SEVENS REPORT

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

January 8, 2024

Pre 7:00 Look

- Futures are slightly lower following some disappointing EU economic data and on hawkish Fed commentary.
- Economically, German Manufacturers' Orders and Euro Zone retail sales both missed estimates, reminding investors of recession risks in Europe.
- This weekend, Dallas Fed President Logan warned that financial conditions have eased materially recently and that may prevent the Fed from cutting rates anytime soon.
- Econ Today: NY Fed Inflation Expectations (E: 3.4%). Fed Speak: Bostic (12:00 p.m. ET).

Market	Level	Change	% Change
S&P 500 Futures	4,731.00	-3.75	-0.08%
U.S. Dollar (DXY)	102.49	0.08	0.07%
Gold	2,026.40	-23.40	-1.14%
WTI	71.66	-2.15	-2.91%
10 Year Yield	4.04%	0.01	0.12%

Equities

Market Recap

The first week of 2024 saw moderate declines in stocks following the strong Q4 rally as economic data pushed back on the idea of imminent rate cuts. The S&P 500 fell 1.01% on the week.

Stocks declined to start the year last Tuesday amid a disappointing Chinese PMI report while a downgrade of AAPL amplified selling pressure on big tech. The S&P 500 fell 0.57%.

The selling continued on Wednesday amid some hawkish commentary out of the Richmond Fed's Barkin (a voting member of the FOMC) and mostly in-line JOLTS and ISM Manufacturing PMI data. The market attempted to stabilize midday but rolled over in the wake of the December Fed meeting minutes, which noted "unusually elevated uncertainty" about future policy. The S&P 500 declined another 0.80%.

An early attempt at a bounce in the market on Thursday was thwarted by a reversal higher in Treasury yields on the back of some hot economic data including a 0.5% rise in headline German CPI, solid jobless claims numbers, and better-than-expected ADP private payrolls data. Another AAPL downgrade left mega-cap tech to bleed lower over the course of the day while the rise in yields pressured the market broadly and the S&P 500 fell 0.34%.

Stocks opened flat on Friday as traders digested the December jobs report which came in on the "hot" side with a better-than-expected headline, lower-than-anticipated unemployment rate and a surprise uptick in wage growth. The ISM report released shortly after the open was soft with a drop in the headline, easing price figures, and a plunging employment subindex that saw some of the week's hawkish money flows dialed back. The S&P 500 peaked midmorning before pulling back into the European close and chopping sideways into the end of the day amid quiet newswires, ending with a slight gain of 0.18%.

Why Did Stocks Drop to Start 2024?

Markets started 2024 with a relative "thud" as the S&P 500 fell 1% while widely held tech names traded even worse, with the Nasdaq falling more than 3% last week. But the reason for the declines wasn't so much because something bad happened and instead just because the first data points of 2024 didn't validate aggressive (and possibly unrealistic) expectations for 2024.

Market	Level	Change	% Change
Dow	37,466.11	25.77	0.07%
TSX	20,937.55	66.20	0.32%
Stoxx 50	4,458.40	-5.11	-0.11%
FTSE	7,662.25	-27.36	-0.36%
Nikkei	33,377.42	89.13	0.27%
Hang Seng	16,224.45	-310.88	-1.88%
ASX	7,451.55	-37.52	-0.50%
Prices taken at previous day market close.			

First, we have to acknowledge that the S&P 500 rallied more than 11% in the Q4, but virtually all of that rally came from late October through December. An 11% gain in a year is a big return, never mind in essentially two months, so it's reasonable we'd have "give back" at the start of the year and we have.

Market	Level	Change	% Change
DBC	22.13	.11	0.50%
Gold	2051.20	1.20	0.06%
Silver	23.37	.18	0.77%
Copper	3.8025	-.0415	-1.08%
WTI	73.83	1.64	2.27%
Brent	78.76	1.17	1.51%
Nat Gas	2.882	.061	2.16%
RBOB	2.1041	-.0060	-0.28%
DBA (Grains)	20.59	-.13	-0.63%

Prices taken at previous day market close.

But there are reasons stocks declined last week other than just being short-term overbought. First, inflation data bounced back and while no one is doubting disinflation, in the context of the market entering 2024 with a 100% probability of a March rate cut, that buoyant inflation data pushed back on that assumption. Second, growth data was "ok" but not good enough to validate the market's full belief in a "no landing" economic scenario. So, while the growth data wasn't bad, it didn't meet the current market assumptions.

Put simply, last Tuesday I identified the five market assumptions for 2024, because whether stocks rally or decline will be determined by how the data measures up to those assumptions. Last week, it didn't measure up well, so stocks dropped. But importantly, none of the data was that bad either, it just wasn't good enough for the S&P 500 to be valued at 19.5X next year's earnings. To that point, if more data this week (including CPI) doesn't meet the dual market expectations of 1) A March rate cut and 2) Continued aggressive disinflation, expect a further pullback in the S&P 500, potentially to 4,600 or lower.

Even if that happens, the outlook for markets will still remain positive over the medium term. As things sit now, any pullback towards 4,500-4,600 should be viewed as an opportunity to add exposure, if you're looking to do so, because the fundamental outlook for stocks remains positive given: 1) Solid economic growth, 2) A newly dovish Fed and 3) Falling inflation.

The problem for the market as we start 2024 is that positive outlook isn't quite good enough to justify a 19.5X multiple. Bottom line: In the near term, this market has an expectation problem as it has priced in rate cuts in March and Immaculate Disinflation (falling inflation and stable growth). If the data doesn't match that expectation (which it didn't last week) stocks will drop.

But just because the outlook isn't perfect, it doesn't mean it still isn't good and that's the needed context to view last week's declines and any continued pullback through the first weeks of the year.

To better explain that point to regular investors, I used this analogy to describe the current market dynamic with a friend at a birthday party this weekend:

It's like you're taking your family to Hawaii for vacation and because the kids flew first class once, they now expect it all the time. So, there's some disappointment when they find out they're in coach, but they're still going on a great vacation!

From a tactical standpoint, given my concern about a growth scare in the markets in the coming months, I continue to prefer defensive sectors (XLU/XLP/XLV/XLRE) and value/quality over growth, and broadly RSP still over SPY. This preference may change if tech pulls back materially. But for now, given lofty market expectations and my worries about a growth scare, I want to add exposure to quality, lower volatility and value sectors that can reduce volatility and downside risk.

Economics

Last Week

Economic data for the first week of 2024 pushed back on the idea that Fed rate cuts are 1) Imminent and 2) Likely to be aggressive in 2024. The net result was lower stock and bond prices and higher Treasury yields.

Starting with the jobs report, it came in slightly "Too Hot" and the immediate market reaction was as expected, as futures declined further while the 10-year yield rose back solidly above 4.00% although stocks bounced from those lows at the open.

Looking at the data, job adds were higher than estimated at 216k vs. (E) 164k, the unemployment rate was

3.7% vs. (E) 3.8% and wages rose more than estimated at 0.4% m/m vs. (E) 0.3% and 4.1% y/y vs. 3.9%. However, there were some parts of the jobs report that were soft and that contributed to the bounce Friday morning. First, the revisions were solidly negative at -71k. Second, the Household Survey showed a massive drop in jobs at 683k jobs lost. The divergence between the two surveys (Establishment, which was what the headline number is and Household) has been wide for a long time and given other labor market indicators (claims, ADP) are strong, it's unlikely the jobs market is a lot weaker than we think. However, for a market that dropped three straight days, that gave the bulls some reprieve and contributed to the bounce on Friday's open.

Turning to growth data, the big surprise was Friday's ISM Services PMI which fell to 50.6 vs. (E) 52.7, the lowest level since May. Details of the report were also a disappointment as New Orders, the leading indicator in the report, declined to 52.8 from 55.5 while Employment plunged to 43.3 from 50.7. Now, it's just one report and we can't read too much into it, especially given it's around the holidays. But the bottom line is this: The ISM Services PMI hasn't been below 50 since December 2022 and it hasn't been below 50 for two consecutive months since the height of the pandemic. This indicator does not drop below 50 often and if that happens in the first few months of 2024 that will absolutely increase my concern that the economy is starting to slow.

Turning to the other growth report from last week, the December ISM Manufacturing PMI, it was solidly Goldilocks as the headline beat estimates at 47.4 vs. (E) 47.2 while prices declined sharply to 45.2 from 49.9. Bottom line, in aggregate, data last week was mostly solid although it did push back on both ideas of imminent rate cuts (in March) and a "no landing" scenario, although the push back was modest.

This Week

The key economic reports this week come on Thursday via CPI and weekly jobless claims, with the former being much more important than the latter.

Over the past week, we've seen rate cut expectations for the ECB get dialed back as EU inflation metrics have bounced back. If the same thing happens in the U.S. via the CPI data, we should expect something similar: A decreased expectation for a March rate cut. And since expectations for aggressive rate cuts were a major part of the December rally, we should see stocks continue to drift lower as a March cut becomes less likely.

Importantly, however, even if headline CPI does increase from the November 3.14% reading, as long as Core CPI continues to decline (which it should), any increase in headline inflation will not push back against the idea that disinflation is still ongoing, and this is an important distinction.

The other notable economic report this week is jobless claims and the refrain is the same: A gradual drift higher in claims would be welcomed but a sustainable rise above 250k would signal some actual deterioration in the labor market. For the next few weeks we can expect claims data to remain noisy given holiday temp hiring but by late January we should be able to get a better read on the state of the labor market, and for now virtually all signs point to continued strength (but not so strong it would make the Fed less dovish).

Market	Level	Change	% Change
Dollar Index	102.16	.02	0.02%
EUR/USD	1.0941	-.0041	-0.04%
GBP/USD	1.2721	.0039	0.31%
USD/JPY	144.67	.04	0.03%
USD/CAD	1.3365	.0015	0.11%
AUD/USD	.6714	.0007	0.10%
USD/BRL	4.8767	-.0240	-0.49%
10 Year Yield	4.042	.051	1.28%
30 Year Yield	4.200	.063	1.52%
10's-2's	-34 bps		
Date of Rate Cut	March 2024		
2024 YE Fed Funds	4.06%		
Prices taken at previous day market close.			

Commodities

Commodities saw a mixed and volatile start to 2024 last week as an early week rebound in the dollar weighed broadly on the space, specifically the metals, which ended the week lower. Energy bucked the trend and rallied on a slew of bullish news flow from rising geopolitical tensions to resilient economic data. The commodity ETF, DBC, rose 0.41% on the week.

Starting with the big mover, oil jumped higher on Wednesday after geopolitical tensions in the Middle East heated up considerably. With the Israel-Hamas conflict pushing across boarders into Lebanon, more ships being attacked by Iran-backed militants in the Red Sea, and a memorial service being attacked by multiple bombs in Iran, the recently dormant "fear bid" in the oil market came back to life in a big way.

Additionally, protests in Libya saw one of the nation's largest oil fields, the Sharara field, shut down completely while OPEC+ reiterated its collective cooperation and commitment to "stable" oil prices. EIA data was skewed by the calendar in a delayed release on Thursday but the report was effectively a wash, all things considered, and oil rallied Friday morning in the wake of the solid December jobs report. WTI ended the week higher by 3.67%. Looking ahead, oil could resume the early 2024 rally if geopolitical tensions remain elevated and soft landing hopes remain alive. But recession fears, a deterioration in OPEC+ relations, and favorable easing of tensions in the Middle East are all risks to the market.

Copper came for sale last week amid the downbeat economic data and cautious commentary out of China. Futures ended the week down 2.30%. On the charts, copper remains just off of multi-month highs but with downside risks emerging. If we do see a more meaningful drop in copper, we will take that as a familiar warning sign for the economy and 2024 growth prospects.

Gold pulled back on the dollar strength and rebound in Treasuries to start last week, but ultimately ended the week well off the lows as the rather disappointing ISM report pushed back on the increasingly hawkish money flows to start 2024. Gold fell 0.93%. With gold futures sitting just off freshly established all-time highs from December, the yellow metal remains our preferred destination for capital in the commodity complex.

Currencies & Bonds

Yields and the dollar started 2024 with solid rallies thanks to a bounce back in EU inflation data and solid (and borderline too hot) economic data in the U.S. The Dollar Index rose 1.12% last week while the 10-year yield gained 11 basis points and closed back above 4.00%.

It's important that we view last week's rallies in the dollar and Treasury yields in the context of the relentless declines in December, because that does matter even despite the bounce in EU inflation metrics and solid economic data. Last week's dollar and yield rally still is wholly expected given the recent steep declines. Point being the dollar and yields were oversold and due for a bounce and they got one.

However, it remains that the data was better than expected and that did push back against aggressive rate cut expectations and that drove the rally in the dollar and Treasury yields. Internationally, the euro fell 0.8% despite the bounce back in inflation while the pound declined 0.2% vs. the dollar. The yen was the biggest decliner vs. the greenback, falling nearly 3%, but that was due to expected economic fallout from the Jan. 1 earthquake, not anything policy related.

Looking at yields, the 2 year rose 8 basis points and the 10 year, as mentioned, gained 11 bps and there were similar increases in 10-year German bund yields and the point is this: Yields rose globally as economic data pushed back against the idea of more dovish global central banks.

Bottom line, markets still view the Fed as the most dovish major central bank and the one that will cut rates first. As such, it'll be difficult for the dollar and yields to sustainably rally. However, that doesn't mean they will decline in a straight line, either, and continued digestion of the multi-month drops in the dollar and yields is to be expected (that's not bad for stocks because it'll take sharp moves in yields to cause direct pressure on stocks and the more sideways digestion we get to start the year, the better).

Have a good week,

Tom

1/8/2024

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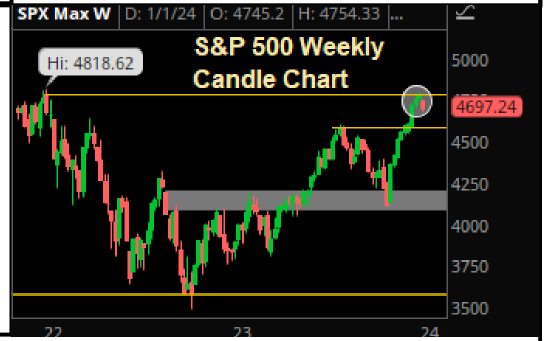
Technical Perspectives (Updated 1/7/2024)

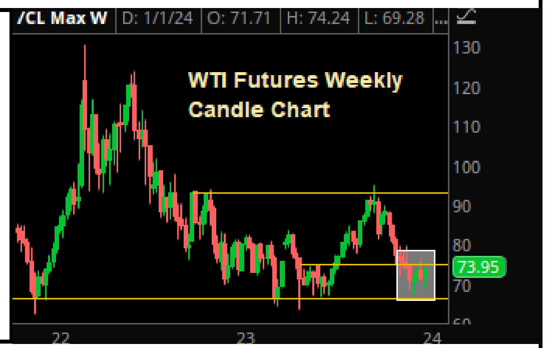
S&P 500

- 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: 4783, 4818, 4850
- Key Support Levels: 4598, 4505, 4415



WTI Crude Oil

- Technical View: The price action in oil deteriorated in H2'23 but continues to hold above the 2023 lows, leaving the outlook neutral.
- Proprietary Model: **Neutral (since the week of November 6, 2023)**
- Key Resistance Levels: $75.43, $77.72, $79.60
- Key Support Levels: $72.40, $71.15, $69.87



Gold

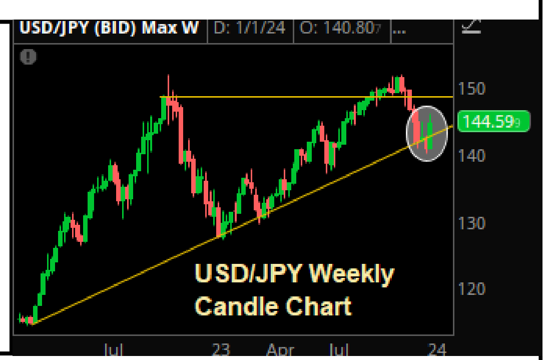
- Technical View: Gold futures broke out to fresh all-time in late 2023 shifting the technical outlook decidedly in favor of the bulls.
- Proprietary Model: **Bullish (since the week of November 27, 2023)**
- Key Resistance Levels: $2089, $2108, $2152
- Key Support Levels: $2033, $2000, $1967

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: 4.099, 4.121, 4.239
- Key Support Levels: 3.907, 3.789, 3.608

Dollar/Yen

- Technical View: The USD/JPY violated a longstanding uptrend line to end 2023 shifting the technical outlook from bullish to neutral.
- Proprietary Model: **Neutral (since the week of December 25, 2023)**
- Key Resistance Levels: 145.46, 146.79, 148.31
- Key Support Levels: 142.37, 140.18, 138.78



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Fundamental Market View
(Updated 1/7/2024)

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 started 2024 with moderate declines as inflation data bounced back while some growth data disappointed, pushing back on the idea of imminent and aggressive rate cuts.*

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 rallied modestly last week thanks to a bounce back in oil (mainly) and despite a stronger U.S. dollar, as rising geopolitical tensions increased the risk premium in oil.*
US Dollar	**Neutral**	*The Dollar Index rallied hard last week despite a bounce back in EU inflation, as markets dialed back expectations for aggressive Fed rate cuts starting in March (although that's still the consensus expectation).*
Treasuries	**Turning Positive**	*Yields rallied to start 2024 thanks to the aforementioned bounce in European inflation data as both the 2- and 10-year yields are again back above 4.00%.*

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.