# How to Incorporate Leading Indicators into Your Portfolio Management Process

Quant Pack DIY

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## #1 – Gather Vast Amounts of Historical Data

It is important to establish a solid foundation of historical data because the data forms the basis of the forecasting process. The process starts with pulling together a wide array of historical data sets across economic inputs (i.e. homebuilding, manufacturing, employment trends) and market inputs (i.e., interest rate levels, credit spreads, commodity prices). This step requires either a data subscription, which can cost thousands of dollars, or countless hours spent finding alternative data sources.

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## #2 – Identify Variables with Explanatory Power (i.e., Statistical Correlations)

This essentially means identifying which variables have historically exhibited a leading relationship with other variables. This crucial step establishes the connection between the variables and the data point being forecasted. Based on our experience, each indicator can require 3 to 6 months of data analysis  to identify statistically significant relationships. Note – This step assumes, at a minimum, you have a basic understanding of economic concepts as well as experience in statistical modeling.

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## #3 – Build and Maintain the Indicators

After identifying the relationships, a system must be established to organize and manage the data. This step involves updating the forecasts as new data is released on a weekly, monthly, or quarterly schedule. Note – This step is time consuming and requires meticulous organization of all the data sets.

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## #4 – Establish the Indicators' Relationships with Financial Markets

This step links the various indicators to financial markets. It uses historical asset classes performance to understand how various asset classes perform in relation to the projected forecast. For instance, how does a continuous tightening of bank lending standards affect the return gap between investment grade and high yield corporate bonds? Similarly, how does a steady rise in the ISM Manufacturing PMI influence cyclical versus defensive sectors?

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## #5 – Monitor and Analyze the Forecasts

Establish a framework for evaluating the forecasts at regular intervals, such as during weekly or monthly investment committee meetings. Although the indicators are not designed to forecast with precision, that is typically not necessary for successful asset allocation. Instead, focus on shifts in the forecast trend, such as loosening lending standards, peaking corporate earnings, or a slowdown in manufacturing activity.

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## #6 – Implement the Investment Views into Portfolios

The final step implements the indicator’s quantitative forecast, combined with your investment process and expertise, into portfolios. It is important to note the Quant Pack is process-agnostic and allows you to maintain control of portfolio construction. Whether your investment approach emphasizes low-cost ETFs, individual stocks, or allocates to active managers, the Quant Pack forecast ensures portfolios are built on rational considerations and sound reasoning, rather than subjective judgments or ‘expert’ opinions.

## Summary

Compared to the DIY option, the MarketDesk Quant Pack handles steps 1 through 5, which are the most time-intensive and costly steps. You then focus only on step 6. The result is a consistent, repeatable macro forecasting process based on a quantitative framework. By subscribing to the Quant Pack, you save both money and time, while enhancing your investment process.