SEVENS REPORT

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

February 21, 2024

Pre 7:00 Look

- Futures are mildly lower as traders look ahead to the Fed minutes this afternoon and NVDA earnings after the close.
- Overseas, Chinese stocks rallied to turn positive YTD after authorities expanded measures aimed at stabilizing the markets while Australian wage growth rose 4.2.% vs. 4.1% y/y prompting some modestly hawkish money flows.
- There are no notable economic reports today but the January Fed meeting minutes will be released at 2:00 p.m. ET.
- Fed Speak: Bostic (8:00 a.m. ET), Bowman (1:00 p.m. ET).
- There is a 20-Yr Treasury Bond auction at 1:00 p.m. ET.

Market	Level	Change	% Change
S&P 500 Futures	4980.00	-11.50	-0.23%
U.S. Dollar (DXY)	104.09	.01	0.01%
Gold	2039.40	-.40	-0.02%
WTI	76.45	-.59	-0.77%
10 Year Yield	4.260	-.015	-0.40%

Equities

Market Recap

Stocks were slightly lower pre-open Tuesday following a mostly quiet weekend of news, as a surprise rate cut from Chinese officials failed to spark much of a rally. Pre-market earnings from HD (slightly disappointing) and WMT (better than expected) didn't move the market materially and stocks opened slightly lower.

From the start, tech was weak, led lower by NVDA, which declined 4.4% on the day. But there wasn't a reason for the tech weakness other than positioning and profit taking ahead of NVDA earnings after the close today on fears expectations are too lofty. Momentum from Friday's declines also weighed modestly on stocks as the S&P 500 drifted steadily lower into lunchtime.

Stocks rebounded in quiet trade during the afternoon to cut the day's losses in half ahead of NVDA earnings later today. Bottom line, yesterday's declines were mostly positioning driven (booking profits ahead of NVDA) and on momentum from Friday's declines, but there was no real, negative change to the market outlook.

P/E ratios for the Magnificent Seven have been volatile, but they aren't materially higher than they were over the past several years, pushing back on the idea there is an AI bubble.

How the Magnificent Seven and the Kansas City Chiefs Are Similar (Bubble Watch)

AI enthusiasm has powered the tech and tech-aligned sectors higher over the past year and that's accounted for the vast majority of the gains in the S&P 500. But with one-year returns in mega-cap tech stocks at eye-popping levels, a lot of investors are wondering if AI enthusiasm has entered a bubble phase. And with NVDA set to report earnings later today, I wanted to address this issue and investigate if AI tech is in a bubble and if so, what it means for stocks.

Market	Level	Change	% Change
Dow	38,563.80	-64.19	-0.17%
TSX	21,217.53	-38.09	-0.18%
Stoxx 50	4,779.43	19.15	0.40%
FTSE	7,654.44	-64.77	-0.84%
Nikkei	38,262.16	-101.45	-0.26%
Hang Seng	16,503.10	255.59	1.57%
ASX	7,608.36	-50.69	-0.66%
Prices taken at previous day market close.			

First, the impact of AI enthusiasm on the market can be easily demonstrated via any number of startling statistics. Nvidia has been the "poster child" of AI enthusiasm because NVDA makes the type of semiconductor chips that power generative AI and demand for those chips has gone through the roof. So too has NVDA's stock, which has gained 218% over the past year. But while NVDA is the proverbial "picks and shovels" of the AI gold rush, other large-cap tech companies such as MSFT, META, GOOGL, AMZN and AAPL have also seen large stock rallies as investors expect these companies to harness the power of generative AI to boost revenues and increase earnings and profitability. And it's not just those stocks. AI enthusiasm has spread beyond tech to the "tech-aligned" sectors such as Communication Services (XLC) and Consumer Discretionary (XLY).

Market	Level	Change	% Change
DBC	21.91	-.12	-0.54%
Gold	2,037.10	13.00	0.64%
Silver	23.08	-.39	-1.66%
Copper	3.8635	.0250	0.65%
WTI	78.18	-1.01	-1.28%
Brent	82.52	-1.04	-1.24%
Nat Gas	1.586	-.023	-1.43%
RBOB	2.2986	-.0374	-1.60%
DBA (Grains)	22.02	.33	1.52%
Prices taken at previous day market close.			

Consider these stats:

- More than half of the 23.8% 2023 gain in the S&P 500 was driven by five stocks: NVDA, MSFT, META, AMZN and AAPL. Rallies in those names combined with their weightings accounted for nearly 55% of the gains in the S&P 500.
- Three S&P 500 sectors (Tech, Communication Services and Consumer Discretionary) accounted for nearly 80% of the gains in the S&P 500 in 2023, more fully revealing that last year's gains in stocks were totally "AI" driven.
- At current valuations, Nvidia has a market cap worth more than the entire S&P 500 energy sector (XLE) and Nvidia is worth more, by itself, than the entirety of the Chinese stock market.
- The market cap of the Magnificent Seven stocks combined is larger than every other country stock exchange in the world (second only the U.S. exchanges).

I can go on and on with these superlatives, but I trust you get the point. So, on to the bigger question: Has the AI mania gone too far and are we looking at a bubble situation?

Based on what most of us think about typical bubbles, the answer is "no" they are not in a bubble, and here's why. Their valuations really haven't changed despite these massive share price increases.

I looked at the forward and backward facing P/Es of five of the Magnificent Seven stocks (NVDA, MSFT, AAPL, META and AMZN). As the chart on Pg. 1 shows, while there's been some volatility over the years with Covid and other surprises, by and large the forward and backward looking P/Es of these stocks are roughly where they were over the past several years, including before Covid and before AI mania.

This is an important distinction between now and the late 1990s/early 2000s, when the P/Es of tech stocks exploded higher, revealing unsustainable valuation expectations. The fact that forward or backward P/Es haven't changed much reveals a very important reality of this AI-stock driven rally in tech: <u>It has occurred because these companies are making a lot more money, not just because people hope these companies make a lot more money</u>.

I reviewed actual earnings of the five stocks referenced above (NVDA, MSFT, META, AMZN, AAPL) and the results were remarkably consistent. Across the board, these companies are earning 2X-3X what they were just several years ago, and EPS for all of them are at or near multi-year highs. So, a large part of the rally in these stocks has been driven by actual earnings growth. These companies are making a lot more money so their shares are worth a lot more!

The conclusion of this research is clear. The AI-driven rally in the "Mag Seven" is largely justified by the fact that they're making a lot more money than they were previously. As such, their stocks should rally!

But that does not mean this historic move higher in the Mag Seven or tech/tech-aligned sectors doesn't pose a risk to the market. It does.

The easiest way to explain that risk is that the performance of the Mag Seven (from earnings growth and stock appreciation) is essentially making the rest of the market look a lot stronger than it actually is. And if the Mag Seven stocks stop performing like money-printing factories, then the market as a whole is worth a lot less than people think. Here's a stat that explains what I'm talking about.

In 2024, analysts expect the S&P 500 to earn about $243 share. Over the next 12 months (so basically 2024) analysts expect earnings from just the Mag Seven stocks to account for $74 of those $243, or about 30% of 2024 earnings for the S&P 500. Put differently, 1.5% of the S&P 500 is expected to account for 30% of the index's earnings. **If these seven stocks do not deliver, then earnings expectations for the S&P 500 will get revised sharply lower and that's where the risk lies.**

Here's a slightly easier way to explain it. The stock market is kind of like the Kansas City Chiefs (for all you football and Taylor Swift fans). The Kansas City Chiefs, like the S&P 500, had an amazing year, winning the Super Bowl. But the team doesn't have that many great players, except the two especially amazing players. Quarterback Patrick Mahomes and tight end Travis Kelce are so good that they produce results far above what the rest of the team should expect. Essentially, those two players help produce results for the team that are much better than the team's aggregate talent level would warrant or imply.

Similarly, the AI-driven earnings growth in the Mag Seven is producing returns for the S&P 500 far above what the "rest" of the market would warrant based on earnings. And as long as they (Mahomes, Kelce and the Mag Seven) continue to perform, the Chiefs (and the S&P 500) can keep winning. However, if one falls off or gets injured, then the reality that the rest of the team isn't that good will be exposed, and the Chiefs will likely go from Super Bowl champs to just another team.

Completing the analogy, the Mag Seven stocks are the "MVPs" of the 2023 rally, but their amazing earnings growth and performance is masking an otherwise average rest of the market, and if earnings growth doesn't meet expectations, then the average nature of the rest of the market will be exposed (and a decline in the S&P 500 will likely follow).

What's This Mean for Markets?

From a tactical standpoint, the takeaway from this analysis advocates for allocations to the equal-weight S&P 500 ETF (RSP), unless you are a true believer in the never-ending profit generation of the Mag Seven. I say that because if the Mag Seven disappoints vs. expectations and AI isn't as profitable as expected, we're going to see their earnings drop while other, unrelated sectors (that have lagged) are unaffected. So, we'll likely see a reversal of 2023, where the S&P 500 drops on tech while RSP outperforms and closes.

Conversely, if the Mag Seven meet expectations, they're just fulfilling what's already expected and as such, we could see investors continue to rotate into other parts of the market to try and capture some relative value, as RSP is trading at a near-20% valuation deficit to SPY. The only scenario where the Mag Seven names continue to lead markets higher is if AI's ability to maximize profits is greater than expected. And while that may be true, I do think the expectations for AI are pretty lofty (although admittedly, I'm not an AI expert).

Market	Level	Change	% Change
Dollar Index	103.97	-.21	-0.20%
EUR/USD	1.0810	.0031	0.29%
GBP/USD	1.2622	.0028	0.22%
USD/JPY	149.99	-.14	-0.09%
USD/CAD	1.3525	.0034	0.25%
AUD/USD	.6552	.0012	0.18%
USD/BRL	4.9307	-.0298	-0.60%
Bitcoin	52,176.74	279.43	0.54%
10 Year Yield	4.275	-.020	-0.47%
30 Year Yield	4.449	.001	0.02%
10's-2's	-34 bps		
Date of Rate Cut	June 2024		
2024 YE Fed Funds	4.50%		
Prices taken at previous day market close.			

Economics

There were no material economic reports.

Commodities

Commodities saw a mixed start to the week as gold rebounded from last week's losses while copper extended gains thanks to a fresh jolt of accommodation by the PBOC. Oil was the notable laggard as hawkish Fed policy expectations continued to weigh on the outlook for demand. The commodity tracking ETF, DBC, fell 0.54%.

Starting with the metals, a solid, 5-basis-point pullback in real interest rates (as measured by TIPS yields) paired with a pullback in the dollar, supported a 0.73% gain in gold. As we mentioned in yesterday's report, rising real rates and the firming dollar had become increasingly negative influences on gold in recent weeks so the pullback in both of those influences helped set up a relief rally. On the charts, gold continues to hold above $2,000/oz. but remains a good distance from the 2024 high of just over $2,070/oz. The outlook for gold hasn't changed with the near-term outlook neutral with futures in a trading range in the low-to-mid $2,000/oz. range while the longer-term view remains bullish thanks to the new record highs reached in late 2023.

Elsewhere in metals, copper failed to rally on the PBOC's deep cut to the Prime Loan Rate aimed at stabilizing the property market and markets more broadly, but the industrial metal did begin to trend higher at the European open as Eurozone Construction Output reportedly rose by 0.8% in December, up from -1% in November. Gains in copper were limited, however, by the lingering worries of a higher-for-longer policy rate environment not only in the U.S. but overseas as well. Copper has posted a solid gain off of last week's newly established 2024 lows and the January closing high of $3.91 is quickly coming into focus. A break higher would be a favorable signal for the health of the global economy.

Turning to energy, WTI crude oil futures dropped 1.62% to start the holiday-shortened week as demand worries were rekindled by the muted response to China's record cut to the Prime Loan Rate late Monday. More broadly, the higher-for-longer policy rate outlook for the Fed and other global central banks remains a major headwind for oil right now as the negative implications for the economy pressure demand expectations.

On the charts, WTI did break out to the upside last week on a daily and weekly time frame suggesting a new uptrend is forming and the term structure of the futures market remains in backwardation signaling very tight conditions in the physical market that should help support a run at $80/barrel. The biggest risk to the emerging oil rally is easing geopolitical tensions in the Middle East or in Ukraine as there is a "war premium" in the market right now given the proximity of oil and gas supply and infrastructure in the two regions.

Currencies & Bonds

There was no notable economic data or central bank speak on Tuesday as this week's important economic reports come over the next few days. If there was one "reason" for the dollar and yield drift lower, it was that Walmart noted continued price depreciation in its earnings call, which implies ongoing disinflation. Some noted that WMT management said the price declines had slowed (which is what last week's CPI and PPI implied) but the broader point here is that price declines were still ongoing according to WMT last quarter. The combination of that comment and digestion of last week's dollar and yield rally led to the modest dip in the dollar, rally in the euro and pound (each up 0.2%) and slight decline in the 10-year yield (again 2 basis points).

Staying with the 10 year, it ended trading at 4.27%, above that 4.25% breakout level. If that rally continues and we see the 10 year move towards 4.30% and higher, that will become a stronger headwind on U.S. stocks and the higher it goes, the more pressure stocks will face. Economic data later this week, including today's FOMC minutes and jobless claims and the flash PMIs will be the main influences on yields this week.

Have a good day,

Tom

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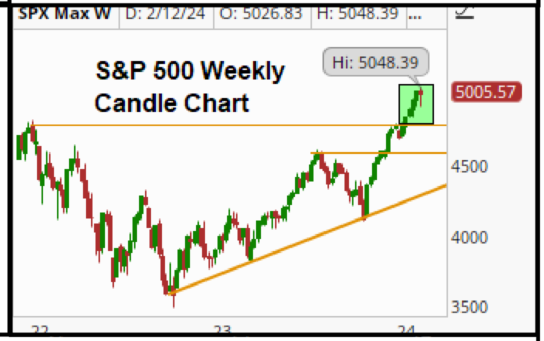
Technical Perspectives (Updated 2/18/2024)

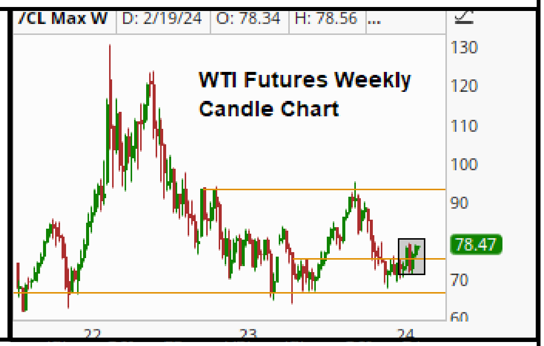
S&P 500

- 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: 4953, 4899, 4792



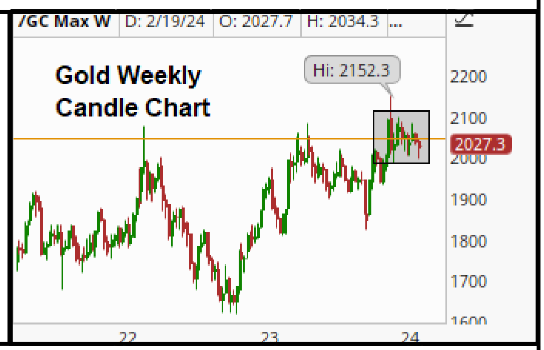
WTI Crude Oil

- Technical View: Oil closed at a fresh 2024 high last week with measurable strength in the term structure of the futures market supporting a bullish outlook for energy.
- Proprietary Model: **Bullish (since the week of February 12, 2024)**
- Key Resistance Levels: $78.90, $80.82, $82.28
- Key Support Levels: $76.56, $74.20, $73.00



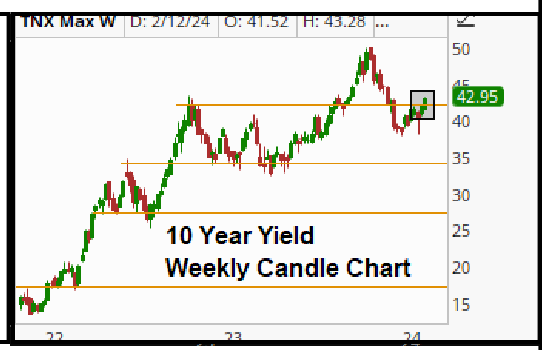
Gold

- Technical View: Gold futures broke out to a fresh all-time in late 2023, shifting the technical outlook decidedly in favor of the bulls but price action has been sideways.
- Proprietary Model: **Bullish (since the week of November 27, 2023)**
- Key Resistance Levels: $2042, $2072, $2094
- Key Support Levels: $2005, $1995, $1950



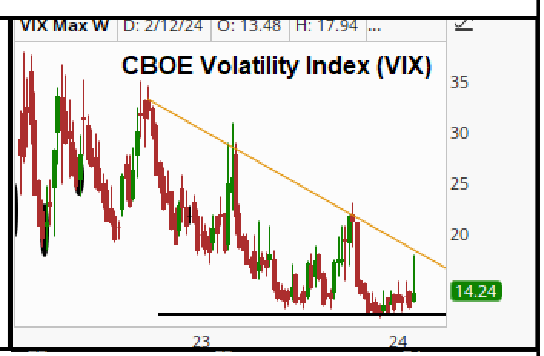
10-Year T-Note Yield

- Technical View: The 10-year yield has stabilized after a steep decline into the end of 2023 and is once again trending higher with the 4.50% area coming into focus.
- Proprietary Model: **Bullish (since the week of August 21, 2023)**
- Key Resistance Levels: 4.316, 4.365, 4.472
- Key Support Levels: 4.187, 4.125, 4.033



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: 14.71, 15.85, 17.94
- Key Support Levels: 13.93, 12.79, 12.07



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Fundamental Market View (Updated 2/18/2024)

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 declined modestly last week as both CPI and PPI ran hotter than expected and the resulting rise in the 10-year Treasury yield weighed on equities, although the losses were modest.*

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 were mixed last week as simmering geopolitical tensions kept a bid in the energy markets despite weak demand data while short-covering led industrial metals to outperform. Gold was the laggard, falling amid a rise in the dollar and firming real rates.*
US Dollar	**Neutral**	*The Dollar Index hit a multi-month high midweek as the hot CPI report caused a solid rally, although the dovish Fed speak kept the gains modest. However, momentum in the dollar remains clearly higher.*
Treasuries	**Turning Positive**	*Treasury yields rose to multi-month highs last week thanks to the hot CPI and PPI readings, as the 10-year yield is threatening to break out of the 3.75%- 4.25% trading range it has inhabited for the past several months.*

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.