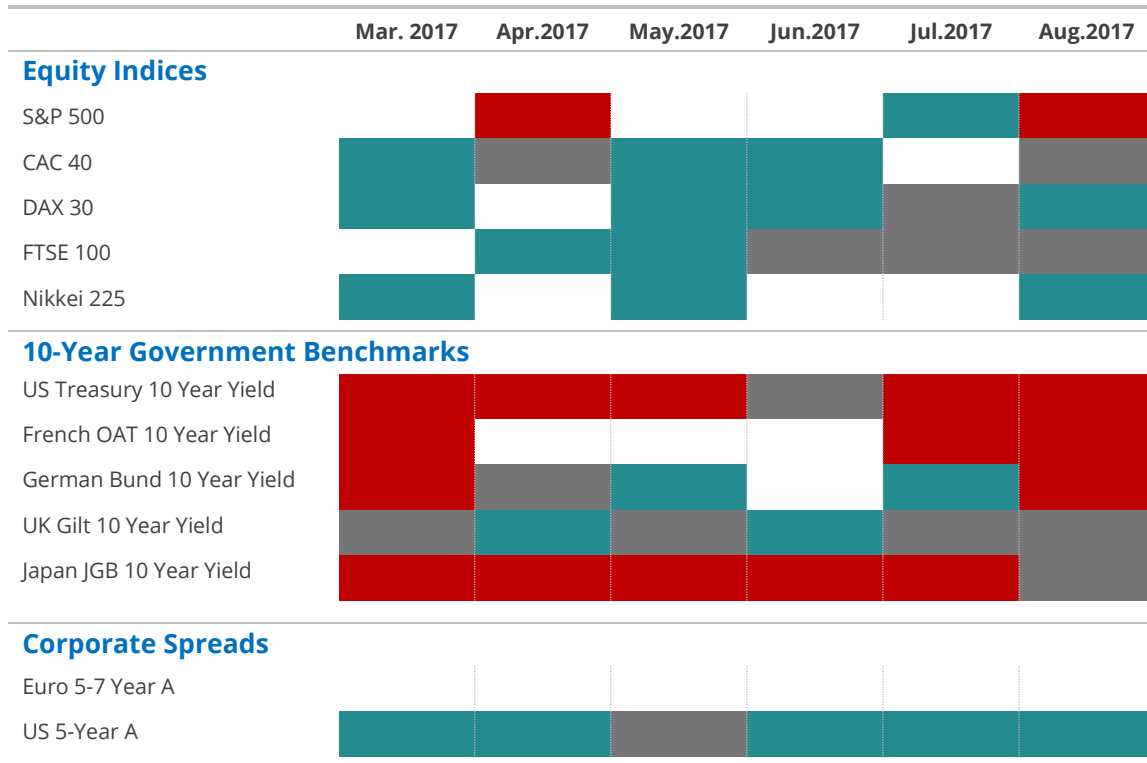
Continuous US yield pressures, Germany back to safe haven status

### US corporate strength

Macro fundamentals over equity valuations

- The one-month-ahead EWS provided in our February 2017 Monthly QMA had good predictive performances on Euro Zone bond markets, moreover, 9 out of the 12 signals were correct. The forecasting errors were concentrated on equity markets, on which we anticipated major changes but where the monthly evolution was finally rather neutral (except for the S&P500).
- Compared to February key messages, this monthly update suggests a “wait and see” approach. For the S&P 500, EWS indicate a more neutral stance (except in April with *deterioration* signal), consistent with profit taking pressures after the past rally. Regarding bond markets, two distinct signals appeared: continuous deterioration on Treasuries yields while less pronounced in Euro Zone bond markets. Corporate spreads signals remained unchanged, continued to highlight US corporate strength.
- A major change is for short-term equity EWS (March and April), compared to last month. The system now suggests a more *neutral* trend on Euro Zone markets, while the signal on the S&P500 for April reversed to a *deterioration*. Overall, our models continue to foresee a positive path at the medium-term horizon, albeit more pronounced on European than US equity markets (especially on the DAX30). Changing EWS on the FTSE100 (from *amelioration* to *double* signals from June to August) appeared more consistent with Brexit related uncertainties.
- Our US bond markets signals are consistent with the current repricing of Fed’s rate hike path given the reversal of market dynamic. Not only momentum is building from March Fed hike, but also markets perception moved toward the Fed’s dot plots. It suggests US yield bond market deterioration is more lasting. On the opposite, the Euro Zone bond markets appear more differentiated: despite robust economic data releases, political risk favored demand for German assets. March to June EWS suggest (1) extensions of political market tensions as German bonds (except April 10y bond) improvements pursue. Still, *neutral* signals on other core yields (as of April) indicate mitigated sovereign risk transmission. (2) Downward ECB tapering expectations in 2017H1 as suggested by limited EWS over the yield curve (more consistent with our ECB 2017Q3 tapering announcement).
- *Improvement* signal on US 5y A corporate spread continues to highlight US corporate strength in the background of expectations of D.Trump’s fiscal boost. Compared to the limited improvement in S&P500 equity markets, US corporate spread EWS suggests an effective improvement in corporate conditions, and softly managed monetary policy tightening in 2017 (limited impact of tightening financial conditions). EWS for Euro Zone 5-7 A corporate spread remains neutral, consistent with negligible gap to the fair-value.
- Please note that acute political uncertainties following D. Trump’s election and the impact on daily information used in our tools create the conditions for abrupt changes and disruptions in our EWS market signals, particularly on US markets.

# Summary of Early Warning Signals



Source: TAC ECONOMICS

**Legend :**



\*Less confidence in EWS signals according to our qualitative analysis.

## Summary on Market Fair Values

The following table summarizes the estimated fair value for each market. The comparison with the market level during the same month allows evaluating the expected short-term direction assuming that market level oscillates around fair-value.

	Market Level (Last value)	Fair Value Jan. 17	Gap to Fair Value	Expected short-term direction	Evolution between Jan.17 and Feb.17
<b>Equity Indices</b>					
S&P 500	2 396	2 107	289	Decrease	Increase
CAC 40	4 961	4 558	403	Increase	Decrease
DAX 30	12 067	10 353	1714	Decrease	Increase
FTSE 100	7 383	6 574	809	Decrease	Increase
Nikkei 225	19 394	17 880	1514	Increase	Decrease
<b>10-Year Government Benchmarks</b>					
US Treasury 10 Year Yield	2.46%	2.11%	+35 bp	Decrease	Decrease
French OAT 10 Year Yield	0.92%	2.05%	-113 bp	Increase	Increase
German Bund 10 Year Yield	0.28%	1.44%	-116 bp	Increase	Increase
UK Gilt 10 Year Yield	1.20%	2.57%	-137 bp	Increase	Decrease
Japan JGB 10 Year Yield	0.06%	-0.06%	+12 bp	Stable	Increase
<b>Corporate Spreads</b>					
Euro 5-7 Year A	43 bp	56 bp	-13 bp	Stable	Decrease
US 5-Year A	84 bp	94 bp	10 bp	Stable	Decrease

Source: TAC ECONOMICS

# S&P 500

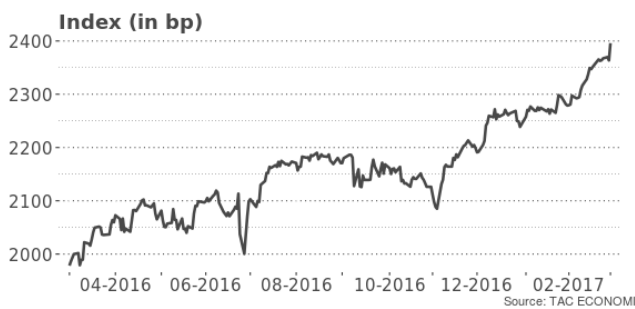
## Early Warning Signals

(red=strong deterioration, blue=strong improvement, grey= double signal and white=no major change)

	Mar.2017	Apr.2017	May.2017	Jun.2017	Jul.2017	Aug.2017
<b>Signals</b>						
<b>Confidence</b>	**	**	*	*	*	*

Source : TAC ECONOMICS

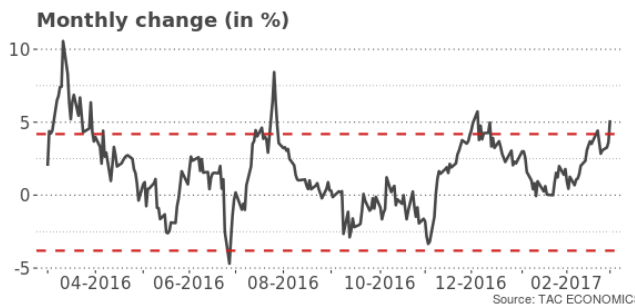
## Evolution of S&P 500



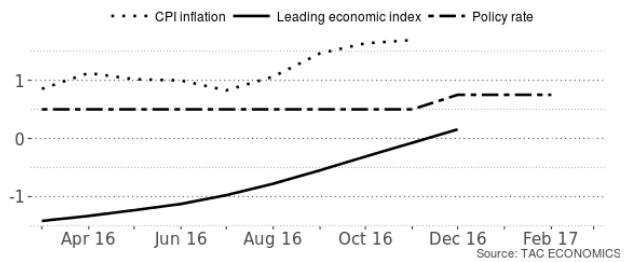
## Comparison of Actual vs. Fair Value

<b>Fair Value (January 17)</b>	<b>2 107</b>
Market Level	2 396
Gap to Fair Value	289
Expected short-term direction	Decrease
Market evolution between Jan. and Feb. 2017	Increase

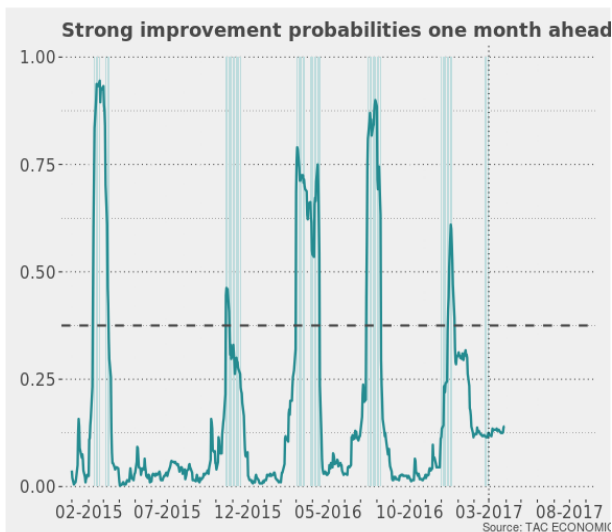
Source : TAC ECONOMICS



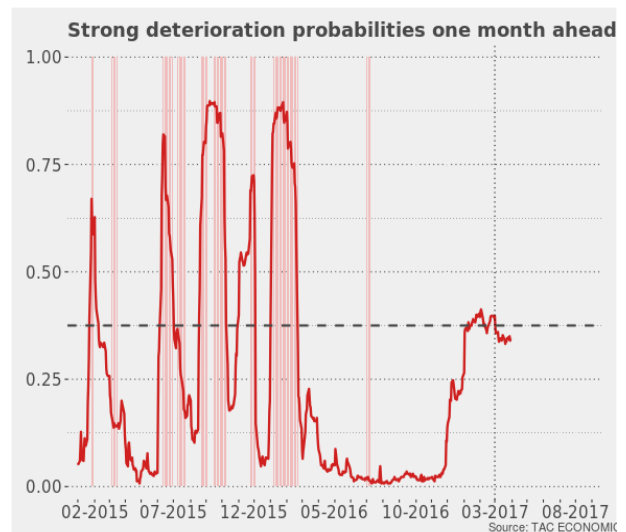
## Fundamental variables (%)



## S&P 500 Early Warning Signals (EWS)



(The blue line represents the improvement probability, bars in blue the observed improvement and the dotted line the EWS threshold)

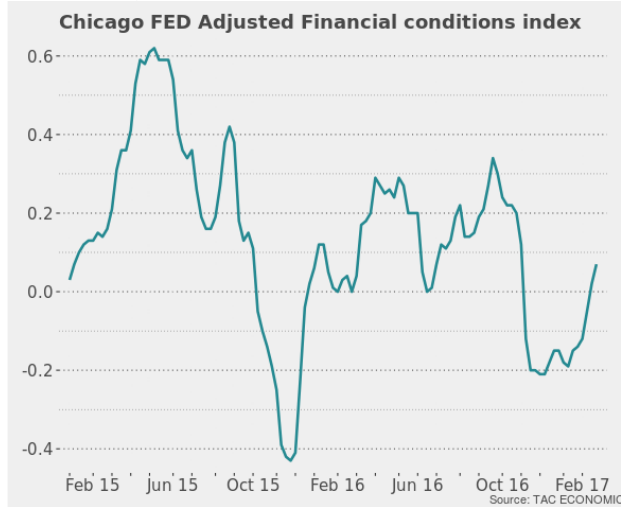


(The red line represents the deterioration probability, bars in red the observed deterioration and the dotted line the EWS threshold)

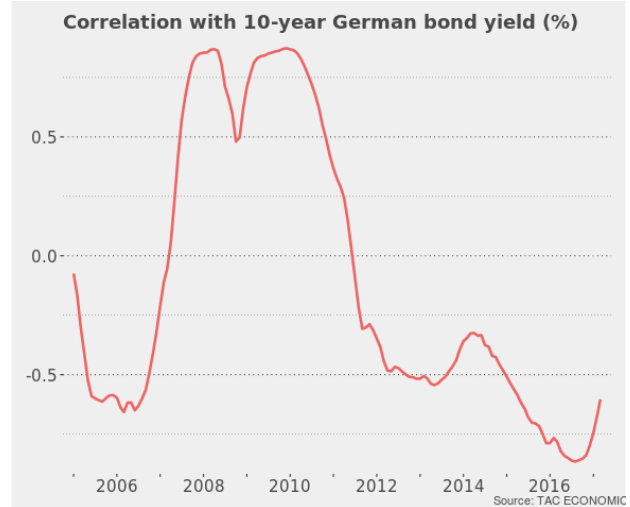
**Main drivers for S&P 500 EWS prediction**

The following graphs describe the main archetypal determinants to predict strong changes for the next six months. We distinguish macroeconomic indicators (in blue), financial market indicators (in red) from technical market analysis (in brown).

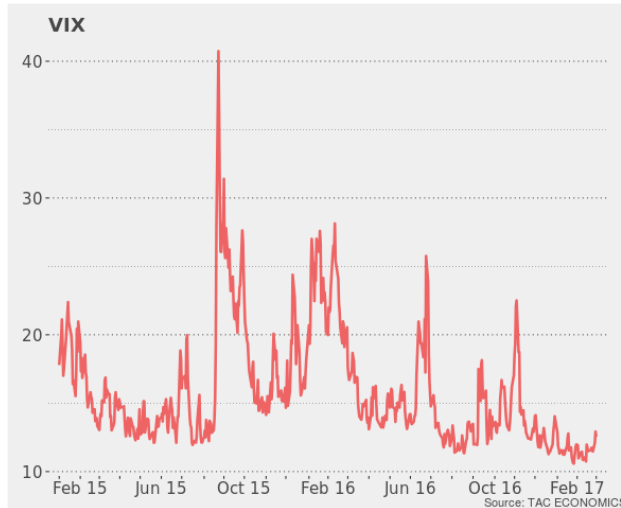
**US Financing conditions**



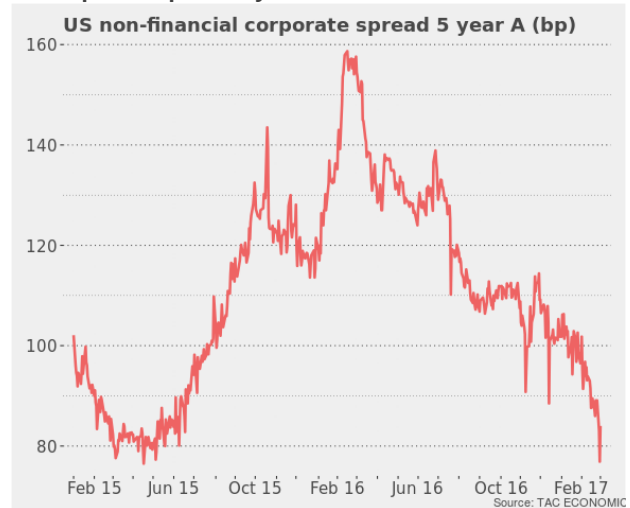
**Market correlations**



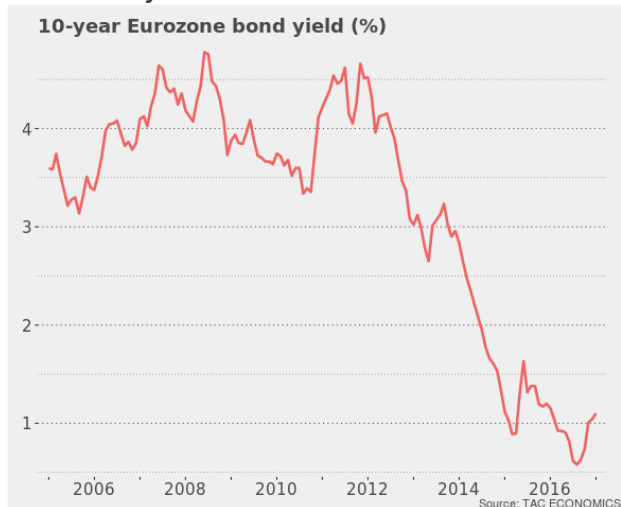
**US Financial stress index**



**US Corporate spread 5-year A**



**EUZ Monetary conditions**



**Market analysis**

