

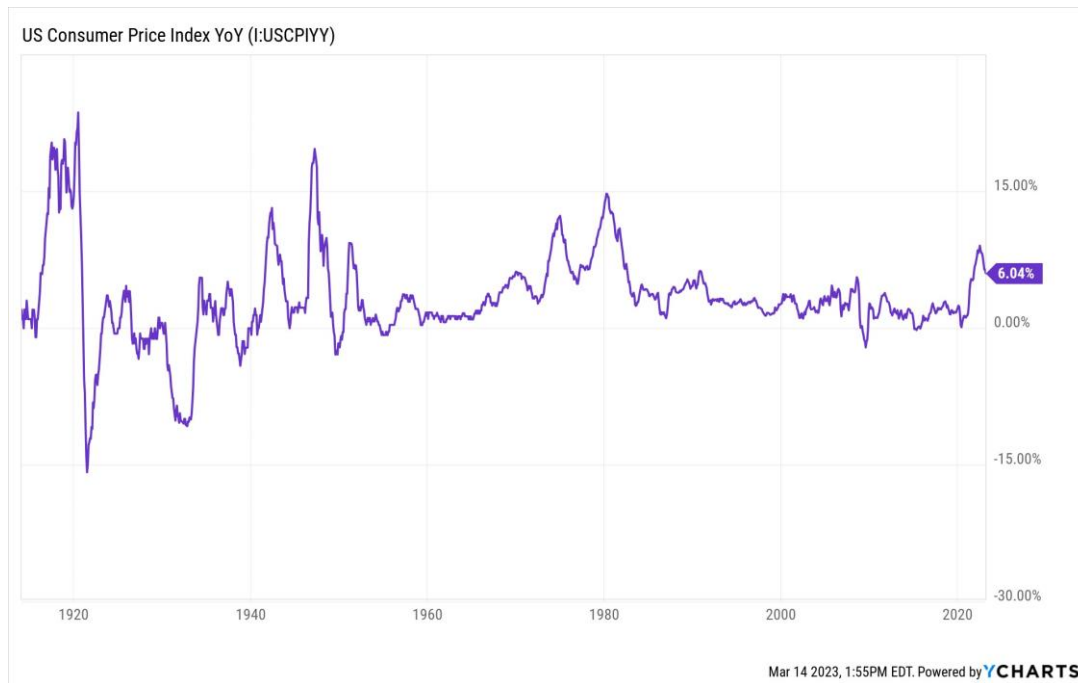
Sevens Report Alpha Webinar – Will the Banking Crisis Make the Fed Turn Dovish?

March 16th, 2023

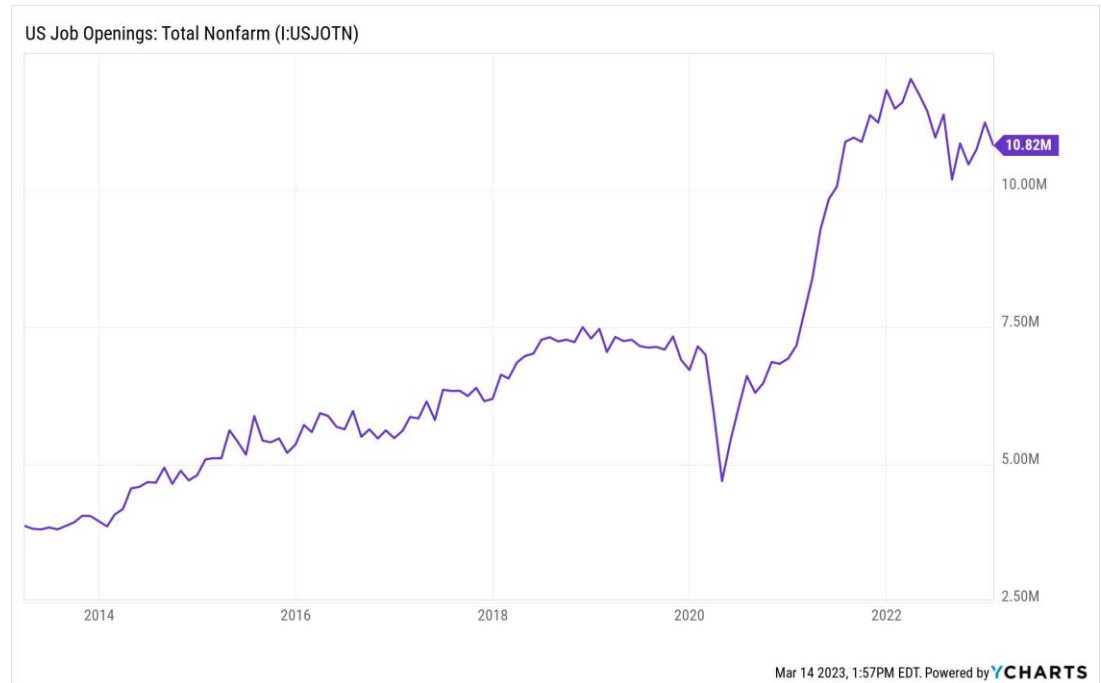
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Why The Fed Should Still Hike 25 bps.

Reason 1: Inflation remains very, very far above the 2.0% target.



Reason 2: The labor market remains historically tight, and that's putting consistent upward pressure on inflation.

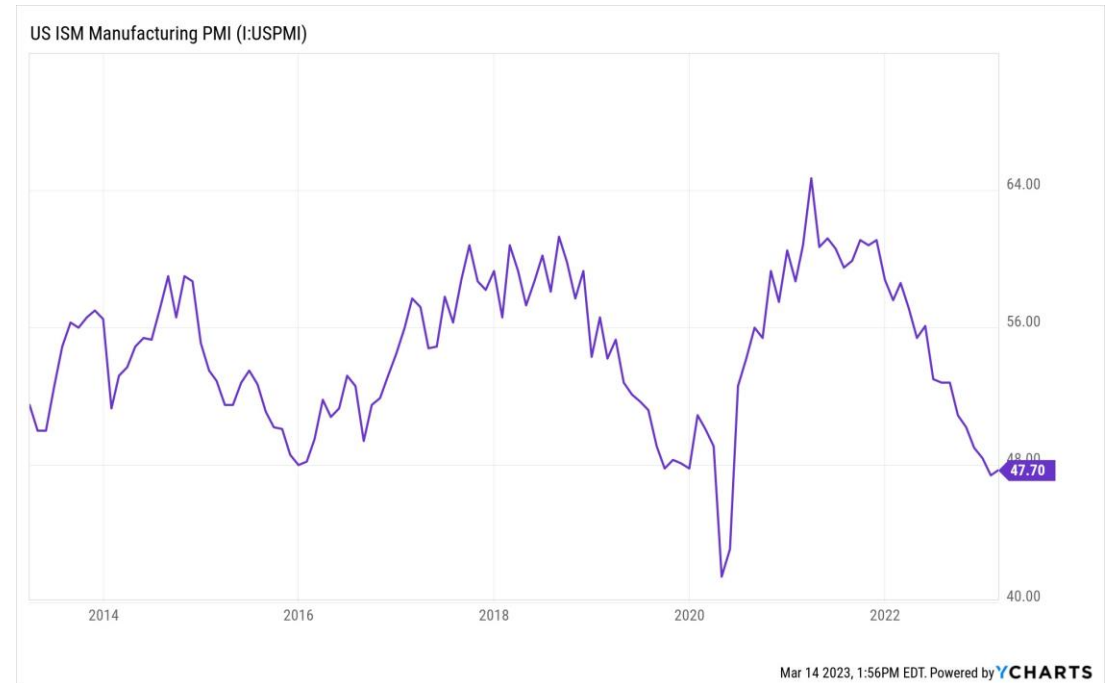


Why The Fed Should Not Hike 25 bps.

Reason 1: Clearly there is major stress in the banking sector, and if that continues it'll majorly pressure economic activity.

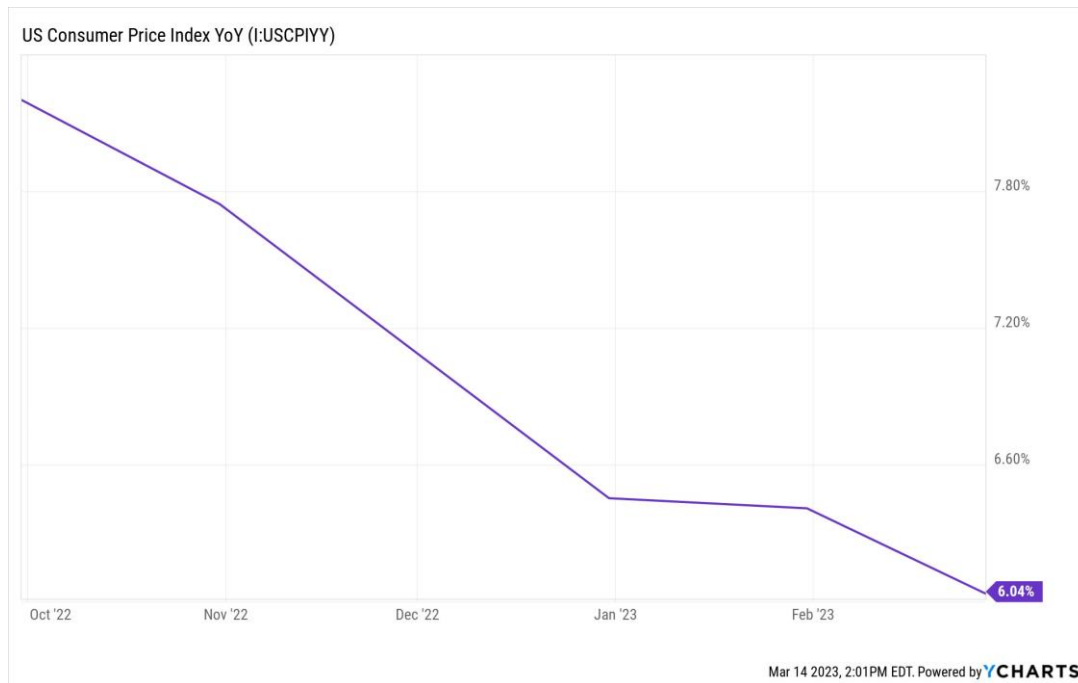


Reason 2: There are several indicators that are flashing economic weakness.

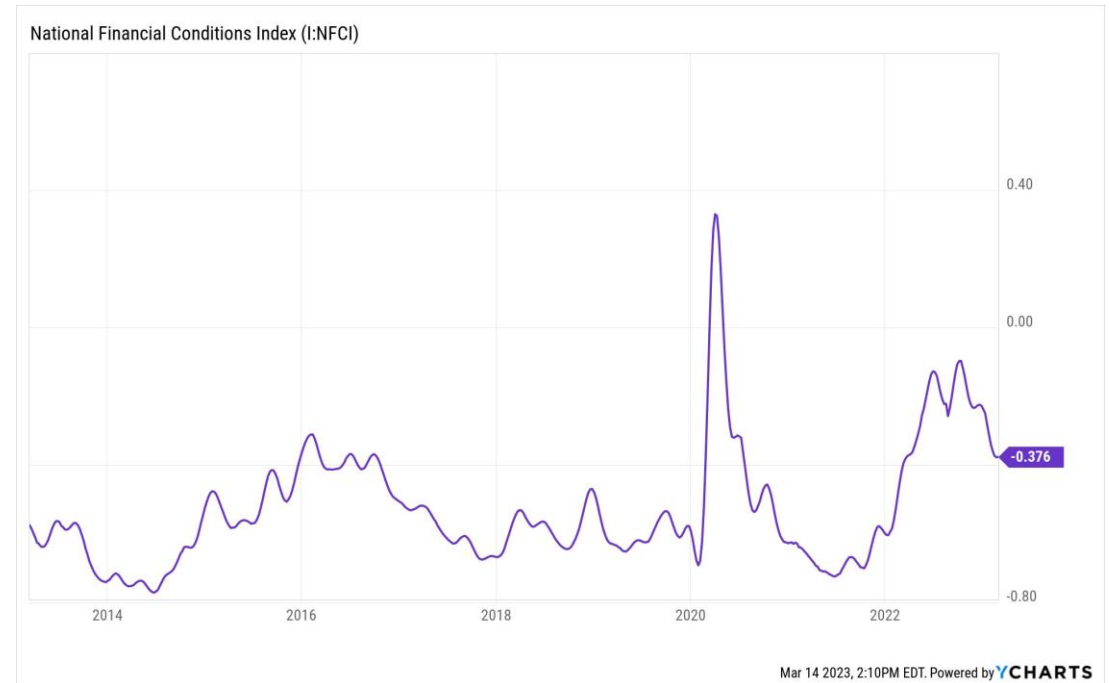


Why The Fed Should Not Hike 25 bps.

Reason 3: Inflation is still elevated but has declined over the past few months.



Reason 4: Financial conditions have tightened materially.



So, What Are the Fed's Options:

- **What's Expected:** A 25 bps hike and “dots” that are either unchanged from December or show a lower terminal rate (4.875%) and the Fed suspends (or drastically reduces) QT. **Probability: 70%.**
- **Dovish If:** The Fed pauses rate hikes to assess the fallout from SVB and says it could resume rate hikes later, while the Fed pauses QT. **Probability: 15%.**
- **Hawkish If:** The Fed hikes 25 basis points, mentions the recent bank stress but reiterates its commitment to bringing inflation down. Dots show another rate hike (bringing the terminal rate to 5.375%) and there is no change to QT. **Probability: 15%.**

No Rate Hike. What's It Mean for the Market, and What Outperforms?

- Market implications:
 - Some initial relief, as markets will be happy that rates are not raising further.
 - But, this action makes a large assumption that this banking stress will be enough to materially reduce economic activity, and that assumption carries major risks.
 - If the Fed is wrong, and the crisis does not materially slow economic activity, then it will risk the Fed mistakes of the 1970's and create a start/stop rate hike policy that risks years of 1) High inflation and 2) Volatile asset markets.
 - Regardless, if the Fed pauses, the market will only be satisfied for a moment. The market will then demand rate cuts, as it will interpret the Fed's pause to mean a looming material economic slowdown on the horizon.
 - So, short term relief but risks a much larger problem (similar to the 1970's).
- Broad market implications.
 - Treasuries higher/yields lower.
 - 10's-2's higher.
 - U.S. Dollar Index lower.
 - Stocks higher (at least initially).
- Sector and factor outperformers.
 - Growth (VUG) over Value (VTV).
 - SPY over RSP
 - These moves would be driven by falling yields, which would boost tech and high growth stocks.
 - Utilities & REITS
 - These "bond proxy" sectors would rally on lower yields.
 - Super cap tech, Healthcare, Consumer Staples
 - These sectors are more insulated from slower growth.
 - Basically, what's outperformed since this banking crisis began on Friday.
 - Longer dated Treasuries over shorter dated Treasuries
 - High grade corporates over junk.

25 Basis Point Rate Hike. What's It Mean for the Market, and What Outperforms?

- Market implications:
 - Stocks would likely drop in the short term as higher rates could put more stress on the market-to-market value of bank bond holdings and further pressure regional banks.
 - More broadly, this decision does risk the Fed adding pressure to a potentially growing financial crisis.
 - However, at the same time, if the Fed has confidence in its tools to address any regional bank liquidity challenges, then the stress on regional banks shouldn't impact the broader fight for inflation.
 - So, more short-term pain for potential longer-term gain.
- Broad Market Implications
 - Treasuries lower/yields higher.
 - 10's – 2's lower.
 - Dollar higher.
 - Stocks lower (at least initially).
- Sector and factor outperformers
 - Value (VTV) over growth (VUG)
 - RSP over SPY
 - These broad moves would be driven by higher yields, which would pressure growth and tech names.
 - Utilities, Consumer Staples and Healthcare
 - Despite rising yields, investors should rotate into defensive sectors as the market braces for slower growth and likely recession.
 - Hedged equity ETFs
 - Both would protect against a material downside.
 - Shorter dated Treasuries over longer dated Treasuries

Alpha Strategy Playbooks

No Rate Hike Alpha Strategies

- Three Strategies to re-Allocate to Growth and Tech. 2.22.23. IMCG/IGM/SMH.
- Opportunity in Long Bonds. 1.24.23. SPTL/PTCIX/MLN.
- Sectors that Outperformed During Recent Recessions. 7.12.22. VHT/IHF/VDC/PBJ.
- Weathering the Market Volatility with “Quality” ETFs. 1.25.22. FXO/QVAL/SYLD/RPV.
 - All of these ETFs are positive since recommendation.

25 bps Rate Hike Alpha Strategies

- MOAT Stocks. 11.1.22. MOAT/MOTE/SMOT
 - These ETFs have handily outperformed the S&P 500 since recommendation.
- Repositioning for Another Rollover. 9.2.22. RYU/SPHD/USFR.
- Weathering the Market Volatility with “Quality” ETFs. 1.25.22. FXO/QVAL/SYLD/RPV
 - All of these ETFs are positive since recommendation.
- How the “Old Economy” Can Help Us Outperform. 1.26.21. DJD/FDL/RPV.
 - These ETFs are outperforming the S&P 500 by 100% - 200% over this timeframe.