Sevens Report Alpha Webinar #120 – July Market Multiple Table

July 7th, 2022

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SEVENS REPORT

- The July Market Multiple Table included several significant changes in the macro-economic influences on markets, and most of them were negative.
- The conclusion of the MMT is clear:
- *At current levels and given the current macro-economic reality, the S&P 500 is overvalued by 5% - 10%.*

Current Situation

A Game of Multiples (Updated 7/7/2022)	
Market Influence	Current Situation
Inflation	Inflation remains at multi-decade highs as CPI continues to move higher month after month.
Fed Tightening	The Fed hikes 75 basis points in reaction to the hot June CPI and rate hikes going forward are expected to be between 50—75 bps.
China Lockdowns	COVID cases have declined in China and the economy has largely opened up, but "Zero COVID" remains the policy so the consistent threat of lockdowns remains.
Russia/Ukraine War	Russia continues to make territory gains in eastern Ukraine and there remains no progress towards a cease fire.
Economic Growth	Economic growth is losing momentum, although that's what's necessary to eventually get to "Peak Hawkishness."
Expected 2023 S&P 500 EPS	$225
Multiple	16X-17X
S&P 500 Range	3,600-3,825
S&P 500 Target (Midpoint)	3,713
Change from today	-5.0%

- The current situation deteriorated notably from June.
  - Earnings cut sharply ($225 from $240).
  - Inflation got worse (8.6% CPI).
  - Fed hawkishness got worse (75 bps hike).
  - Economic data rolling over (question is by how much).
  - Multiple reduction (from 17X-18X to 16X – 17X).
  - China reopened but Zero COVID policy still in force.

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Gets Worse If

A Game of Multiples (Updated 7/7/2022)	
Market Influence	Things Get Worse If...
Inflation	The July CPI increases again, above 8.6%.
Fed Tightening	The Fed hikes 75 bps in July and signals more are coming until inflation is under control.
China Lockdowns	COVID cases rise and new lockdowns are implemented in industrial cities (like Shanghai).
Russia/Ukraine War	The conflict extends beyond Ukraine, increasing the risk of a larger conflict (possibly with NATO).
Economic Growth	Economic growth collapses, resulting in intense stagflation.
Expected 2023 S&P 500 EPS	$210
Multiple	15X-16X
S&P 500 Range	3,150-3,360
S&P 500 Target (Midpoint)	3,255
Change from today	-17%

- We get a repeat of June
  - CPI > 8.6%
  - Fed hikes 75 bps in July – disavows a pause.
  - Economic data drops.
  - No progress in Russia/Ukraine cease fire.
  - China locks down again.
  - No progress towards a bottom, material economic contraction becomes more likely.

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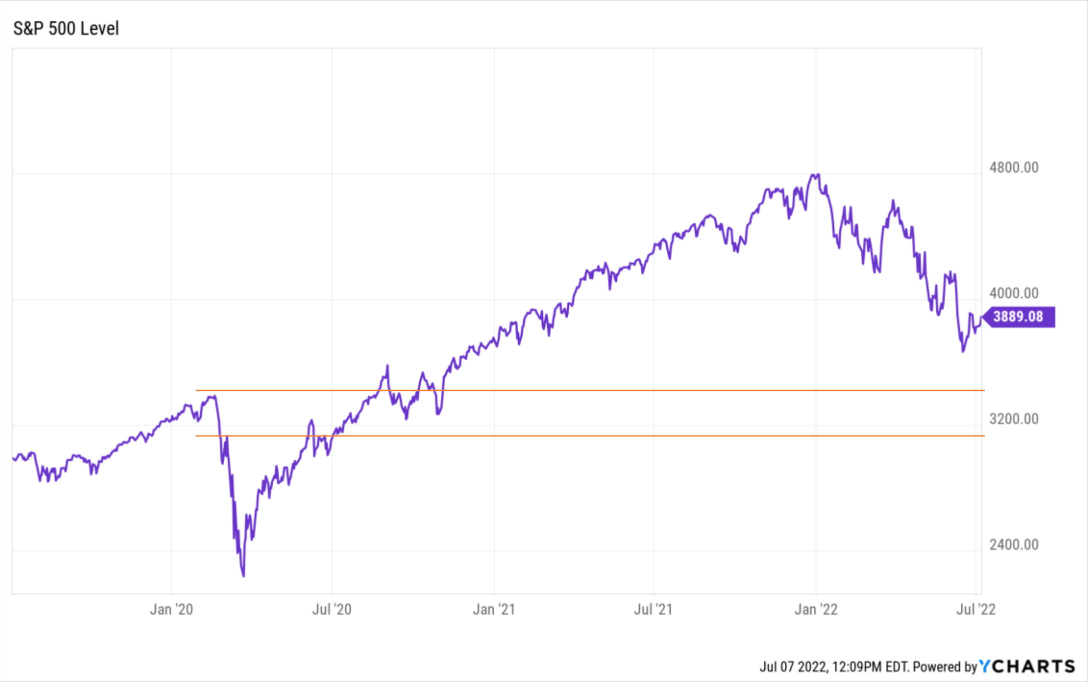

Gets Better If

A Game of Multiples (Updated 7/7/2022)	
Market Influence	Things Get Better If...
Inflation	The July CPI report shows a decline in yoy headline CPI (towards 8%).
Fed Tightening	The Fed hikes 50 bps in July and starts to signal it's nearing a place where it can pause rate hikes.
China Lockdowns	COVID cases stay low and, ideally, Chinese officials distance themselves from "Zero COVID"
Russia/Ukraine War	Russia declares "victory" and stops it advance and discusses terms of a cease fire.
Economic Growth	Economic growth continues to moderate, allowing the Fed to "pause" rate hikes in the fall or winter.
Expected 2023 S&P 500 EPS	$235
Multiple	17X-18X
S&P 500 Range	3,995-4,230
S&P 500 Target (Midpoint)	4,113
Change from today	5.5%

- More actual evidence of:
  - Inflation peak.
  - Peak Hawkishness
  - China distancing itself from "Zero COVID"
  - Economic data that shows moderating growth.
  - Cease fire in the Russia/Ukraine war.

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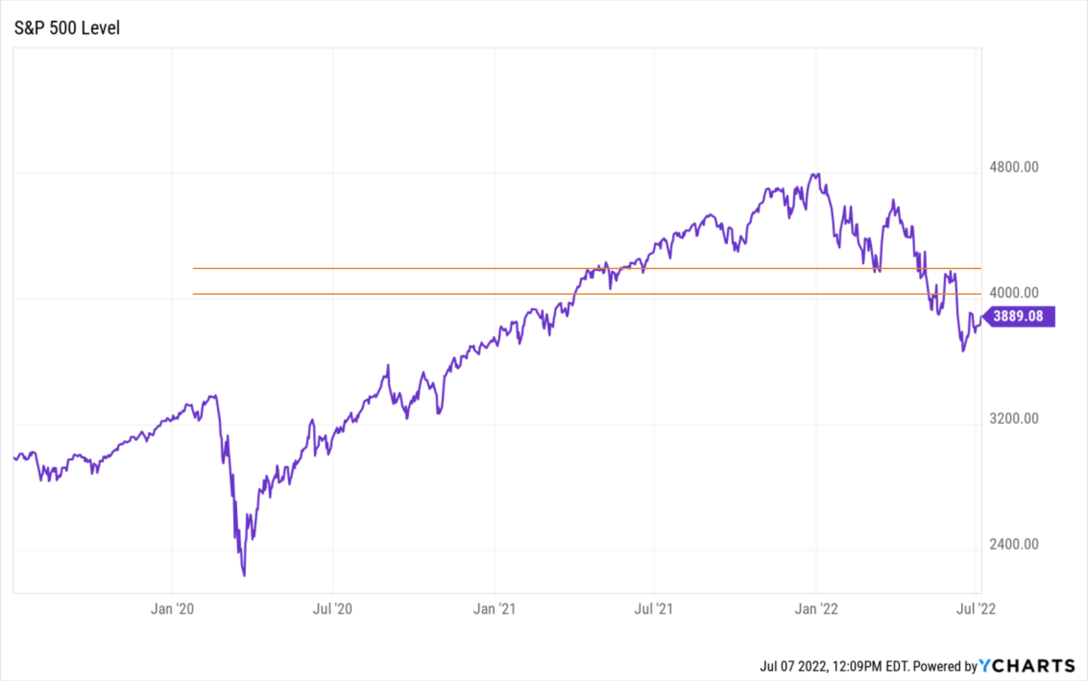

Takeaways

- The macro-economic situation deteriorated somewhat materially in June.
- And, the rally over the past few weeks isn't being driven by anything fundamental. There's literally been no concrete improvement in 1) Inflation metrics (that matter to the Fed) or 2) Fed hawkishness.
- Instead, the market is assuming they will come – but these assumptions have been occurring all year and they have not turned out to be true.
- Even if we get a "Gets Better If" scenario, that only likely marks the bottom. For a material rally in stocks, we'll need to see the light at the end of the tunnel of Fed tightening and inflation.
- Meanwhile, if we get a repeat of June, then a decline that retraces the entire post-COVID rally in the S&P 500 should not surprise anyone (so another 10% - 20% lower).
- Bottom line, markets are acting more resiliently, but that's based on hope – not facts. We need facts before we can become confident this rally isn't just a bounce.