SEVENS REPORT

EVERYTHING YOU NEED TO KNOW ABOUT THE MARKETS BY 7AM EACH MORNING IN SEVEN MINUTES OR LESS

January 18, 2024

Pre 7:00 Look

- Futures are bouncing modestly following solid earnings and positive corporate news overnight.
- Earnings overnight were decent as TSMC beat expectations while Bank of American upgraded AAPL.
- Economically, however, the Aussie jobs report was soft (-66k vs. (E) 15k) and that's increasing global growth worries.
- Econ Today: Jobless Claims (E: 206K), Housing Starts (1.425 million), Philly Fed Manufacturing Index (E: -6.7). Fed Speak: Bostic (7:30 a.m. and 12:05 p.m. ET).
- Earnings: TSM ($1.37), PPG ($1.50), JBHT ($1.74).

Market	Level	Change	% Change
S&P 500 Futures	4,785.75	14.50	0.30%
U.S. Dollar (DXY)	103.30	-0.15	-0.15%
Gold	2,014.50	8.00	0.40%
WTI	72.77	0.21	0.29%
10 Year Yield	4.09%	-0.01	-0.34%

Equities

Market Recap

Stocks continued to decline Wednesday amid unfavorable economic data overseas with disappointing growth figures and higher inflation numbers (stagflation) while strong U.S. data poured cold water on dovish Fed policy hopes. The S&P 500 fell 0.56%.

The mood on Wall Street was already sour coming into Wednesday's session as economic data overseas was net negative for risk assets and weighed on global investor sentiment. First, data out of China showed a slightly healthier-than-expected manufacturing sector within the world's second largest economy. However, that favorable news was largely offset by disappointing metrics regarding the health of the consumer as Chinese Retail Sales slowed from 10.1% to 7.4%, below the expected drop to 8.0%, while an index for Chinese House Prices fell to -0.4% vs. (E) -0.2%. In Europe, the U.K.'s CPI headline unexpectedly edged higher by 0.1% to 4.0% vs. (E) 3.8% while the Eurozone's HICP (CPI equivalent) rebounded from 2.4% in November to 2.9% in December.

The net takeaway was that economic data from Tuesday night/Wednesday morning was market negative and saw global bond yields extend the week's losses while stock indexes around the world came for sale.

Towards the start of the Wall Street session, focus turned to the December U.S. Retail Sales report, and it came in hot across the board adding pressure to bond markets, which in turn dragged equity markets lower at the open. Industrial Production also came in positive versus expectations for a modest decline and the U.S. Housing Market Index jumped from 37 to 44 vs. (E) 39, all of which added to the already-hawkish money flows.

Stocks attempted to stabilize over the course of the morning, but as odds of a March rate hike dropped back towards 50% from nearly 75% at the start of the week, the S&P 500 rolled over and fell towards a two-week low. Once Treasuries leveled off midday with the 10-Yr holding the 4.10% area, the S&P 500 found its footing just above 4,700 and began to creep higher. The Fed's Williams and the latest Beige Book release failed to squash the late-day rebound and the S&P 500 ended near the best levels of the day, but still down on the session and handily negative for the week.

Trading Color

The impact of higher Treasury yields was evident in the market internals Wednesday as stocks were broadly low-

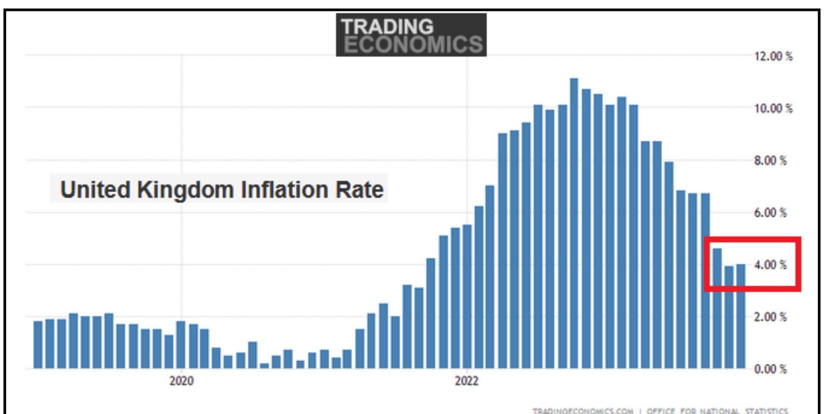
Market	Level	Change	% Change
Dow	37,266.67	-94.45	-0.25%
TSX	20,695.02	-253.07	-1.21%
Stoxx 50	4,431.95	28.87	0.66%
FTSE	7,453.82	7.53	0.10%
Nikkei	34,466.17	-11.58	-0.03%
Hang Seng	15,391.79	114.89	0.75%
ASX	7,346.48	-46.61	-0.63%
Prices taken at previous day market close.			

er. All three major indices declined with the Dow relatively outperforming (-0.25%) while the Russell 2000 lagged (-0.73%) and that's what we'd expect when higher yields are the driver of price action (high yields are most negative for small caps).

Market	Level	Change	% Change
DBC	21.84	-.03	-0.14%
Gold	2008.10	-22.10	-1.09%
Silver	22.68	-.41	-1.79%
Copper	3.7375	-.0290	-0.77%
WTI	72.75	.35	0.48%
Brent	78.05	-.24	-0.31%
Nat Gas	2.869	-.031	-1.07%
RBOB	2.1361	.0142	0.67%
DBA (Grains)	20.61	-.15	-0.70%
Prices taken at previous day market close.			

On a sector level, all 11 SPDRs were lower and again the influence of higher yields was evident. Consumer staples, healthcare and financials were the relative outperformers, falling 0.1% and 0.2%, respectively, as higher yields are negative for growth and positive for banks (broadly speaking). Conversely, the laggards were the dividend-proxy sectors of utilities (XLU) and REITs (XLRE), which fell 1.45% and 1.83%, respectively, as higher yields make these dividend sectors less attractive. Other laggards include cyclical sectors (consumer discretionary, materials, energy) as higher yields are an economic headwind.

So far this week, the story has been higher yields and just like in the August-October timeframe, higher yields are a headwind on stocks and the higher yields rise, the stronger the headwind will become (just like August-October).



U.K. inflation edged higher in December with the headline CPI figure rising from 3.9% to 4.0% vs. (E) 3.8%, which weighed on global bond markets, and ultimately stocks, in Wednesday morning trade.

The Reason Stocks and Bonds Are Declining (You've Seen It Before)

Stocks declined for the second straight day this week and the reason for the drop is clear: Expectations for a March rate cut are falling and since that idea was a major contributor to the late-December melt up, we're seeing some of those gains given back.

To that point, at the start of the year, fed funds futures were pricing in virtually a 100% chance of a March rate cut. Now, thanks to push back from the Fed and ECB as well as some "hot" economic data (last week's CPI, yesterday's retail sales, and the December jobs report) we're seeing those expectations for a rate cut decline. At this point, it's about a 60% probability of a March rate cut and the drop from 100% is the reason behind this dip in stock prices. If the probability of a March rate cut falls solidly below 50%, expect the S&P 500 to continue to pullback also.

These declines are largely what we'd expect, and in Tuesday's issue we cautioned that if the market dialed back May rate cut expectations, we could see a mild pullback in stocks. That's what's happening now and it'll continue if the probability of a March cut falls below 50%.

However, it's going to take a May rate cut coming into doubt for Fed policy to become a real headwind on markets and open up the possibility of a 5%-10% decline in stocks. So far, there is no budging on the May rate cut expectations as they remain above 90%. However, where that number goes, stocks also will go. And if we see that May rate cut probability fall to and through 70% and 50%, expect a pullback in stocks to intensify (meaning that 5%-10% probability).

Bottom line, the market is dialing back some of its rate cut expectations but it's still way ahead of the Fed. As things sit now, markets can withstand no March rate cut. But if we see those May rate cuts come into doubt then don't be surprised if the S&P 500 trades to, and through, 4,500 or lower.

Economics

Retail Sales

- December Retail Sales rose 0.6% vs. (E) 0.4%.

Takeaway

Consumer spending is the engine of growth for the U.S. economy and yesterday's Retail Sales print showed it is not slowing down. And as long as consumer spending is strong, then the chances of a hard landing will remain low. Not only was the headline strong, but the details of the report were also solid as the "Control Group," which filters out gasoline, autos and building materials, and offers the "purest" look at consumer spending, accelerated to 0.8% in December, the strongest print since July.

From a market reaction standpoint, the retail sales report pushed the 2-year yield higher and increased the headwind on stocks because it was viewed as "Too Hot" in the context of March rate hikes. Put differently, with CPI buoyant and solid employment data (the jobs report) and Retail Sales, there's not really a compelling reason for the Fed to cut rates. As such, rate cut expectations declined, the 2-year yield rose and stocks dropped.

Bottom line, the Retail Sales report shows that the consumer remains in solid shape and that is a medium-term positive as a hard landing is unlikely as long as the consumer is strong. But in the near term, the data was "Too Hot" and pushed yields higher and stocks lower and we should continue to expect markets to view data through the "Too Hot" lens until there's more clarity on a March rate cut. Very strong data, for now, will be mildly "bad" for stocks.

Commodities

Commodities were universally lower early in the session as the combination of a hotter-than-expected retail sales report driving the dollar higher, and downbeat Chinese economic data weighed heavily on the complex. Energy caught a bid late in the day, however, thanks to weather-related supply disruptions in the northern United States. That left the commodity ETF, DBC, to end with a modest loss of 0.14%.

Market	Level	Change	% Change
Dollar Index	103.22	.11	0.10%
EUR/USD	1.0872	-.0003	-0.03%
GBP/USD	1.2677	.0040	0.32%
USD/JPY	148.25	1.06	0.72%
USD/CAD	1.3524	.0029	0.21%
AUD/USD	.6542	-.0042	-0.64%
USD/BRL	4.9336	.0067	0.14%
10 Year Yield	4.106	.040	0.98%
30 Year Yield	4.312	.009	0.21%
10's-2's	-25 bps		
Date of Rate Cut	March 2024		
2024 YE Fed Funds	4.01%		
Prices taken at previous day market close.			

Beginning with oil, speculators appeared to once again be pressuring the market yesterday as the tensions in the Middle East, while still elevated, have not yet caused any meaningful disruptions to supply, and concerns about the regional conflict are easing with time. Additionally, the net-negative economic data overseas was also weighing on oil as demand expectations came into question while the hot retail sales data in the U.S. rekindled risks that the Fed follows through with a "higher for longer" policy approach, which would further weigh on demand.

WTI futures fell to a one-week low of $70.50 in early trade; however, the market stabilized amid news that frigid temperatures across much of the American West were expected to knock out a significant amount of domestic production including upwards of 700K b/d in North Dakota alone. That saw the oil market reverse back towards the unchanged mark into the settlement before WTI futures continued to rally in after-hours trade ending the day up 0.57% and just shy of $73/barrel. Today, focus will be on the delayed release of the weekly EIA data with WTI still pinned in a tight range between $70 and $74/barrel.

Copper declined mostly due to the disappointing consumer data out of China that poses risks to the sustainability of the nations more-than-5% growth rate last year. The hot retail sales data and uptick in inflation readings in Europe also pressured industrial metals as a "higher for longer" rate environment would greatly increase the threat of a demand-crippling recession. On the charts, copper futures held above Friday's low close of $3.735 and that will be a key level to watch in the sessions ahead as a break of that support will open the door to more pronounced losses into month-end.

Switching to precious metals, the data-driven rally in the dollar and hawkish money flows in the fixed income markets were the most notable bearish influences on gold yesterday with futures falling 1.6% on the session. Gold futures violated initial support at $2,020/oz., which is slightly bearish for the near term. For the long-term the outlook continues to decidedly favor the bulls with more support between $1,985/oz. and $2,000/oz. More hawkish money flows in the sessions ahead would put the sustainability of that support zone to the test with the threat of a break back towards the November lows in the mid-$1,900s.

Currencies & Bonds

Treasury yields surged for a second straight day thanks to hot economic data, more hawkish rhetoric and underwhelming demand for Treasury bonds. The 2-year yield rose 14 basis points while the 10-year yield gained 4 basis points, as the markets dialed back March rate cut expectations.

The move higher in the 2-year yield has been dramatic. On Friday (so less than a week ago) the 2-year Treasury yield hit 4.11%, the lowest level since May. But in just two trading days the 2-year yield has surged 24 basis points as markets have dialed back March rate cut expectations. Yesterday's rally in the 2-year was driven mostly by Fed Governor Waller pushing back on the idea of dramatic and intense rate cuts. On Wednesday, economic data and more hawkish central bank rhetoric kept the upward pressure on Treasury yields as the 2-year yield rose sharply again.

Specifically, the hot U.K. CPI, which pushed 10-year GILT yields higher by 18 basis points, started the Treasury yield rally early on Wednesday. That was compounded by the hotter-than-expected U.S. retail sales report, which rose more than estimates. Additionally, ECB President Lagarde said that rate cuts before the summer were unlikely, pushing back against imminent rate cut hopes. Finally, a 20-year Treasury bond auction saw muted demand as the bid to cover, a measure of demand, declined to 2.53X vs. the six-month average of 2.62X while bidding was tentative, evidenced by the actual yield being 0.8 bps higher than the "When Issued" yield. Most importantly, foreign buyers were unenthused and bought just 62.2% of the auction, down from last month's 66.4% and the lowest percentage since November 2021.

Looking forward, the past two trading days has reinforced that sharply higher Treasury yields are a negative for stocks, just like they were in August through October. If markets further dial back March rate cut expectations, look for the 2-year yield to rise back towards 4.50% and for that headwind on stocks to remain.

The real problem will be if markets begin to push back on May rate cuts too and if that occurs, look for the 2-year Treasury yield to rise above 4.50% and for the headwind on stocks to increase, because rising Treasury yields are still a headwind on stocks.

In currencies, global economic data (excluding China) was "hot" yesterday as the U.K. CPI rose more than expected (4.0% vs. 3.8% y/y) while U.S. retail sales, both on a headline and core reading, were also hotter than estimates. The net result was a little-changed Dollar Index that added 0.1%.

The best performer on the day was the British pound, which rose 0.4% vs. the dollar on the hotter-than-expected CPI report. Put simply, the U.K. CPI makes imminent rate cuts less likely in the U.K. and as a result, the pound gained modestly vs. the dollar. However, that gain was partially offset by a 0.7% decline in the yen, which continued to fall on economic worries and as the Bank of Japan continues to push back on expected easing. Finally, the euro was flat vs. the dollar despite Lagarde's caution on rate cut expectations, as the final EU HICP met market expectations.

The bottom line is the dollar declined as markets priced in a "certain" March rate cut and now it's rallying as markets dial back those rate cut expectations. Much like the 2-year yield, if the market further reduces March rate cut expectations then look for mild upside in the greenback. However, if May rate cuts come into doubt, don't be shocked if we see the Dollar Index move towards 105 and, as it does, increase the headwind on stocks.

Have a good day,

Tom

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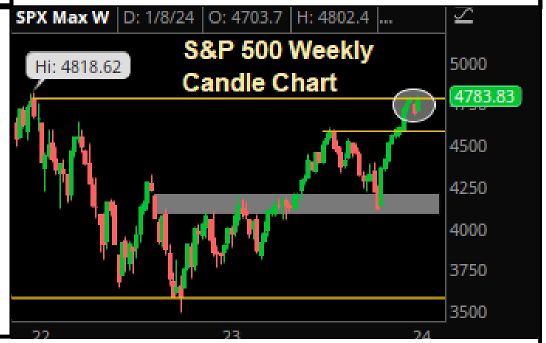
Technical Perspectives (Updated 1/14/2024)

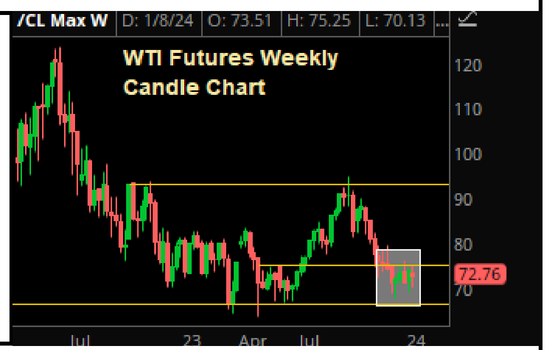
S&P 500

- Technical View: **The medium-term trend in equities flipped bullish** to start December as the S&P 500 rallied to fresh 2023 highs.
- Dow Theory: **Bullish (since the week of July 10, 2023)**
- Key Resistance Levels: 4803, 4818, 4850
- Key Support Levels: 4598, 4505, 4415



WTI Crude Oil

- Technical View: The oil market has stabilized to start 2024 but futures remain well off the 2023 highs above $90/barrel.
- Proprietary Model: **Neutral (since the week of November 6, 2023)**
- Key Resistance Levels: $75.43, $77.72, $79.60
- Key Support Levels: $71.32, $69.87, $68.73



Gold

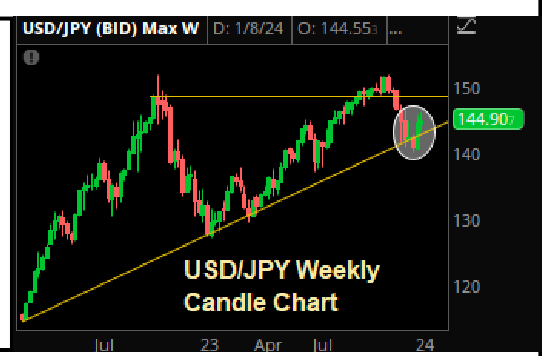
- Technical View: Gold futures broke out to fresh all-time in late 2023 shifting the technical outlook decidedly in favor of the bulls.
- Proprietary Model: **Bullish (since the week of November 27, 2023)**
- Key Resistance Levels: $2076, $2094, $2152
- Key Support Levels: $2030, $2000, $1967

10-Year T-Note Yield

- Technical View: The 10-year yield has pulled back considerably since the October highs, but the "V-shaped" top has not seen a bearish "lower low" established yet.
- Proprietary Model: **Bullish (since the week of August 21, 2023)**
- Key Resistance Levels: 4.059, 4.121, 4.239
- Key Support Levels: 3.907, 3.789, 3.608

Dollar/Yen

- Technical View: The USD/JPY recovered a longstanding uptrend line to start 2024, however, the heavy price action in late 2023 leaves the outlook neutral.
- Proprietary Model: **Neutral (since the week of December 25, 2023)**
- Key Resistance Levels: 145.75, 146.79, 148.31
- Key Support Levels: 143.83, 142.37, 140.18



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Fundamental Market View (Updated 1/14/2024)

Near-Term General U.S. Stock Market Outlook

This is designed to provide a snapshot of our near-term (1 month) outlook for stocks. For general equity market exposure, we use a mix of SPHB (S&P 500 High Beta) and SPLV (S&P 500 Low Volatility) to create an aggressive, neutral or defensive stance on general equity market exposure.

Near Term Stock Market Outlook: **Cautious** **SPHB: 25% SPLV: 75%**	*Stocks rallied last week thanks mostly to falling Treasury yields as markets ignored a hot CPI report and hawkish Fed rhetoric to log a solidly positive return and push the S&P 500 slightly high on the year.*

Tactical Allocation Ideas:

- **What's Outperforming: Growth factors, tech, consumer discretionary and communication services, the worst performers in 2022, have outperformed YTD. However, higher yields remain a headwind and as such we don't think this outperformance will last over the longer term.**
- **What's Underperforming: Defensive sectors and value have underperformed YTD, but are still massively outperforming since the bear market started in 2022, and since our primary concern in 2023 is economic growth, we think this underperformance will be temporary.**

Long Term Fundamental Outlook for Other Asset Classes

	Fundamental Outlook	Market Intelligence
Commodities	**Neutral**	*Commodities declined modestly last week despite an increase in geopolitical tensions as concerns about economic growth and oversupply continue to be a formidable headwind on the oil markets.*
US Dollar	**Neutral**	*The Dollar Index was little changed last week as expectations for a March rate cut from the Fed were unchanged despite the hot CPI report.*
Treasuries	**Turning Positive**	*The 2-year Treasury yield dropped sharply last week despite the hot CPI report as markets more aggressively priced in a March rate cut.*

This page is meant to provide a general outlook for the path of each major asset class and is updated at the start of each week.