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Equity Outlook—Improving, but Still Risk Off

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Despite mounting headwinds the US equity markets have continued to remain relatively buoyant. The S&P 500 is about 3% off its recent highs and the uptrend since June remains well intact. Our macro view remains relatively constructive. That is, we don't see a major recession on the horizon, so the risk of a substantial equity price decline remains low in the near-term. In the last 40 years, the equity markets have tended to experience its worst declines during GDP contractions so any good risk management based macro approach should be able to properly distinguish between an environment in which recession risk is high and recession risk is low. Fortunately, we've been taking the other side of the many recession calls in the last 18 months and the equity markets have confirmed this view.

"Risk comes from not knowing what you're doing."
- Warren Buffet

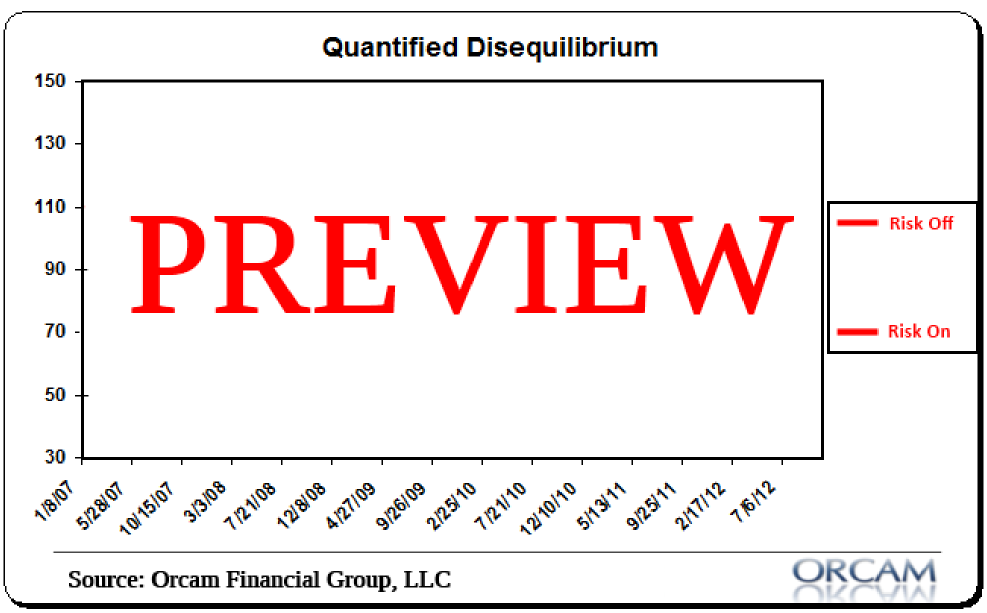

Figure 1—The QD Model

That said, we do remain in risk off mode in the short-term active trading strategies as our equity model continues to point to a defensive posture as shown in figure 1.

The QD model is an algorithmically based summation index that calculates the current disequilibrium or risk in the market. The index has improved substantially in recent weeks during the minor sell-off, but recent readings are still consistent with a market position that is “risk off”. We are not so negative on the equity market that we would be aggressive short sellers, however, we would feel more comfortable buying equities at lower prices when the QD model shows a better risk/reward profile.

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