

Sevens Report Alpha Webinar – Updated Market Outlook October 26th, 2023

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Short Term Influences

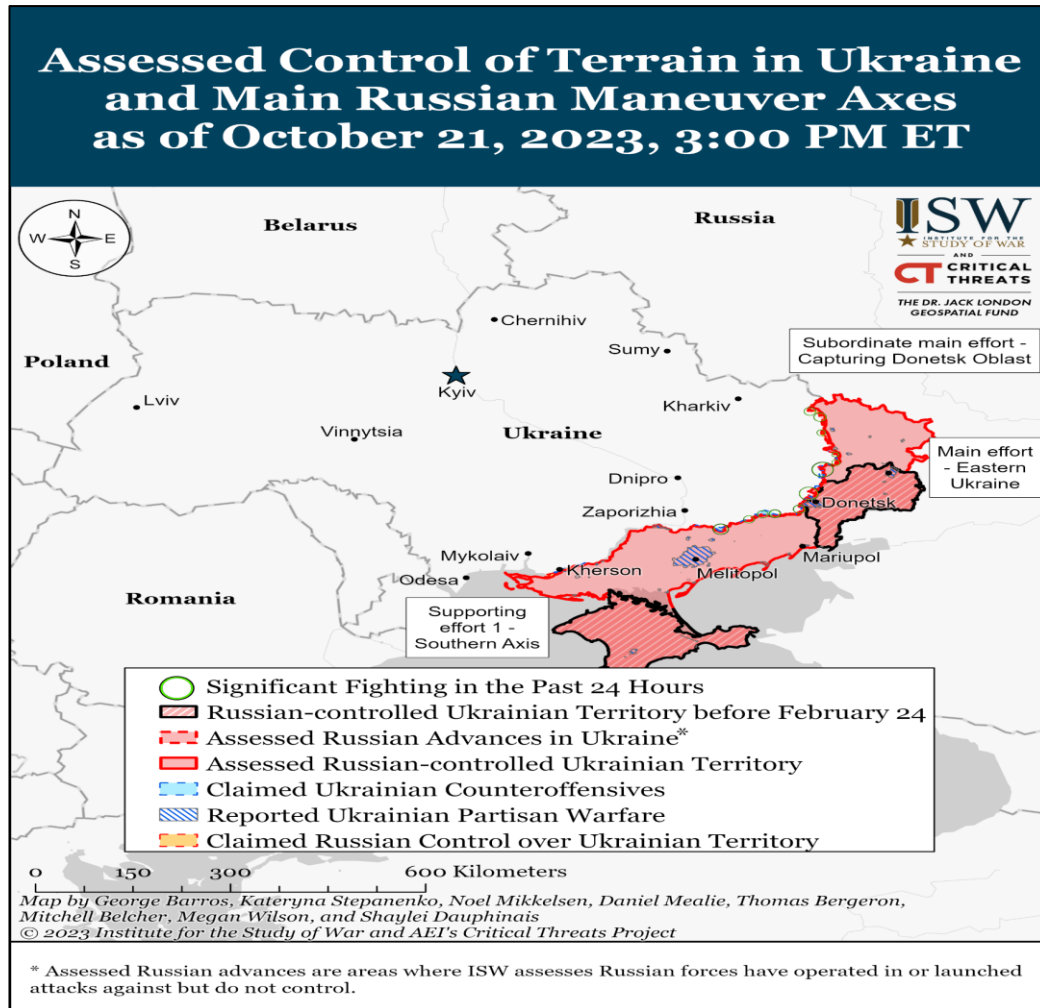
- Geo-Politics
- Rising Treasury Yields
- Government Dysfunction

Geo-Politics: Middle East Conflict



- A ground invasion of Gaza by Israel remains imminent.
- If the conflict remains contained to Israel and Hamas in Gaza, then this will not be a sustainable negative on markets.
- However, if the conflict expands to include Lebanese Hezbollah, Iran, and the U.S., this will become a substantial headwind on markets, primarily via surging oil prices.

Geo-Politics: Ukraine & Russia Conflict



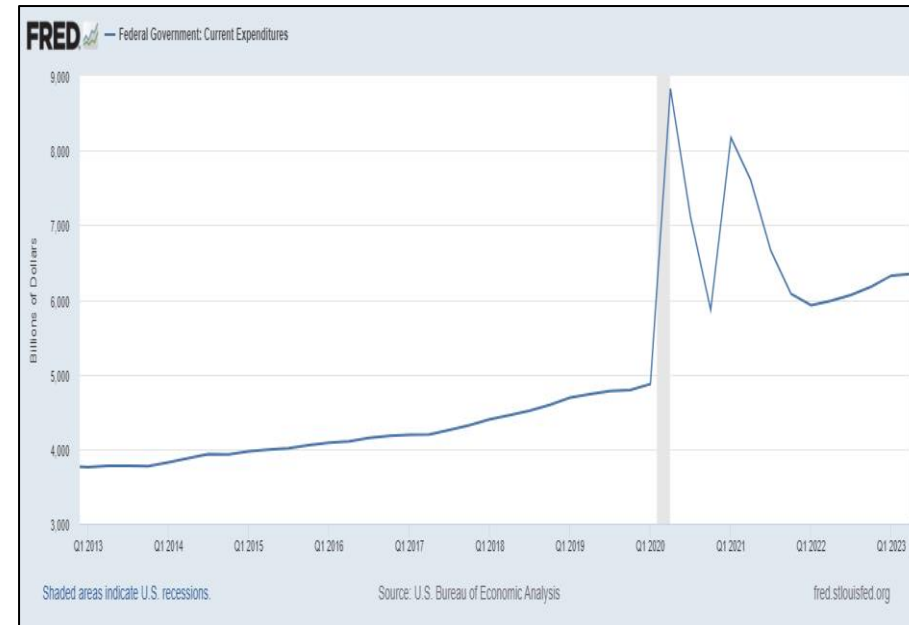
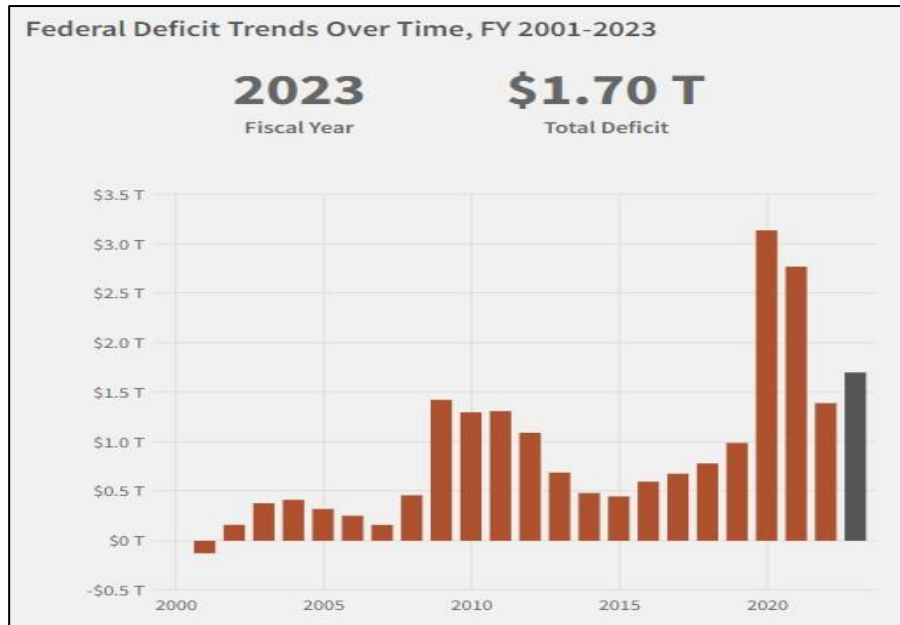
- The Russia/Ukraine war has largely stalemated.
- As long as this conflict remains broadly stalemated, it should not impact the broader markets.
- However, there is a constant threat of direct Russia/NATO conflict (either on purpose or mistake) and that would be a new headwind on markets (again via higher commodity prices (primarily oil, natural gas, and wheat)).
- Notably, there remains the chance of a cessation of fighting (think Korean War) and that would be a positive (but not a bullish game-changer).

Government Dysfunction

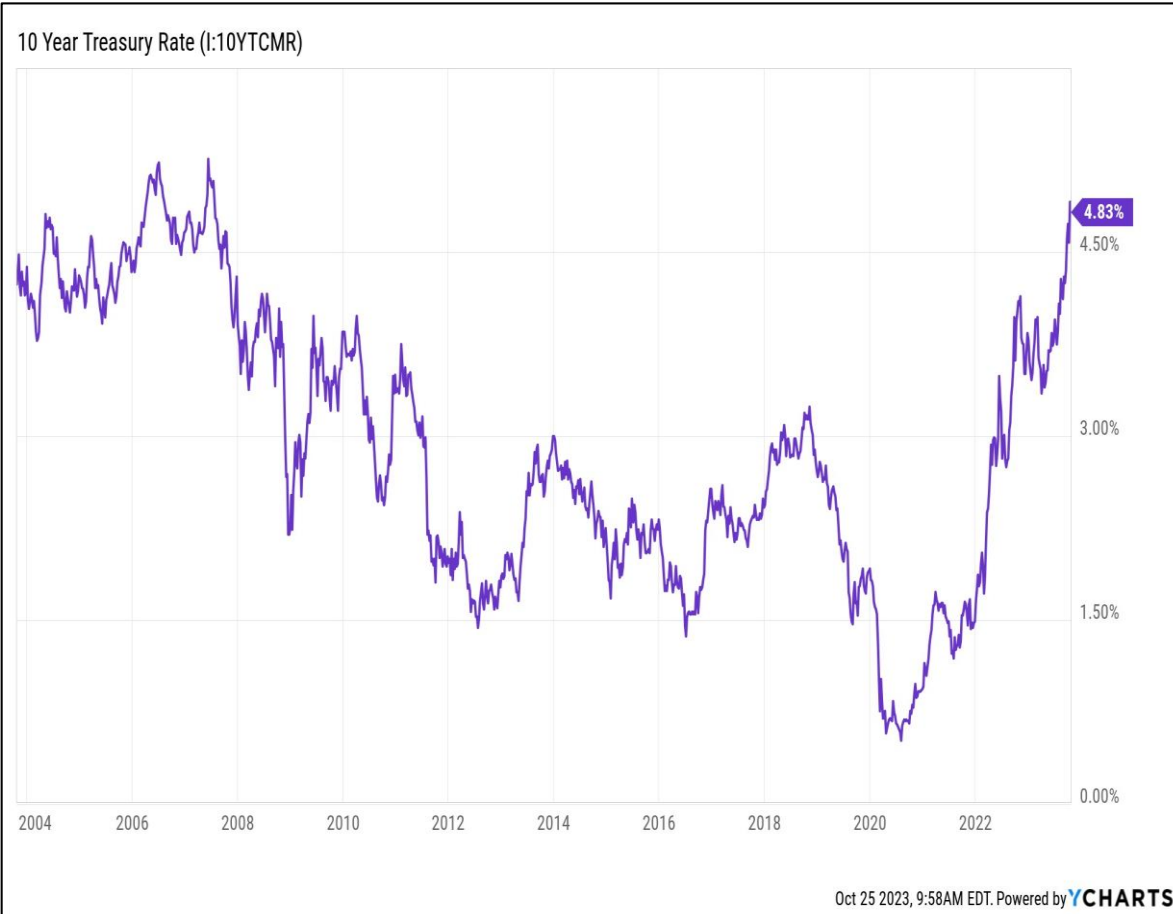
For the first time in two decades, bond markets are reacting to the deteriorating fiscal situation in the U.S.

Any signs of progress on restraining new spending from Congress of the administration will be a positive for markets as it would ease upward pressure on Treasury yields.

Conversely, another government shutdown drama in mid-November would likely push yields higher and further weigh on stocks.



Rising Yields



Longer Term Influences

- Economic Growth
- Inflation
- Fed Policy

Economic Growth: Hard Landing vs. Soft Landing Scoreboard

Hard Landing vs. Soft Landing Scoreboard				
	Current	One Month Ago	Three Months Ago	Hard Landing/ Soft Landing
ISM Manufacturing PMI	49.0	47.6	46.0	Hard Landing
ISM Services PMI	53.6	54.5	53.9	Soft Landing
Job Adds (Non-Farm Payrolls)	336k	227k	105k	Soft Landing
Retail Sales	\$613.02B	\$608.87B	\$600.74B	Soft Landing
NDCGXA	\$73.92B	\$73.25B	\$73.87B	Soft Landing
Jobless Claims 4WK MA	206K	224K	247K	Soft Landing

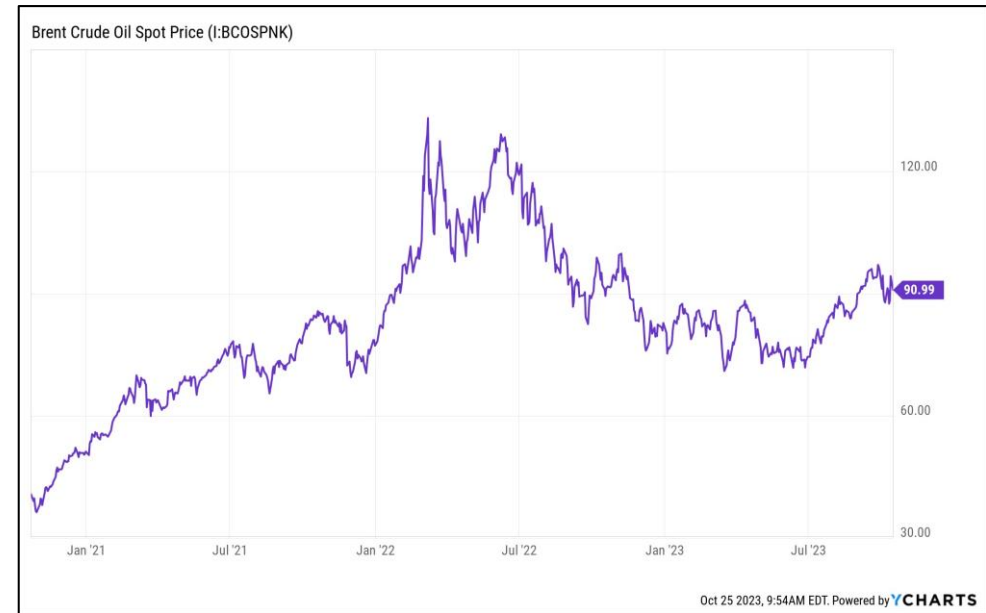
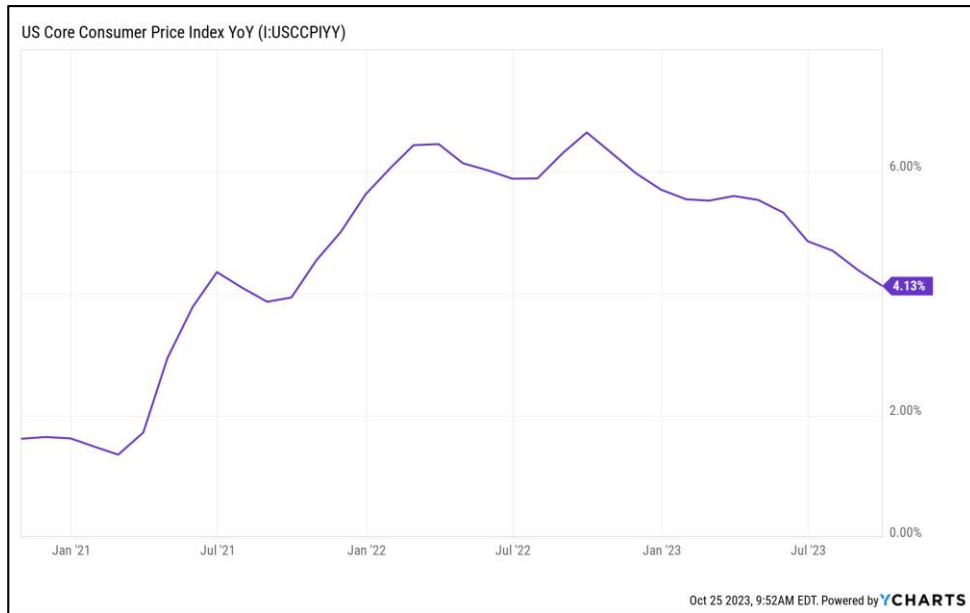
- Worries about future economic growth are legitimate and commentary from Q3 earnings calls implies the economy is losing momentum.
- But, data matters, and so far there is virtually no data that implies the economy is substantially deteriorating.
- A “Goldilocks” data set is needed to help Treasury yields stabilize, so in-line economic data will be a positive for markets.
- Conversely, “Too Hot” or “Too Cold” data will remain a tailwind on Treasury yields.
- Key economic reports between now and year-end include the two remaining jobs reports, October and November ISM PMIs, Retail Sales Durable Goods, and Jobless claims.

Inflation

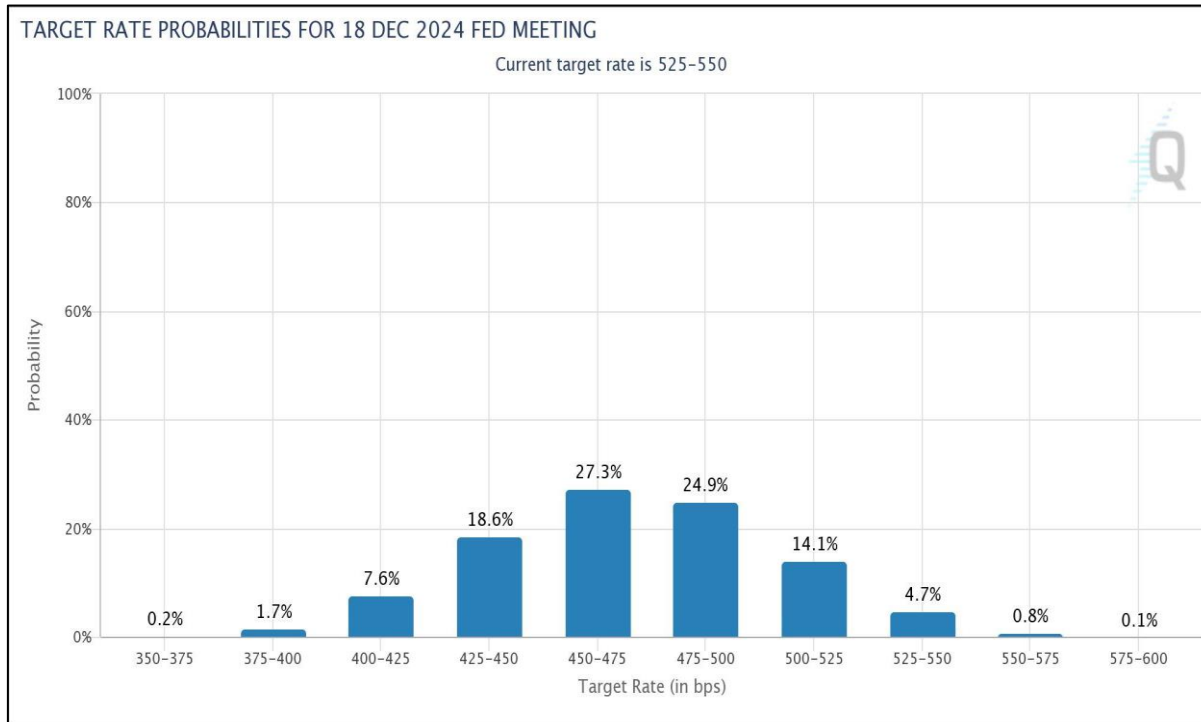
Inflation metrics have declined meaningfully from last year, but at 4% Core CPI is more than double the target. The longer high inflation lasts, the worse for the economy (we're seeing that in Q3 earnings).

Core CPI trading with a "3" handle by year-end would be a welcomed positive for markets and ease upward pressure on yields.

Conversely, a bounce back in inflation would push Treasury yields higher across the curve, further weighing on stocks.



Fed Policy



- The Fed is likely done with interest hikes and that should be generally confirmed at next week's FOMC decision.
- The focus will then turn to when the first cut occurs, and to an extent, the sooner the better.
- The market is split on whether we will see two or three cuts in 2024. The higher the percentage expectation is for three cuts the better, as that will pressure the two-year Treasury yield.
- Conversely, if the market prices in two (or fewer) cuts, it will put upward pressure on yields and weigh on stocks.

The Positive Path

- The key for market stabilization in the near term is a “calming” of recent dramas:
 - No escalation of the Israel/Hamas conflict beyond Gaza.
 - No direct NATO/Russia conflict.
 - Quick passage of a “Continuing Resolution” in Congress to fund the government well ahead of the November 17th deadline.
 - A stabilization in the 10-year Treasury yield.
- The key for a resumption of the 2023 rally remains:
 - Conclusive “soft landing” signals from economic data (removing the changes of a recession near term).
 - A decline in Core CPI to below 4.0% y/y (signaling the battle with inflation is almost won).
 - The market expects three rate cuts in 2024 from the Fed.

The Negative Path

- The S&P 500 remains vulnerable to a decline below 4,000 in the near term if:
 - The Israel/Hamas conflict extends beyond Gaza as it'll send oil sharply higher, raising inflation and recession fears.
 - There is accidental or direct NATO/Russia conflict, sending prices of major commodities surging, raising inflation and recession fears.
 - Continuation of the historic dysfunction occurring in Washington, no progress on restraining spending, and a government shutdown.
 - A rise in the 10-year Treasury yield comfortably above 5.0%.
- The entire 2023 rally remains at risk (meaning it could all be given back) if:
 - Data points to a hard economic landing.
 - Core CPI bounces back and moves back towards a totally unacceptable 5.0%, increasing the need for higher rates.
 - The market begins to price in less than two rate cuts in 2024, confirming higher for longer rates (which will increase hard landing chances, depress valuations, and jeopardize earnings growth).