# SEVENS REPORT

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

*January 23, 2024*

## Pre 7:00 Look

- U.S. futures are flat amid mixed trade overseas as European shares pulled back modestly after a weak ECB Lending Survey while Asian shares bounced solidly amid news China is planning a $278B "market rescue package."
- Econ Today: Richmond Fed Manufacturing Index (E: -15), December M2 Money Supply (1:00 p.m. ET). There are no Fed officials scheduled to speak today.
- There is a 2-Yr Treasury Note auction at 1:00 p.m. ET.
- Earnings: VZ ($1.07), MMM ($2.31), GE ($0.90), PG ($1.70), JNJ ($2.27), SYF ($0.96), NFLX ($2.20), TXN ($1.46).

| Market | Level | Change | % Change |
|---|---|---|---|
| S&P 500 Futures | 4881.75 | .75 | 0.02% |
| U.S. Dollar (DXY) | 103.381 | .050 | 0.05% |
| Gold | 2027.20 | 5.00 | 0.25% |
| WTI | 74.13 | -.63 | -0.84% |
| 10 Year Yield | 4.130 | .036 | 0.88% |

## Equities

*Market Recap*

Stocks advanced to a fresh set of intraday highs to start the new week as traders digested last week's run to the first record close for the S&P 500 in over two years. The benchmark index finished Monday's session up 0.22%.

The major equity indices gapped higher at the open yesterday as limited news from the weekend left bullish momentum and optimism surrounding the new record highs in the S&P 500 to drive stocks higher early. The gains came despite renewed weakness in Chinese markets at the start of the week after the PBOC failed to offer the stimulus the market was hoping for via cuts in benchmark prime loan rates following an array of weaker-than-anticipated economic data in recent weeks.

Domestically, there was just one economic report, Leading Economic Indicators, and it was slightly better than feared at -0.1% vs. (E) -0.3%. But the market response was limited as the LEI has been flashing a "warning sign" for several quarters with no meaningful slowdown in the economy in sight at the moment. The S&P 500 stalled just shy of 4,870 (note that the "better if" MMT valuation target is 4,875) and began to churn sideways in directionless trade as the new highs were digested in the wake of Friday's big options expiration date.

Newswires were fairly quiet over the course of the day and the S&P 500 largely drifted sideways in a tight trading range before closing pinned to 4,850, an important index options strike that acted magnetic for most of yesterday's session.

*Why Are Chinese Stocks So Weak? (And Is There Opportunity?)*

The Chinese stock market has started 2023 with a "thud" as the Hang Seng is down 12% YTD (just three weeks) and is now at the lowest level since 2009, providing a stark contrast to the S&P 500, which hit another all-time high yesterday.

While movement in the Chinese market may seem distant and detached from U.S. stocks given the recent performance disparity, it won't stay that way if the volatility in the Chinese markets gets worse and/or spills over into the Chinese economy. If that happens, it will become a headwind on global markets, including the U.S.

Because of that, I want to cover why Chinese stocks are so weak, address if these declines create any potential long-term opportunities for investors in those markets

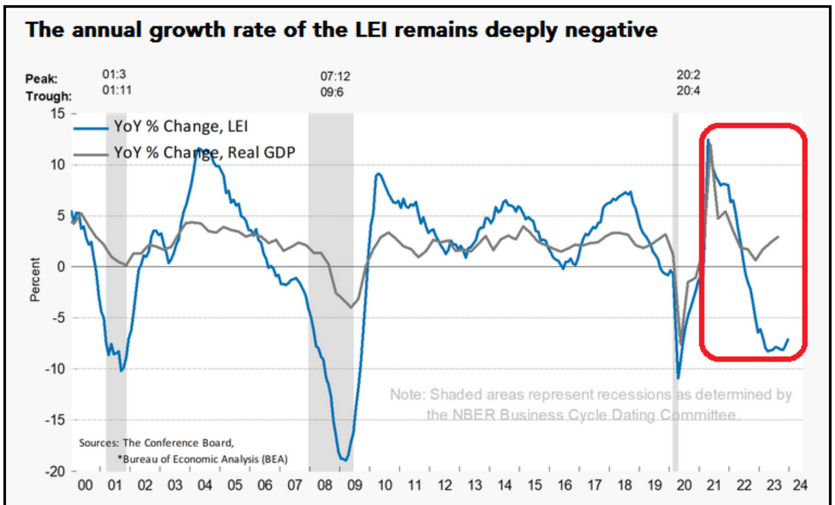
| Market | Level | Change | % Change |
|---|---|---|---|
| Dow | 38,001.81 | 138.01 | 0.36% |
| TSX | 20,924.30 | 17.78 | 0.09% |
| Stoxx 50 | 4,467.45 | -12.87 | -0.29% |
| FTSE | 7,473.37 | -14.34 | -0.19% |
| Nikkei | 36,517.57 | -29.38 | -0.08% |
| Hang Seng | 15,353.98 | 392.80 | 2.63% |
| ASX | 7,514.94 | 38.38 | 0.51% |
| Prices taken at previous day market close. | | | |

and identify the two events that need to occur for Chinese markets to stabilize.

| Market | Level | Change | % Change |
|---|---|---|---|
| DBC | 22.03 | .09 | 0.41% |
| Gold | 2,021.90 | -7.40 | -0.36% |
| Silver | 22.17 | -.54 | -2.36% |
| Copper | 3.7500 | -.0365 | -0.96% |
| WTI | 75.19 | 1.78 | 2.42% |
| Brent | 79.86 | 1.30 | 1.65% |
| Nat Gas | 2.423 | -.096 | -3.81% |
| RBOB | 2.2367 | .0739 | 3.42% |
| DBA (Grains) | 21.11 | .10 | 0.47% |
| Prices taken at previous day market close. | | | |

Starting with "why" this is happening, the reasons broadly fall into two categories: 1) Fundamental and 2) Technical. Starting with the fundamental reasons, the Chinese economy isn't doing well. Assessing data on the Chinese economy can sometimes be like watching a "slight of hand" trick as the numbers produced don't usually match the experience on the ground. But even knowing that, some of the more reliable economic readings from China aren't great.

The manufacturing PMI, which is arguably the most important metric, declined below 50 in December to the lowest level in a year, excluding last May's reading. Additionally, while Chinese GDP printed over 5%, most analysts think that number is inflated. Finally, export data remains, at best, rangebound and is still off the highs of a few years ago. So, the Chinese economy is struggling and that's negatively impacting Chinese stocks.




***The Conference Board's Leading Economic Indicators is not a release we particularly follow very closely, but when glaring divergences between historically correlated economic indicators emerge, we take notice. And right now, the LEI data is flashing a major economic warning signal.***

Second, constant and, most importantly, erratic Chinese regulatory meddling is finally coming home to roost and that's weighing on Chinese markets. The longer President Xi has been in office, the more the Chinese government has exerted control over private industries as authorities have singled out various industries, most of them tech related, and imposed draconian and nonsensical regulations that have slowed growth and stifled innovation. Additionally, the constant propping up of the property bubble in China has created "zombie" companies and banks in the economy and that's also a headwind on growth. Bottom line, investors are nervous about regulatory risks in China and rightly so, and that's also hurting these markets.

Now, these fundamental headwinds have been joined by more technical factors that are also causing weakness in Chinese shares. Specifically, regulatory meddling in the tech sector, combined with geopolitical anxiety surrounding semiconductors and U.S. tariffs and sanctions has hit the Chinese tech sector hard and since the tech sector is largely responsible for much of the gains in stocks over the past year, the Chinese markets have essentially "missed out." This is best evidenced by the performance gap between XLK (S&P 500 tech SPDR) and KWEB (KraneShares CSI China Internet ETF). Over the past year, XLK is up 53% while KWEB is down 34%!

These factors (economic doubts, poor performance, regulatory and geopolitical risks) have led to international investors essentially "throwing up their hands" at the Chinese markets and reducing Chinese exposure and rotating to other, more stable regions and countries. Evidence of this can be seen in the performance of Chinese markets vs. broader emerging market ETFs. Over the past year, the MSCI Emerging Markets ETF has declined 8% but FXI, the iShares China Large-Cap ETF, has declined more than 34%!

Bottom line, Chinese stocks have been hit by a series of (mostly) self-inflicted wounds from a policy standpoint and until there's evidence that authorities are committed to stimulating growth or reducing regulatory interference, we should expect continued pressure on Chinese stocks.

*What This Means for You*

This is potentially important for investors and advisors for several reasons. First, from a macro sense, economic chaos or a market crash in China is a potential headwind for U.S. equities. Thankfully, we are not at that point yet. But economic stresses due to the property market bubble bursting and various banking bailouts are a threat.

From a "what to watch" to look for increased macro risks from China, its two indicators are 1) Hang Seng and 2) The yuan. The Hang Seng (Chinese stocks traded in the loosely controlled Hong Kong market) is falling sharply and trading at the steepest discount to mainland Chinese stocks in nearly 15 years. That's because the mainland Chinese indices such as the Shanghai and Shenzhen are being propped up by various government interference (short sale bans, forced buying by funds, etc.) Point being mainland Chinese stocks need to come down (rather than the Hang Seng going up).

Meanwhile, the yuan has been weakening vs. the dollar, falling from 6.8 yuan/dollar a year ago to 7.16 yuan/dollar as of this month. If a decline in the yuan becomes "disorderly" that will be a new macro headwind like is was in the late 20-teens. Thankfully that's not happening yet, but it's something to watch. The yuan hit a five-year high in late 2022 and if we see the yuan rise materially above 7.30 towards 7.50, look for some added macro headwinds on global assets.

However, there's also a tactical side to this situation. As mentioned, the Hang Seng is trading at a 15-year discount to mainland Chinese stocks. Chinese stock ETFs such as FXI and others have dramatically underperformed the S&P 500, yet they are full of profitable companies such as Alibaba, Tencent, JD.com and others. If one is looking for value in this market, China is likely the most 1) Hated and 2) Beaten down major market out there and for anyone that's a contrarian at heart, that's got to spur some interest.

So, is China a buy? In my opinion, not yet. The declines in the market are undoubtedly stretched and Chinese stocks are due for a bounce. But for a bounce to become sustainable (and be anything other than a trade) I believe we need to see two events in China: **First, real, meaningful stimulus. Second, real evidence Chinese authorities will become more business friendly.** So far, there is little evidence of either.

Regarding stimulus, to get specific I'd want to see rate cuts (which didn't happen on Monday despite the need for them) and also, ideally, greater cuts to the banks' reserve ratios as that would provide powerful stimulus to the Chinese economy. As for regulation, I'd want to see improved rhetoric and the end to consistent threats against tech companies, gaming companies and the tech industry.

One or both of those events would reflect a materially positive, fundamental change to the outlook for Chinese stocks and at that point, I think the risk/reward would become more attractive for ETFs KWEB, FXI and MCHI (iShares MSCI China ETF). For now, just because China is "cheap" it doesn't mean it's a value and I think we need to see real, actual progress on 1) Economic stimulus and 2) Less meddlesome regulation before we can take advantage of the declines in Chinese shares for anything more than a bounce.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dollar Index | 103.12 | .05 | 0.05% |
| EUR/USD | 1.0883 | -.0015 | -0.14% |
| GBP/USD | 1.2704 | .0001 | 0.01% |
| USD/JPY | 148.08 | -.04 | -0.03% |
| USD/CAD | 1.3481 | .0052 | 0.39% |
| AUD/USD | .6570 | -.0027 | -0.41% |
| USD/BRL | 4.9852 | .0563 | 1.14% |
| 10 Year Yield | 4.094 | -.052 | -1.25% |
| 30 Year Yield | 4.316 | -.037 | -0.85% |
| 10's-2's | -29 bps | | |
| Date of Rate Cut | May 2024 | | |
| 2024 YE Fed Funds | 4.10% | | |
| Prices taken at previous day market close. | | | |

# Economics

There were no material economic reports yesterday.

# Commodities

Commodities saw a mixed start to the week with energy surging higher amid tightening supply and demand dynamics emerging in the physical markets while a stronger dollar weighed on metals with industrial varieties underperforming in sympathy with weakness in Chinese equities. The commodity ETF, DBC, rose 0.41%.

In metals, a bounce in the dollar and uptick in real yields offset a pullback in the 10-Yr Note yield resulting in a 0.35% decline in gold futures. The less-dovish shift in Fed policy expectations since the start of the year has dialed back one of the key bullish tailwinds for oil and we are seeing some profit taking in gold as a result, despite the fact that the new record highs established in December are bullish for the long-term outlook for precious metals. On the charts, gold futures held above support at $2,020/oz., albeit barely, leaving that level key to watch in the week ahead.

Copper futures declined 1% but held above last week's lows which are providing support just under the $3.75 mark. The disappointing policy decision by the PBOC paired with an increasingly cautious outlook for the Chinese economy both weighed on copper. This week, we will look for aforementioned support to hold and copper to stabilize to confirm the still-optimistic global growth outlook right now, primarily based on the resilient U.S. economy.

WTI crude oil futures jumped to new intraday highs for 2024 and settled at the best level since the week of Christmas, closing with a gain of 2.42%. Brent futures topped $80/barrel in intraday trade before retreating to close just below that psychological threshold with a still-respectable gain of 1.91%.

As far as catalysts, it was another supply-side disturbance that sparked the early week rally, this time in Russia as a drone attack that Ukraine claimed responsibility for (which had yet to be confirmed late yesterday) halted operations at a fuel export terminal on the Baltic coast. Additionally, an unknown amount of North Dakota's oil production remained idled due to a extreme cold weather while geopolitical tensions in the Middle East have shown no signs of easing in so far in 2024.

Technically speaking, WTI futures have been range-bound since bottoming in early December, oscillating between $69 and $76/barrel. Yesterday's new highs for 2024 skew the path of least resistance in favor of the oil bulls in the very near term, but the longer-term outlook for oil remains very neutral with futures stuck in broad trading range for over a year now.

## Currencies & Bonds

Currency and bond markets were mostly quiet Monday as there was little movement in the dollar or Treasury yields as there was no notable economic data or central bank speak. The Dollar Index rose 0.07%.

The dollar was slightly lower to start the week and that was mostly a factor of digestion of last week's solid rally. Additionally, the important growth data Wednesday and Thursday (flash PMIs, Durable Goods) and the important inflation data Friday (Core PCE Price Index) contributed to the modest moves in the greenback. Similarly, we saw no real movement from the pound, yen or euro.

The dollar rallied hard last week and is sitting in the mid-103 range for the first time in over a month, as investors reduced March rate cut expectations. However, for the dollar rally to continue, we'll need to see rate cut expectations for March continue to decline and have EU economic data remain broadly firm (and not materially weaken) and if that happens, the dollar can rally back through 104 towards 105.

Turning to Treasuries, yields also digested last week's rally as the 2-year yield fell 2 basis points while the 10-year yield dipped 4 bps. As in the currency markets, there were no real, direct influences on the Treasury market yesterday as there was no notable economic data or central bank speak. To that point, the Fed is now in the "quiet" period leading up to next Wednesday's rate decision so we won't have any Fed speak this week.

Bottom line, yields have risen as markets again reduced the expectation for a March rate cut. And, that rise in yields did weigh on the broader market last week. Going forward, "calm" in yields remains important because if data is hot or the Fed is hawkish and the 10-year yield moves back towards 4.50%, we will likely see a stronger headwind on stocks and while the declines won't be as bad as the August-October pullback, they will be enough to cause a pullback. Calm in yields remains an important ingredient for a continued rally in stocks.

Have a good day,

Tom

1/23/2024

# SEVENS REPORT

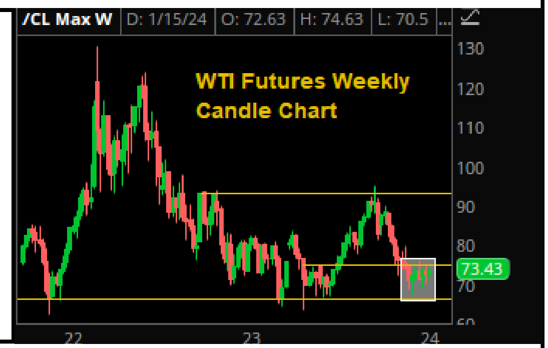
## Technical Perspectives (Updated 1/21/2024)

### *S&P 500*

- Technical View: **The medium-term trend in equities remains bullish** confirmed by the latest run to all-time highs in the benchmark equity index.
- Dow Theory: **Bullish (since the week of July 10, 2023)**
- Key Resistance Levels: 4875, 4900, 4950
- Key Support Levels: 4783, 4697, 4598

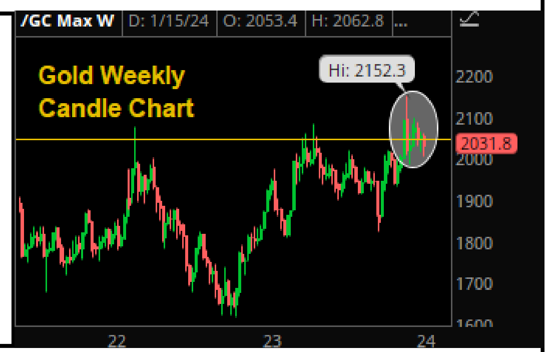

### *WTI Crude Oil*

- 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: $70.91, $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: $2009, $1995, $1950

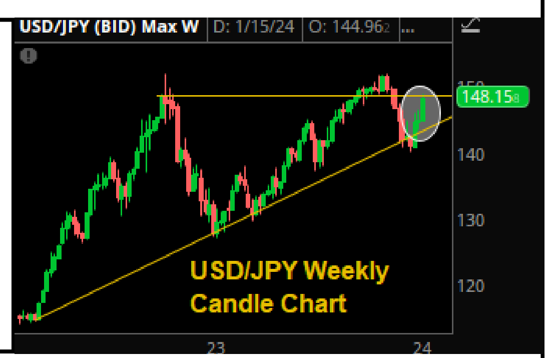



### *10-Year T-Note Yield*

- 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: 4.206, 4.274, 4.352
- 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: 148.67, 149.57, 151.38
- Key Support Levels: 146.15, 144.62, 142.37



# SEVENS REPORT

**Fundamental Market View (Updated 1/21/2024)**

## *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:**<br>**Cautious**<br>**SPHB: 25% SPLV: 75%** | *The S&P 500 hit a new all-time high last week recouping the past two years' declines despite a rise in Treasury yields as strong earnings and positive economic data pushed stocks higher.* |

### *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 on a combination of a stronger dollar, soft Chinese growth and lingering demand concerns for oil.* |
| **US Dollar** | **Neutral** | *The Dollar Index rallied nearly 1% last week thanks to strong retail sales and low jobless claims while Fed officials pushed back on expectations for a March rate cut.* |
| **Treasuries** | **Turning Positive** | *Treasury yields rose sharply last week as Fed officials pushed back on the idea of imminent rate cuts while the economic data showed no significant signs of slowing growth.* |

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.