SEVENS REPORT

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

February 14, 2024

Pre 7:00 Look

- Stock futures are rebounding back from yesterday's steep post-CPI selloff thanks to some "cooler" inflation data in the U.K. overnight and better than expected factory data out of Europe. The 10-Yr yield is stable, just below 4.30%.
- Economically, the Q4 Eurozone GDP Flash met estimates at a tepid 0.1% y/y but EU Industrial Production jumped 2.6% vs. (E) -0.3% in December easing some ongoing growth worries. U.K. PPI also favorably declined across the board.
- There are no notable economic reports today.
- Fed Speak: Goolsbee (9:30 a.m. ET), Barr (4:00 p.m. ET).

Market	Level	Change	% Change
S&P 500 Futures	4989.25	18.25	0.37%
U.S. Dollar (DXY)	104.897	-.060	-0.06%
Gold	2005.70	-1.50	-0.07%
WTI	78.05	.18	0.23%
10 Year Yield	4.293	-.023	-0.53%

Equities

Market Recap

Volatility picked up materially yesterday with stocks dropping sharply amid a rise in bond yields and a firming dollar after hotter-than-expected CPI data. The S&P 500 dropped 1.37%

A hawkish reaction to the "warmer-than-expected" January CPI report prompted a steep selloff in equities amid a sharp rise in yields and broadly stronger dollar at the open. The S&P 500 filled a technical gap down to last Tuesday's settlement level near 4,955 in the first few minutes and then drifted around the 4,950 level as the inflation data was digested.

Yesterday's selloff was amplified by derivatives markets in the wake of the CPI report. The near-30% intraday surge in the VIX was reminiscent of January 2018 when multiple "short-volatility" funds were forced to liquidate due to insolvency. It will be important to watch whether the VIX breaks beyond yesterday's high of 17.94 today, or reverses lower.

The index held support at the psychological 4,950 area and began to climb towards the opening highs into the European close. But with limited news flow and Treasury yields climbing steadily higher, stocks rolled back over in the early afternoon hitting new one-week lows amid a VIX that jumped to new 2024 highs. Stocks hit the lows of the day during the final hour when options activity and some positioning into the close caused a rally off the lows, although that wasn't driven by any positive news.

Was Yesterday's Hot CPI the Start of a Pullback?

Stocks dropped sharply after the January CPI was "hot" and there are four important issues I want to address. First, why did stocks drop? Second, is this the start of a broader pullback? Third, what would make this a full-blown correction and fourth, what sectors should outperform?

Market	Level	Change	% Change
Dow	38,272.75	-524.63	-1.35%
TSX	20,584.97	-482.33	-2.29%
Stoxx 50	4,702.10	12.82	0.27%
FTSE	7,576.66	64.38	0.86%
Nikkei	37,703.32	-260.65	-0.69%
Hang Seng	15,879.38	132.80	0.84%
ASX	7,547.74	-55.85	-0.73%

Prices taken at previous day market close.

Why Did Stocks Drop? It's important to realize that while the hot CPI was the catalyst for yesterday's stock and bond market declines, stocks didn't decline because CPI implied inflation was bouncing back. In fact, CPI did not imply inflation was bouncing back, as headline CPI continued to decline to 3.1% from 3.4% y/y and core CPI was flat at 3.9% and will face future downward pressure from housing, sometime in the coming months. Point being, disinflation is still ongoing and this is an important distinction to make because that prevents yesterday's CPI from being a substantial bearish game-changer. Instead, the reason stocks dropped was because the CPI report was the first data point in 2024 to not confirm these fantastically positive assumptions that have driven this rally. Put simply, yesterday's CPI didn't really change the conversation on disinflation. Instead, it just exposed that the S&P 500 at 5,000 is priced for absolute perfection, and yesterday's number shattered that idea of perfection. But importantly, disinflation is still ongoing (albeit slower than markets expected/ hoped).

Market	Level	Change	% Change
DBC	22.14	-.13	-0.58%
Gold	2,005.60	-27.40	-1.35%
Silver	22.09	-.68	-2.97%
Copper	3.7035	-.0205	-0.55%
WTI	77.67	.75	0.98%
Brent	82.57	.57	0.70%
Nat Gas	1.663	-.105	-5.94%
RBOB	2.3839	.0166	0.70%
DBA (Grains)	21.99	-.06	-0.29%

Prices taken at previous day market close.

Is This the Start of a Pullback? It would not surprise me. But by pullback I'd expect something on the order of 3%-5%, not close to 10%. I say that because even considering yesterday's declines, the market is still priced for a near-perfect macro environment while most other assets are saying something different.

Here is essentially the problem: The entire October to the February rally in the S&P 500 has been based on the idea of: 1) Sooner-than-expected Fed rate cuts, 2) Continued falling inflation and 3) A decline in the 10-year yield that helps increase the market multiple. **All three of those have reversed back to December or November levels yet the S&P 500 remains 8% higher than it was in December.** Fed rate cut expectations are now for three to four cuts, which is the same level it was late last summer, when the S&P 500 was trading around 4,400. The 10-year yield is now back to where it was during the first week of December, when the S&P 500 was trading around 4,500. And inflation has essentially gone nowhere since October with Core CPI sitting at 3.90% y/y versus 4.0% y/y in October, yet the S&P 500 has rallied from 4,400 to 5,000 over that timeframe. If those reasons for the rally have totally round-tripped the December move, then it is reasonable to expect the S&P 500 to partially follow them (although growth and earnings will help cushion the decline). And that's what gets me to expect a 3%-5%-ish pullback. Now, to be clear, this does not mean the medium- or long-term outlook has shifted material bearish and it does not mean the outlook is much more negative than it was. But what it does mean is that the CPI report is the first economic report of this year to challenge the market's outrageously positive assumptions, and as a result, we should see give back in markets as it reprices a new macro reality—one that is still good, but not as positive as the market had hoped.

What Could Make It Worse? A disorderly rise in yields or a spike in growth worries. If we see an acceleration higher in Treasury yields similar to what we witnessed in late-summer/early fall, expect stocks to drop sharply (more like 10%). Additionally, if growth suddenly rolls over (and this includes the data on Thursday) or we get a commercial real estate related financial firm failure, then look for stagflation worries to be resurrected and at that point, a 10% correction becomes possible. So, we will be watching the 10-year yield and economic growth in the coming days. Bulls need calm yields and Goldilocks data. Unless we get additional negatives in the form of surging yields, suddenly bad growth or commercial real estate-related financial company collapse, I'd view any near-term pullback as a digestion in an ongoing rally and not the end of this October-February move higher.

What Should Outperform If This Is a Pullback? I've preferred to skew exposure to less-volatile ETFs and sectors at the start of the new year because I was concerned about the sustainability of this rally in the short term and that worked for the first few weeks of 2024 but lagged the past two weeks. I continue to prefer that strategy because I'm concerned the next three-four months will be more volatile than the last three-four months and if yields move higher or growth slows, reducing volatility via ETFs such as USMV and SPLV and focusing on value via VTV will help limit losses while keeping positive exposure intact.

If the selling continues for another 3% or more but we don't get any additional negatives, I'd look to use that decline to potentially add exposure to less-volatile funds focusing on those value/defensive-oriented ETFs. Regarding tech, if yields move sharply higher, I'd expect even super-cap tech to get hit and would prefer to see a broader decline before allocating to TDIV or similar dividend-focused tech ETF (again, to gain exposure but keep volatility minimized).

Economics

Consumer Price Index

- CPI rose 0.3% vs. (E) 0.2% M/M and 3.1% vs. (E) 3.0% Y/Y in January
- Core CPI rose 0.4% vs. (E) 0.3% M/M and 3.9% vs. (E) 3.7% in January

Takeaway

Yesterday's CPI release showed a smaller-than-expected decline in inflation as both the headline and core figures topped estimates and pushed back on the idea of consistently (and quickly) falling inflation.

Looking at the numbers, positively, the headline CPI reading declined further (from 3.4% in December to 3.1% in January) but that wasn't as much as expected and more importantly, core CPI failed to decline on a year-over-year basis (staying put at 3.9% yoy) and rising slightly more than expected on a monthly basis.

Looking deeper into the data, the financial media correctly pointed out that shelter costs (renting and buying real estate) rose 0.6% and was the main contributor to the disappointing report and that continued rise flies in the face of what we're seeing in the "real world" with real estate prices. But it's a mistake to blame this bad inflation report on housing and that is because "super core" CPI (which is core services inflation minus housing) rose 0.8% vs. 0.3% in December, the highest rate since May of last year.

Bottom line, this report confirmed what we saw in the ISM Manufacturing and Services price indices and while it shows that headline inflation is still declining, the market was expecting more and the market reaction was clear disappointment, as Treasury yields surged to a multi-month high while stocks dropped sharply in response, as investors dropped rate cut expectations for May below 50%, delivering a blow to "dovish Fed" market expectations.

Market	Level	Change	% Change
Dollar Index	104.82	.77	0.74%
EUR/USD	1.0707	-.0065	-0.60%
GBP/USD	1.2587	-.0042	-0.33%
USD/JPY	150.75	1.40	0.94%
USD/CAD	1.3576	.0125	0.93%
AUD/USD	.6450	-.0081	-1.24%
USD/BRL	4.9552	-.0412	-0.82%
Bitcoin	49,196.45	-755.75	-1.55%
10 Year Yield	4.316	.144	3.45%
30 Year Yield	4.466	.096	2.20%
10's-2's	-34 bps		
Date of Rate Cut	June 2024		
2024 YE Fed Funds	4.53%		
Prices taken at previous day market close.			

Commodities

Commodities were mixed as oil extended gains on continued geopolitical tensions in the Middle East and Europe while industrial and precious metals turned lower immediately following the release of the hotter-than-anticipated January CPI report. The commodity tracking index ETF, DBC, fell 0.58%.

Starting with the metals, gold and copper were both higher ahead of the latest CPI release, but once the numbers hit with both the headline and core figures coming in higher than expected, the dollar surged and Treasuries came for sale hard, which weighed heavily on both types of metals.

Gold underperformed in a big way with futures falling 1.36% to test the $2,000/oz. level in mid-morning trade but held above that psychological threshold by a matter of a few dollars. The only thing that likely kept gold above the $2,000 mark was a spike in market-based inflation expectations as 5-YR Breakevens jumped to 2.34%, the highest since early November (when risk assets were in the process of bottoming). On the charts, gold did close at a new low for the year, however, and it seems increasingly likely we will see some downside in the near-term for gold futures with key support lying between $1,940 and $1,950/oz. The long-term bullish view on gold remains intact based on the new highs from late 2023, but how far futures drawdown between now and that eventual expected outcome remains to be seen.

Copper outperformed with a more modest loss of 0.50% yesterday and importantly held above last week's closing low, which happens to be the low close for 2024. That level of $3.69 will be key support to watch in the sessions ahead to decipher whether economic expectations are making a material turn for the worse if soft landing hopes remain widely held.

WTI crude oil futures rallied 1.24% after the U.S. rejected a ceasefire deal in Ukraine presented by Russia, which keeps the risks of more attacks by Ukrainian forces on Russian energy facilities elevated. Additionally, tensions remained high in the Middle East as the Israeli military reiterated plans to push down into Rafah in their fight with Hamas. WTI did fall just short of making a new 2024 high though, ending below $78/barrel.

Today, focus will turn to the weekly EIA data and the bulls will want to see continued strength in consumer demand, which rebounded solidly to the 2023 average last week as well as a steady production rate and no evidence of a surplus re-emerging in the domestic physical markets (i.e. refined product supply builds). Looking ahead, the price action continues to favor the bulls but the market outlook remains neutral for the time being and that will remain the case until we get new highs in the active-month futures contract as well as in the major calendar spreads (specifically Dec24-Dec25).

Currencies & Bonds

The hotter-than-expected CPI report caused both the dollar and Treasury yields to rise to multi-month highs as investors pushed back the date of the first expected rate cut to June. The Dollar Index rose 0.75% while the 10-year yield rose 14 basis points.

The dollar and Treasury yields were flat pre-CPI, but that changed with the hotter-than-expected report and the movement was immediate, as the Dollar Index shot higher by 0.60% and then drifted slightly higher throughout the day to finish near the highs and just under 105.00. This is the highest close for the dollar since early November. As you'd expect, with the dollar so much stronger, foreign currencies fell sharply as the euro dropped 0.6%, the yen declined 1.0% and the pound dropped a more moderate 0.3% (there are hawkish rumblings from the BOE that helped the pound).

The 10-year yield, meanwhile, surged following the report rising 10 basis points immediately and then drifting steadily higher to close basically at the highs of the day above 4.30% for the first time since late November. The reason for the rallies was obvious: fed fund futures dropped the odds of a May and June rate cut below 50% each and now have the first rate cut coming in June. And, they have a year-end fed fuds rate around 4.50%, meaning the market is split between whether the Fed will cut three or four times this year, which is dramatically lower than the five-seven cuts expected at the start of the year.

Looking forward, the 10-year yield remains the key indicator to watch and the higher it goes, the more pressure will be exerted on stocks. The 4.35% and 4.47% levels are two resistance points to watch and if both of those are broken on momentum, expect stocks to continue to decline. Digestion of yesterday's rally (perhaps on some Goldilocks data or dovish Fed speak) is the best thing for markets right now.

Regarding the Dollar Index, the upward momentum is intact and it's going to take soft data, dovish Fed speak or hawkish commentary from the ECB to stop the dollar rally as it's within striking distance of 105. Much above 105, the stronger dollar will start to become a headwind on earnings and stocks in general, so again some digestion of the move via Goldilocks data on Thursday or dovish Fed speak would help settle markets going forward.

Have a good day,

Tom

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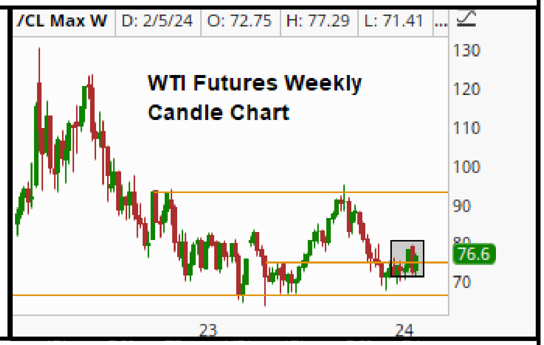
Technical Perspectives (Updated 2/11/2024)

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: 5050, 5100, 5135
- Key Support Levels: 4959, 4899, 4792

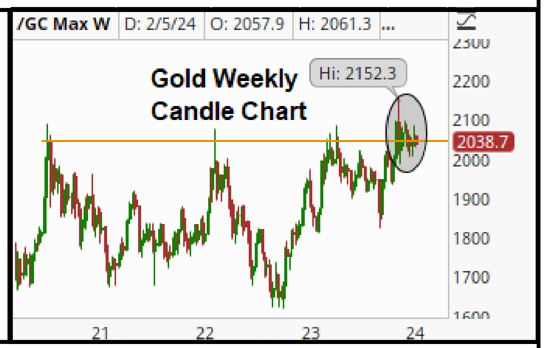
WTI Crude Oil

- Technical View: The oil market has stabilized and begun to rally in early 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: $77.79, $78.90, $80.82
- Key Support Levels: $76.04, $74.20, $73.00



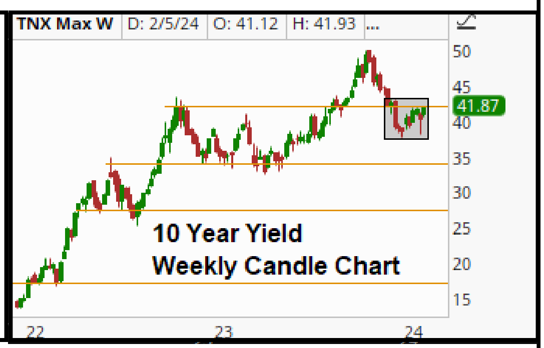
Gold

- 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: $2072, $2094, $2152
- Key Support Levels: $2032, $1995, $1950



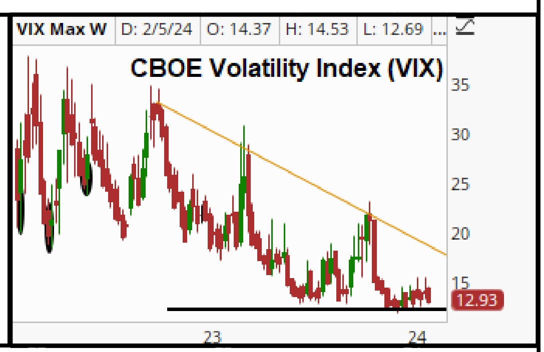
10-Year T-Note Yield

- 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: 4.239, 4.352, 4.472
- Key Support Levels: 4.125, 4.033, 3.927



CBOE Volatility Index (VIX)

- Technical View: The VIX is in a tight, uptrend channel pointing to upside risks but in absolute terms the index remains well off Q3'24 highs and has a neutral outlook
- Proprietary Model: **Neutral (since the week of February 5th, 2024)**
- Key Resistance Levels: 13.31, 13.85, 14.35
- Key Support Levels: 12.55, 12.07, 11.84



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Fundamental Market View (Updated 2/11/2024)

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%**	*The S&P 500 traded above 5,000 last week thanks to strong Treasury auctions reducing concerns about demand for U.S. debt and on generally solid economic data.*

Tactical Allocation Ideas:

- **What's Outperforming: Growth factors, tech, consumer discretionary and communication services have outperformed thanks to strong earnings and continued "AI" enthusiasm.**
- **What's Underperforming: Defensive sectors and value have underperformed recently mostly as Treasury yields have risen, although they are poised to rebound substantially if there is a surprise slowing of growth.**

Long Term Fundamental Outlook for Other Asset Classes

	Fundamental Outlook	Market Intelligence
Commodities	**Neutral**	*Commodities rallied moderately last week thanks mostly to gains in oil, as a lack of a ceasefire in Gaza increased geopolitical tensions and sent oil sharply higher on the week.*
US Dollar	**Neutral**	*The Dollar Index was little changed last week as there was minimal economic data while central bank speak didn't alter the expectation for a May rate cut from the Fed and summer rate cuts from the ECB/BOE.*
Treasuries	**Turning Positive**	*Treasury yields rose last week but the gains were generally muted and it wasn't enough to weigh on stocks. Hotter-than-expected price data in the ISM Services PMI combined with more pushback on March rate cuts pushed yields higher.*

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.