Multi-Asset Survey: 2019Q3

19th September 2019

Probability of Global Recession Exceeds 50%

Asset Allocators Endorse the Bearish Macro Narrative …

For the first time in the history of the survey, the probabilitity of a global recession within the coming year has exceeded 50%. Moreover, the majority of those polled think it unlikely that we will see an improvement in business confidence; nor do they expect to see higher corporate earnings. Importantly for asset allocators, they put the probability of a higher US unemployment rate at 61% in what will be an election year.

… But They Have not Gone Maximum Defensive

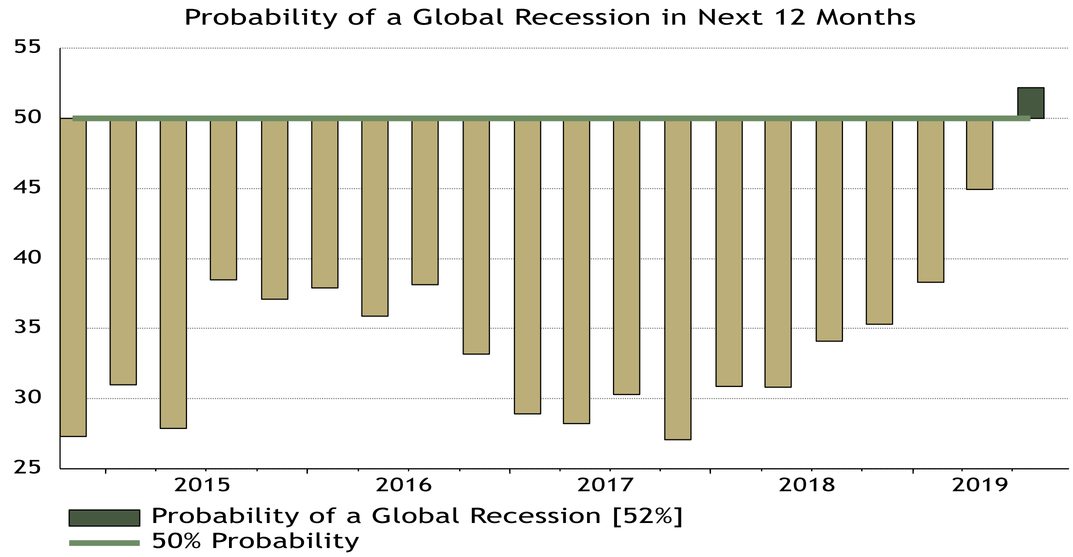
Faced with this deteriorating macro outlook, asset allocators have turned slightly more cautious on equities, on US credit and on EM assets. But this looks little more than a defensive tilt. They continue to put a probability of 55% on stocks beating bonds over the coming year, and a striking 52% probability on 'value' beating 'growth'. It looks like investors are placing high hopes on a policy stimulus: 38% of those polled expect a more positively sloping US yield curve as unemployment rises and inflation stays low.

Three things that also stand out in this survey: (1) there is no conviction about where the USD goes next over the next 12 months; (2) there is no conviction about where US 10yr Treasuries go over the next 12 months; and (3) there is growing conviction that gold is the place to be within the commodity complex, rather than oil / industrial metals.

Big Data Analysis: Cautious Outlook Widens Range of Investor 'Tribes'

Our analysis of 'tribes' of panellists shows a big rise in the size of the most cautious group, almost doubling to a quarter of the panel, who expect a recession that will push unemployment up and risk assets down. In contrast the number of bulls is unchanged at 17%. The rest of the panel have less extreme views, and can be differentiated by whether they see the slowdown impacting credit markets. See page 15.

MAS. 1: Implied Probability of a Global Recession now Exceeds 50%



Source: ASR Ltd. / Datastream from Refinitiv

• September Survey based on 206 respondents, representing U$4.1 trillion of AUM (Fieldwork: 29th Aug – 11th Sep)

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Probability of Recession Exceeds 50%

ASR's Multi-Asset Survey is a survey of probabilities. Every quarter we ask more than 200 CIOs, asset allocators, economists and multi-asset strategists about the outlook for financial markets for the next 12 months. However, instead of asking them about they are positioned (as some surveys do), we ask them about the likelihood of certain financial events occurring: for example, how likely do they think it is that the dollar will be higher; how likely they think it is that stocks will outperform bonds; how likely do they think it is that 10yr bond yields will be higher? We are trying to map how they see the financial world in terms of probabilities. Where possible we contrast those probabilities with how often those events have actually occurred over the past decade. This is a cartographical tool that can be useful in identifying pockets of 'group think'.

Highlights from the Survey.

For the first time in the history of the survey, the probabilitity of a global recession within the coming year has exceeded 50%

1. **The Macro Environment**. For the first time in the history of the survey, the probabilitity of a global recession within the coming year has exceeded 50%. At the same time, our panel is increasingly convinced that the US unemployment rate will be higher a year from now, with a 61% implied probability. As asset allocators will know, historically stocks underperform bonds when US unemployment starts to rise. That said, there is still some debate among asset managers: while 28% of respondents think that business confidence is unlikely to improve and a recession is likely, 17% of our panel take the opposing view.

There has been a significant collapse in inflation expectations

2. **Inflation**. There has been a significant collapse in inflation expectations over the past year. Investors continue to think that the probability of core PCE deflator exceeding 2% is less than 50% for the second survey running. In Japan and eurozone, investors have largely given up expecting core CPI inflation to exceed 2%: in both countries, the probability is now less than 25%.

The probability of US 10-year yields being higher a year from now is 50%

3. **Bonds.** Expectations for higher bond yields have declined as bond yields have fallen. This shift appears to have been driven by lower real yield expectations. The implied probability of US 10-year yields being higher a year from now is 50%.

Our panel remains surprisingly ambivalent about whether US inflation-linked bonds (TIPS) will deliver higher returns than Conventionals

4. **Other US Interest Rates**. The abrupt shift in Fed policy has had a dramatic impact on investors' rate expectations. A year ago, investors put the probability of higher US 2yr yields at 65%; today the probability has fallen sharply to 37%. The probability for higher real yields has also declined. However, our panel remains surprisingly ambivalent about whether US inflation-linked bonds (TIPS) will deliver higher returns than Conventionals over the coming year. Given the downward pressure on inflation expectations amid a deteriorating business cycle, we would have thought Conventionals would have been the asset class of choice.

5. **US Corporate Credit & EM Debt.** The latest survey sees fresh doubts about the prospects for credit. The probability of IG credit outperforming Treasuries has fallen to 46%, and the chance of

We are surprised that investors are not more pessimistic about US corporate credit given the macro and corporate earnings backdrop

HY credit outperforming IG credit has fallen to 42%. We are surprised that these probabilities are not lower, given the growing likelihood of recession, and pressure on corporate earnings. That said, there is still a core within our panel that is positive about the asset class: around 18% expect credit to do well and for HY to do outperform. Hard-currency EM debt has lost some of its shine – with the chances of EM bonds beating US HY credit having fallen to 54%.

Investors are losing confidence in equities. Almost a third of panel are looking for lower earnings and lower multiples

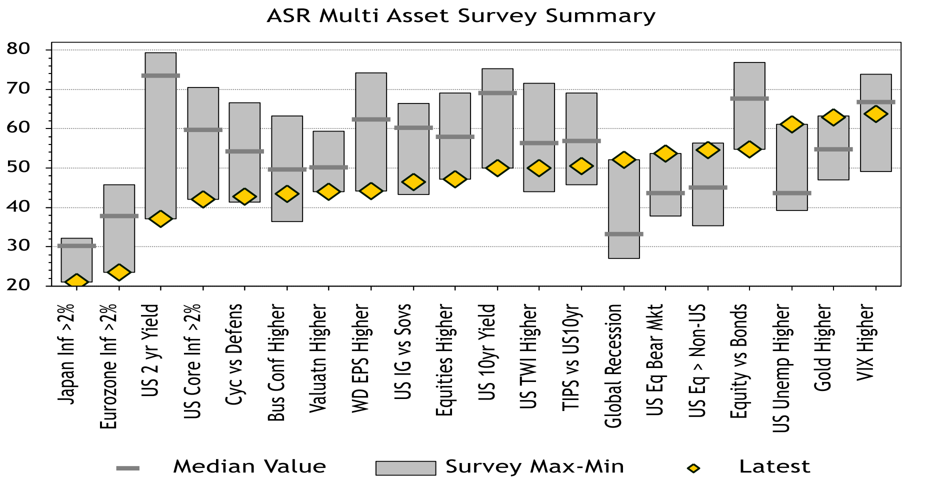
6. **Global Equities.** For the second survey running, the probability that equities will be higher a year from now has fallen below 50%. The implied probability of higher corporate earnings has fallen to 44% and investors have become more pessimistic about valuations coming to the rescue. 31% of those polled expect both lower earnings <u>and</u> lower multiples.

Investors remain risk averse

7. **Risk Appetite.** The fear of a US bear market within the next 12 months continues to be highly elevated, especially relative to its historical base. Investors remain confident that equity volatility will be higher a year from now. 27% of those polled expect higher equity volatility and lower global equities over the coming year. Another cross-check on risk appetite is whether investors think that cyclical stocks can outperform defensive stocks. The chances of the former beating the latter fell back to 43%.

Note just how many questions in the survey are sitting at extremes … levels of probability that the survey has not seen before

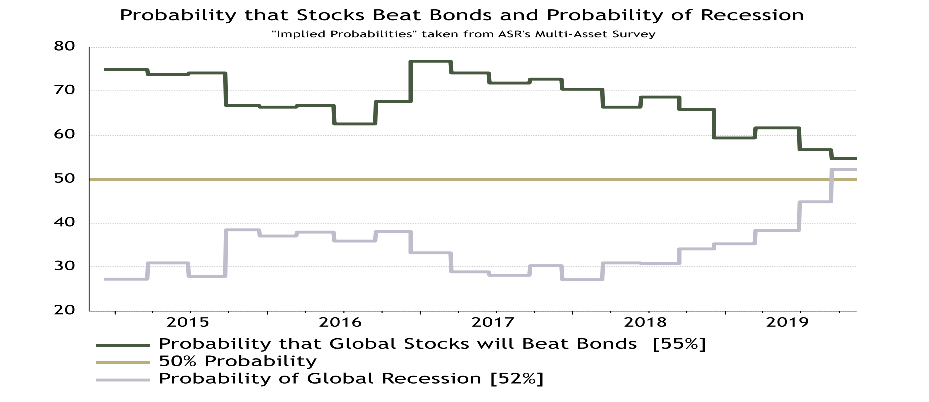
MAS. 2: Implied Probabilities Relative to the Survey's History



Source: ASR Ltd. / Datastream from Refinitiv

The probability of stocks outperforming bonds falls (1) as the probability of a global recession rises (see adjacent chart), and (2) as the probability of a higher US unemployment rate rises (not shown)

MAS. 3: Stocks Beating Bonds Less Likely as Recession Risks Rise

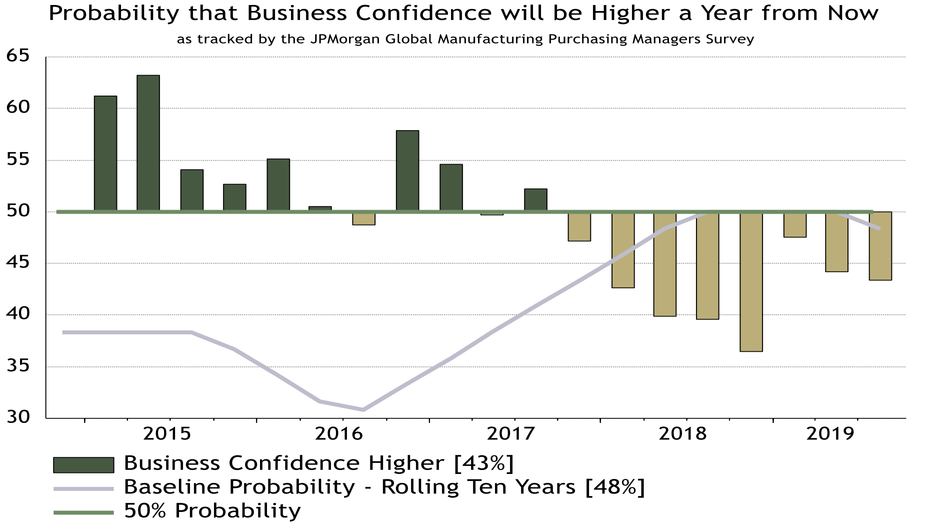


Source: ASR Ltd. / Datastream from Refinitiv

Macro Environment

Over the past three months our panel has become more cautious about the outlook for the business cycle. The probability that business confidence will be higher a year from now remains low at 43%

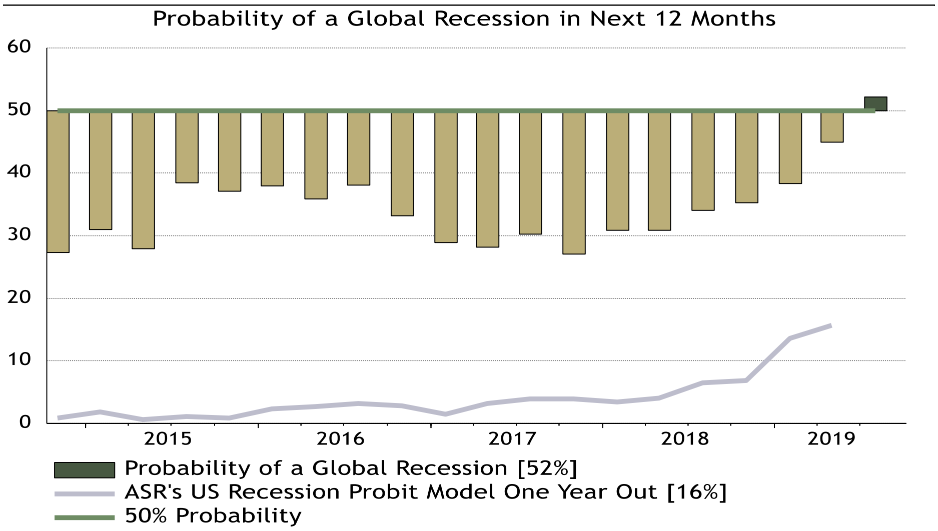
MAS. 4: Probability of Higher Business Confidence a Year from Now



Source: ASR Ltd. / Datastream from Refinitiv

This persistent caution about the outlook for the business cycle has taken place against a backdrop of growing fears of a global recession. This is the first Multi-Asset Survey where more investors expect a recession than not. It is consistent with ASR's base case of a US Recession in 2020

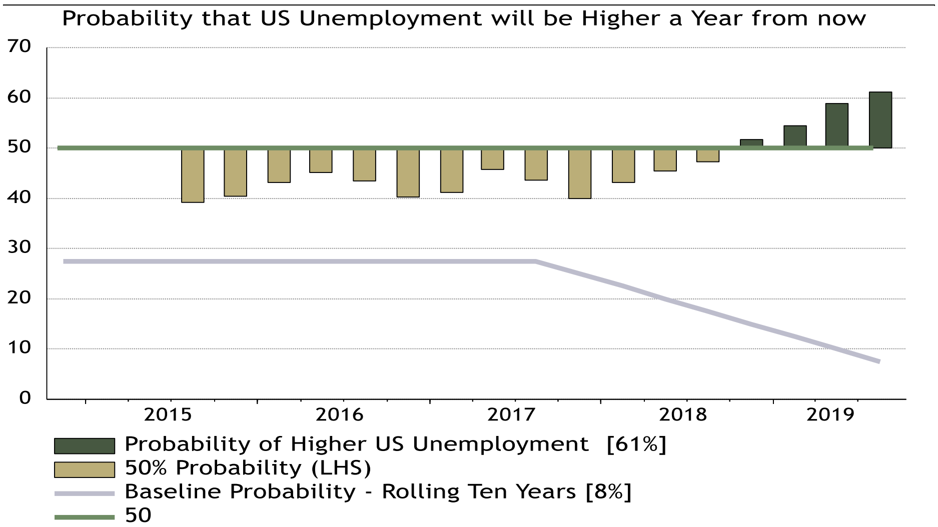
MAS. 5: Probability of a Global Recession in the Next 12 Months



Source: ASR Ltd. / Datastream from Refinitiv

More worrying is the growing conviction that the US unemployment rate will be higher a year from now. This is the fourth survey in a row where the survey puts the probability above 50%. As regular ASR readers will know, the US unemployment rate is a totemic indicator for asset allocation: stocks tend to underperform bonds when the unemployment rate rises

MAS. 6: Probability of Higher US Unemployment Rate in 12m Time



Source: ASR Ltd. / Datastream from Refinitiv

Core Inflation

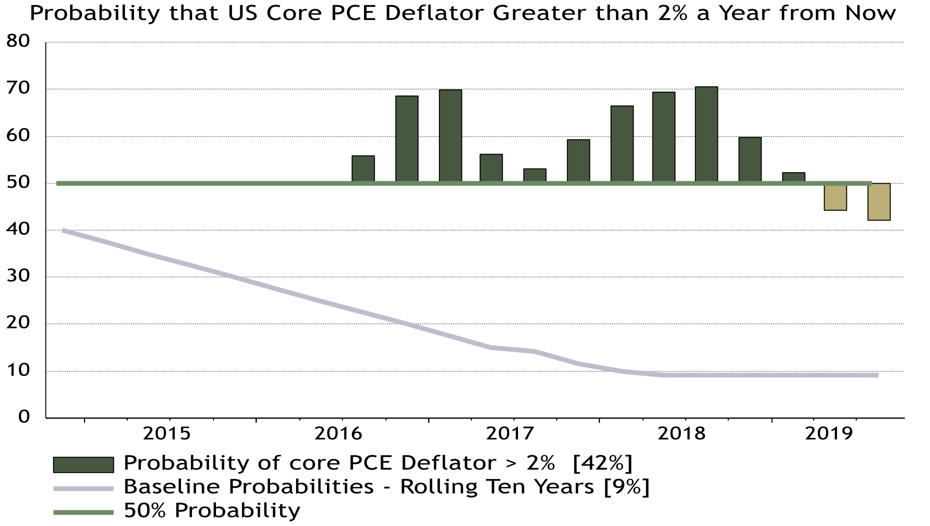
Our panel has also lost confidence that inflation around the world will rise and hit respective policy targets.

In the US we have seen inflation probabilities switch from their most inflationary, a year ago, to their most deflationary in the survey's history. The majority of our panel think it unlikely that core PCE deflator will exceed 2%

Meanwhile investors have declining confidence that eurozone core inflation will exceed 2% a year from now. The implied probability of 24% is one of the lowest in the Survey. Interestingly, in the past 15 years, eurozone core inflation has never exceeded 2%

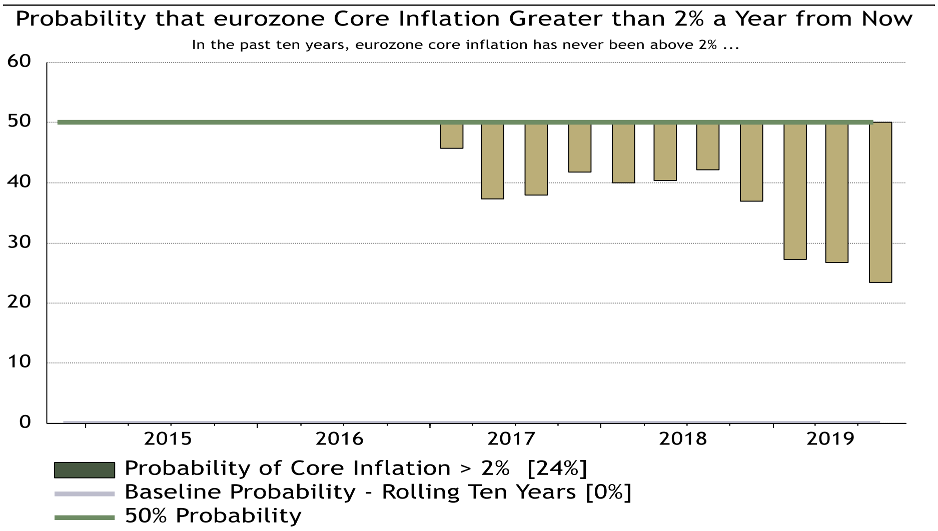
The chances of Japanese core CPI exceeding 2% in the next 12 months (adjusting for the consumption tax increase) is the least likely event to occur in our survey, with an implied probability of just 21%

MAS. 7: Probability that US Core PCE Deflator will Exceed 2%



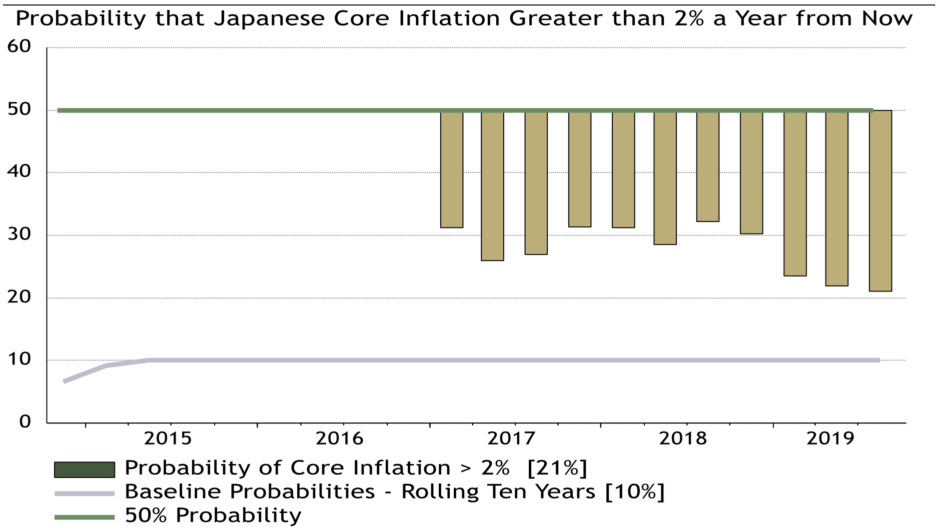
Source: ASR Ltd. / Datastream from Refinitiv

MAS. 8: Probability that eurozone Core CPI will Exceed 2%



Source: ASR Ltd. / Datastream from Refinitiv

MAS. 9: Probability that Japanese core CPI will Exceed 2%

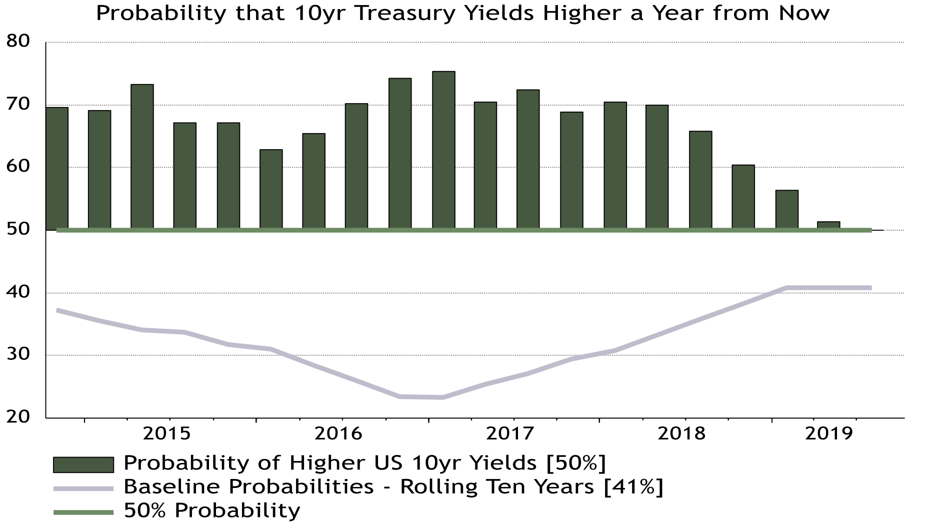


Source: ASR Ltd. / Datastream from Refinitiv

Bond Yields

As US bond yields have fallen, so have investors' expectations of higher bond yields. A year ago, our panel placed a 70% probability on higher bond yields; today that has dropped to 50%

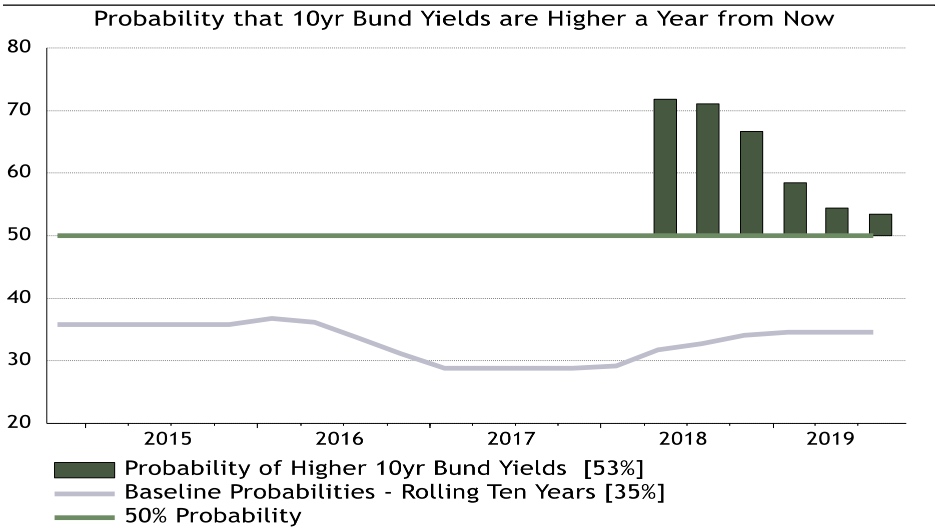
MAS. 10: Probability of Higher10yr Treasury Yields 12m from Now



Source: ASR Ltd. / Datastream from Refinitiv

The shift in the outlook for Bund yields is equally dramatic. A year ago, investors gave a 70% probability to the likelihood of higher yields; today the figure has fallen to 53%

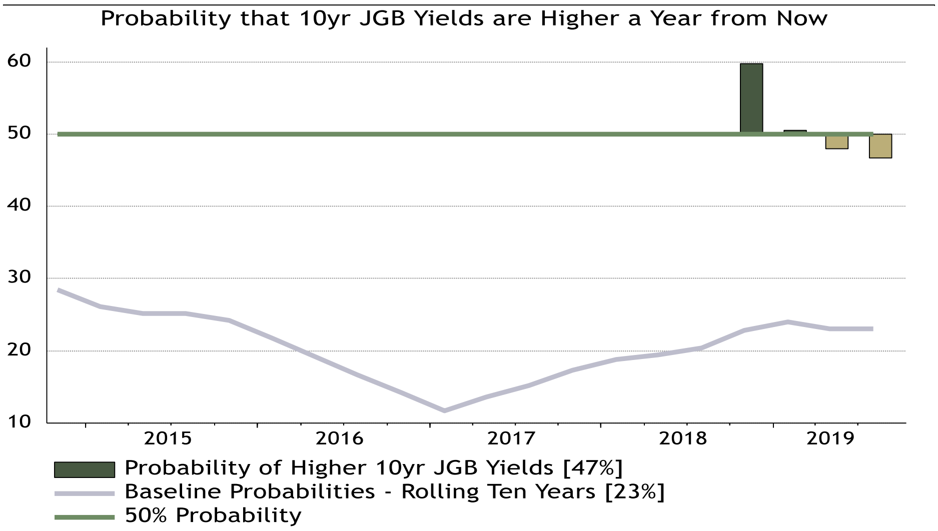
MAS. 11: Probability of Higher10yr Bund Yields a Year from Now



Source: ASR Ltd. / Datastream from Refinitiv

The probability of higher JGB yields has fallen below 50% for the second survey in a row

MAS. 12: Probability of Higher10yr JGB Yields a Year from Now

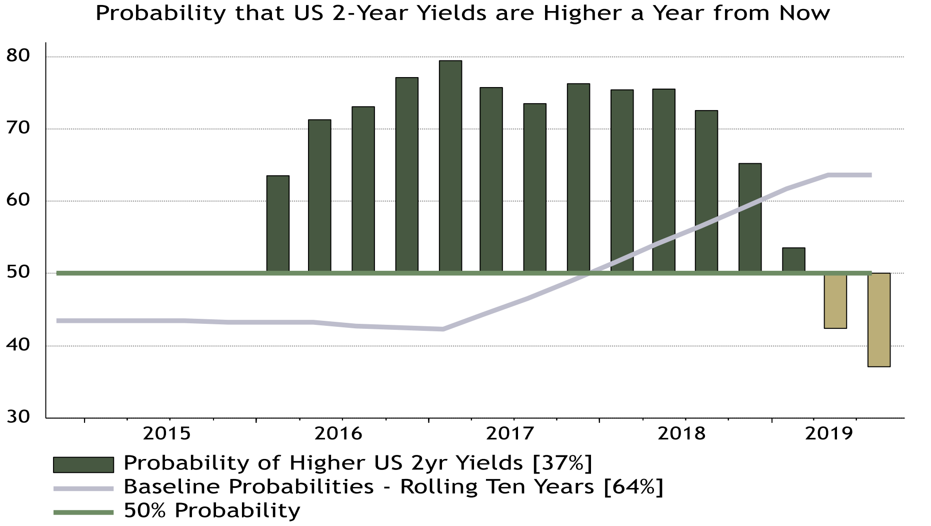


Source: ASR Ltd. / Datastream from Refinitiv

US Short Rates / Real Yields / TIPS

Our survey tracks beautifully the capitulation at the front end of the US yield curve. Investors now think that it is unlikely that two-year yields will be higher a year from now … they would place a probability of just 37% on such an outcome

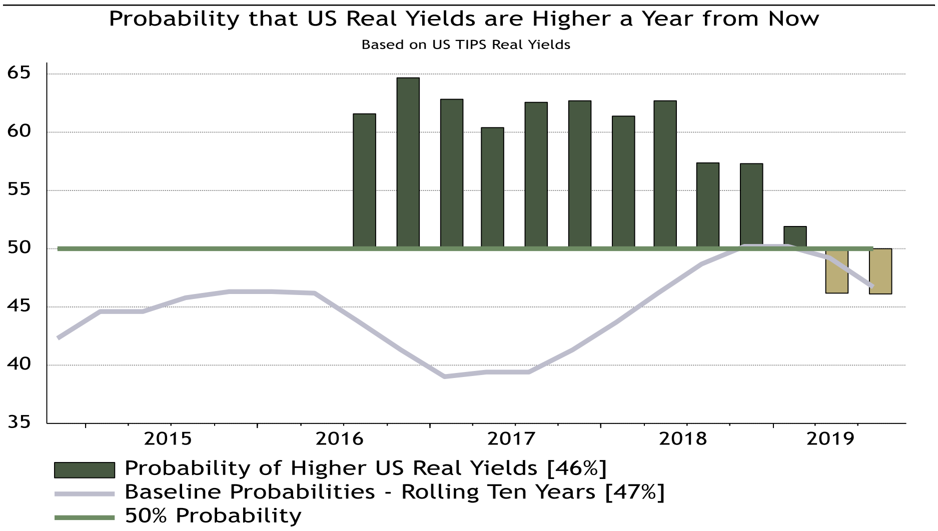
MAS.13: Probability of Higher 2yr Treasury Yields a Year from Now



Source: ASR Ltd. / Datastream from Refinitiv

The decline in expectations for higher nominal yields has gone hand in glove with a decline in expectations for higher US real yields. The chances of real yields being higher a year from now stands at 46% - significantly lower than a year ago

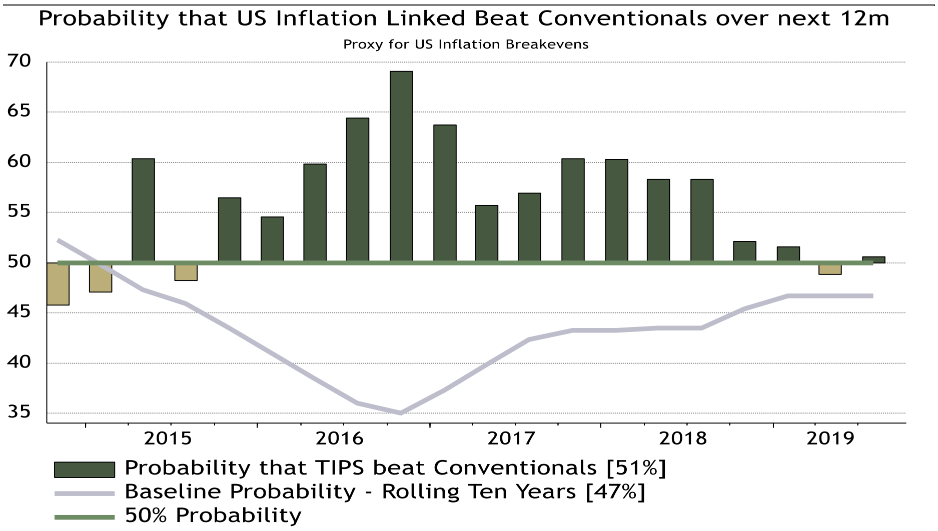
MAS.14: Probability of Higher US Real Yields a Year from Now



Source: ASR Ltd. / Datastream from Refinitiv

We are struck by ambivalence around US inflation-linked TIPS. Our panel has sat on the fence for almost a year about whether they will out- or underperform Conventionals. We are surprised that there has not been a greater preference for the latter given the weak inflation environment

MAS.15: Probability that US TIPS Will Beat Conventionals

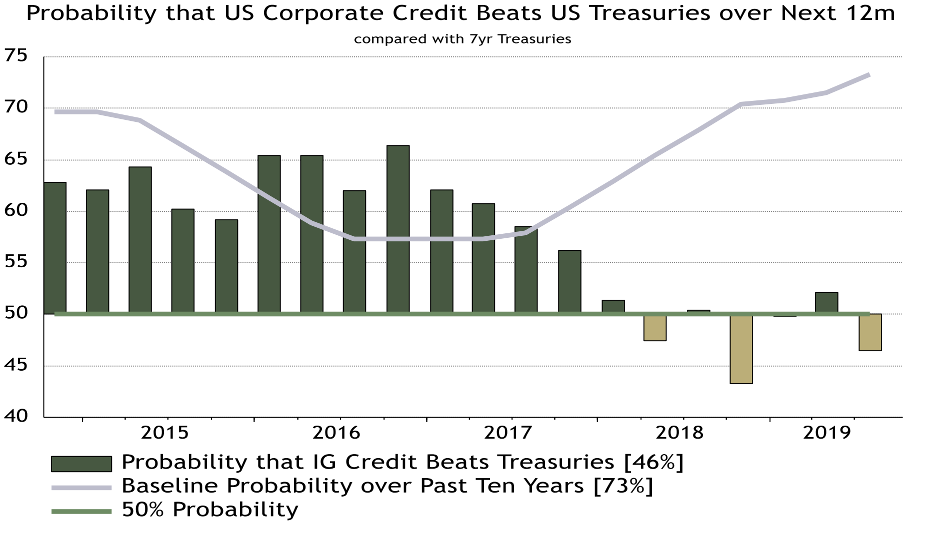


Source: ASR Ltd. / Datastream from Refinitiv

Credit & EM Debt

Despite growing expectations of a Global recession, lower business confidence, and weaker corporate earnings, we are surprised that corporate credit has not been more impacted. That said, there has been quite a big move over the quarter. The chances of IG Credit beating US Treasuries over the next 12 months is the second lowest on record at 46%

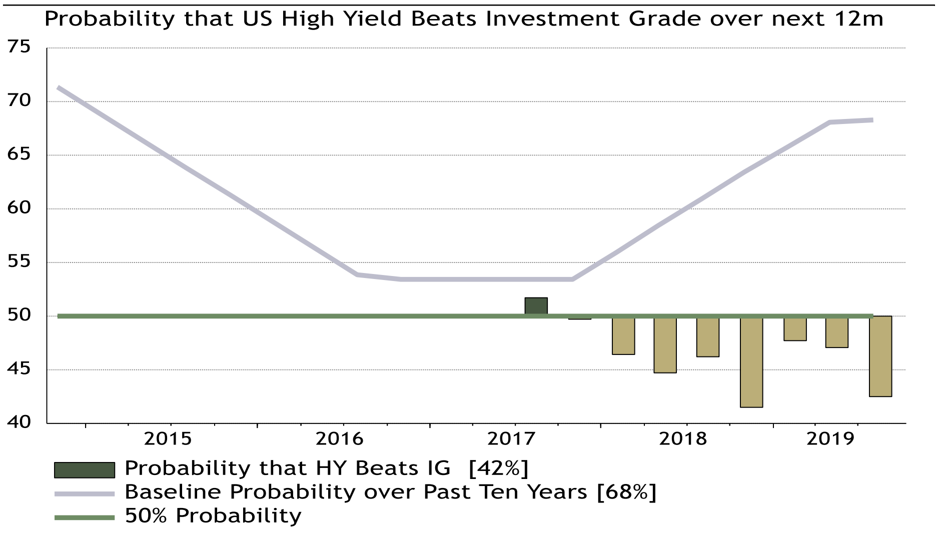
MAS.16: Probability that US IG Credit will Beat Treasuries



Source: ASR Ltd. / Datastream from Refinitiv

High Yield credit ought to be more impacted than IG credit by the deteriorating macro outlook. Our panel has turned more negative on the asset class, and think that the chances of HY beating IG is as low as 42%

MAS.17: Probability that US HY Credit will Beat US IG Credit

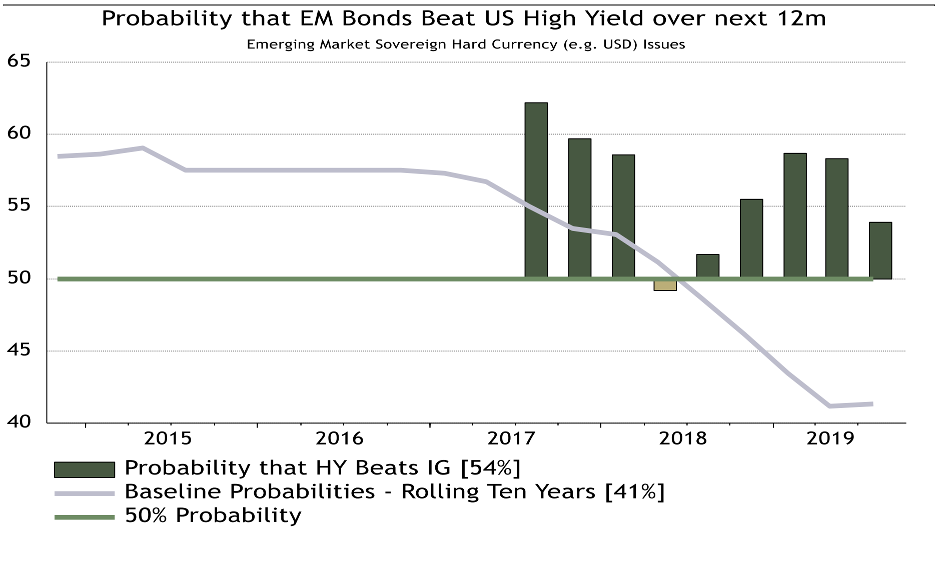


Source: ASR Ltd. / Datastream from Refinitiv

While 36% of our panel think it unlikely that IG will outperform UST and that HY will outperform IG, surprisingly 18% of the panel take the opposite view

Our panel continues to take the view that (hard-currency) EM sovereign bonds are safer than US High Yield. But investors are less confident that they will outperform, with the probability of outperformance dropping from 58% to 54%

MAS.18: Probability that EM Bonds will Beat US High-Yield Credit

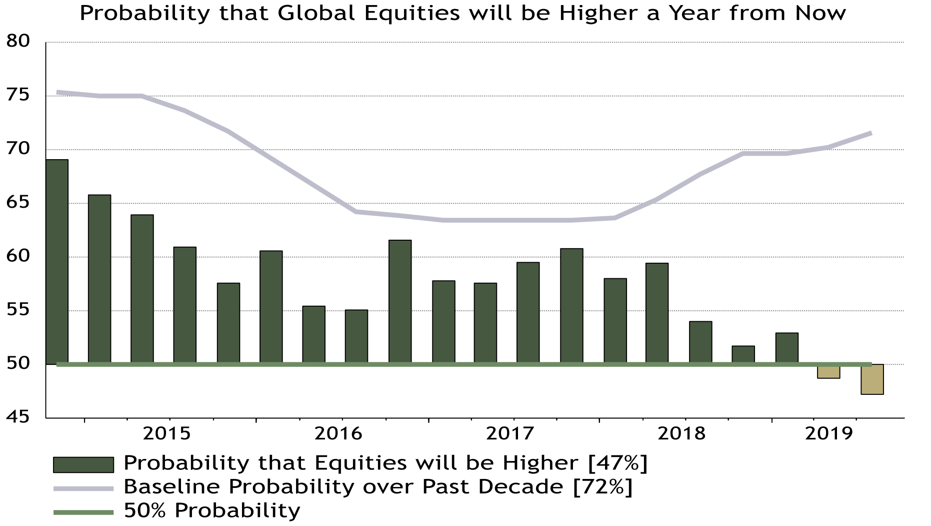


Source: ASR Ltd. / Datastream from Refinitiv

Global Equity Drivers

For the second survey in a a row, investors think that the probability that equities will be higher a year from now is below 50%

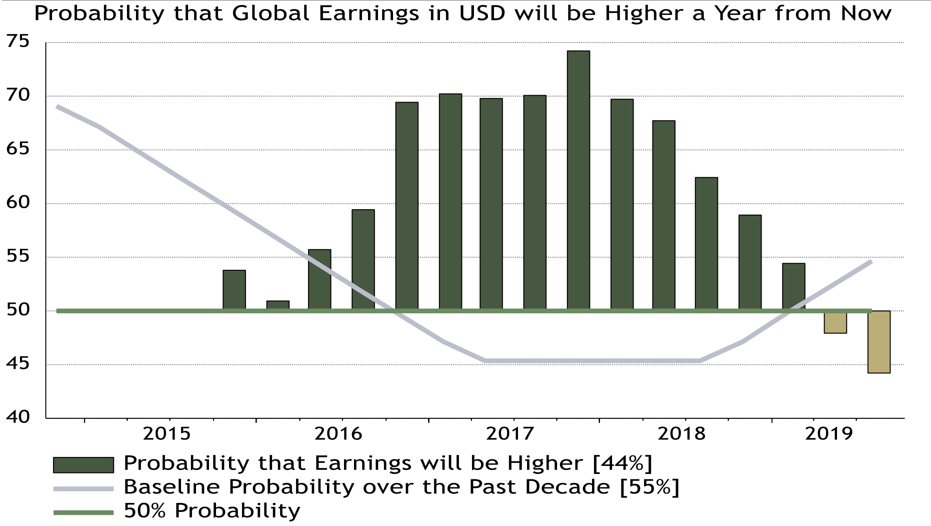
MAS.19: Probability that Global Equities will be Higher in 12m Time



Source: ASR Ltd. / Datastream from Refinitiv

There is growing concern around the outlook for Global Corporate Earnings. The chances of earnings being higher a year from now has fallen to just 44% - the lowest reading in the history of the survey

MAS.20: Probability that Global Corporate Earnings will be Higher

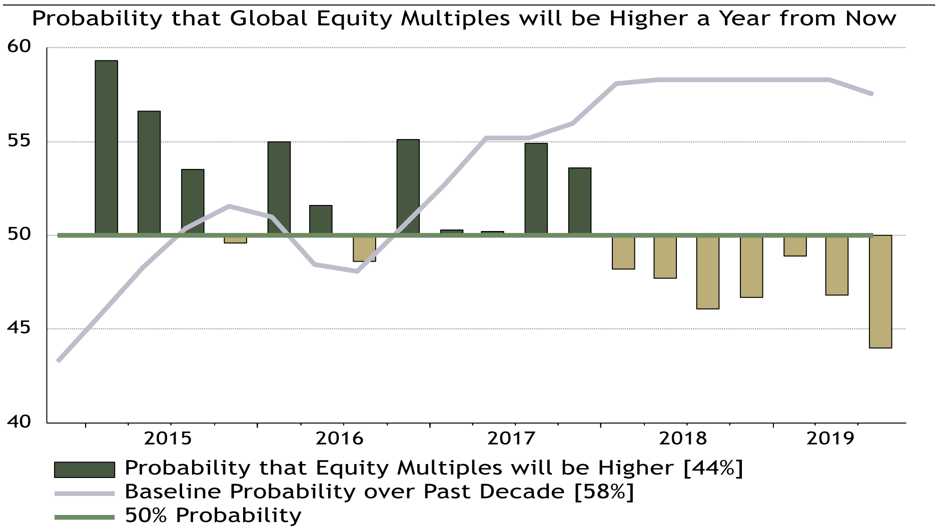


Source: ASR Ltd. / Datastream from Refinitiv

What makes matters worse is that investors also have low conviction around multiple expansion – they are putting a 44% probability on equity PEs being higher a year from now

Only 9% of respondents think it likely that both earnings and multiples will be higher a year from now; while 31% of those polled think that both are unlikely

MAS.21: Probability that Global Equity PEs are Higher in 12m Time

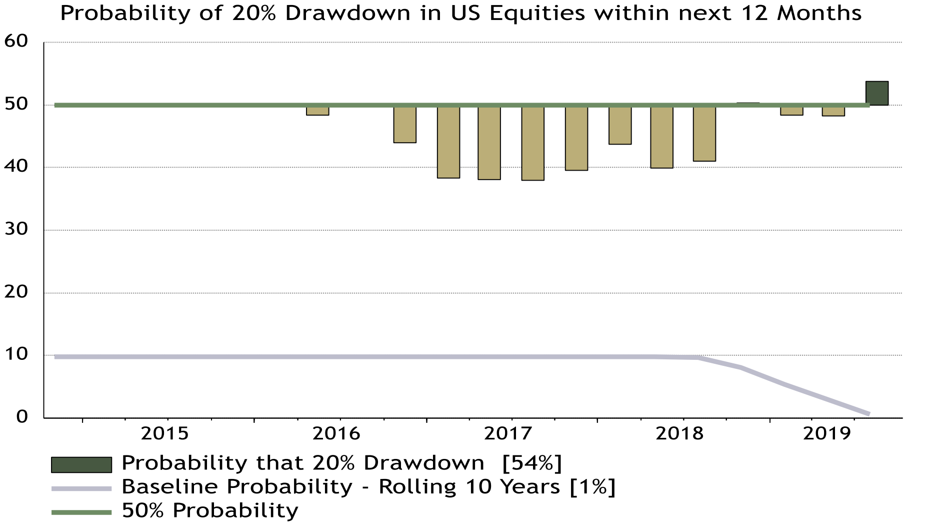


Source: ASR Ltd. / Datastream from Refinitiv

Equity Risk Appetite

Equity investors have become even more nervous and now put the chances of a 20% drawdown in US equities within the next 12 months at better than evens (54%). This is the highest in the survey's history, and remains consistent with a move into the "Late Cycle" phase of the business cycle - traditionally a testing time for risk assets

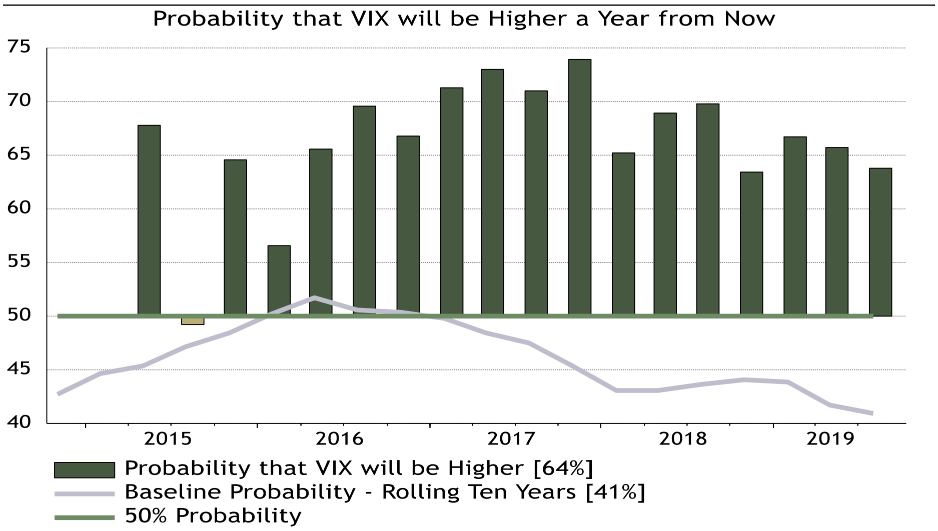
MAS.22: Probability of 20% Drawdown in US Equities in next 12m



Source: ASR Ltd. / Datastream from Refinitiv

Investors appear to have bought into the idea that equity volatility is unsustainably low. They are placing a 64% probability on it being higher a year from now (VIX is currently 14)

MAS.23: Probability that Equity Volatility (VIX) will be Higher …

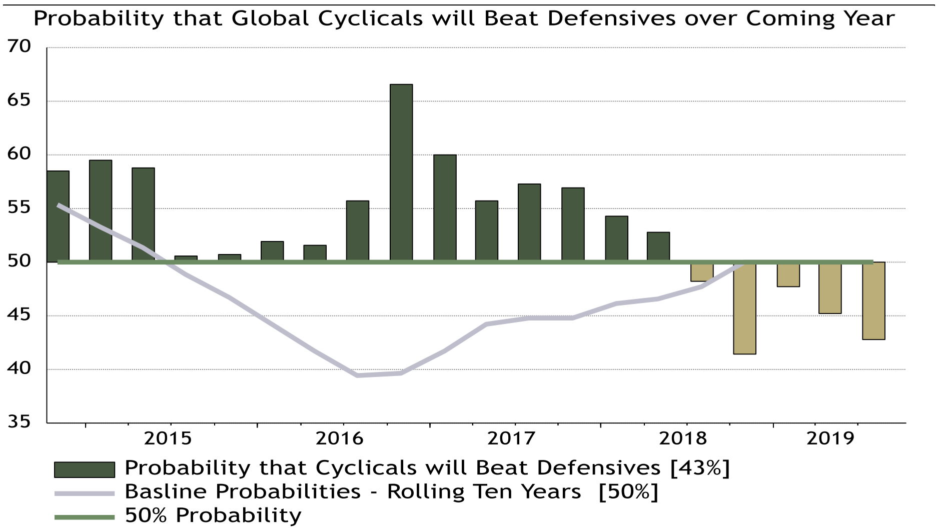


Source: ASR Ltd. / Datastream from Refinitiv

33% of the panel think it likely that VIX will be higher <u>and</u> equities lower; 35% expect VIX to be higher <u>and</u> that HY credit will underperform IG credit. Curiously 12% expect VIX to be higher and equties to be higher

There is still a reluctance to embrace cyclicals over defensives. The latter are supported by the strong performance from bonds, while the former face the headwind of lacklustre growth, an absence of pricing power, and growing fears of global recession

MAS.24: Probability that Cyclicals will Outperform Defensives …



Source: ASR Ltd. / Datastream from Refinitiv

Equity Allocation

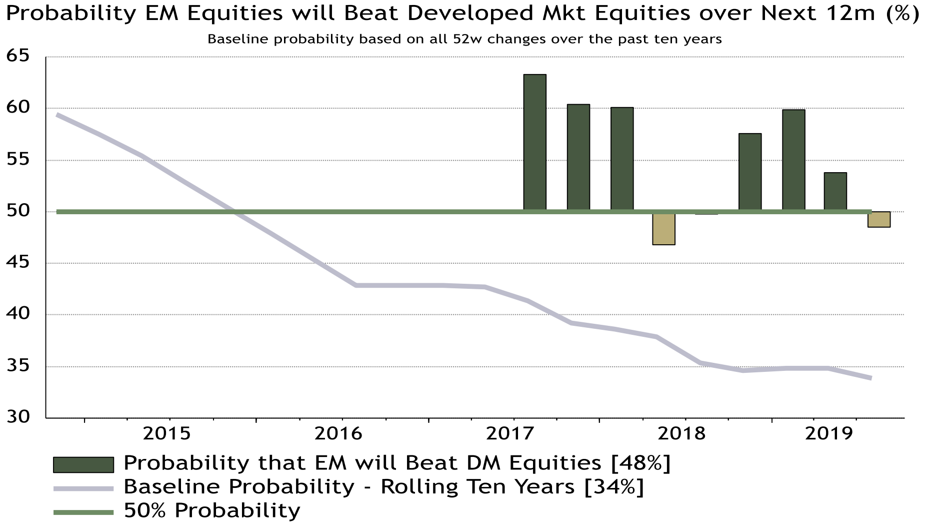
Emerging Markets (EM) have fallen back out of favour. Investors are putting just a 48% probability on EM equities outperforming Developed Markets (DM) over the next 12 months – an aggressive stance relative to history

There does seem to be more nervousness around EM assets. Three months ago 38% of respondents thought that not only would EM equities outperform DM, but also that EM bonds would beat US HY. That figure has slumped to just 18%

The probability of another year of US equity underperformance has risen to 55% - close to the survey's highs. As we have pointed out on a number of occasions, it is rare for EM equities to outperform when US equities outperform – a fact recognised by 25% of the panel

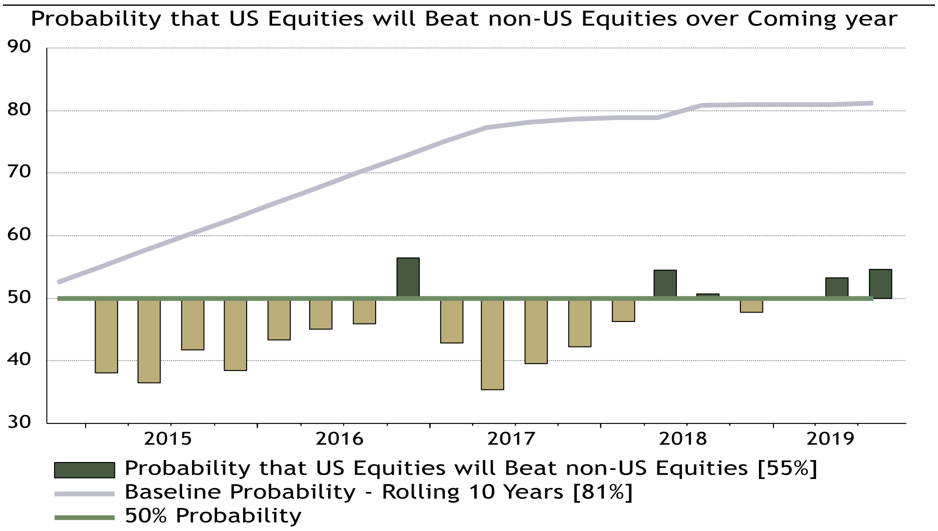
The concerns about the global economy have not deterred investors from placing a 52% probability on Value to outperform Growth over the next 12 months. History suggests this is a brave call with Value only beating Growth 32% of the time over the past decade. However, it makes more sense with 38% of the panel looking for a more positive-sloping US yield curve a year from now

MAS.25: Probability that EM Equities will Beat DM Equities …



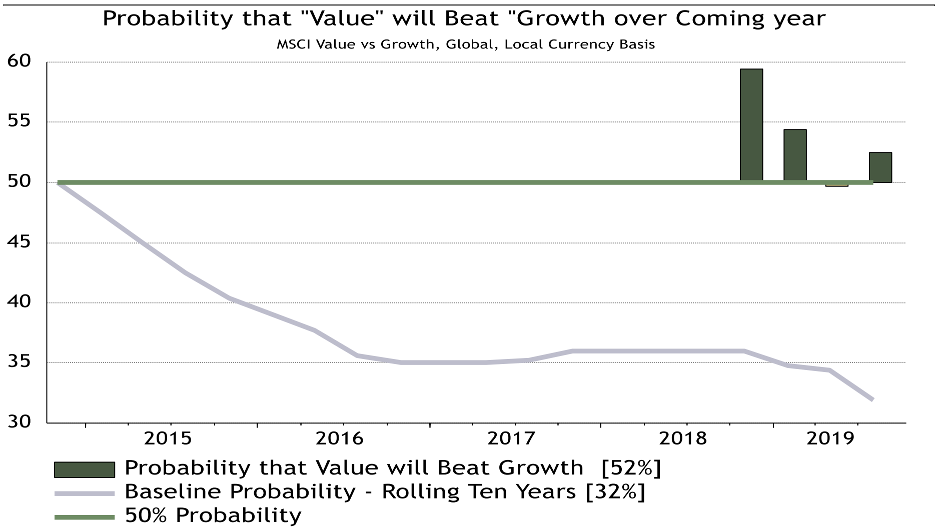
Source: ASR Ltd. / Datastream from Refinitiv

MAS.26: Probability that US Equities will Beat non-US Equities …



Source: ASR Ltd. / Datastream from Refinitiv

MAS.27: Probability that Global 'Value' will Beat Global 'Growth' …

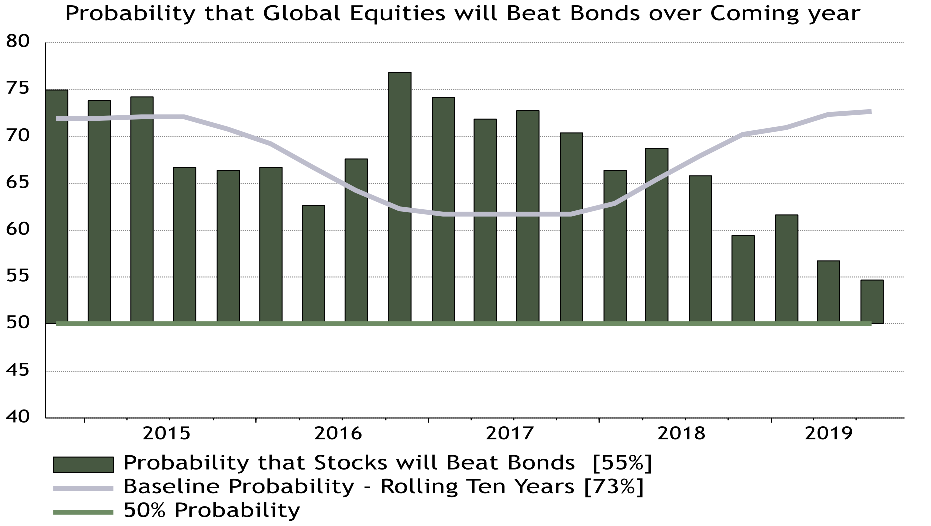


Source: ASR Ltd. / Datastream from Refinitiv

Asset Allocation

Investors still expect Global stocks to beat bonds over the next 12 months, with an implied probability of 55%. This is the lowest reading since we started the survey

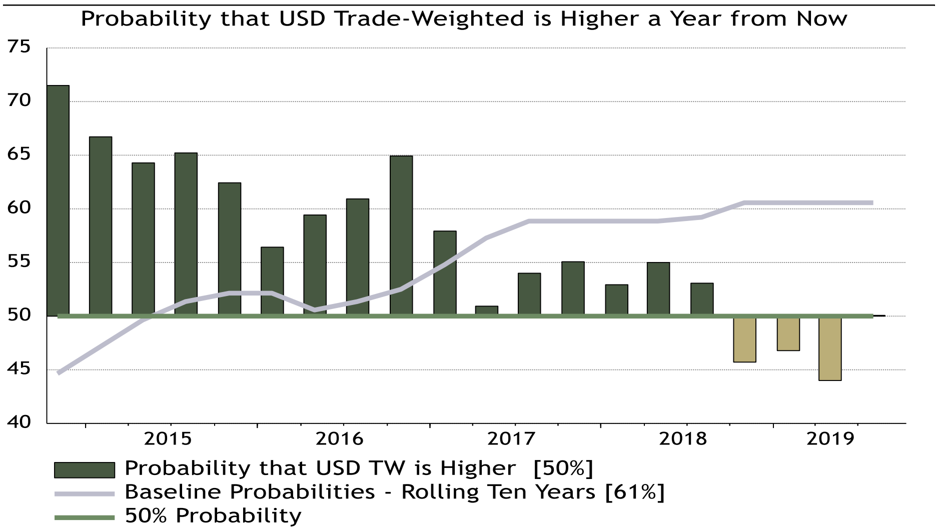
MAS.28: Probability that Global Equities will Beat Global Bonds ...



Source: ASR Ltd. / Datastream from Refinitiv

You cannot see it in the chart, but investors believe that the probability of a stronger USD a year from now now stands at 50%

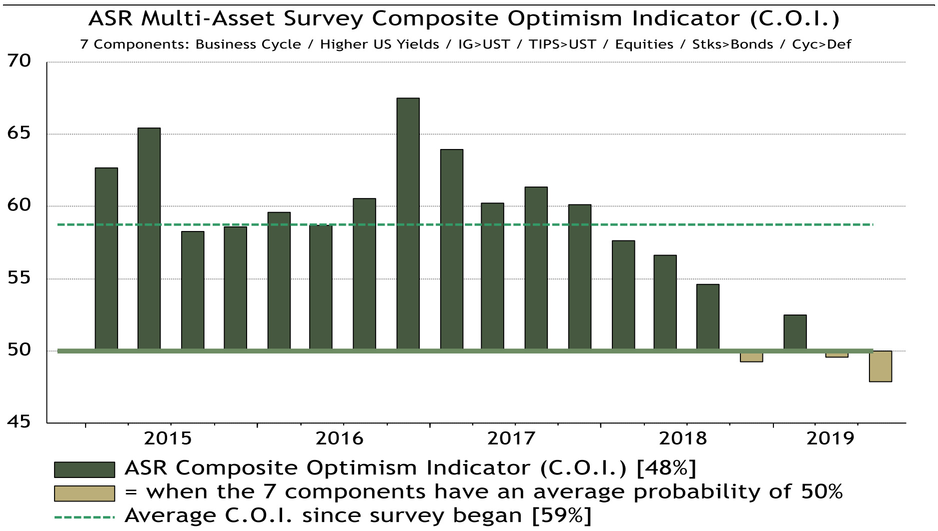
MAS.29: Probability that US Dollar will be Higher a Year from Now



Source: ASR Ltd. / Datastream from Refinitiv

ASR's "Composite Optimism Indicator" (COI) takes seven long-running questions that would normally be associated with "risk-on". It shows just how much investor expectations have fallen below the average of the past four years. This 'wave' has recorded its lowest reading ever at 48% - well below the long-run average of 59%

MAS.30: ASR Composite 'Optimism' Indicator (COI)

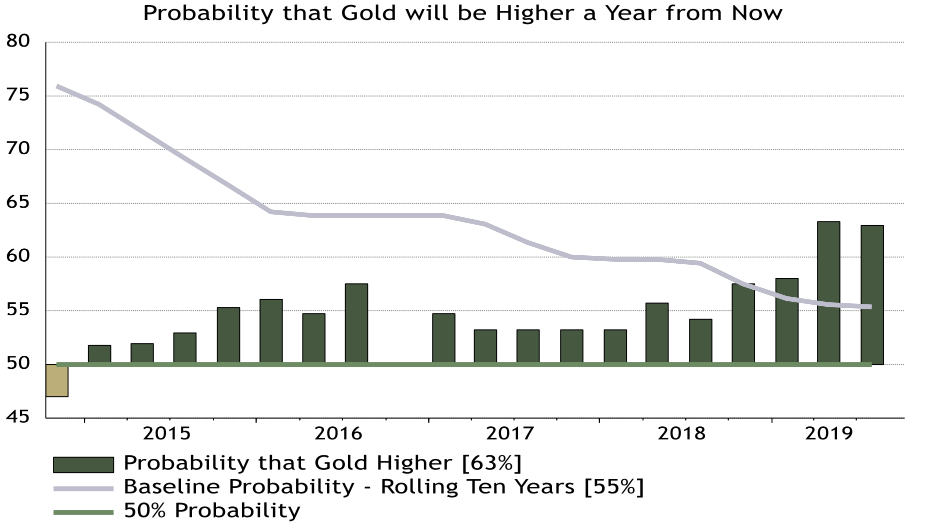


Source: ASR Ltd. / Datastream from Refinitiv

Commodities

As secular dollar strength evaporates, and expectations of higher real yields fade, so commodities start to look relatively attractive. For the second survey running, investors have placed a high probability on the gold price being higher a year from now

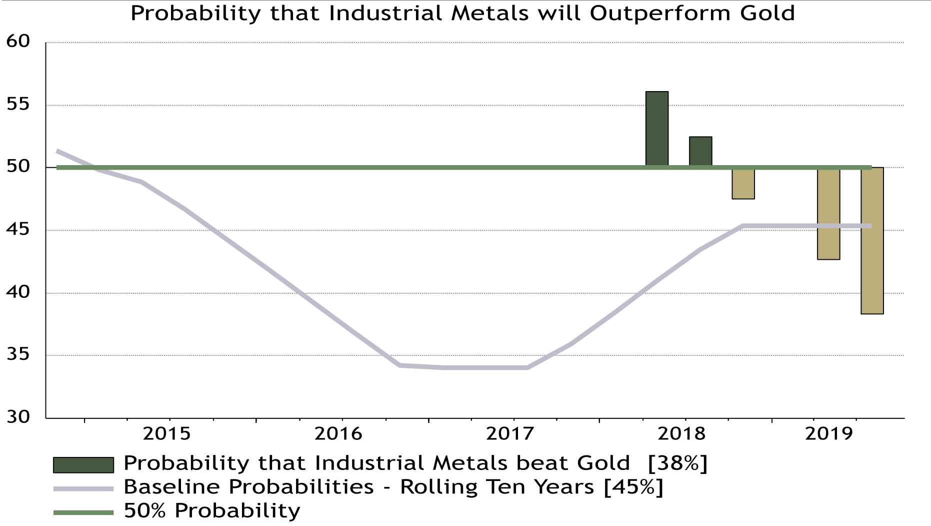
MAS.31: Probability that Gold will be Higher a Year from Now



Source: ASR Ltd. / Datastream from Refinitiv

Investors have developed some strong views on gold versus other commodities. They now think that it is highly unlikely that indutrials metals (such as copper) are going to outperform gold. Historically that is consistent with falling bond yields – a link with which 23% of our panel concur

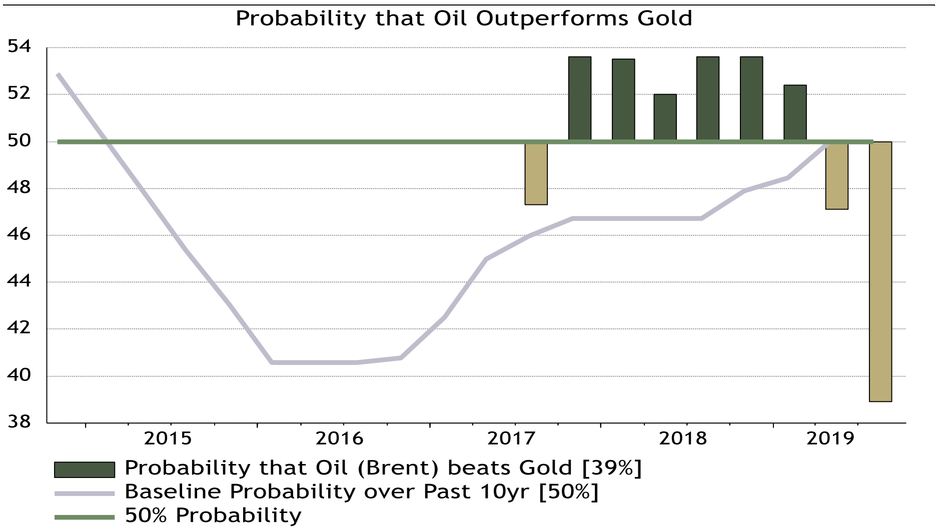
MAS.32: Probability that Industrial Metals will Outperform Gold …



Source: ASR Ltd. / Datastream from Refinitiv

Our fieldwork closed before the drone attack on Saudi oil facilities, but we were very struck by the high conviction call by our panellists that oil was likely to underperform gold over the coming year

MAS.33: Probability that Oil Outperforms Gold over next 12m

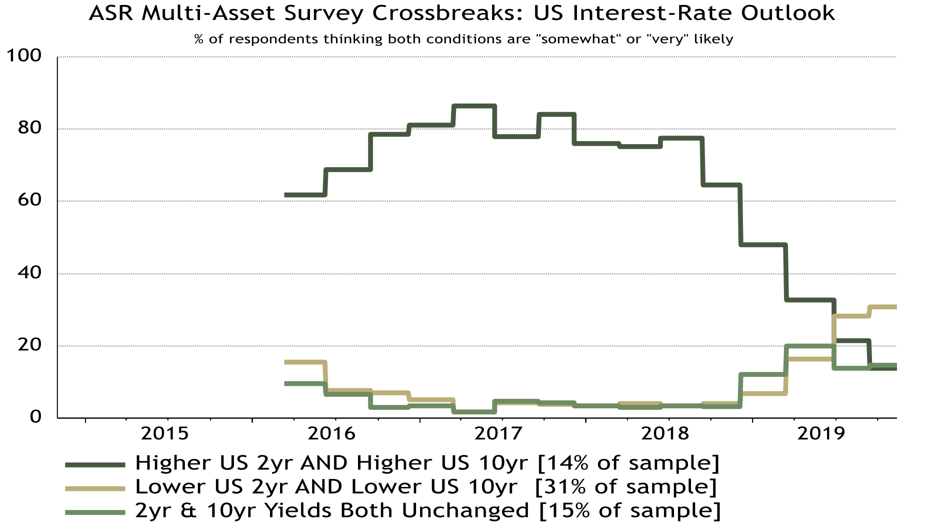


Source: ASR Ltd. / Datastream from Refinitiv

Crossbreak Charts

MAS.34: % Respondents with Different Views on US 2y & 10y Yields

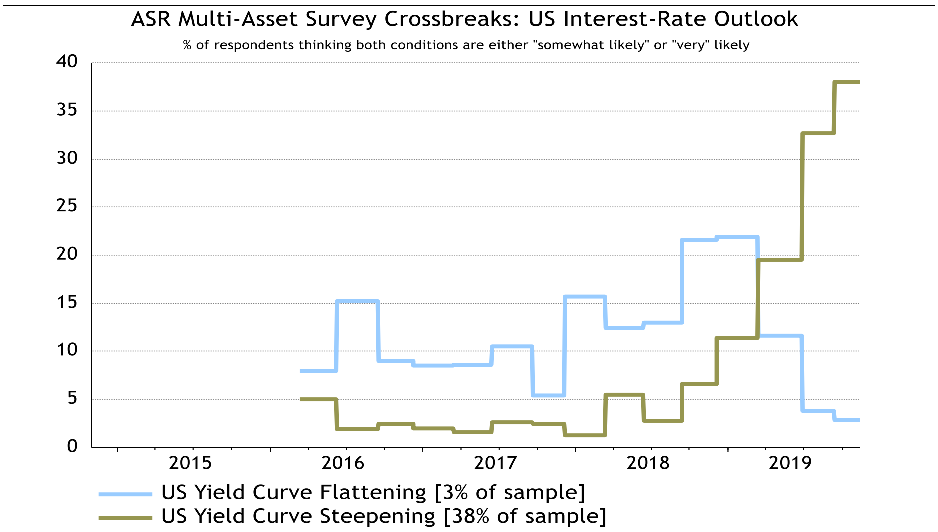
One innovation we have added is to look at how investors have answered pairs of questions over time. The adjacent chart shows that five surveys ago almost 80% of the panel expected both US 2yr and 10yr yields to be higher in a year's time. Today only 14% of our respondents hold that view. And 31% believe that both could be lower



Source: ASR Ltd. / Datastream from Refinitiv

MAS.35: % Respondents Expectating US Yield Curve to Change

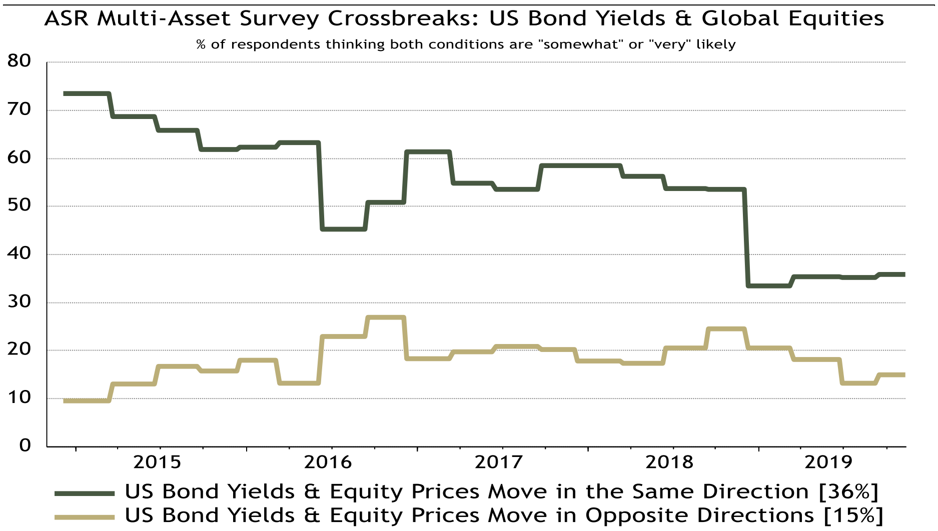
We can also back out an implied view of how our panellists expect the US yield curve slope to evolve over the next 12 months. Only 3% expect the US curve to be flatter a year from now … while 38% of our panel expect the curve to steepen



Source: ASR Ltd. / Datastream from Refinitiv

MAS.36: Tracking the Relationship Between Stocks & Bonds

The final crossbreak looks at the relationship between stocks and bonds. The dark line shows the percentage of our panel that believe there is a positive correlation between US bond yields and global equities (currently 36%). In contrast, 15% of respondents expect higher bond yields and lower equity prices (a negative correlation)



Source: ASR Ltd. / Datastream from Refinitiv

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Cluster Analysis: an Extreme Range of Views

Panel splits into 5 groups

Our regular big data analysis of panellists' responses into 'tribes' shows that our panel continues to be fragmented and now has a broad range of views. Our grouping algorithm sees to see our panel as best split into 5 similarly sized groups (MAS. 37), the same number as the last two quarters.

The largest group (almost a quarter of panellists) is now the most bearish and expects a recession with falling equity prices

Since the last survey the most cautious group, *Recession Bears*, has more than doubled in size to become the largest one, with almost a quarter of the panel (24%). This group cannot see business confidence recovering and expects a Global recession, that will push unemployment up and yields down around the globe (MAS. 39). With corporate earnings and valuations under pressure this group has the strongest expectation of a bear market in equities.

A sixth of the panel remains optimistic about the economy and risk assets

In contrast the most bullish group, *Accelerating Growth*, comprising an unchanged 17% of the panel, have an unequivocally positive view of the outlook for business confidence (MAS. 38). This group is not expecting a Global recession in the next 12 months or unemployment to rise. This is the only group that expects both short and long Treasury yields to rise. And, with an optimistic view on the economy, this group expects equities to rally, led by Cyclicals. The group has little doubt that Equities will beat Bonds.

The remaining 59% of our panel is represented by three groups, which all have less extreme views about the prospects for economic activity.

Rate cuts will keep the economy out of recession for 23% of our panel

23% of the panel is allocated into the *Extended Cycle* group (MAS. 40), which expects rate cuts to keep the economy just out of recession, Maybe they see policymakers getting ahead or at least in line with the curve, so steepening it. This group is the second most confident about Global equities continuing to rally (after Accelerating Growth) and the most confident about US equities beating the rest of the world, probably because that is the source of the stimulus in their eyes. This leads them to be the only group that sees Growth stocks outperforming Value. They are, though, neutral on the credit market.

But the final two groups believe that a slowdown will lead to rising unemployment

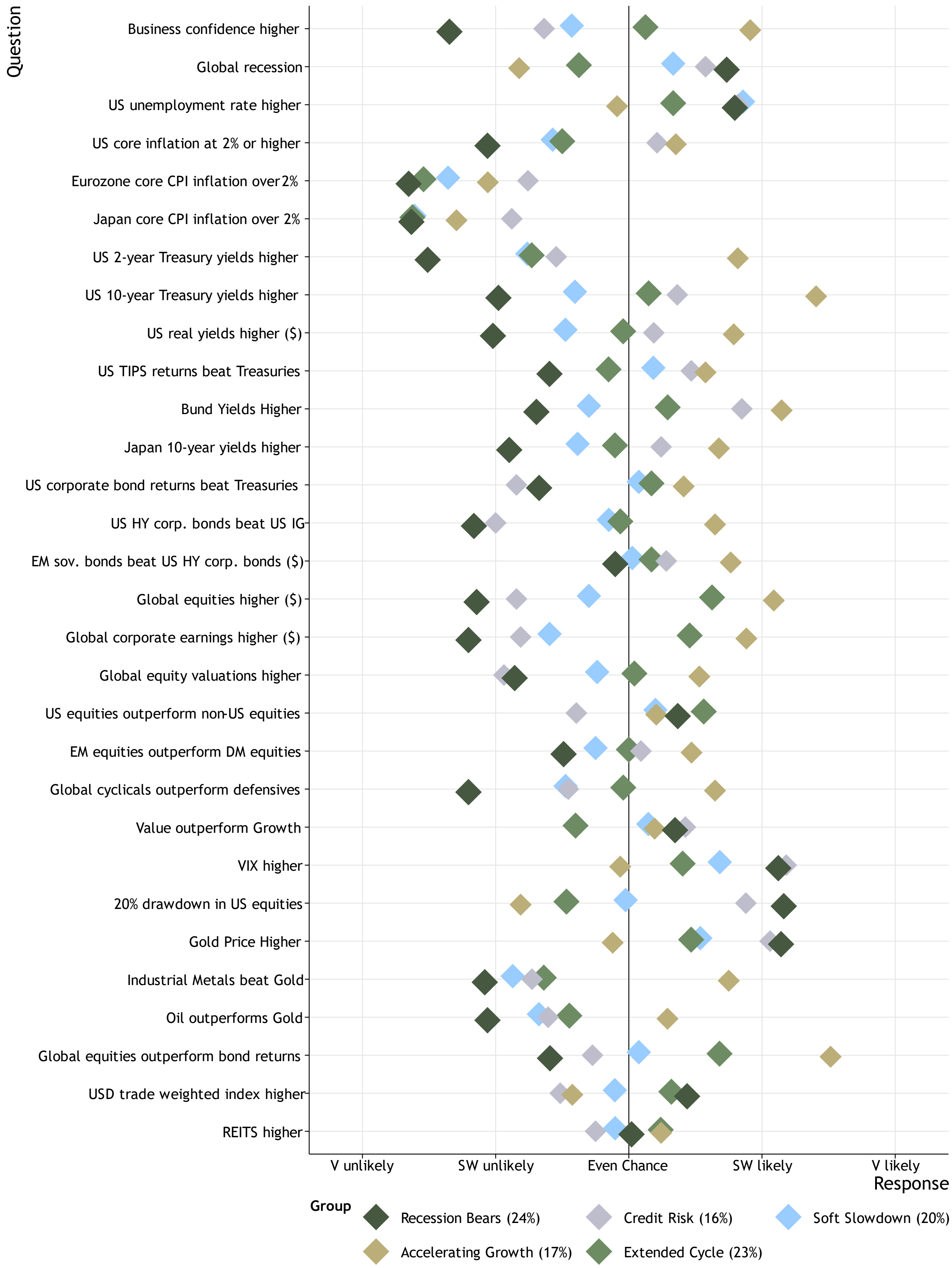
The final two groups both expect an economic slowdown and mild economic recession that will lead to rising unemployment, but the groups have differing views about inflation and so the multiple that should be applied to Equities.

And are differentiated on whether the credit markets will be impacted

The *Soft Slowdown* group (20% of panel) sees decelerating inflation but does not see credit risks appearing despite corporate earnings declining and so does not expect a derating of equities and a bear market (MAS. 41).

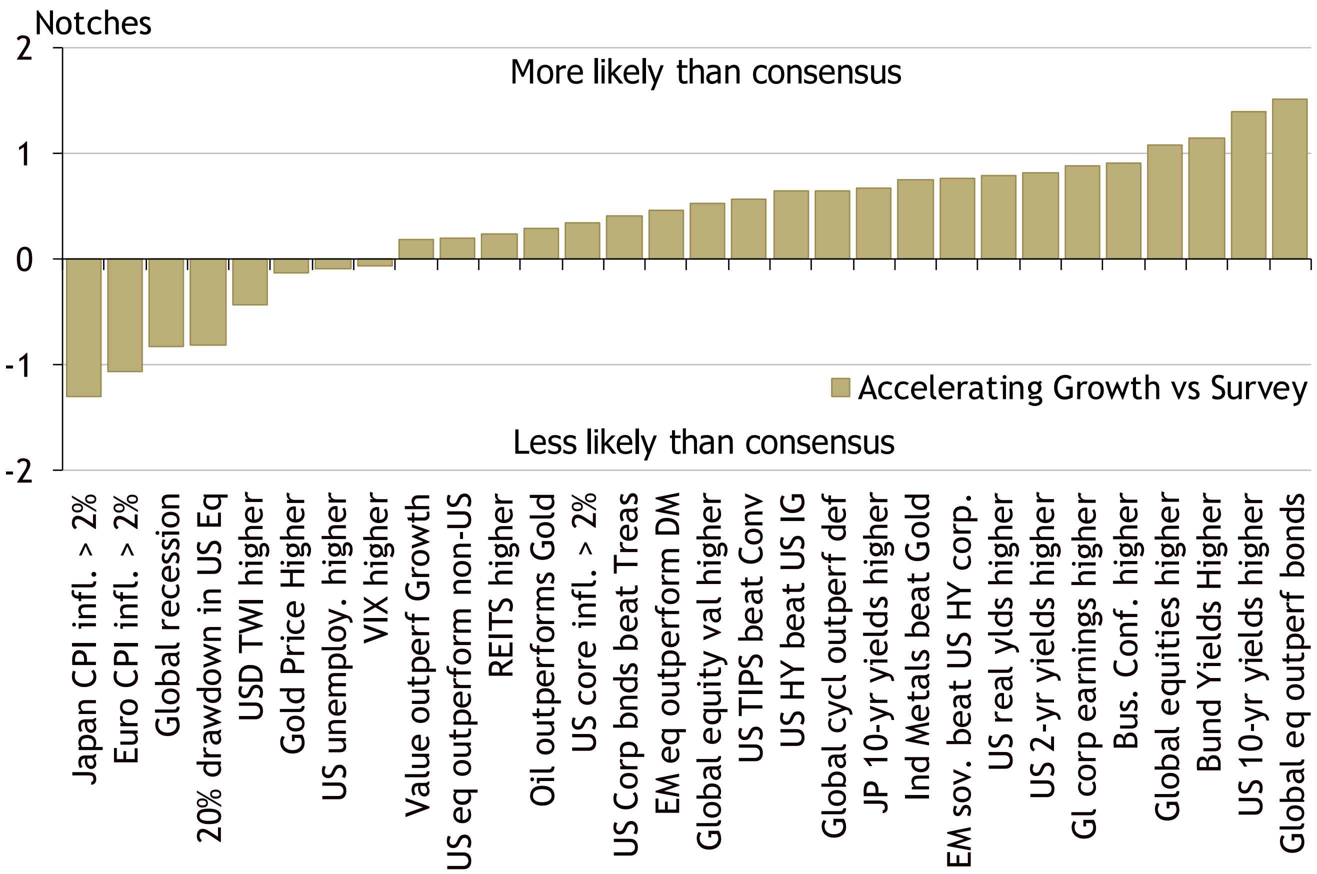
In contrast the *Credit Risk* group (16% of panel) does not expect inflation to slow but instead sees Credit underperforming. This credit risk leads them to expect equities to derate on falling earnings and see a bear market as quite likely. In their view, EM Equities might provide safety, although they really trust Gold as a store of wealth.

MAS. 37: Average response of the 5 groups identified in our Machine Learning Analysis



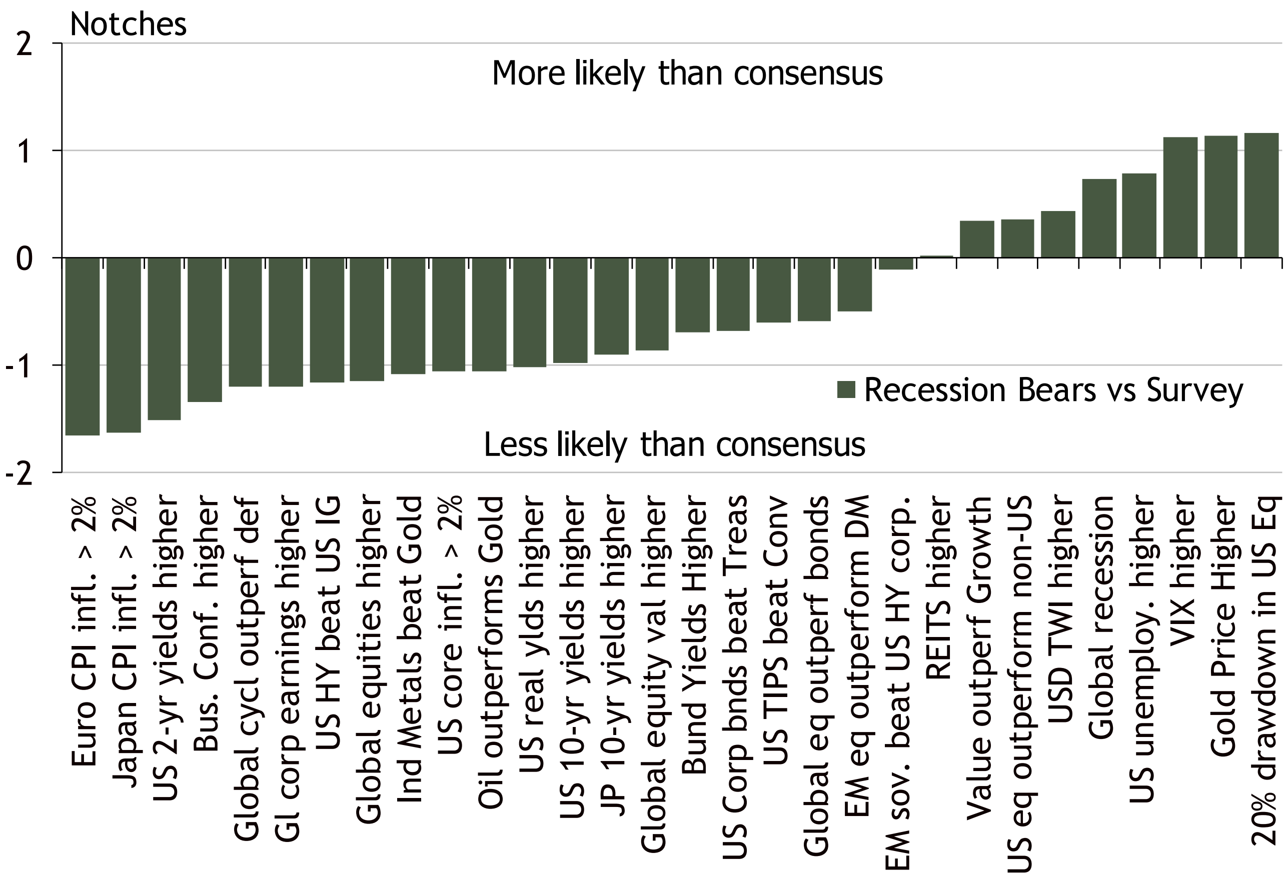
Source: ASR Ltd. / ExtelSurveys

MAS. 38: Comparison of 'Accelerating Growth' Group (17%) with Survey



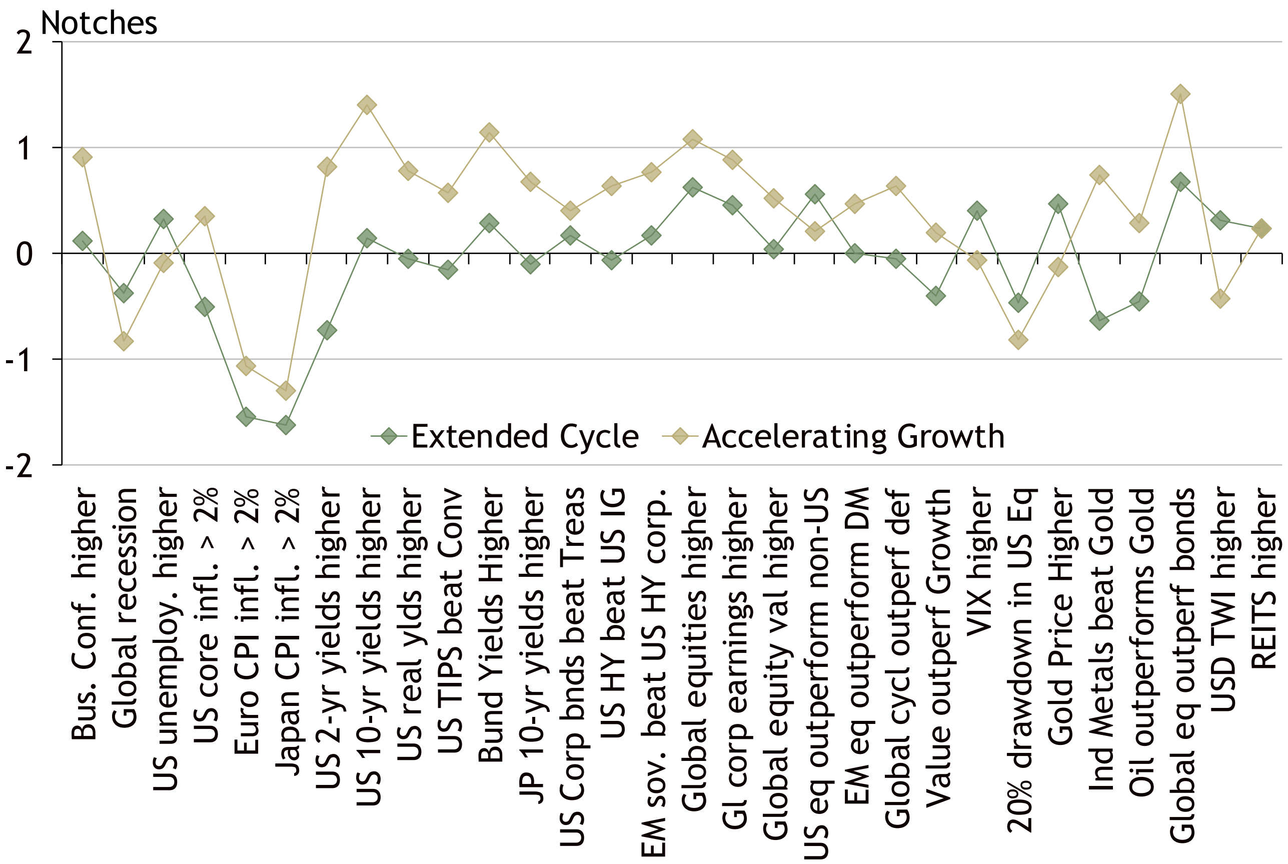
A **Notch** is the difference between each possible answer | Source: ASR Ltd. / ExtelSurveys

MAS. 39: Comparison of 'Recession Bears' (24%) Group with Survey



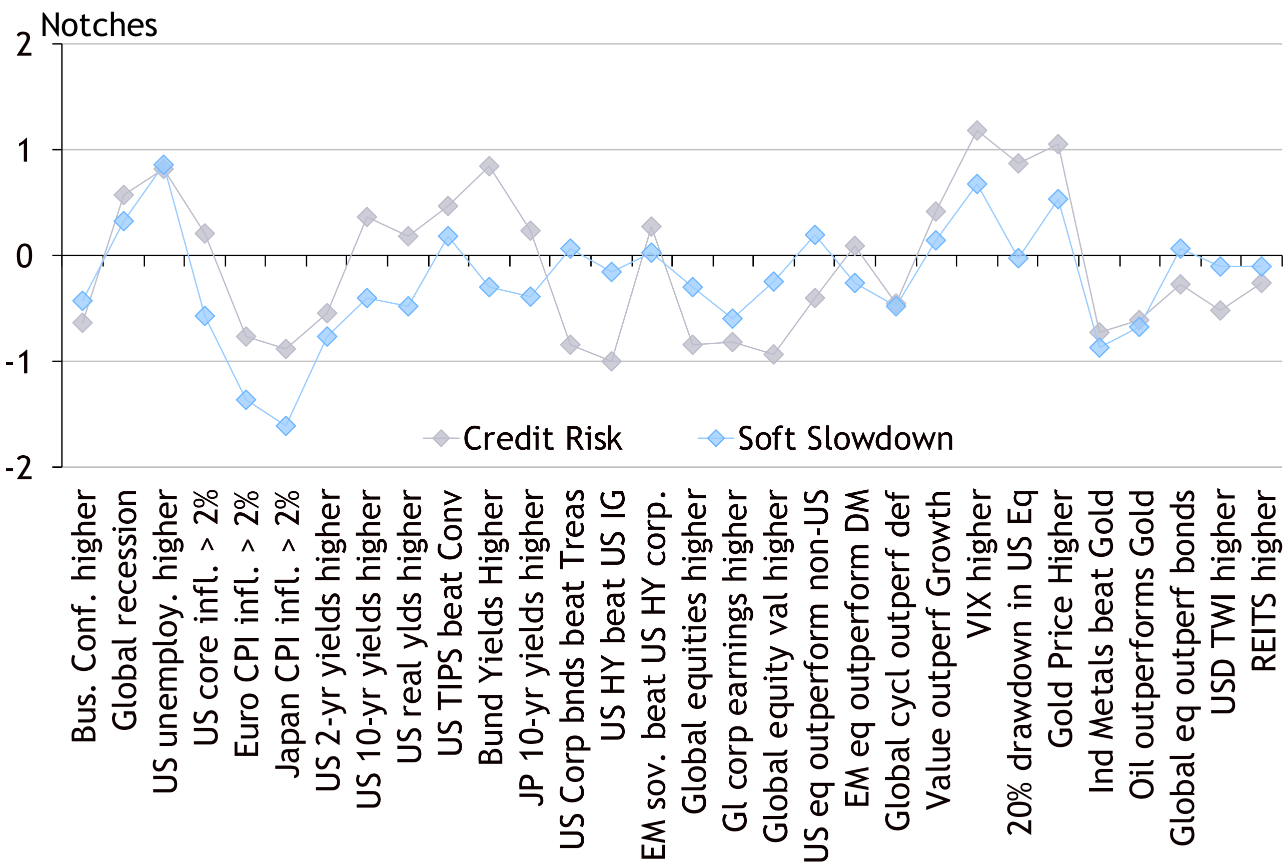
A Notch is the difference between each possible answer | Source: ASR Ltd. / ExtelSurveys

MAS. 40 Comparison of Extended Cycle (23%) Group with Accelerating Growth (17%) Group



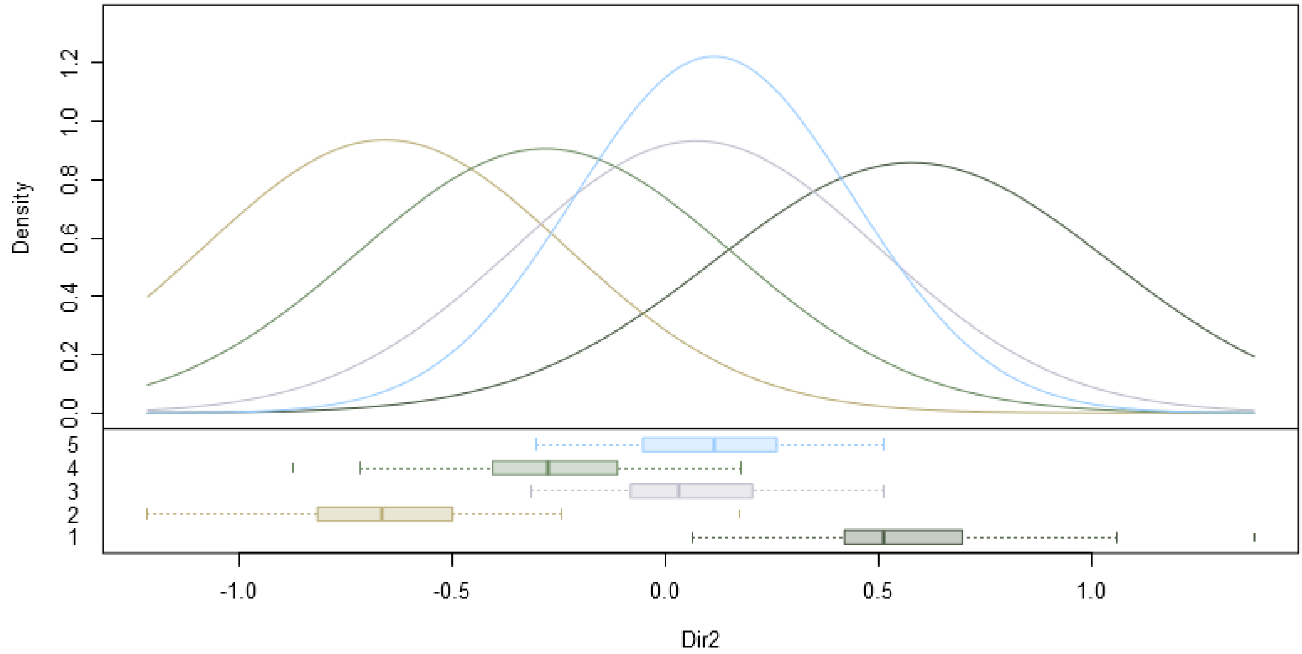
A **Notch** is the difference between each possible answer | Source: ASR Ltd. / ExtelSurveys

MAS. 41 Comparison of 'Soft Slowdown' (20%) Group with 'Credit Risk' (16%) Group



A **Notch** is the difference between each possible answer | Source: ASR Ltd. / ExtelSurveys

MAS. 42: Differentiation of Clusters (Second component after PCA transformation)



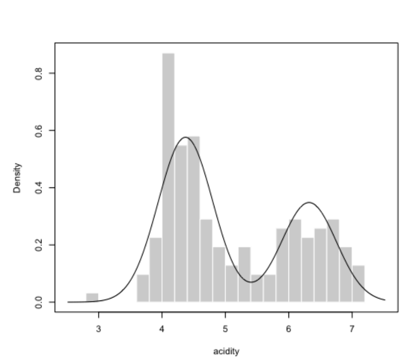
We have applied a PCA transformation of the panellists responses, and then plotted the distribution of response of each group for the second principal component (ie a combination of questions), which is one of the key differentiators of the views of the groups. On this axis, Group 1 (Recession Bears) has little in common with Group 2 (Accelerating Group). The other three groups are all much more similar and are differentiated on other PCA components (ie combinations of questions) Source: ASR Ltd. / ExtelSurveys

Methology - How we find our groups of similar investors

The basis of this group analysis is that there are only a limited number of generic categories of investors. An investor's answers are the combination of their generic categories' answer and some individual variation (i.e. 'noise'). So we try to classify investors into one of these generic categories.

Our approach is 'unsupervised': ahead of the analysis we do not know either the number of generic categories, or even their views! However, this is not an insurmountable problem. We can use a Bayesian approach: that is, we create a model of the generic categories and see whether we can get it to fit the data. The parameters of the model (the number of clusters and their means and variances) are then adjusted until the 'most likely' model is found. So, in the example in MAS. 43, the data is the bars, which are modelled by superimposing two normal distributions (each distribution represents a generic type). Increasing the number of distributions might lead to a better fit. However, this runs the risk of over-fitting, and so each extra group increases a penalty factor when calculating the how good a fit the model is.

MAS. 43: Fitting two normal distributions to a dataset



Source: W. Härdle, Fraley & Raftery

Transferring this idea to our survey, the bars would be the responses to a question, and so the two distributions in the chart are equivalent to two basic investor categories. Of course our survey has 30 questions with discrete responses which makes the maths more complex in practice but are still possible to solve using the algorithms provided by the `mclust` package in R.

Methodology – What we Mean by 'Implied Probabilities'

- ASR's Multi-Asset Survey is a Survey of Probabilities.
- Every quarter we contact around 200 asset allocators and multi-asset strategists from around the world.
- We ask them "how likely" they think certain financial and economic events are to occur in the next 12 months. All thirty questions are framed with a binary outcome (will 'X' happen or will it not happen?) with a fixed time horizon. Each question offers five options: (1) very likely (2) somewhat likely, (3) even chance, (4) somewhat unlikely, (5) very unlikely.
- We then ascribe notional probabilities to each of the five options. For example, if someone responds "very likely", we apply a 90% probability to their response. If they reply "very unlikely", we apply a 10% probability. If someone says "even chance", then we apply a 50% probability.
- By applying different probabilities to the responses, we can calculate an overall probability. This is more sophisticated than other surveys, which just calculate a "net balance" (e.g. % respondents that are 'optimists' minus % respondents that are 'pessimists'). Our approach captures differences in convictions.
- Small changes in the implied probabilities matter: a 5% point change over a quarter can indicate an important shift. A 10% point change can reflect a profound change in expectations.
- These "implied probabilities" are powerful as they can be used in multiple ways. First, we can compare them with the probabilities that are implied in the market. Secondly, we can compare them with our own views and see where we are most different from the consensus. And thirdly, we can compare them with the historic baseline probability (how often has this event occurred over the past decade).
- For example, an implied probability of 50% may sound like a neutral call, but if the event has only occurred 20% of the time over the past decade, then this 50% probability is in fact a much more aggressive call that it may first appear. It is 'big' relative to the history of the past ten years.

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