

Sevens Report Alpha Webinar – The Positive and Negative Path for Markets During 2H 2023

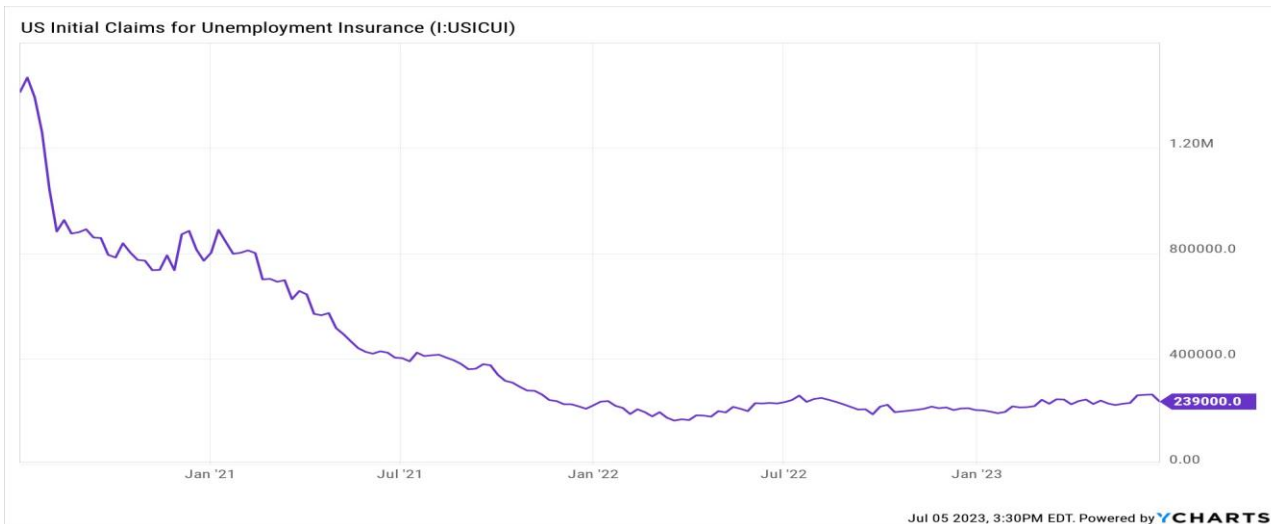
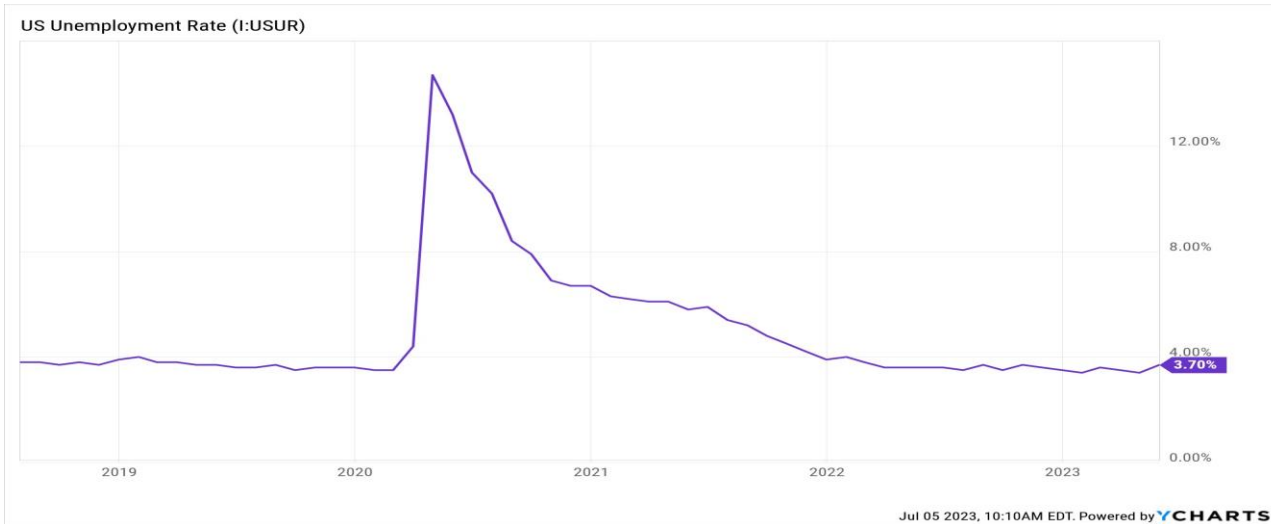
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Key Variables for Stocks and Bonds in 2H 2023

- The Status of the Labor Market
- Hard Landing vs. Soft Landing
- Sentiment
- Core CPI
- Earnings
- Terminal Fed Funds
- Treasury Yields

Status of the Labor Market



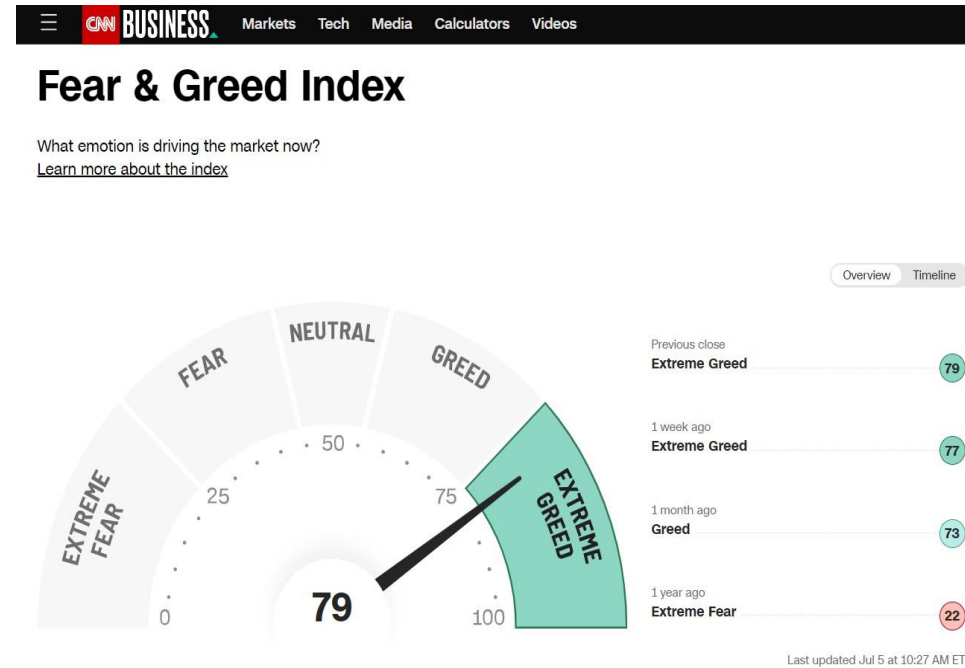
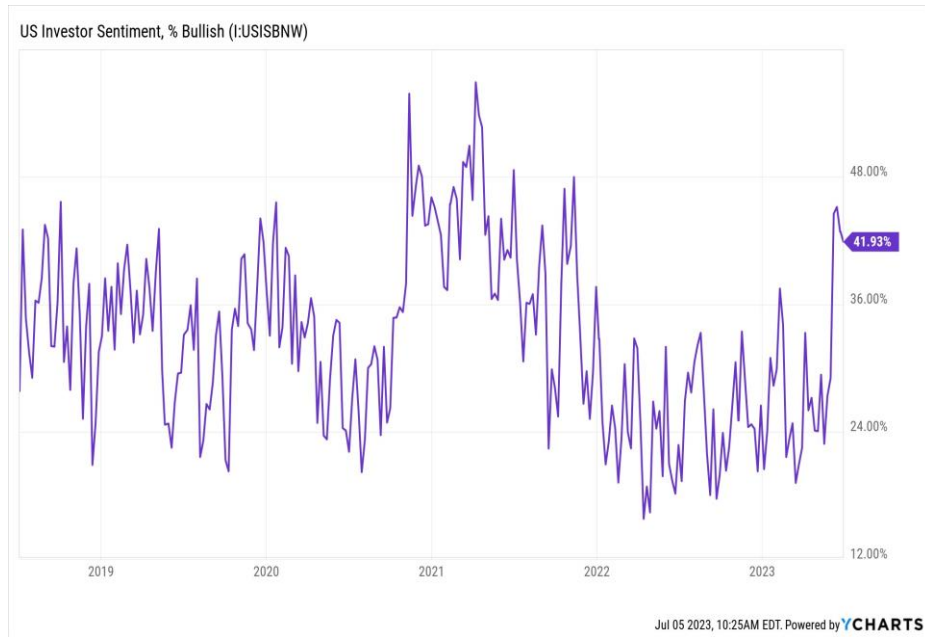
- Current Status: A very tight labor market.
- The labor market remains extremely resilient, and as we covered in Sevens Report, it's likely the Fed will want to see further moderation in the labor market before it can end the rate hike campaign.
- Key Indicator: U-3 Unemployment Rate
 - “Good” level: > 4.3%
 - “Ok” level: 4.0% - 4.3%
 - “Bad” level: < 4.0%
 - Timeframe: 2nd half of 2023.

Hard Landing vs. Soft Landing Scoreboard

<u>Hard Landing vs. Soft Landing Scoreboard</u>				
	Current	One Month Ago	Three Months Ago	Hard Landing/Soft Landing
ISM Manufacturing PMI	46.0	46.9	46.3	Hard Landing
ISM Services PMI	50.3	51.9	55.1	Soft Landing
Job Adds (Non-Farm Payrolls)	339k	294k	248k	Soft Landing
Retail Sales	\$598.58B	\$596.52B	\$600.67B	Soft Landing
NDCGXA	\$73.96B	\$73.46B	\$74.60B	Soft Landing
Jobless Claims 4WK MA	253.3k	237k	224k	Soft Landing

- Current Status: Data is pointing to a soft landing.
- Economic data in 1H '23 showed the economy is losing momentum, but most indicators were resilient, and the loss of momentum was less than investors feared at the start of the year.
- Data pointing to a soft economic landing was one of the biggest reasons stocks were able to rally in the first half of 2023.

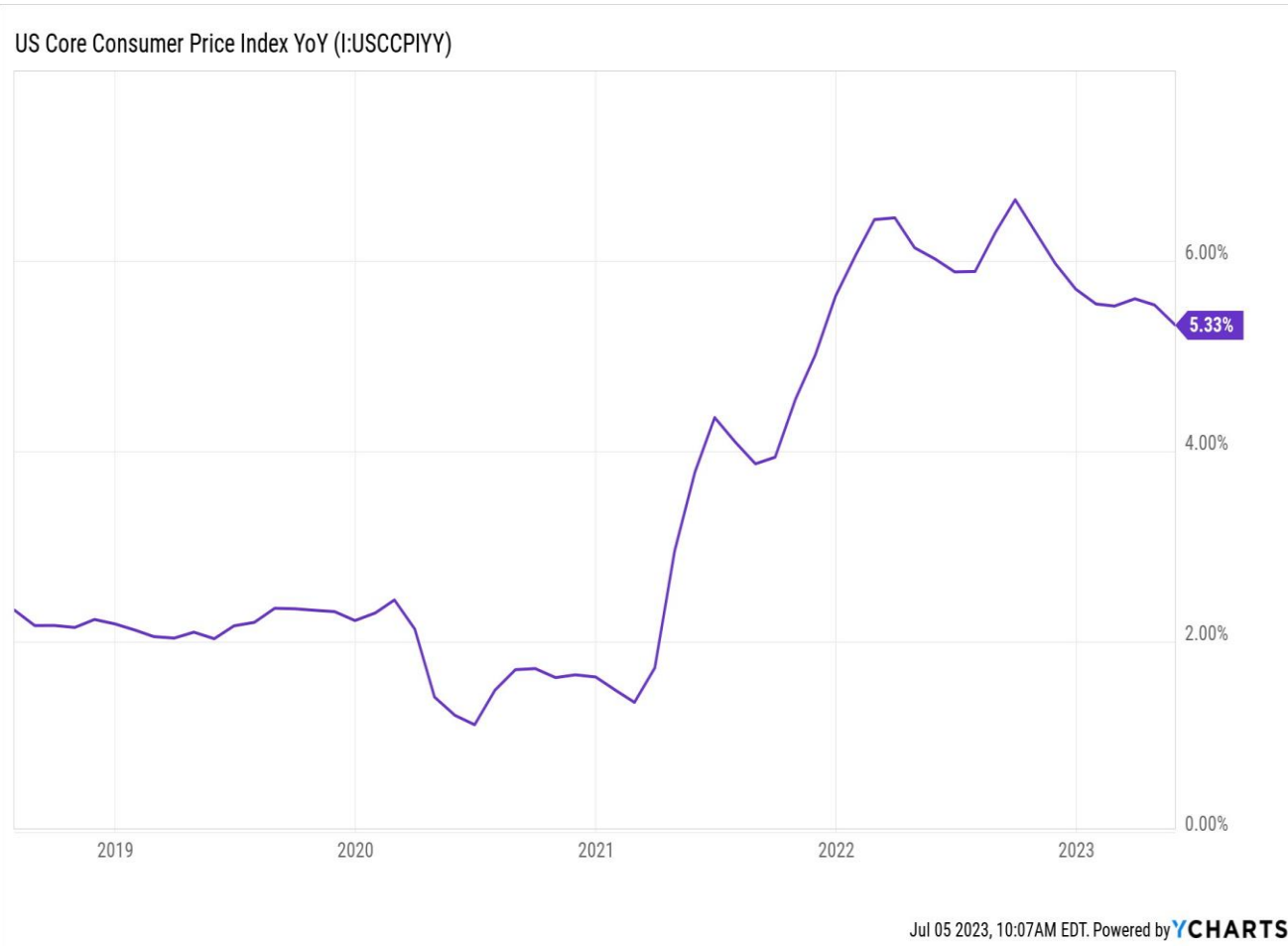
Sentiment



Sentiment (Cont.)

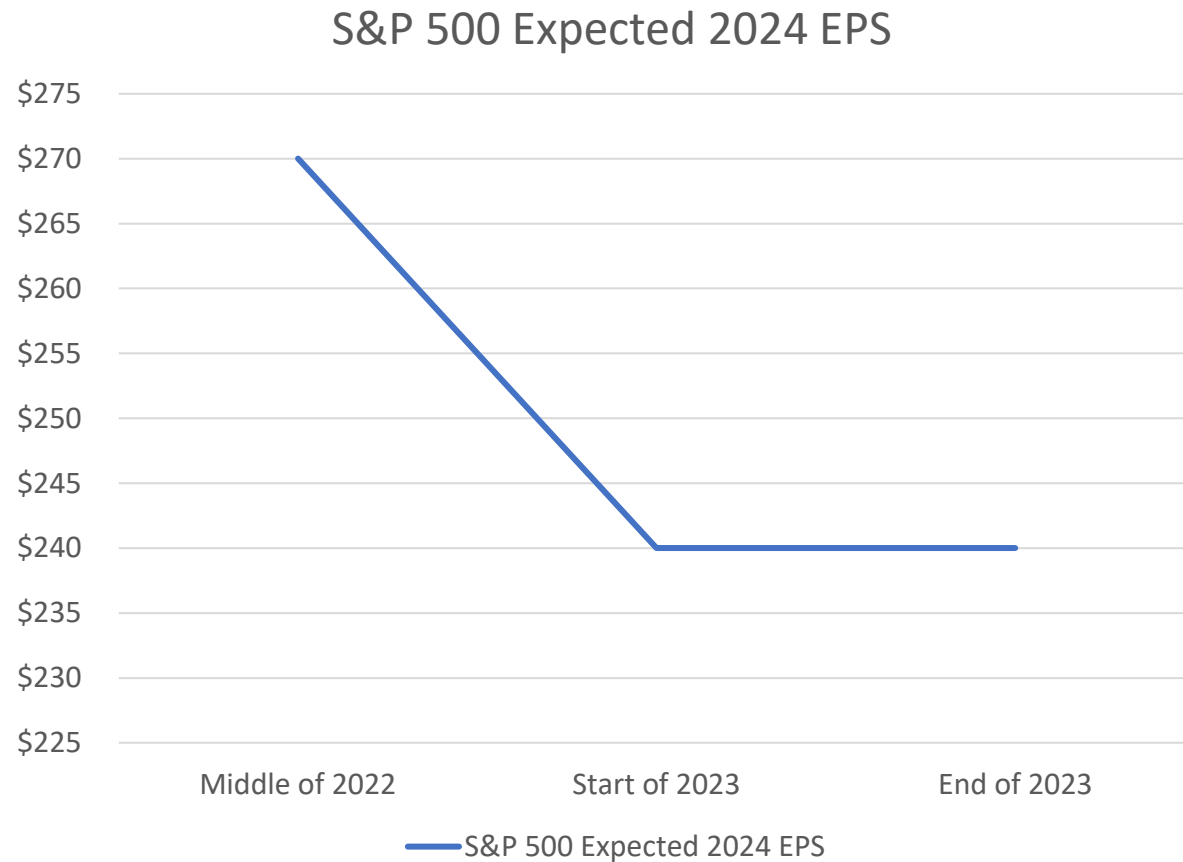
- Current Status: Sentiment has turned decidedly positive.
 - AAll: Bulls/Bears Most positive since November of '21.
 - CNN Fear/Greed: Extreme Greed.
 - Investors Intelligence Advisor Sentiment Bull-Bear Spread: 36.6%, highest since November of '21.
 - Merrill Lynch/Bank of America Fund Manage Survey: 5.1% average cash allocation, still historically high but down from 5.6% in May.
- Negative sentiment was a powerful tailwind on stocks in 1H '23, as investors started the year extremely pessimistic, as such better than feared economic data and earnings along with AI mania caused a “chasing” effect that pushed stocks higher.
- Looking forward, however, we start 2H '23 with the opposite: Sentiment is positive, leaving the investors and market vulnerable to disappointing data.

Inflation



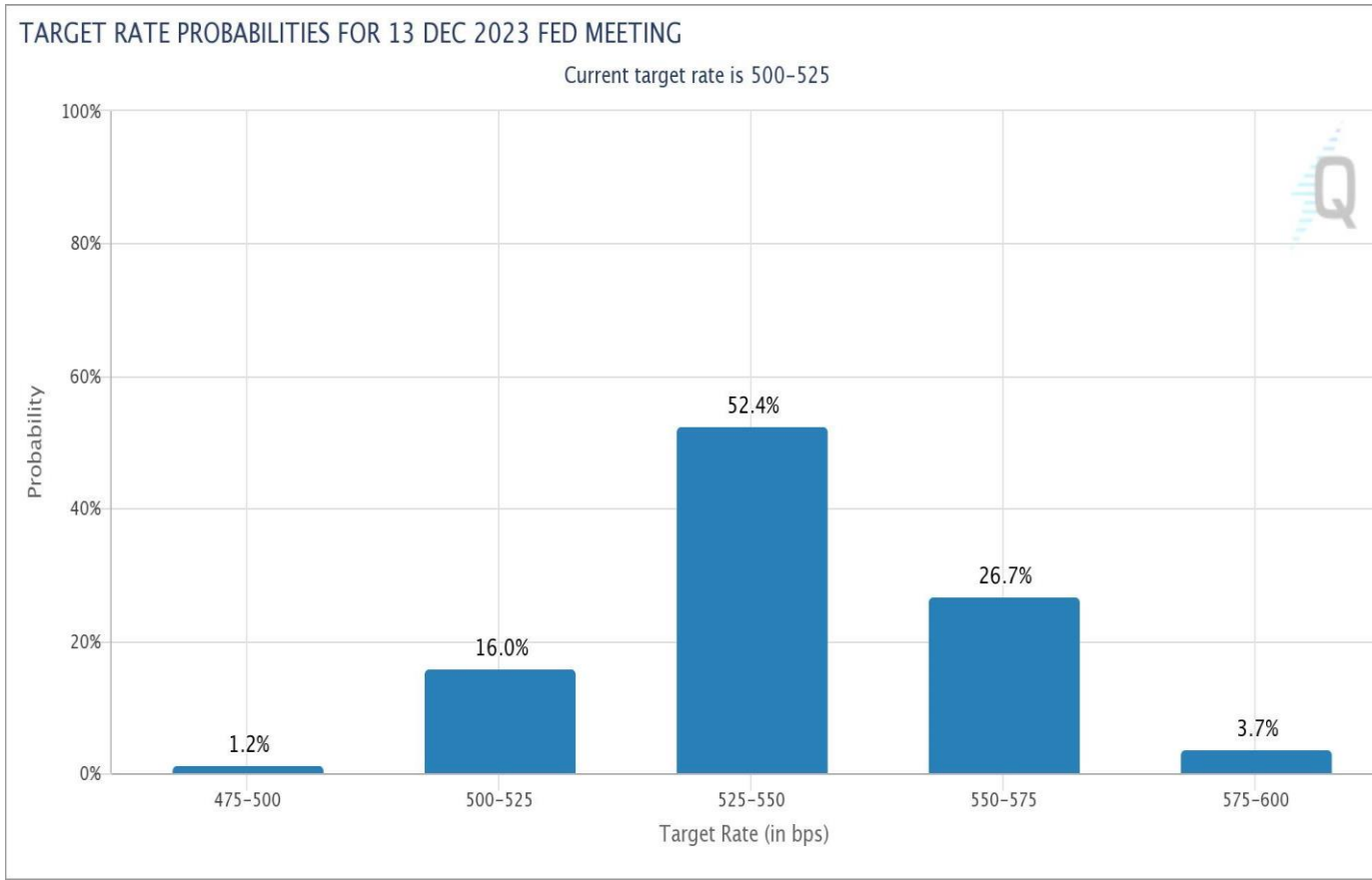
- **Current Status:** Disinflation occurred in the first half of 2023, as headline and core inflation both dropped from previous highs.
- But, the decline in inflation (disinflation) slowed, and core inflation must decline further if the Fed is going to end its rate hike campaign.
- **Key Index:** Core CPI
 - “Good” level: < 4.0%
 - “Ok” level: < 4.5%
 - “Bad” level: > 5.0%
 - Timeline: 2nd half of 2023.

Corporate Earnings



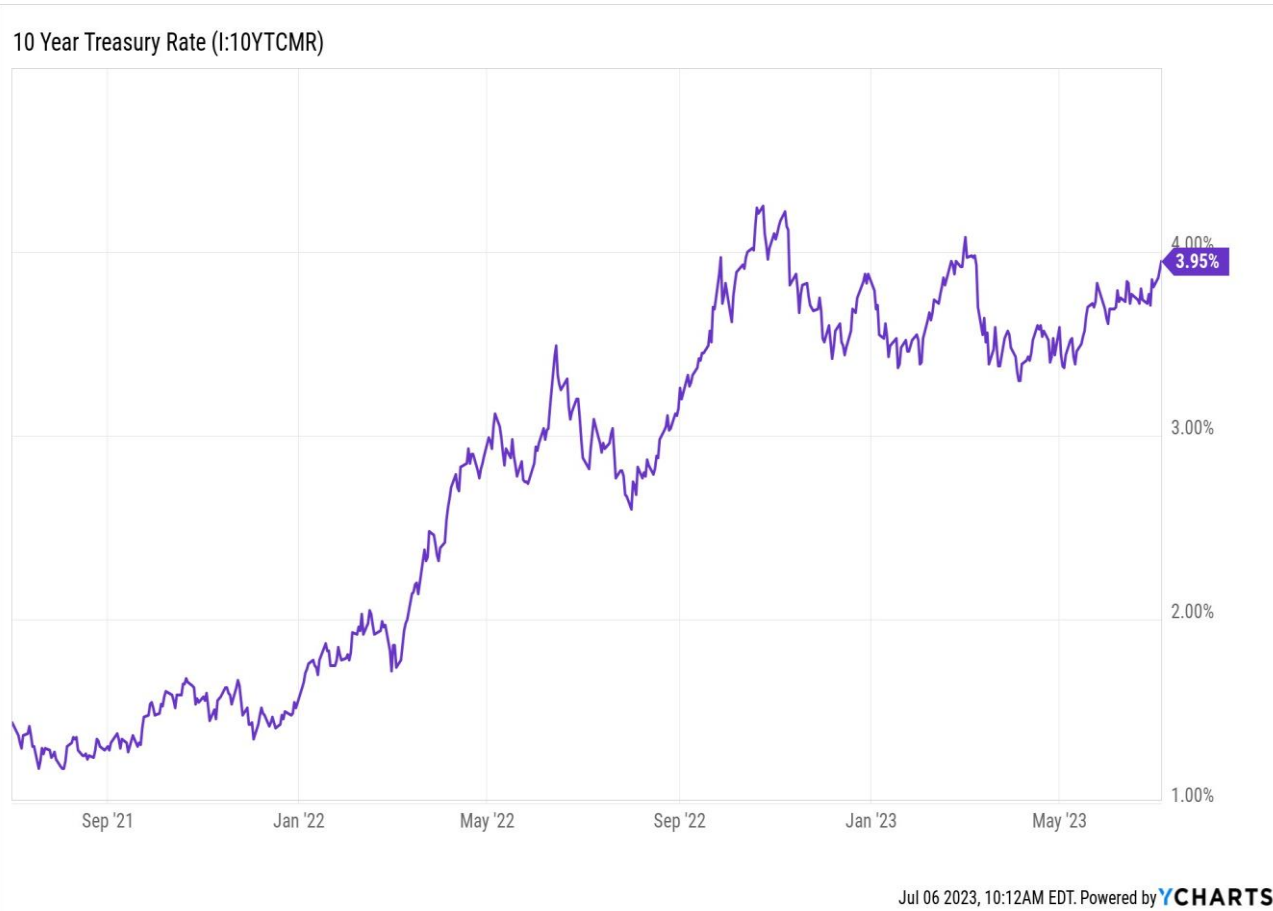
- Current Status: Earnings were an important and positive tailwind for stocks in 1H 2023, as '23 and '24 expected EPS weren't revised meaningfully lower.
- However, disinflation and a slowing of growth are real risks to corporate earnings, and expectations are not as negative as they were at the start of the year.
- Key Indicator: Consensus 2024 S&P 500 EPS
 - Current Expectation: \$240/share
 - "Good" level: > \$240/share
 - "OK" level: = \$240/share
 - "Bad" level < \$240/share
- Timeframe: 2nd half of 2023.

Terminal Fed Funds



- Current Status: Expected terminal Fed Funds surged in 1H '23 from 4.625% to 5.375%.
- Stocks withstood a more hawkish than expected Fed in 1H '23 in part because the market still thinks the Fed is near the end of rate hikes, and that a cut will come soon after the terminal rate is reached.
- Key Indicator: Fed Funds Rate
 - “Good” level: $\leq 5.375\%$
 - “Ok” level: $< 5.625\%$
 - “Bad” level: $> 5.625\%$
 - Timeframe: By December.

Treasury Yields



- Current status: Yields have surged to fresh multi-year highs on rising rate hike expectations.
- Stocks withstood a surge in yields in 1H '23 thanks, in part, to better-than-feared data. But, for that to continue, economic data in 2H '23 will need to be good, not just better than feared.
- Key Indicator: 2-year Treasury Yield
 - “Good” level: 3.75% - 4.25%
 - “Ok” level: < 4.50%
 - “Bad” levels: > 5.00% or < 3.50%
 - Timeframe: 2nd half of 2023.

The “Good” Scenario

- U-3 Unemployment: $> 4.3\%$
- Soft Landing
- Neutral Sentiment
- Core CPI: $< 4.0\%$
- 2024 Consensus S&P 500 EPS $\geq \$240$
- Fed Funds: $\leq 5.375\%$
- Two-year Treasury yield: $3.75\% - 4.25\%$
- S&P 500 Target: 4,680-4,800.
 - How I get there: A 19.5X to 20X multiple times \$240 EPS.
 - Return from current level: 4.6%
- Strategies that should outperform:
 - Small Cap Stocks (IJR/RWL/CALF). 11/29/22.
 - What Would Outperform If Markets Turn Around (XITK/VCR/USHY/SRLN). 2/23/22.
 - Three Contrarian Ideas to Start 2023 (ARKW/VOX/EMB). 1/10/23.

The “OK” Scenario

- U-3 Unemployment: 4.0% - 4.3%
- Soft Landing
- Neutral Sentiment
- Core CPI: < 4.5%
- 2024 Consensus S&P 500 EPS = \$240
- Fed Funds: $\leq 5.625\%$
- Two-year Treasury yield: < 4.50%
- S&P 500 Target: 4,320
 - How I get there: 18X multiple times \$240 earnings.
 - Return from current level: - 2.0%.
- Strategies that should outperform:
 - MOAT Stocks (MOAT/MOTE/SMOT). 11/2/22.
 - Defined Outcome and Buffered ETFs. 3/21/22.
 - Sectors That Outperformed During Recent Recessions (VHT/IHF/VDC/PBJ). 7/12/22.

The “Bad” Scenario

- U-3 Unemployment: < 4.0%
- Hard Landing
- Bullish Sentiment
- Core CPI: > 5.0%
- 2024 Consensus S&P 500 EPS < \$240
- Fed Funds: > 5.625%
- Two-year Treasury yield: > 5.00% or < 3.50%
- S&P 500 Target: 3,825
 - How I get there: 17X multiple times \$225 EPS.
 - Return from current level: -13%.
- Strategies that should outperform:
 - Protection in a Deeper Bear Market. (SH/PSQ/PTLC/SGOV). 10/4/22.
 - Utilizing High Returns on Cash (SGOV/BIL/CLTL/BILS/PULS). 5/31/23.