Macro Investing for Stock Investors

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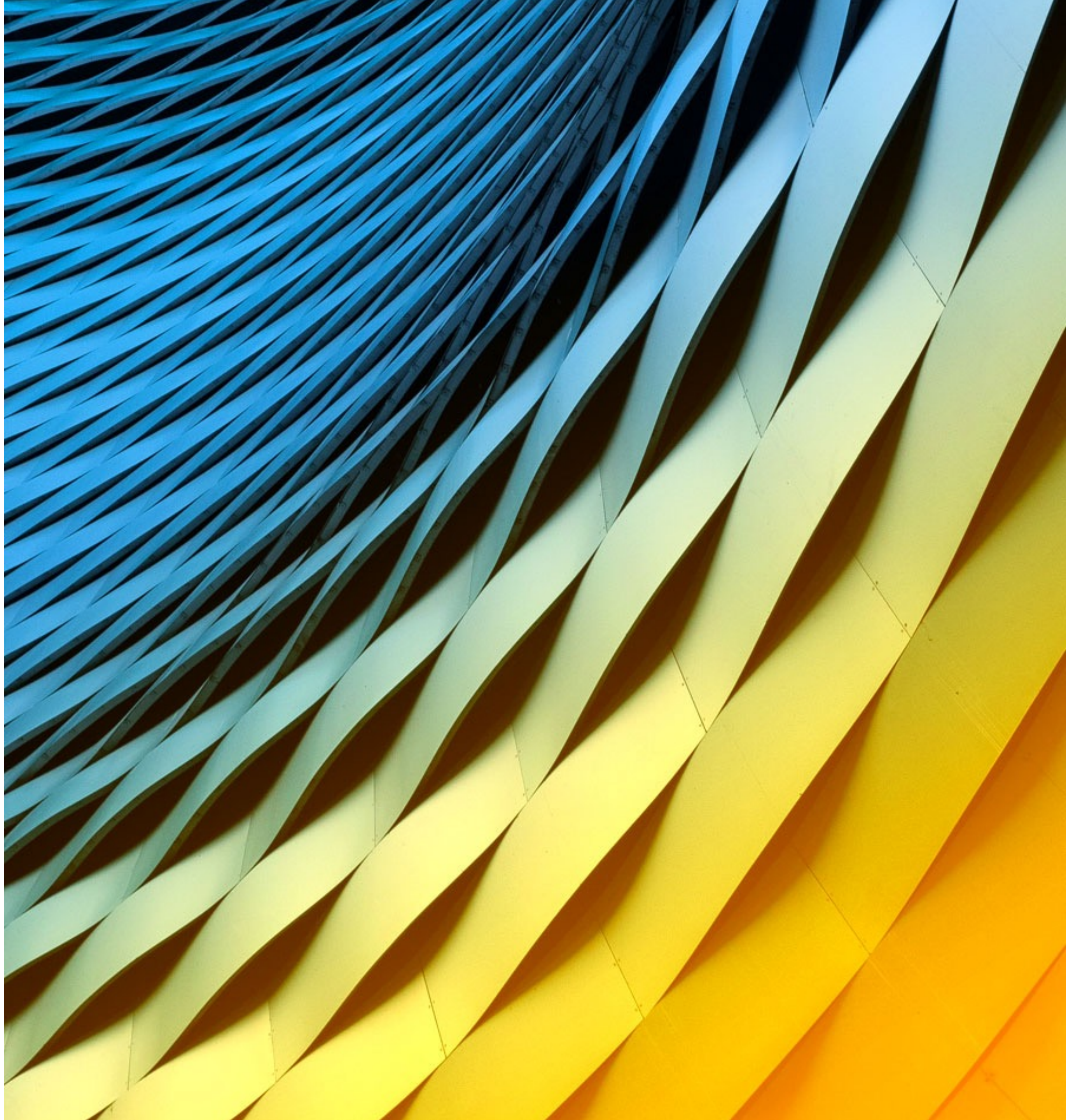

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Invest Rationally, Not Rashly

Macro investing for stock investors

May 27, 2021

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Worrying about the beta: ripples vs. the tide

Conventional thinking assumes equity investors should only worry about company fundamentals or price charts. But macro events tend to drive the systemic risk (the beta) rather than the idiosyncratic risk (the alpha) for each asset. Here are a few reasons why paying attention to macro could help:

- Macro events (fiscal stimulus, monetary policy) often impact the level of interest rates, which drives valuation models for companies
- Geopolitical events can lead to risk aversion that temporarily drives investors into safe assets, offering potentially attractive entry points to risky assets
- Company management actions can improve margins and profitability but macro events (transition from recession to expansion) can drive volume and topline

The Yield curve

The yield curve is a central element of asset pricing in the economy. Some rates – such as corporate bond rates or mortgage loan rates – are based on longer-term risk-free yields, while others – such as bank loan rates for firms – are mostly priced off shorter maturities.

- The yield curve reflects market expectations of future Central Bank policy, which is primarily driven by macro variables like economic growth and inflation
- The yield curve is used extensively in discounted cash flow models to determine fair valuation of equities and identify “cheap” and ”expensive” stocks

Risk-on, risk-off

Risk-on risk-off is an investment paradigm under which asset prices are dictated by changes in investors' risk tolerance. Risk tolerance (or appetite) is often determined by highly publicized geopolitical (terrorism, wars, financial crisis).

- During periods of low risk tolerance, investors abandon riskier investments and pile into safe assets like US Treasuries, driving interest rates lower
- Depending on the nature of the risk (oil shock vs. financial shock) certain sectors are impacted much more significantly

The macro vs. micro

Evaluating company fundamentals (the micro) gives investors a good sense of a company's profit margin and potential within a particular macro context. But macro context can drive wholesale shifts in the demand curve (think Zoom, Netflix) and therefore volume.

- Fundamental analysis worries about the slope of the demand curve (how much can company earn if it prices the product here, or here). Macro analysis worries about upward and downward shifts of the demand curve.

- Cyclical changes can lead to substantially different environments for a particular sector (Netflix in the pandemic, Housing during monetary easing etc.)

Can individual investors do macro analysis?

Machines can help. Smart assistants are ubiquitous in our daily lives… Why don't they exist in investing?

- Machines are really good at monitoring and processing large amounts of information
- They can uncover price patterns in assets around events/data changes
- They can test each relationship for robustness … in seconds
- They can deliver curated insights tailored to specific users

AI = Augmented Intelligence

AI can crunch the numbers instantly and alert the manager to drivers that are key to their portfolio at the moment (macro vs. micro, momentum or fundamentals etc)

Human intelligence is very good at strategy (the “big picture”) but AI can be helpful with the tactics (the “details”).

This can provide a crucial macro lens through which investors can peer at assets.

Machines replicate investor’s work on a much larger scale

Machines are replacing the analysis investors should be doing anyway – but they do it much faster

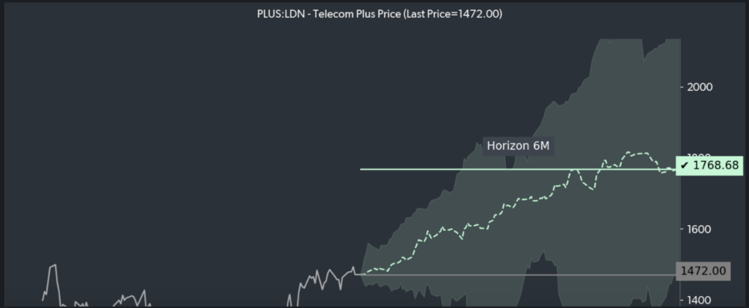
ACTIONABLE

BOOKMARK

PLUS - UK New Orders PMI crossed above 50, in the past this led to a increase in Telecom Plus price

by Toggle A.I. 1d ago

Economic Growth indicators for UK crossed above 50 . Historically this led to a median increase in Telecom Plus price of 18.31% over 6M, as shown in the chart below. In other words, it went up 18.31% at least half the time. This conclusion is based on 13 similar occasions in the past when this occurred, most recently on 2020-01-01. In our quality assessment this insight received 8 out of 8 stars. Insights with 6 stars and above exhibit the most compelling statistical properties. (What is a star rating?)



Source: Toggle

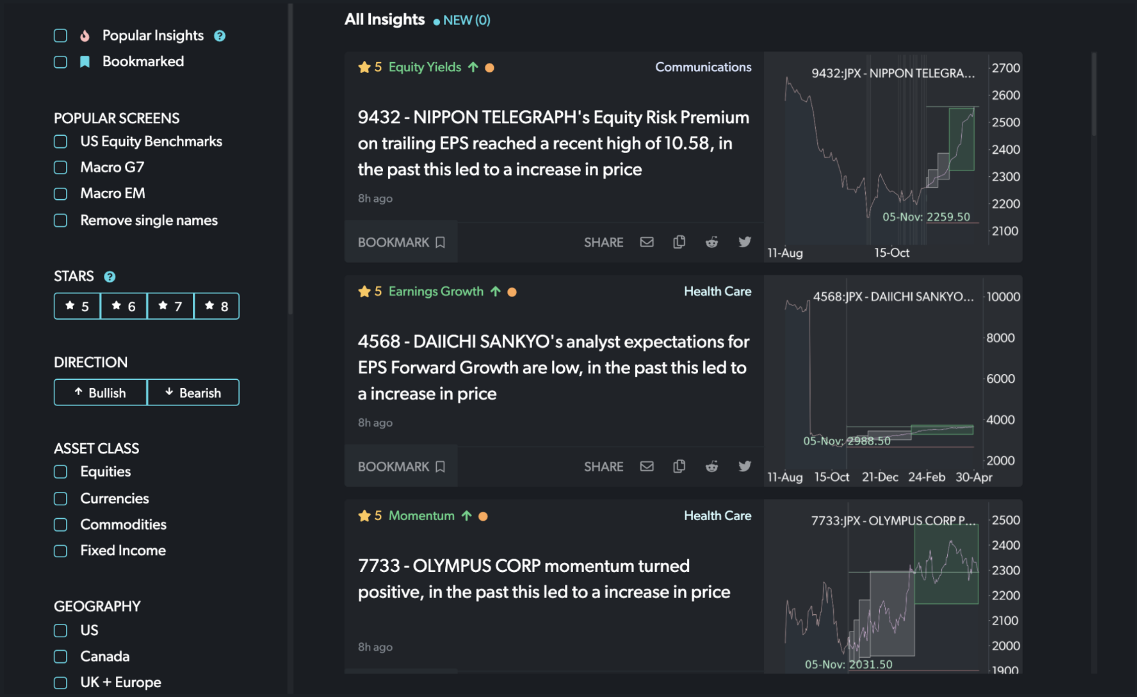
Where can machines be helpful to individual investors?

Where in the investment process can machines add a macro lens

- Idea generation ("What assets will suffer if economic growth picks up?")
- Portfolio risk management ("What is my downside risk if the yield curve inverts?")

Idea generation

Machines can instantly pinpoint incremental drivers and price pressures



Source: Toggle

Idea generation

Translating macro-environment into actionable ideas

House of Representatives passes $1.9tn Covid stimulus package

Relief bill includes $1,400 cheques, jobless aid, and funds for state and local governments

Pimco boss warns of inflation 'head fake'

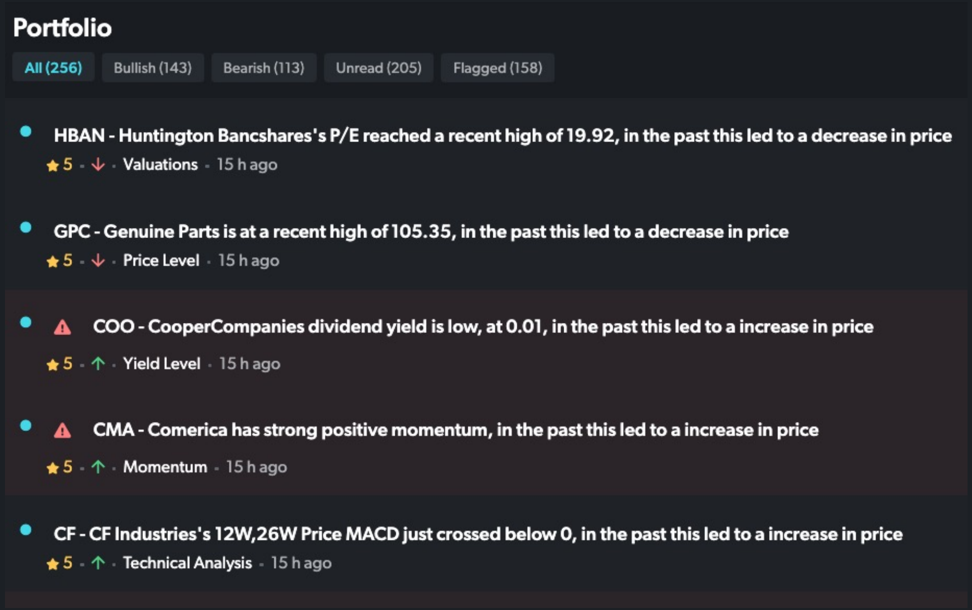
Dan Ivascyn says bond market could be anticipating price rises that never come

Economics

Larger Stimulus Leads to Big Upgrade to U.S. Growth Forecasts

RISK MANAGEMENT

TOGGLE keeps a watchful eye on your portfolio to identify potential risks



Source: Toggle

Hypothesis testing

Machines can help you test your instincts against the data: is the economic environment bad for stocks?

Source: Toggle

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