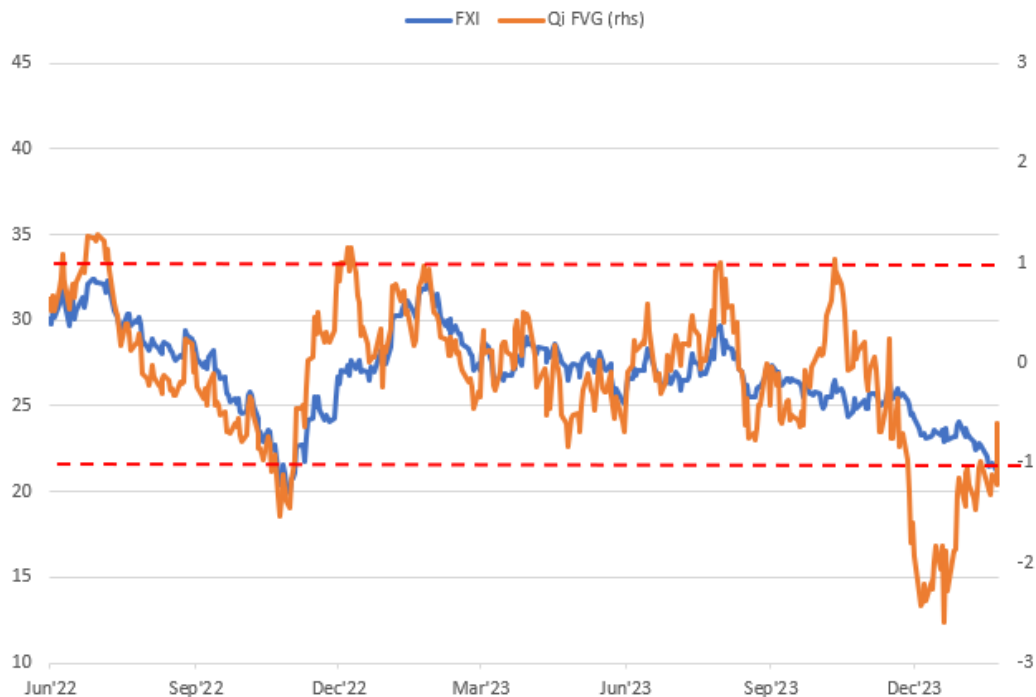
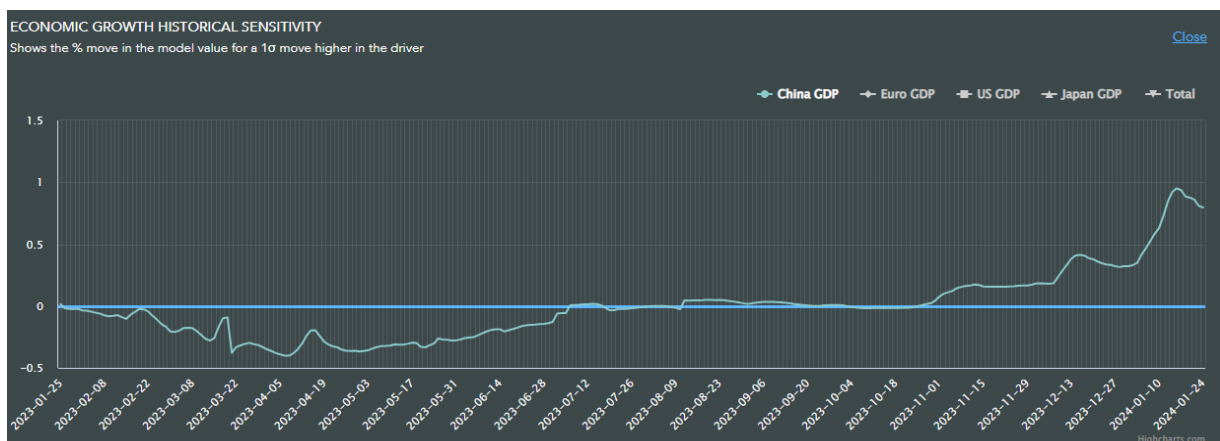


Qi Sector Spotlight: US Materials - Hunting for Value

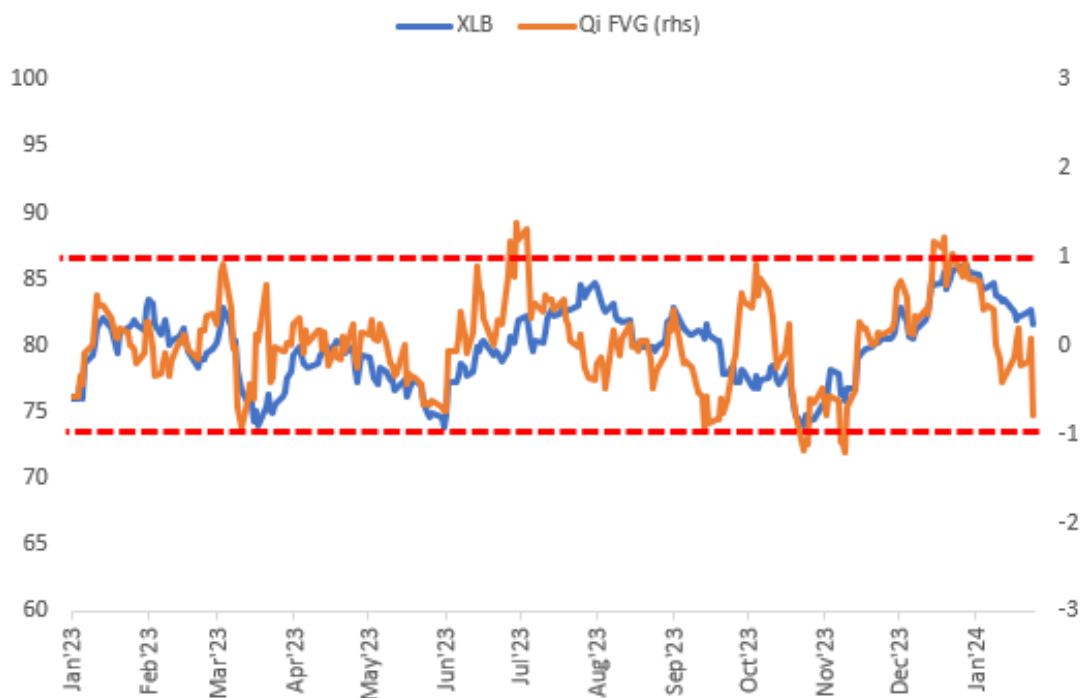
- The investment case for China rests on the view that policy makers have hit the panic button coupled with an anemic foreign investor allocation to the region.
- **Qi's macro-warranted valuation signal on FXI was supportive of a tradeable bounce:** Into the RRR cut news, Qi's FVG rose above -1 sigma (i.e. 1 sigma below its macro warranted fair value according to Qi's model). Consider the chart below – over the last 2yrs, risk/reward has been to fade when FXI hits +1 sigma but to consider adding risk when rising through -1 sigma. The chart plots Qi's FVG against the FXI spot price.



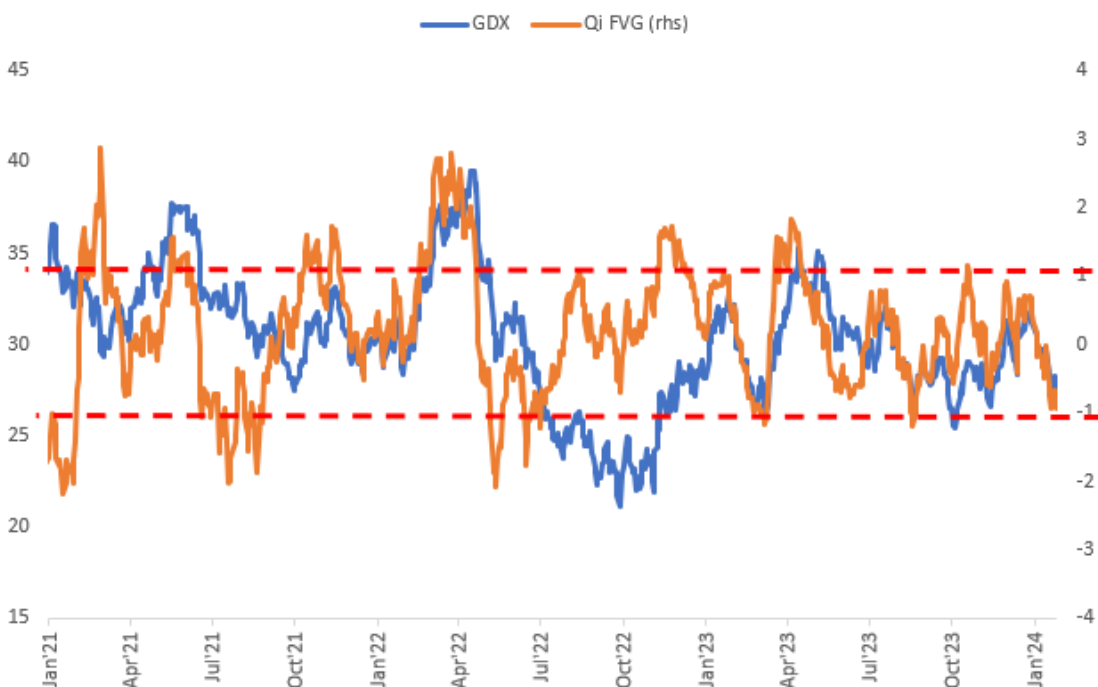
- **However, in the hunt for value within a highly valued US market, where else can one look to play more constructive China sentiment?** The natural expression in developed markets would be to look at the Materials sector. After all, China is one of the largest importers of iron ore and copper.
- Outright, Qi shows the biggest driver of US Materials is China GDP Growth and that sensitivity has been growing through the last quarter:



- **If history is any guide, buying Materials when the Qi FVG is close to -1 sigma has offered a good tradeable entry point.** The sector today stands at -0.78 sigma. See the chart below. Note the good correlation between the FVG peaks / trough and the underlying XLB ETF.



- **Within Materials, the gold miners look of interest.** Below we show a similar chart plotting GDJ to Qi's FVG. At -0.93 sigma, it is also at levels where risk / reward favours being bullish:



- **Further, Qi offers the ability to backtest our FVG signals.** Going back to 2009, buying GDJ at -1 sigma and closing when at fair value is back zero, subject to model RSq >65% (it is 78% today), has yielded 9 signals, 8 of which proved profitable (mean holding period 22 days).

The RSq threshold is important – without respecting that, there are more signals but the trade hit ratio and win / lose ratio were not as attractive.

Results	
Hit Rate	88.888889
Avg. Rtrn	5.065059
Median Rtrn	4.637445
Avg. Max Gain	7.459787
Avg. Max loss	-5.591733
Avg. Holding Period	24.111111
Median Holding Period	22.000000
No. of Trades	9.000000
Avg. Win	6.297008
Avg. Loss	-4.790535
Win/Loss	1.314469

- **As a relative value pair trade, US Materials looks attractive relative to US Financials:** RSq for the RV stands at 78% with the Qi FVG standing at -1.3 sigma. Relative performance has closely tracked FXI over the last year. However, model price momentum has yet to inflect notably higher. Note also that this is a defensive trade from a financial conditions standpoint. Materials would outperform Financials if credit spreads started to widen. While equities have made new highs, we note that HY credit spreads are yet to make new 1yr lows.

