SEVENS REPORT

Sevens Report Alpha Webinar – Are We Looking for the Slowdown Too Soon?

July 20th, 2023

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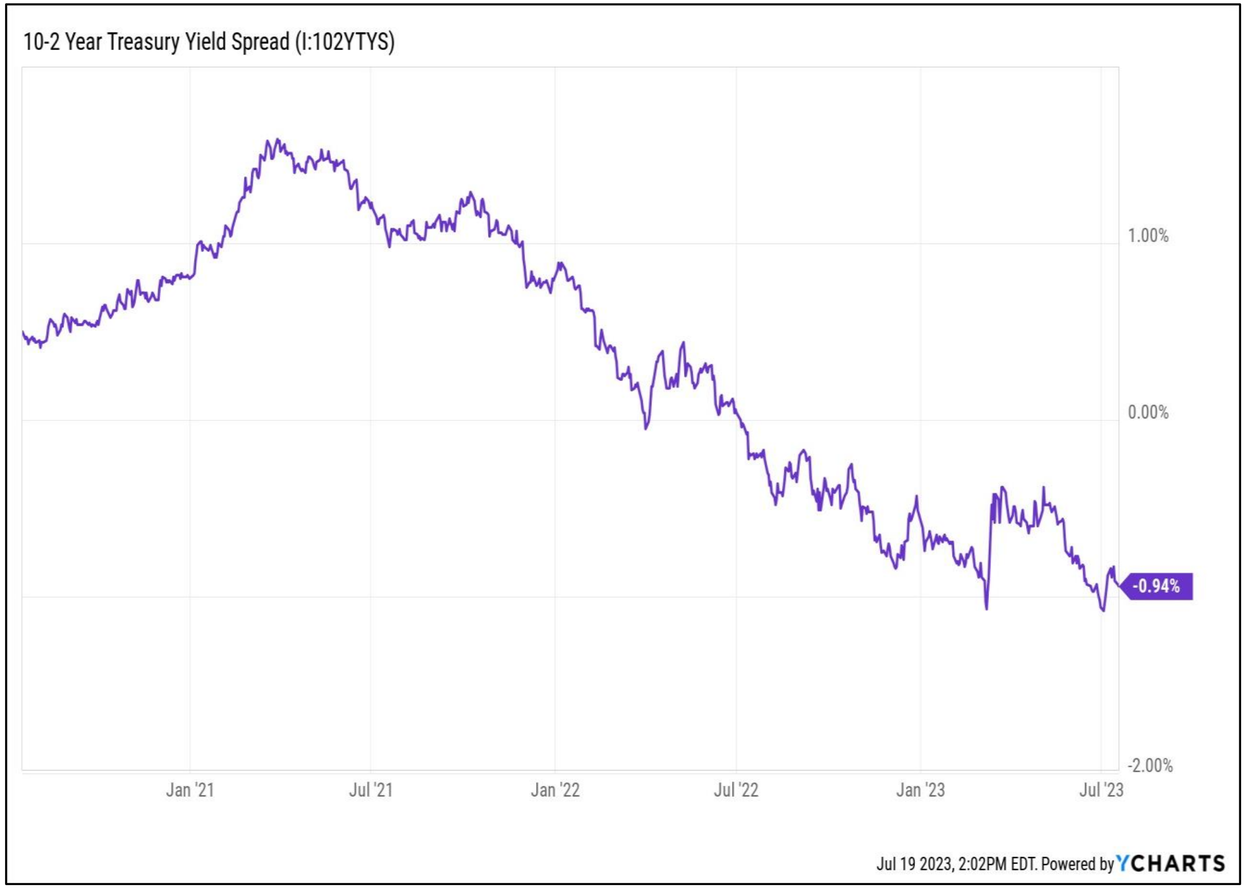
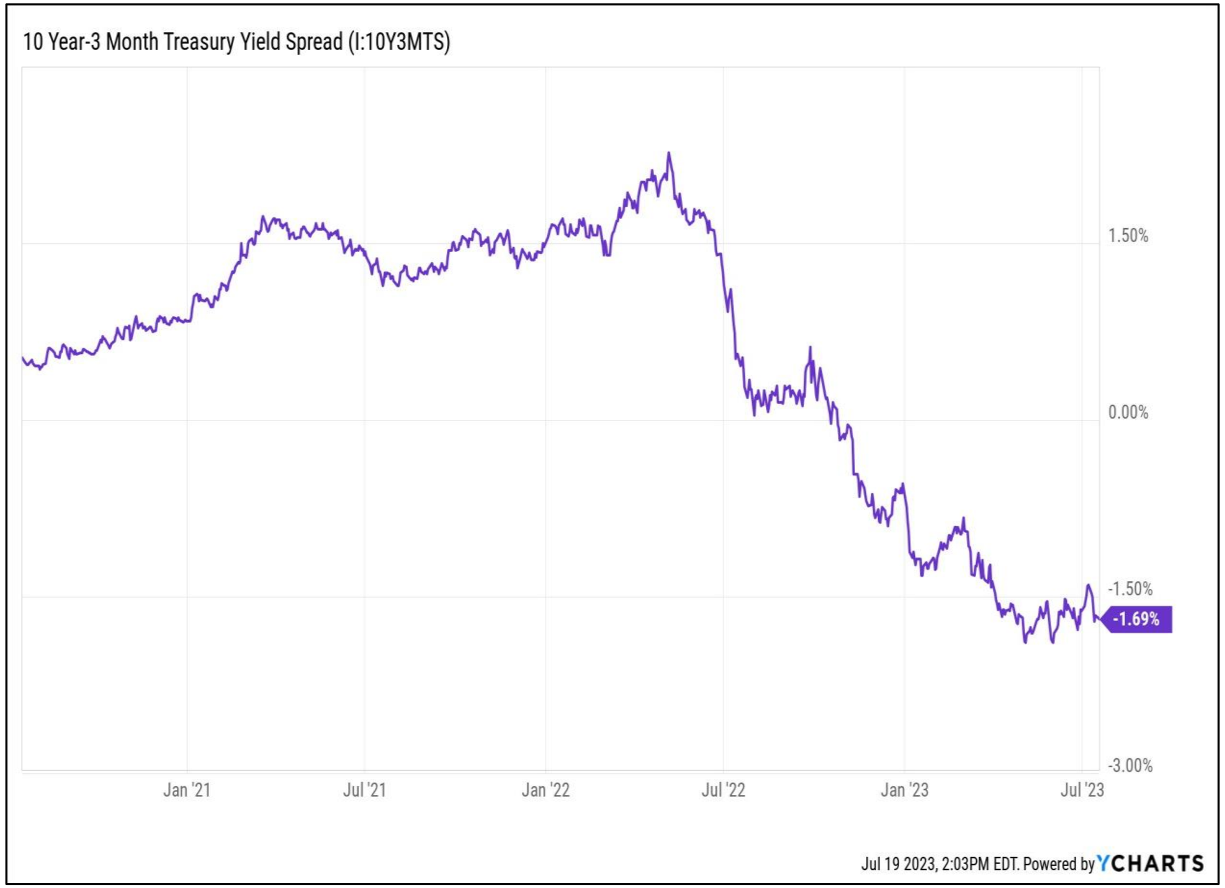
Rising Rates & Yield Curve Inversions Haven’t Resulted in a Recession Yet





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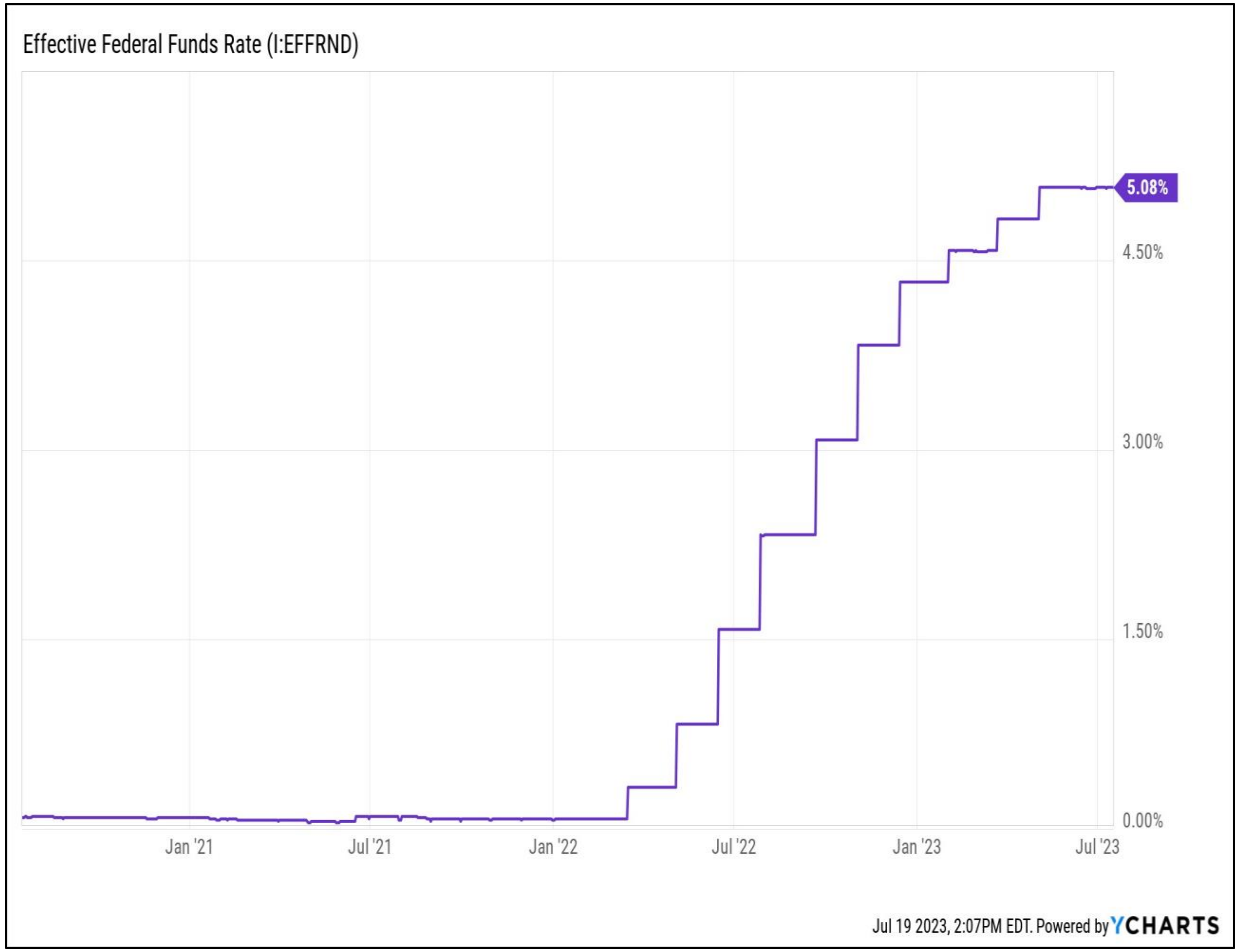

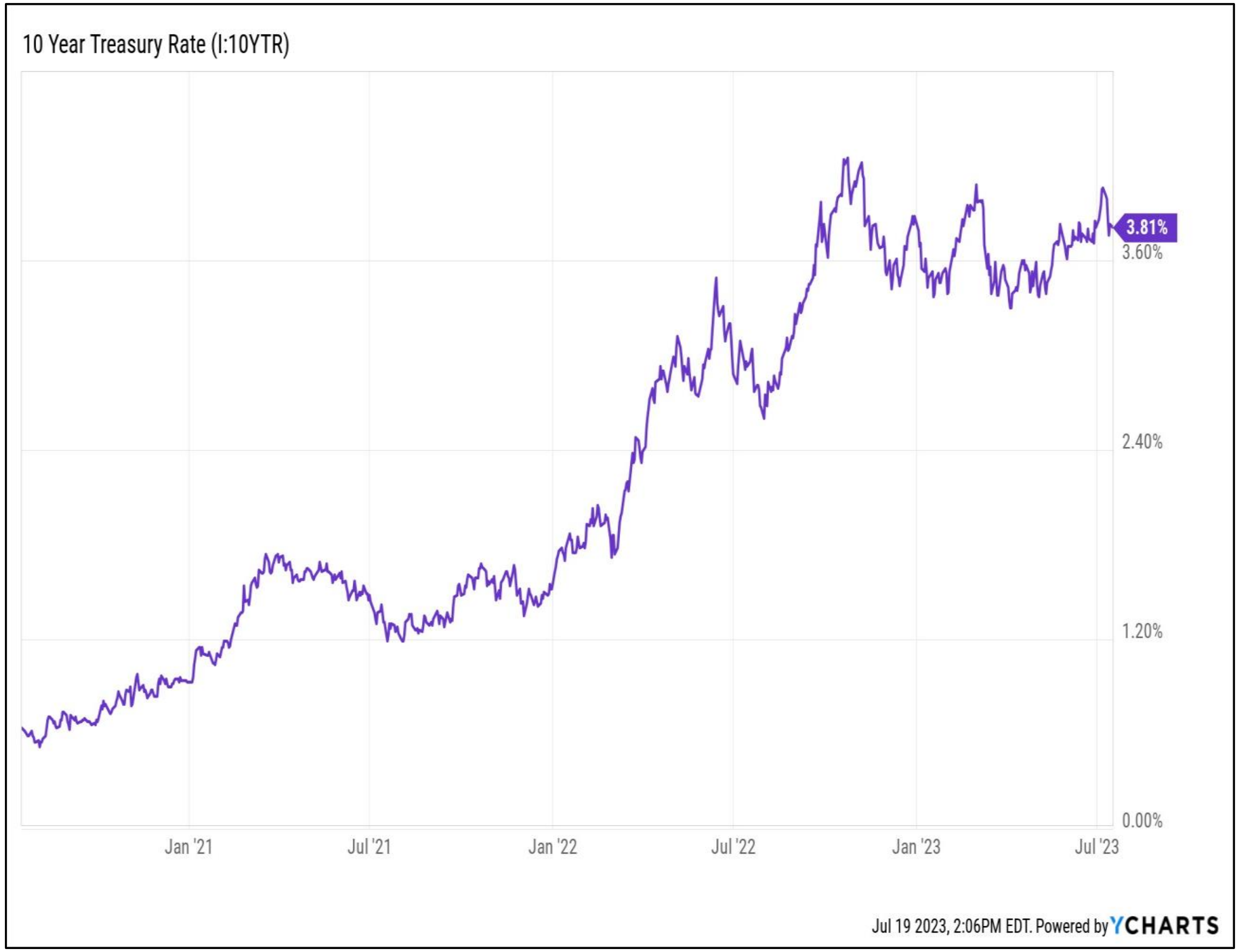

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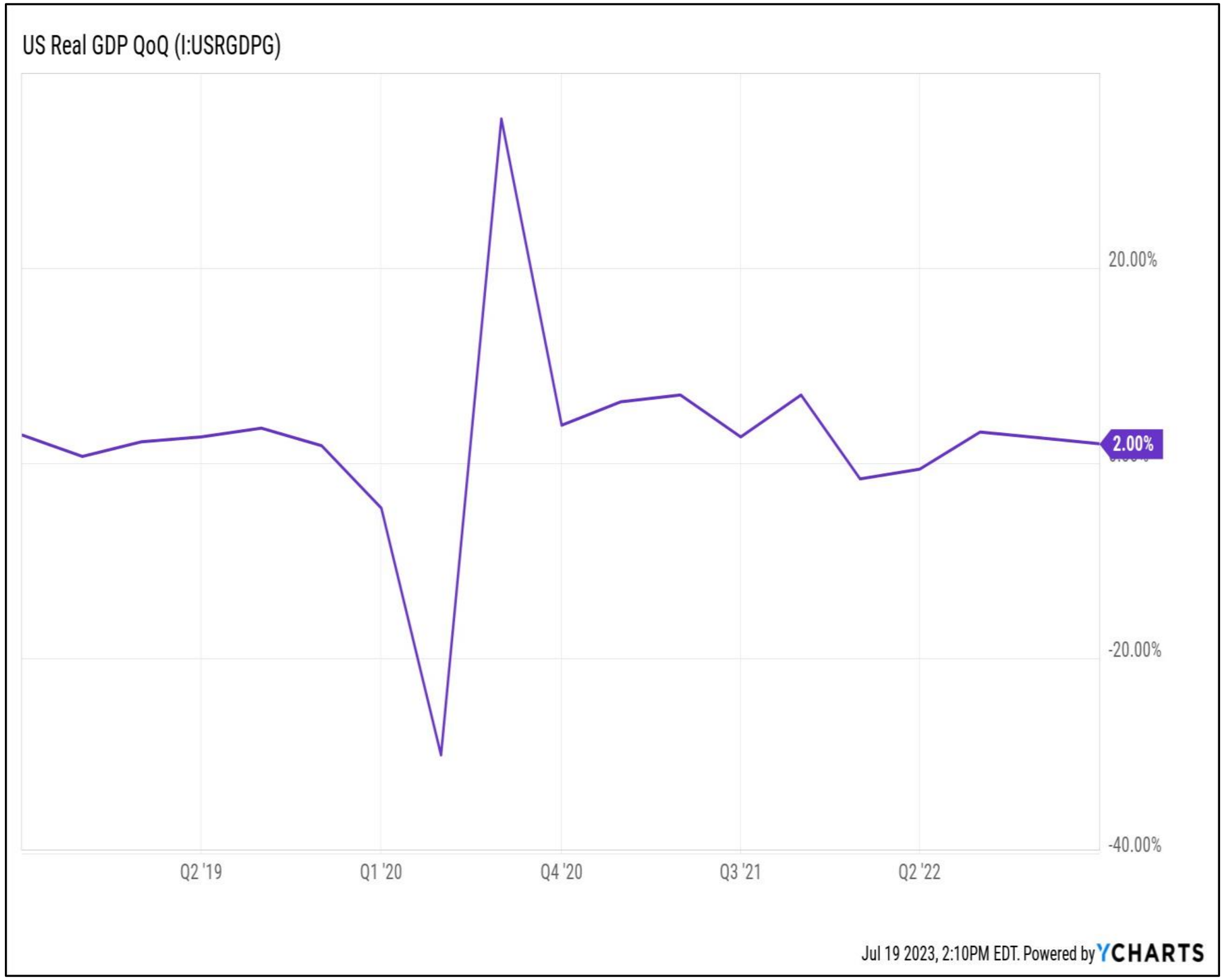
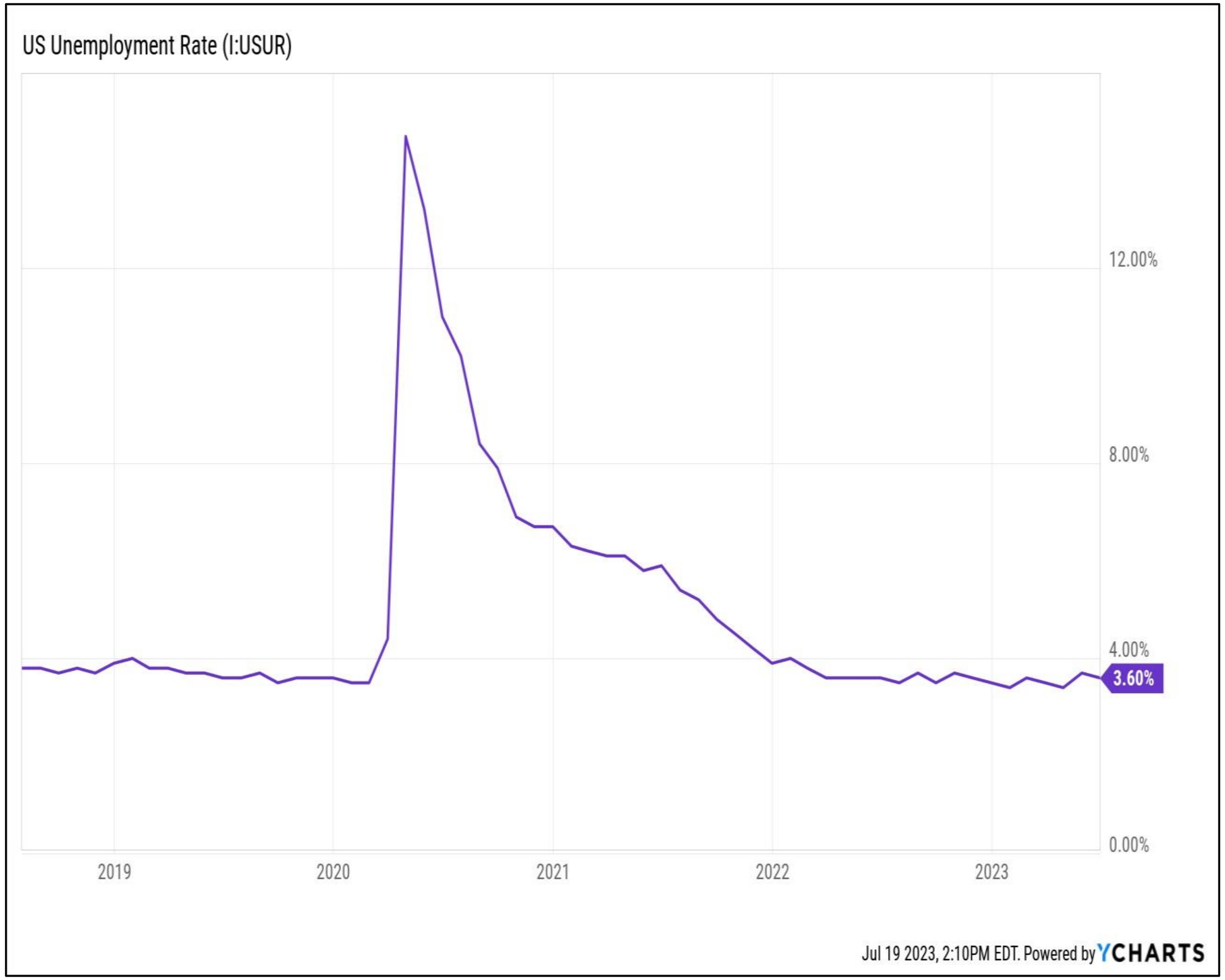




But, Does This Mean the Recession Isn’t Coming?

Yield Curve Inversions and the Peak in Stocks

10-2 Year Treasury Yield Spread

Date of Inversion	Date of Peak in stocks	Days from Inversion to Peak in Stocks
8/18/1978	2/8/1980	539
9/12/1980	11/28/1980	77
12/27/1988	7/13/1990	563
5/26/1998	7/17/1998	52
2/3/2000	3/24/2000	50
12/27/2005	7/20/2007	570
8/27/2019	9/13/2019	17
7/6/2022	*Today*	*379*
Average Days		**280.75**

10 Year-3 Month Treasury Yield Spread

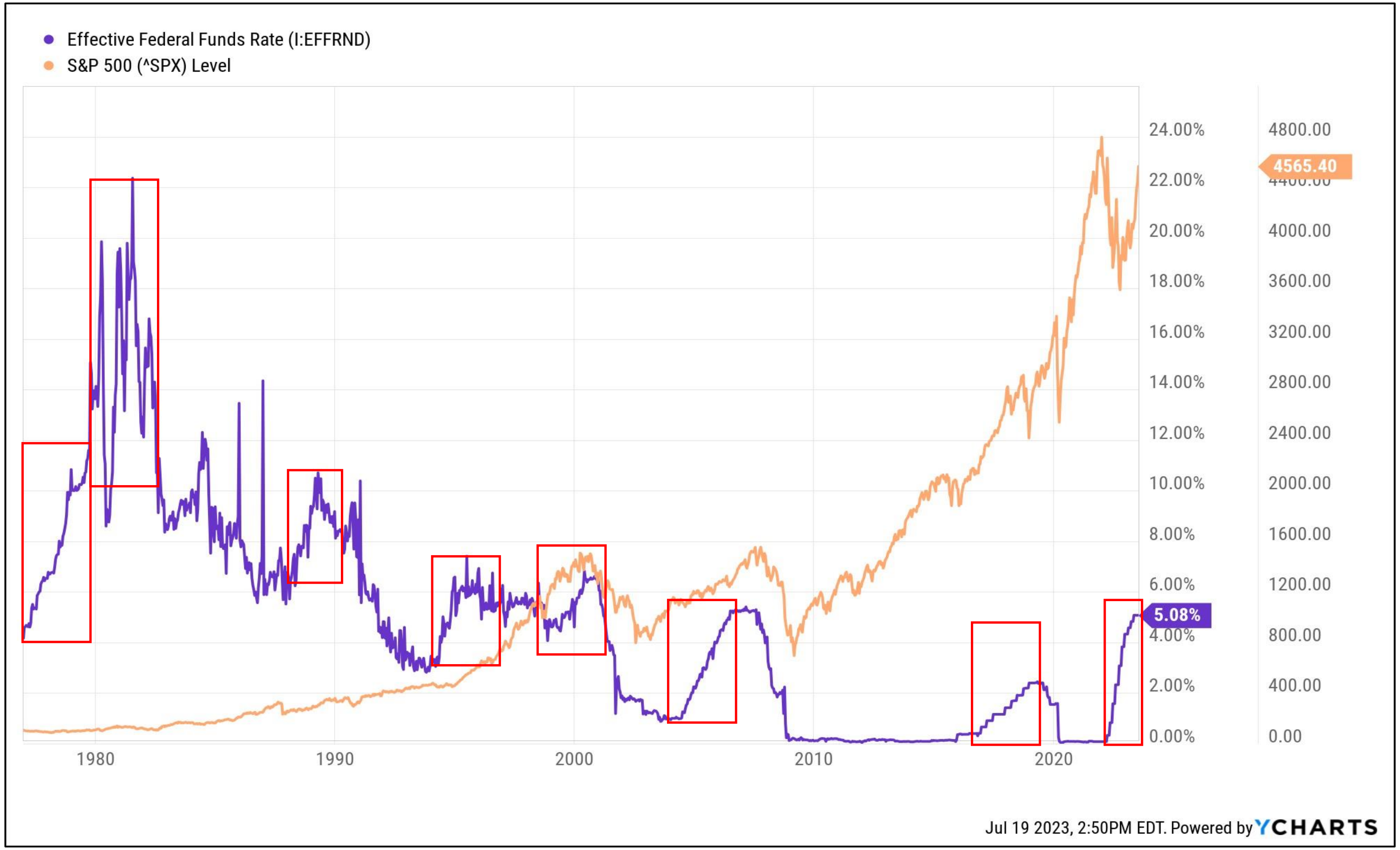
Date of Inversion	Date of Peak in stocks	Days from Inversion to Peak in Stocks
10/27/1978	2/13/1980	474
9/12/1980	11/28/1980	77
2/1/1982	11/1/1982	273
5/22/1989	6/4/1990	378
9/10/1998	9/23/1998	13
7/7/2000	9/1/2000	56
7/17/2006	7/20/2007	368
3/22/2019	7/26/2019	126
10/25/2022	*Today*	*268*
Average Days		**225.78**

Takeaways

- In both inversions, there seems to be two scenarios:
  - A quick inversion after the peak (we're obviously long past that).
    - The peak in stocks comes, on average, 49 days after a 10's-2's inversion.
    - The peak in stocks comes, on average, 49 days after a 10's- 3-month inversion.
  - A long-delayed peak.
    - That peak in stocks comes, on average, 557 days after a 10's-2's inversion.
    - That peak in stocks comes, on average, 324 days after a 10's- 3-month inversion.
    - Given the 379 days that have already passed since the 10's-2's inversion, that would put the peak in stocks sometime in late 2023/early 2024.
    - Given the 268 days that have already passed since the 10's – 3-month inversion, that would put the peak in stocks sometime around the 4th quarter of 2023.
  - Bottom line: If the yield curve inversion signals are to be believed, then the risk of a peak in stocks should peak in Q4 2023 and/or early 2024.

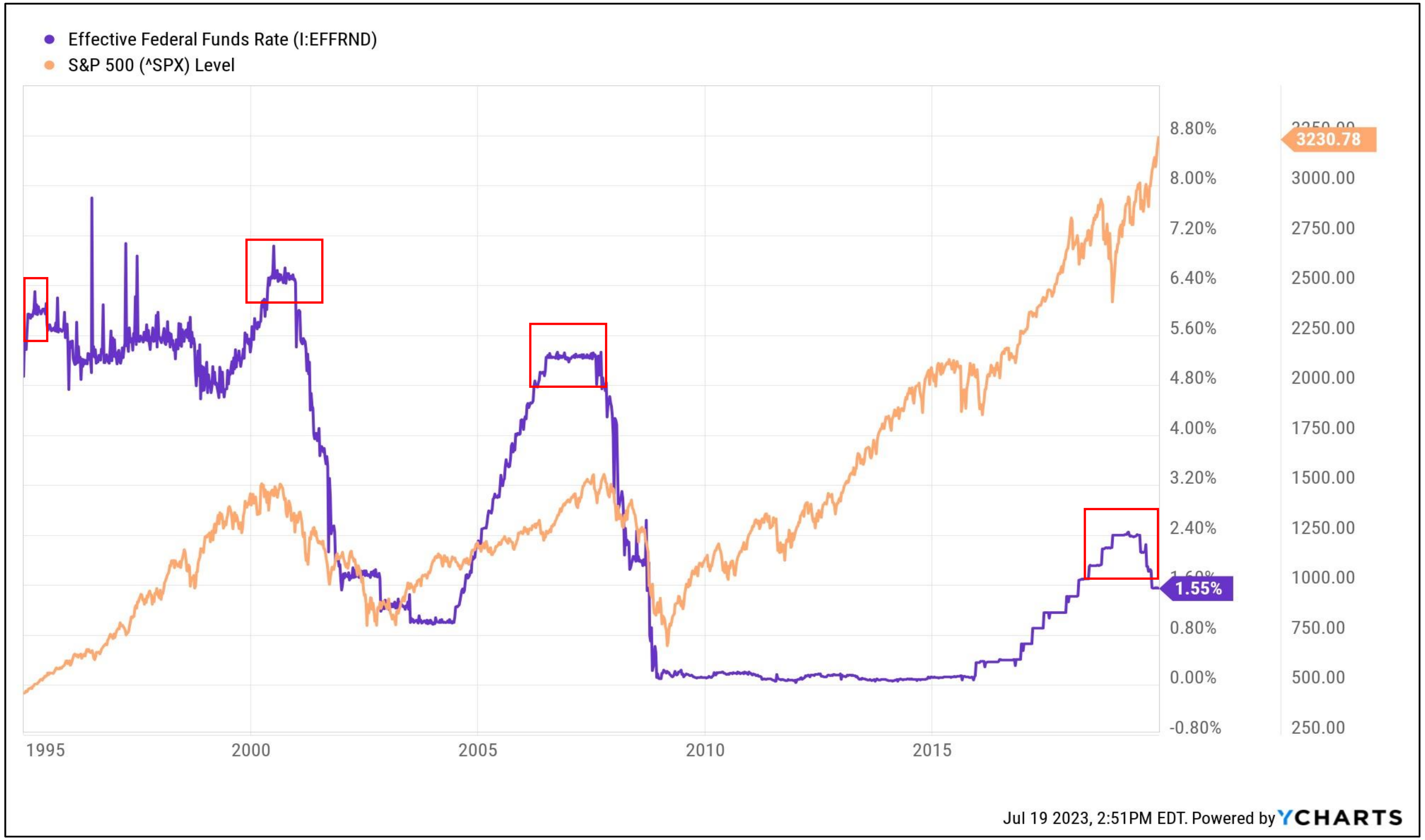
Rate Hike Cycles and Stock Returns

First Hike	Last Hike	S&P 500 Return
8/16/1977	3/18/1980	6.52%
8/7/1980	5/18/1981	7.49%
5/24/1983	8/21/1984	1.38%
12/16/1986	11/4/1987	-0.43%
2/4/1994	2/1/1995	0.13%
6/30/1999	5/16/2000	6.80%
6/30/2004	6/29/2006	11.57%
12/17/2015	12/20/2018	20.84%
3/17/2022	*Today*	*2.33%*
Average Return		**6.29%**



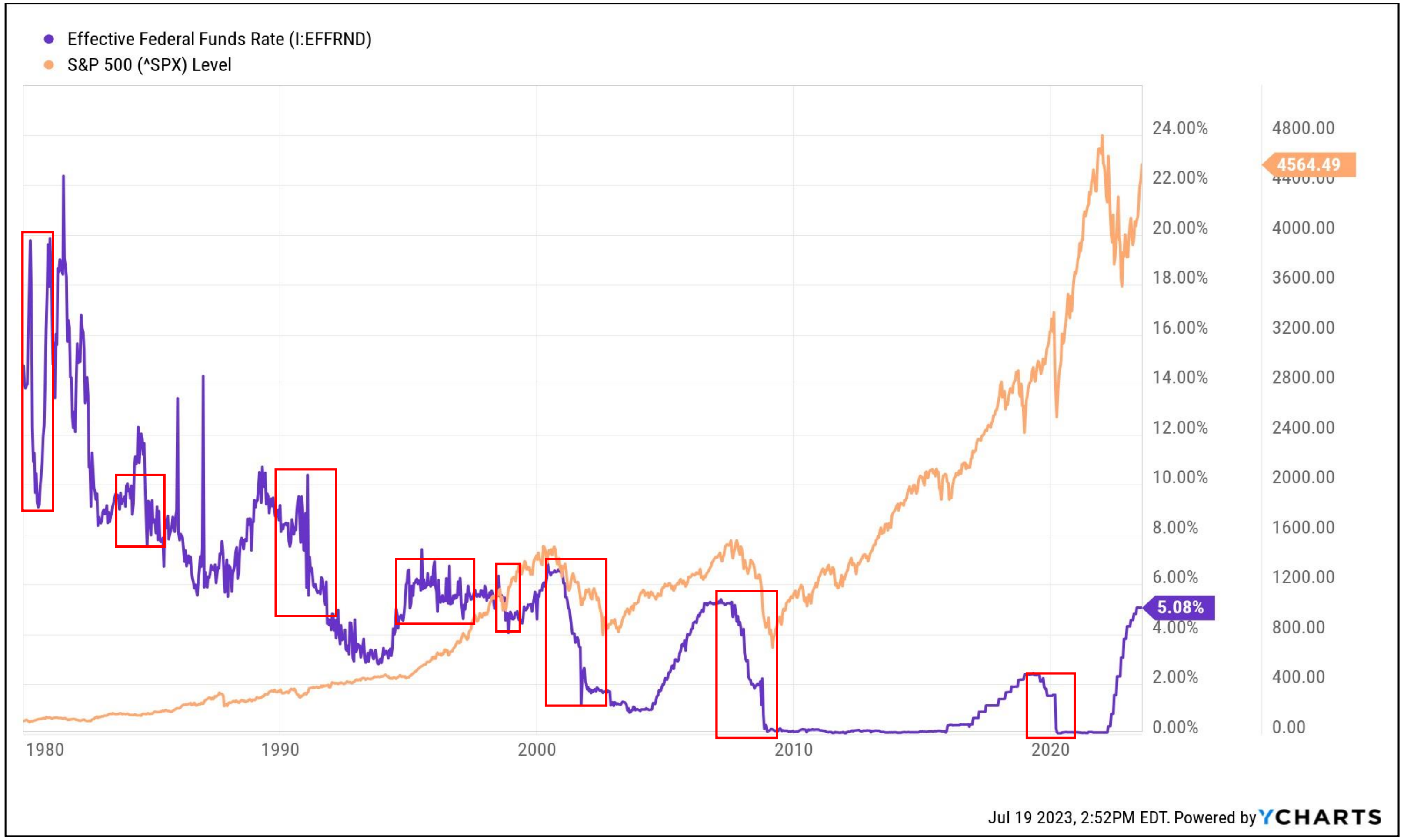
Rate Hike Pauses and Stock Returns (Hike to Pause)

Fed Pause Start	Fed Pause End	S&P 500 Return
2/1/1995	5/23/1995	12.37%
5/16/2000	12/19/2000	-10.94%
6/29/2006	8/7/2007	16.01%
12/20/2018	6/20/2019	19.73%
Average Return		**9.29%**



Performance During Rate Cut Cycles

First Cut	Last Cut	S&P 500 Return
5/15/1980	6/5/1980	5.41%
11/17/1981	12/21/1982	14.41%
10/2/1984	5/20/1985	15.97%
7/13/1990	9/4/1992	13.55%
7/6/1995	1/31/1996	14.81%
9/29/1998	11/17/1998	8.61%
1/3/2001	6/25/2003	-27.62%
9/18/2007	12/16/2008	-39.91%
8/1/2019	3/16/2020	-19.21%
Average Return		**-1.55%**



What Does This Mean for the Current Rally and Market Outlook?

- Takeaway #1: For the yield curve, it's not different this time (at least not yet).
  - A stock market peak following a yield curve inversion is not late. So, the fact that it has not happened yet does not mean it's different this time and this indicator can't be dismissed at this point.
- Takeaway #2: It's not surprising that stocks have rallied during the rate hike cycle.
  - Stocks historically rally during rate hike cycles, and that's turning out to be true yet again. And, that makes sense because the Fed is hiking rates because inflation and growth (both positive for stocks and earnings) are too high.
  - Point being, don't take the resilience in stocks during the rate hike cycle as a signal it's different this time – it's exactly as it should be.
- Takeaway #3: The near term for stocks, from a rate and curve standpoint, looks good.
  - Rate hike pauses are also likely positive for stocks, so this is a potential future positive given the Fed is likely to pause after next week's rate hike.
- Takeaway #4: It's rate cuts that we need to worry about.
  - The last three rate cut cycles have been very negative for stocks. And, that makes sense because the Fed is cutting rates because growth and inflation (both negative for stocks and earnings) are falling too quickly.
- Bottom line, broadly, this analysis implies the near-term outlook for stocks remains positive.
  - **But, it also clearly shows that, according to history, a recession and possible new bear market are not late, nor is it different this time (at least not yet).**

What Does This Mean for the Current Rally and Market Outlook?

- What does this mean tactically?
  - Near term (next 3 months) the outlook is positive (according to macro factors).
  - So, hold longs, especially in cyclical stocks (our upcoming Alpha issue is about getting more targeted cyclical exposure).
  - Alpha strategies to consider (three to six-month time horizon)
    - Small Cap Stocks (11/29/2022)
    - Upcoming Cyclical Alpha Issue (This Tuesday)
- However, starting in the fourth quarter, according to the yield curve and rate history, the risk of a slowdown or peak in stocks does rise.
  - So, rotating to more defensive sectors into the end of the year (or at least reducing downside risk) does have merit, again according to the yield curve and history of market reactions to the Fed.
  - Fed Fund futures have the first rate cut coming in March of 2024.
  - Alpha strategies to consider:
    - Defined Outcome and Buffered ETFs (3/21/23)
    - MOAT Stocks (11/1/22)
    - Sectors that Outperformed During Recent Recessions (7/12/22)