SEVENS REPORT

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

February 8, 2024

Pre 7:00 Look

- Futures are slightly lower following more disappointing Chinese economic data and on dimming hopes for an Israel/Hamas ceasefire.
- Chinese CPI fell more than expected (-0.8% vs. (E –0.5%) and increased deflation concerns for that economy.
- Geopolitically, Secretary of State Blinken returned from the Mid-East without a Israel/Hamas cease fire deal and oil is rallying as a result.
- Econ Today: Jobless Claims (E: 222K). Fed Speak: Barkin (8:30 a.m. and 11:30 a.m. ET).

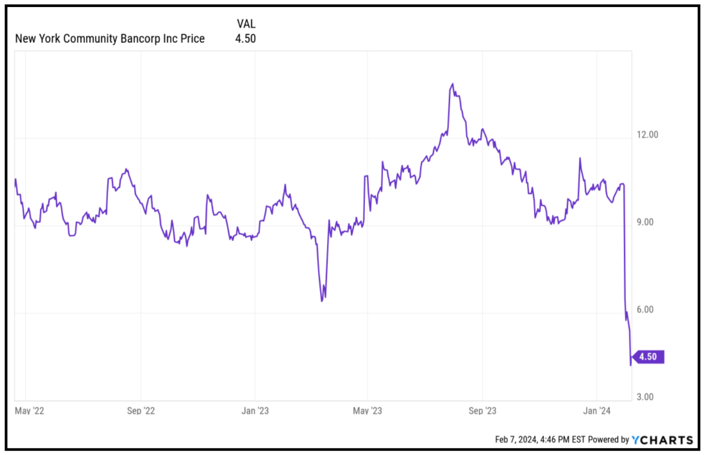
Market	Level	Change	% Change
S&P 500 Futures	5,006.75	-8.50	-0.17%
U.S. Dollar (DXY)	104.20	0.14	0.14%
Gold	2,044.10	-7.60	-0.37%
WTI	74.56	0.70	0.95%
10 Year Yield	4.13%	0.03	0.76%

Equities

Market Recap

Stocks extended the 2024 rally Wednesday with the S&P 500 coming to within a fraction of a point of touching the psychological 5,000 level as investors shrugged off more community bank volatility and instead focused on mixed Fed chatter and a steadying Treasury market. The S&P 500 gained 0.82% to close at 4,995.

The equity market gapped higher at the open yesterday as there was no materially negative news overnight that would trigger profit taking in early trade with investors looking ahead to a busy few hours of potential catalysts.



NYCB: The collapse of NYCB has reignited concerns about the commercial real estate market.

Stocks melted higher in midmorning trade thanks to the latest Manheim Used Vehicle Price Index, which held steady from December levels at -9% year-over-year in January, adding a fresh dose of anecdotal evidence to the case for a continued drop in inflation. From there the market turned sideways as the sprint towards 5,000 was digested ahead of the busy Fed speaker circuit.

On balance, Fed officials including FOMC voting members Kashkari, Kugler, and Barkin all largely echoed the recent mantra of "higher for longer" policy in order to get inflation back down to target amid good prospects for a soft landing. Market-based Fed policy expectations largely maintained the view that the Fed will commence a rate cutting cycle in May that will continue through the end of the year with a total of five or more cuts in 2024. The final potential catalyst was a 10-Yr Treasury Note auction, which saw the yield-awarded "stop through" the when-issued yield (a sign of strong demand), which kept a bid in the bond market and allowed the S&P 500 to power on for a test of 5,000 in afternoon trade. The S&P's advance stalled at 4,999.89, less than 1/10th of a point from hitting 5,000 (likely due to the massive amount of open interest at that level in the options mar-

Market	Level	Change	% Change
Dow	4,995.06	40.83	0.82%
TSX	20,969.18	11.44	0.05%
Stoxx 50	4,696.89	18.04	0.39%
FTSE	7,615.43	-13.32	-0.17%
Nikkei	36,863.28	743.36	2.06%
Hang Seng	15,878.07	-203.82	-1.27%
ASX	7,639.25	23.41	0.31%
Prices taken at previous day market close.			

ket right now). The index churned sideways in the final hour to end within 5 points of the highs.

Market	Level	Change	% Change
DBC	22.08	.10	0.45%
Gold	2,050.40	-1.00	-0.05%
Silver	22.29	-.19	-0.84%
Copper	3.7365	-.0445	-1.18%
WTI	73.93	.62	0.85%
Brent	79.25	.66	0.84%
Nat Gas	1.968	-.041	-2.04%
RBOB	2.2679	.0506	2.28%
DBA (Grains)	21.86	.09	0.44%
Prices taken at previous day market close.			

Is NYCB A Canary in the Commercial Real Estate Coal Mine? (Part I)

New York Community Bank (NYCB) stock has continued to decline following last week's disastrous earnings report and because the main reason for NYCB's unexpected quarterly loss was two poorly performing commercial real estate loans (one on a co-op building and one office building) that has resurrected worries that the commercial real estate market may be a brewing crisis on the horizon.

Those concerns are not unfounded and commercial real estate is a legitimate risk to this market and the economy, but it has to be viewed in the appropriate context. So, I wanted to cover 1) Why commercial real estate worries are legitimate, 2) If it can be compared to what occurred in '07/'08 and 3) What any type of commercial real estate stress means for markets. *Because of space constraints, I'll cover the first two points today and in tomorrow's Report, I'll address the potential market impacts of weakness in the CRE market and the specific indicators I'm watching that should tell us if this becomes a bigger problem for the markets and economy.*

Why Are People Worried About Commercial Real Estate?

The commercial real estate (CRE) market is facing stress and prices are declining thanks to the dramatic Fed rate hikes of the past two years and lingering impact of the pandemic.

Commercial real estate loans are very different from residential mortgages but there are two particular differences that make CRE especially susceptible to quickly rising rates. First, most CRE loans are "interest only" meaning there's no principal reduction. Second, they are mostly variable rate, meaning the interest rate resets every several years. That means CRE is especially sensitive to a sharp and intense increase in rates (like we've seen over the past two years) because the amount of principal outstanding never declines and because a big increase in interest expense can make CRE projects unprofitable, which can result in fire sales that further depress property values.

And this is what's started to happen in recent months as the CRE market is performing poorly. Based on Fed data, the delinquency rates on CRE loans have risen to 1.07%, which is only slightly below the 1.13% Q4 2020 high (at the peak of the pandemic shutdowns). That 2020 reading was the highest level since 2015, so if we see the default rate rise above 1.13%, that will be a nine-year high and a clear sign of deterioration.

Looking forward, it's reasonable to expect that delinquency rate to rise as the IMF estimates there's $1.2 trillion in CRE debt that's maturing (and will have to be renegotiated at potentially higher yields) in the next two years. The whole CRE market is valued at slightly over $5 trillion, so we're talking about 20% of the market, not an insignificant amount.

Finally, the deterioration in the CRE market is impacting prices. According to the IMF, an aggregate measure of CRE prices have dropped more sharply than during any other Fed tightening cycle over the past 50 years. Aggregate prices of CRE have declined more than 12% over the past two years, much more than during any other tightening cycle. And the office portion of the CRE market is especially weak thanks to the slow return of the American worker to the office and the permanent changes to demand for office space as more workers go hybrid. Default rates for office-related CRE projects (which makes up more than 13% of the CRE market according to Vanguard) have risen above 5% and are pricing in stress.

Bottom line, a combination of higher rates and workplace changes has negatively impacted the CRE market and default rates are rising and prices are declining. But for this to be a material, negative influence on broad markets, we must see evidence of contagion, as that's the key to determining when one sector's stress becomes a major problem for markets.

Can What's Happening in CRE Be Compared to the Origins of the Housing Crisis? So far, thankfully the answer is "No," but the list of similarities is growing. One of the key factors that made the subprime implosion so damaging to the economy and markets was the failure of regulators and investors to understand the reach and depth of leverage in the deals. In 2007, it would have been laughable to think a collapse in subprime housing would have bankrupted AIG (an insurance company) and General Motors (via the GM Financing unit). Yet, that's what happened.

So, it was disconcerting to learn about rising stress in the mezzanine funding portion of the real estate market, which is linked to CRE. Mezzanine financing is utilized by investors who are looking to buy a property and either 1) Can't obtain enough equity for a conventional purchase or 2) As a way for investors to increase total leverage and boost returns (and also risk). Essentially, think of mezzanine financing as covering the gap between equity and a conventional mortgage, but with a higher interest rate and higher risk.

In many ways, it's reasonable to expect any real, significant stress in the CRE market to appear in these mezzanine deals, and according to the WSJ, that's what's starting to happen. The WSJ compiled a list of what it believes to be mezzanine-related foreclosures filed through October 2023 and the number was a record high. The WSJ estimates there were 62 mezzanine-related foreclosures (which are very hard to track because they are not conventional mortgages) in 2023, nearly double the amount in 2022. And given the difficulty in identifying these foreclosures, it's reasonable to assume there are many more in the pipeline.

This is concerning for two main reasons. First, it implies the stress in the CRE market is getting progressively worse. Second, it reveals the liability from CRE debt may run deeper and stretch wider than it's currently believed. I say that, because while regulated banks are much better capitalized compared to before the GFC and the Fed and other institutions can quantify those banks' CRE risk, it's much harder to do so with the mezzanine deals because many of the loans are made by private investment groups such as PE firms and asset management companies. If these mezzanine deals go south, it has the potential to create contagion across previously thought to be unrelated assets. Thankfully, at this point it'd be an exaggeration to link what could happen with the CRE market to the housing crisis.

First, the size of the markets is vastly different. The residential real estate market is valued at over $50 trillion. The CRE market is valued at around $5 trillion. Point being, the potential problem is much smaller than what we were facing in the residential real estate market in 2007. Additionally, the key from a systemic standpoint remains the large banks and they should be mostly insulated from any substantial CRE risks due to 1) More stringent capital requirements and 2) The fact that they are too big to fail, and in the end, we know how this goes if it gets bad enough (with the Fed extending funding).

But just because this isn't lining up to be a repeat of '07/'08 doesn't mean it couldn't impact markets in a direct and intense way. Tomorrow, I'll investigate some of the potential winners and losers from the continued deterioration of the commercial real estate market.

Market	Level	Change	% Change
Dollar Index	103.91	-.16	-0.15%
EUR/USD	1.0771	.0016	0.15%
GBP/USD	1.2626	.0028	0.22%
USD/JPY	148.12	.18	0.12%
USD/CAD	1.3466	-.0026	-0.19%
AUD/USD	.6518	-.0005	-0.08%
USD/BRL	4.9665	.0071	0.14%
Bitcoin	44,133.65	982.42	2.28%
10 Year Yield	4.110	.020	0.49%
30 Year Yield	4.310	.014	0.33%
10's-2's	-32 bps		
Date of Rate Cut	May 2024		
2024 YE Fed Funds	4.22%		
Prices taken at previous day market close.			

Economics

There were no material economic reports yesterday.

Commodities

Commodities traded with a moderate upside bias led by gains in the refined products amid bullish inventory data from the EIA; however, metals lagged with copper falling more than 1% and gold little changed, stuck to the recently magnetic $2,050/oz. level. The commodity ETF, DBC, edged up 0.14%.

Gold was perfectly flat on the session as an early rally alongside the bond market gave way to a pullback as traders sifted through a busy day of Fed chatter and a pretty solid 10-Yr Treasury Note auction that kept bonds rather stable into the afternoon. The outlook for gold remains bullish based on the new all-time highs in late 2023, but for now the market remains in a consolidation phase stuck near $2,050.

EIA Data Takeaways and Oil Market Update

Oi continued to stabilize yesterday after a rout last week saw futures decline nearly 10% peak-to-trough. Trader focus was on the latest weekly data release from the EIA early as well as rates markets in the afternoon as investors interpreted another busy session of Fed speak into the close. WTI crude oil futures ultimately closed higher by 0.63%.

Starting with the headlines, the 5.5-million-barrel build in commercial crude oil stocks was rather bearish relative to the consensus estimate of +1.3 million and the API's reported build of +674K. But sizeable drawdowns in refined product supply largely offset that headline oil number as gasoline stocks fell -3.1 million vs. (E) +300K and the sizeable build of 3.65 million reported by the API. Distillate inventories also fell considerably with a drop of -3.2 million barrels, more than the forecasted drop of -2.0 million bbls but more or less inline with the -3.7 million barrel build reported by the API. The net takeaway of the headline inventory changes was effectively a wash and the details help explain the moves.

Specifically, a subdued refinery utilization rate of 82.4%, which was down 0.5% from the prior week and 5.5% from 2023, helps explain the build in oil stockpiles, as oil input demand from refiners is unseasonably low. Refining activity should rebound in next week's report, as operations at a sizeable refinery owned by Total Energy in Texas resumed on Friday of last week. Another notable detail in the report was a rebound in domestic oil production back to a record high of 13.3 million barrels/day as all of the North Dakota weather-related outages appear to have been resolved by the end of last week. As could be reasonably expected, gasoline and heating oil (diesel) futures outperformed oil futures by a multiple of 3X and 4X, respectively, yesterday.

The other key metric we were monitoring in yesterday's release was the gasoline-supplied figure as it offers a good, high-frequency read on current consumer demand dynamics. Importantly, gasoline supplied jumped 663K b/d to 8.807 last week, which is in line with the average level of H2'2023 and moderately above the H1'23 average of 8.78 million b/d. The four-week moving average remains low at just 8.275 million b/d, but it has risen the last two weeks helping indicate a trend of improving demand underway right now.

Bottom line, the headlines of this week's EIA report largely offset each other with bearish oil numbers but bullish refined product figures that could be explained by the unseasonably low refinery usage so far in 2024. The two most important details in the release, the total domestic production and gasoline supplied, also offset as the former recovered to a record while the latter rebounded solidly, underscoring renewed strength in demand. As long as these current dynamics persist (low refinery utilization rate, steady production, and solid consumer demand) the oil market's threat of an early 2024 rally will remain in place. However, if we see a meaningful run to new highs in oil production domestically, signs of demand dropping off again, or refinery runs surge higher, then worries of oversupply will return to weigh on prices and keep $80/barrel off the table.

Currencies & Bonds

Currency and bond markets were quiet Wednesday as there was no notable economic data, Fed speak largely met expectations, and the 10-year Treasury auction saw solid demand. The Dollar Index fell 0.15% while the 2-year and 10-year yields rose 2 basis points each.

The Dollar Index spent most of the session chopping with modest declines as ECB officials pushed back on rate cut expectations early on Wednesday, boosting the euro and pound by 0.2% each. Trading in the dollar was quiet as investors look ahead to Friday's CPI revisions.

In Treasuries, the 10-year saw strong demand with a bid to cover of 2.56X vs. the 2.52X six-month average. Bidding was also aggressive with the actual yield 1 bp below the "When Issued" yield Investors are focused on the looming CPI revisions coming tomorrow as the next potential catalyst in the currency and bond markets, so another quiet day today shouldn't be a shock.

Have a good day—Tom.

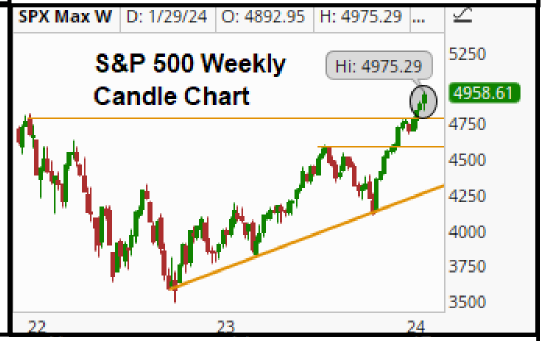
2/8/2024

SEVENS REPORT

Technical Perspectives (Updated 2/4/2024)

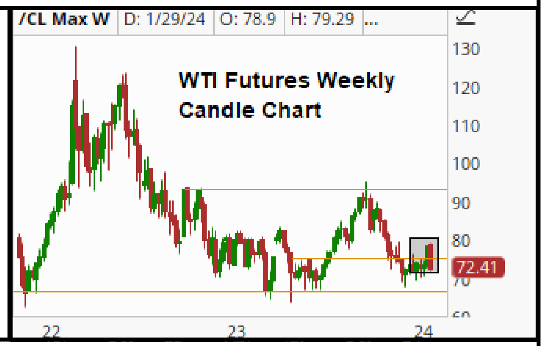
S&P 500

- 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: 4969, 5011, 5100
- Key Support Levels: 4928, 4846, 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: $73.57, $75.30, $76.98
- Key Support Levels: $70.92, $69.28, $68.03



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: $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: 4.094, 4.178, 4.293
- Key Support Levels: 3.967, 3.863, 3.789

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: 14.35, 14.79, 15.40
- Key Support Levels: 13.31, 12.55, 12.07

SEVENS REPORT

Fundamental Market View (Updated 2/4/2024)

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 hit another all-time high last week despite pushback on a March rate cut and a hot jobs report, as neither were seen as reducing the expected five or six rate cuts in 2024. Meanwhile, economic data was solid.*

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 dropped sharply last week in response to the stronger U.S. dollar and on declining geopolitical tensions following reports of a ceasefire in Gaza.*
US Dollar	**Neutral**	*The Dollar Index rose moderately last week as Powell pushed back against a March cut while the Friday's jobs report was very hot.*
Treasuries	**Turning Positive**	*Treasury yields rose last week but that's almost entirely thanks to Friday's jobs report, as prior to the report yields were lower mostly on NYCB-related regional bank anxiety.*

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.