SEVENS REPORT

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

February 15, 2024

Pre 7:00 Look

- Futures are slightly higher despite soft economic data and more earning guidance cuts.
- UK monthly GDP declined –0.3% and the UK officially entered recession, boosting rate cut expectations.
- On earnings, both CSCO and DE cut guidance and both stocks are solidly lower pre-market.
- Econ Today: Jobless Claims (E: 219k), Retail Sales (E: -0.1%), Philly Fed (E: -9.0), Empire Mfg Index (E: -12.5), Industrial Production (E: 0.2%), Fed Speak: Waller (1:15 p.m. ET), Bostic (7:00 p.m. ET).

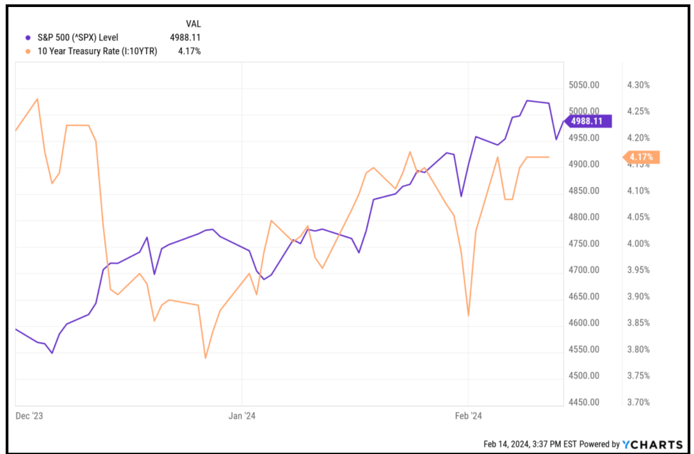
Market	Level	Change	% Change
S&P 500 Futures	5,024.00	6.00	0.12%
U.S. Dollar (DXY)	104.61	-0.12	-0.11%
Gold	2,008.80	4.50	0.22%
WTI	75.85	-0.79	-1.03%
10 Year Yield	4.23%	-0.04	-0.86%

Equities

Market Recap

Stocks bounced back and the S&P 500 recouped more than half of Tuesday's losses thanks to encouraging global inflation readings and dovish commentary from Fed officials. The S&P 500 rallied 0.96%.

Stocks were higher from the outset Wednesday, as most expected a bounce following Tuesday's steep declines. The early rally was solid and aided by a smaller-than-expected increase in UK CPI, which helped to push back against the hot U.S. data. Stocks opened with moderate gains as investors took advantage of the biggest single-day decline in stocks in months.



Since December, the 10-year yield has traded in a 3.75% - 4.25% trading range. During that time, stocks have moved steadily higher. If the-10 year yield breaks out above 4.25% that would be a new headwind for stocks.

The rally accelerated midmorning thanks to dovish commentary from Chicago Fed President Goolsbee, who pushed back against the hot CPI report by stating the Fed follows the core PCE, not CPI. That contributed to the feeling that Tuesday's decline was an overreaction and stocks continued to drift higher into midday.

News flow quieted into the afternoon but stocks held their gains and that resulted in a drift higher during the final hour, led by tech and small caps as the S&P 500 closed basically at the highs of the day and again recouped the majority of Tuesday's losses.

What Is the "Short-Vol" Trade and How Is It Affecting Markets This Week?

The "Short-Vol" or "Short-Volatility" trade became a very popular strategy in the 2010s as volatility was historically low for much of the decade with only limited periods of brief volatility. That, in turn, provided a very favorable environment to be "short" volatility, or bet

Market	Level	Change	% Change
Dow	38,424.27	151.52	0.40%
TSX	20,889.40	304.43	1.48%
Stoxx 50	4,739.70	30.48	0.65%
FTSE	7,569.15	0.75	0.01%
Nikkei	38,157.94	454.62	1.21%
Hang Seng	15,944.63	65.25	0.41%
ASX	7,605.72	57.98	0.77%
Prices taken at previous day market close.			

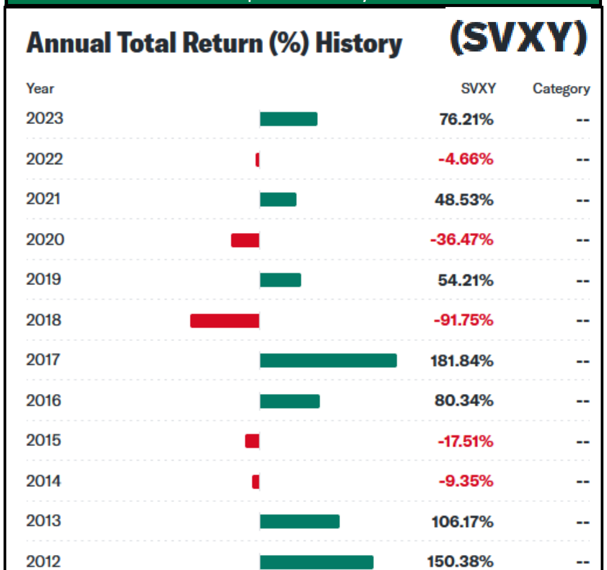
against the VIX. Because the VIX and VIX derivatives are based on options, there is a strong degree of "theta decay," which is simply the decreasing amount of time value an options contract has as it approaches expiration, especially those that are out-of-the-money. Theta decay can be taken advantage of by those who are short options or VIX products, particularly those which expire within 30 days when the time value of money effectively goes into freefall on options contracts that are not in-the-money.

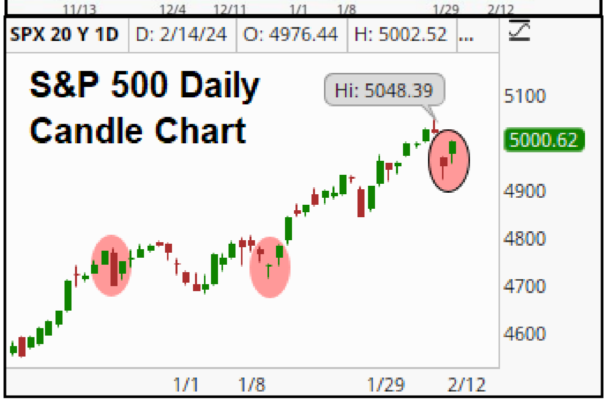
This derivatives-based strategy and its strong prospects for profitability resulted in structured products including ETFs to come about such as SVXY. And the demand for these short-vol products was through the roof in the mid-2010s but that caused problems in the markets later in the decade. Looking at the returns, of the six years between the start of 2012 and the end of 2017, the short VIX futures ETF, SVXY, posted an annual return of over 100% in half of the years, the best being a whopping 181.84% gain in 2017. Essentially, the short-vol trade became an easy way to add alpha to an equity portfolio given the outsized returns during those favorable years along with the fact that, for a while, the "bad years" weren't that bad with the biggest annual loss between 2012 and 2017 being just 17.5% in 2015.

The perception of very strong risk-reward dynamics that were almost "too good to be true" lured in a slew of greed-oriented investors resulting in a very overcrowded short volatility position in the markets into the end of 2017. As many likely remember, things came to a head in early 2018 as volatility surged and triggered a massive squeeze in the short-vol trade sending the VIX up by a staggering 450% between the first week of January and the first week of February 2018. There was plenty of fallout surrounding the "Vol-mageddon" event of early 2018 including the liquidation of several of the most widely followed and heavily invested short-volatility ETFs. It took the better part of 2018 for the implications of the short-vol trade blow up to be digested by the market. Ultimately, SVXY ended the year with an unfathomable loss of 91.75%, a textbook example of capitulation in a given trading strategy.

Market	Level	Change	% Change
DBC	21.93	-.21	-0.95%
Gold	2,004.10	-3.10	-0.15%
Silver	22.39	.24	1.07%
Copper	3.703	-.008	-0.22%
WTI	76.50	-1.37	-1.76%
Brent	81.48	-1.29	-1.56%
Nat Gas	1.611	-.078	-4.62%
RBOB	2.3115	-.0831	-3.47%
DBA (Grains)	21.87	-.12	-0.55%

Prices taken at previous day market close.





Fast forward to 2023 and the short-vol trade was back in vogue, ending the year with a more than 76% gain, which makes sense given that volatility was suppressed for much of the year despite some shorter-lived bouts of volatility in March (bank failures) and into October (sharp rise in real yields).

Interestingly, we have seen negative moves in the stock market leading into the last three VIX futures expirations as complacent options sellers and VIX shorts get squeezed through the expiration (the Wednesday before monthly options expiration each month) before the market experiences a sense of "release" from certain strike price levels and rips back higher. Note how smooth the price action in the front-month futures calendar spread was up until Tuesday of this week (see Pg. 2) when the "warm" CPI report triggered a massive move across options, futures, and ultimately cash markets over the course of the day.

Bottom line, investor complacency is elevated and a reach for alpha seems to be steadily on the rise among portfolio managers again following the strong returns in 2023, but amid wide divergences between sectors and styles. And the rebound in interest in short-volatility strategies is once again posing a risk to the broader markets here as a negative catalyst can clearly spark a momentous, derivatives-driven selloff in the broader stock market like that which we saw in 2018, and a glimpse of which we saw on Tuesday and yesterday into VIX futures expiration. Going forward, these expirations will remain dates to keep in mind as the threat of volatility will be elevated as we move further into 2024. So far, the last three VIX expirations have presented buying opportunities, but that won't necessarily remain the case.

An Important Trading Range to Watch

The 10-year Treasury yield is arguably the most important financial indicator on the markets today as the 10 year encompasses market expectations for growth, inflation and the Fed. So it's notable that the 10-year yield is threatening to break out of a two-month 3.75%-4.25% trading range that's supported the rally in stocks.

The 10-year yield traded above 4.25% for the first time since early December on Tuesday following the hot CPI report and notably, despite a mild decline yesterday, closed just above that level once again. If the 10 year is able to close above 4.25% for several sessions that will send a message to investors that the bond market is expecting either 1) Higher inflation or 2) Stronger-than-expected growth, and both of those are negative for a June rate cut. So, the farther above 4.25% the 10 year rises, the more of a headwind it'll become on stocks because again it'll be signaling stronger growth or higher inflation.

For stock bulls, the sooner the 10 year drops below 4.25% and re-enters that trading range, the better, because that range in the 10 year reflects Goldilocks levels of inflation (not too high) and growth (solid, but not too hot) and that's an environment where stocks can rally and the longer the 10 year stays in that range, the better. Finally, if the 10 year suddenly plunges through that range, that's not a positive, because a drop below 3.75% would reflect worries about future economic growth and in that instance, Fed rate cuts wouldn't be able to save stocks.

So, the longer the 10 year stays in the 3.75%-4.25% range, the better for stocks. If the 10 year climbs over the coming days and decisively breaks out above 4.25% that will increase the headwind on stocks and in that instance, I'd be surprised if Tuesday's low in the S&P 500 of 4,920 isn't broken.

Market	Level	Change	% Change
Dollar Index	104.62	-.24	-0.23%
EUR/USD	1.0728	.0019	0.18%
GBP/USD	1.2563	-.0029	-0.23%
USD/JPY	150.50	-.30	-0.20%
USD/CAD	1.3546	-.0018	-0.13%
AUD/USD	.6491	.0038	0.59%
USD/BRL	4.9733	.0181	0.37%
Bitcoin	51,794.46	2,517.95	5.11%
10 Year Yield	4.267	-.049	-1.14%
30 Year Yield	4.448	-.018	-0.40%
10's-2's	-32 bp		
Date of Rate Cut	June 2024		
2024 YE Fed Funds	4.47%		
Prices taken at previous day market close.			

Economics

There were no material economic reports yesterday.

Commodities

Commodities were broadly lower yesterday as a bearish EIA report sparked a heavy wave of selling in the energy complex while metals were lower amid a continuation of higher-for-longer Fed policy concerns. The commodity ETF, DBC, dropped 0.95%.

Gold was the relative outperformer with futures declining a modest 0.17% but notably holding above $2,000/oz. A steadying bond market, with the 10-year yield retreating from the 4.30% level paired with a pullback in the dollar all contributed to gold being able to rebound out of the high $1,900s to end back above $2,000. Looking ahead, the next move for gold will depend on whether the Dollar Index continues to firm (bearish) and if real rates level out here after hitting new 2024 highs (also bearish). If the 2024 trends of a strengthening dollar and rising real yields continue, look for gold to give up $2,000/oz. and fall towards key support near $1,940.

Copper also suffered a modest loss with futures ending down 0.24%. Similar to gold, copper was able to hold key support above last Friday's closing low of $3.68. From a macroeconomic standpoint, those bullish risk assets amid hopes of a soft-landing will want to see copper at a minimum stabilize if not begin a new leg higher in the sessions ahead in order to help offer anecdotal evidence that global growth and demand remain healthy.

EIA Data Takeaways: A Bearish Report

There was very little for oil bulls to be excited about within yesterday's weekly EIA data. As such, WTI futures retreated from a run at the 2024 highs near $79/barrel to turn negative for the week, ending down 1.59%.

There was a massive +12.0MM bbl build in commercial crude oil stockpiles, considerably more than the estimate of +2.8MM and even above the unexpectedly large API print of +8.5MM from late Tuesday. Gasoline supply fell -3.7MM bbls vs. (E) -1.0MM (API: -7.2MM), and distillate inventories dropped -1.9MM bbls vs. (E) -2.2MM (API: -4.0MM). The big oil build and less-than-feared product draws saw futures selloff sharply in the immediate wake of the release.

Moving down through the details, what we considered to be the most important component of yesterday's report was a sharp drop in products supplied, which put a serious damper on the outlook for consumer demand. Specifically, gasoline supplied, an implied measure of demand for fuel at the pump, dropped back to just 8.17MM b/d, well below the 8.6MM b/d from Q1'23. Looking at production, U.S. oil output held steady at a record 13.3MM b/d while the refinery utilization rate fell 1.8% from an already unseasonably low level to just 80.6% (this week last year it was 87% and in 2022 it was 85%).

Refinery outages in the Midwest are having an impact on the inventory data right now, but refining activity does not impact the trends in consumer demand and last week's data showed an unfavorable drop off in consumption of gas and diesel. That was one of two developments we had noted could pose a threat to the tentative early 2024 rally in oil. The other being a rise to new record highs in domestic production. While the latter did not occur and geopolitical tensions remain high, the weak demand metrics will, for now, remain a headwind on oil and likely prevent a run into the $80/barrel range.

Currencies & Bonds

There was expected digestion of Tuesday's big rallies in the dollar and Treasury yields on Wednesday and it was aided by some positive inflation data from the UK. The Dollar Index declined 0.23% while the 10-year yield fell 5 basis points.

UK CPI came in under expectations (4.0% vs. (E) 4.2%) and that helped to push back against inflation-rebound fears early. Later in the U.S. session, the Fed's Goolsbee pushed back against the hot CPI stating inflation didn't need to get to 2% for the Fed to cut (something we already knew) and he reminded investors that the Fed watches core PCE, not CPI (and the core PCE is usually lower than CPI due to weighting and construction).

Those comments combined with the soft UK CPI and expected digestion of Tuesday's rally to push the Dollar Index and Treasury yields moderately lower by midday. However, the dollar drifted slightly higher during in the afternoon while the 10-year yield rallied off the lows of -10 bps to finish with modest losses.

Looking forward, the key levels to watch remain 4.25% in the 10 year (can it hold this break out?) and 105 in the Dollar Index. Moves well above those levels will likely signal stronger inflation or too-hot growth and further reduce expectations for a June rate cut, and that will likely increase headwinds on stocks. If the 10 year trades solidly above 4.25% and the Dollar Index trades sustainably with a 105 handle, I'd be very surprised if Tuesday's lows in the S&P 500 hold.

Have a good day,

Tom

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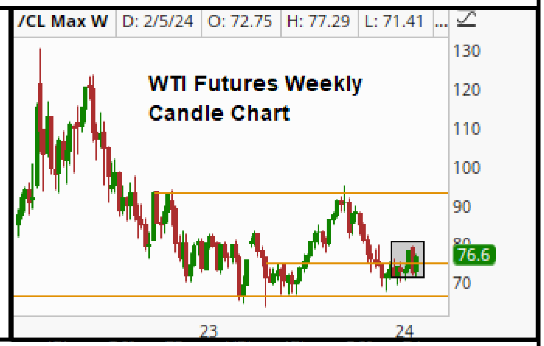
Technical Perspectives (Updated 2/11/2024)

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

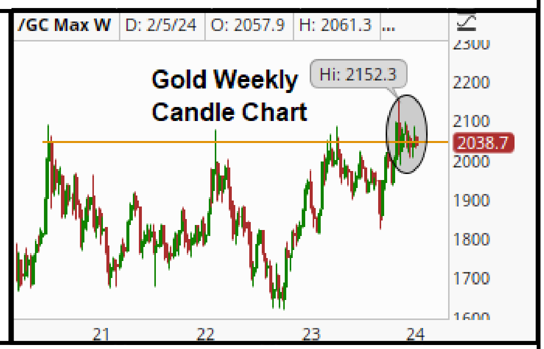
WTI Crude Oil

- 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



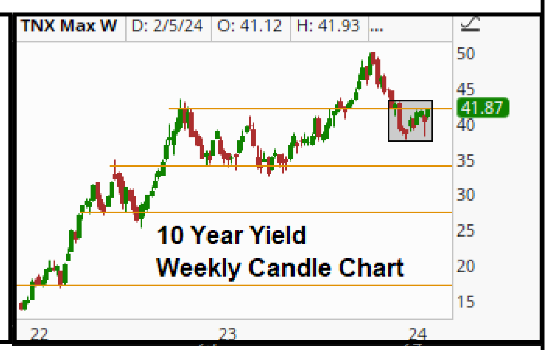
Gold

- 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



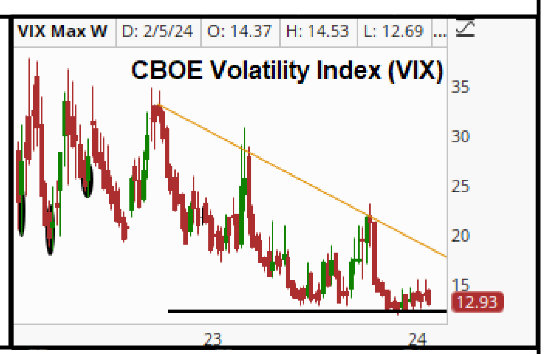
10-Year T-Note Yield

- 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.