SEVENS REPORT

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

August 6, 2024

Pre 7:00 Look

- There is a sense of stability in global markets this morning as the yen and VIX, two major sources of the recent volatility, are both pulling back amid easing recession fears.
- Economically, German Manufacturing Orders rose a solid 3.9% vs. (E) 0.8% but EU Retail Sales fell 0.3% vs. (E) 0.1%.
- Econ Today: International Trade (E: -$72.5B). There are no Fed officials scheduled to speak today.
- The Treasury will hold a 52-Week Bill auction at 11:30 a.m. ET and a 3-Yr Note auction at 1:00 p.m. ET.
- Earnings: UBER (E: $0.31), SMCI (E: $8.10), ABNB (E: $0.92).

Market	Level	Change	% Change
S&P 500 Futures	5242.50	25.00	0.48%
U.S. Dollar (DXY)	103.115	.440	0.43%
Gold	2455.00	10.60	0.43%
WTI	73.32	.38	0.52%
10 Year Yield	3.832	.052	1.38%

Equities

Market Recap

Stocks remained under heavy selling pressure to start the week as recession worries continued to dominate sentiment around the globe while there was a short squeeze in the VIX, which weighed on the broader stock market. The S&P 500 fell an even 3.00% on the day.

The stock market gapped sharply lower at the Wall Street open yesterday after U.S. equity futures had already been tracking global shares lower in overnight trade amid ongoing concerns about a global economic recession. A 12% drop in Japan's Nikkei marked the largest one-day decline in the benchmark index since 1987, which added to investor angst as did rates traders pricing in a 60% chance of emergency cuts from the Fed before November. The S&P 500 fell below 5,120 for the first time since early May in the opening minutes.

Investor complacency and an overcrowded short-volatility trade resulted in one of the largest one-day VIX rallies on record yesterday. Looking ahead, stocks will have a difficult time establishing a bottom until the VIX turns lower.

Economic data in Asia and Europe was largely better than anticipated but that did little to curb the heavy price action. At the top of the 10 a.m. hour the ISM Services PMI hit the wires with a better-than-expected headline and mostly solid details including Employment and New Orders subindices. That report sparked a modest relief rally that saw the S&P 500 embark on a relief rally that lasted into the European close when the S&P 500 stalled out at derivative-sensitive resistance at 5,250. Stocks drifted steadily lower until the S&P 500 stabilized at its opening levels before closing almost perfectly in the middle of the day's range.

What Makes This Stop?

There were two driving factors behind Monday's market

Market	Level	Change	% Change
Dow	38,703.27	-1,033.99	-1.17%
TSX	22,227.63	-495.58	-2.18%
Stoxx 50	4,560.06	-11.54	-0.25%
FTSE	7,990.37	-17.86	-0.22%
Nikkei	34,675.46	3,217.04	10.23%
Hang Seng	16,647.34	-51.02	-0.31%
ASX	7,680.64	31.09	0.41%

Prices taken at previous day market close.

collapse, one fundamental and one technical.

The fundamental reason is economic data finally forcing investors to accept what, frankly, has been obvious to anyone paying attention for the past several months: Namely, that the economy is losing momentum and an economic hard landing, while not yet likely, is possible.

Market	Level	Change	% Change
DBC	21.86	-.04	-0.18%
Gold	2,449.40	-20.40	-0.82%
Silver	27.22	-1.16	-4.11%
Copper	3.987	-.116	-2.83%
WTI	73.44	-.08	-0.11%
Brent	76.78	-.03	-0.04%
Nat Gas	1.942	-.025	-1.27%
RBOB	2.3422	.0246	1.06%
DBA (Grains)	23.56	.26	1.14%
Prices taken at previous day market close.			

The technical reason has to do with the two stretched markets that happen to be two of the most important in the global markets: Short yen (aka “yen carry trade”) and long AI-related tech (best exemplified by the Mag 7.

Nearly three weeks ago, a surprisingly soft CPI solidified rate cut expectations and that immediately caused a sharp rotation out of stretched tech stocks and that began a correction in the Nasdaq that is still going to this day. Shortly thereafter, the BOJ began aggressively intervening in the currency markets to defend the yen and followed on with some hawkish rhetoric and a surprise rate hike, causing a violent spike in the yen which is further pressuring various risk assets (including Mag 7) via an unwind of that trade.

For this pullback to stop, we will need to see both the fundamental and technical factors neutralized. Here’s how that can happen.

First, the fundamentals. U.S. growth is clearly slowing and that’s giving way to recession concerns. However, in actuality, most of the important U.S. data is showing a still-solid economy, including yesterday’s ISM Services PMI. **This market needs some solid economic data and the sooner, the better, because that will push back on pre-mature recession concerns and remind investors that while growth is slowing, it’s not collapsing (and that’s the key difference).** The problem is that we are in a mini “dead zone” for data and we don’t get any numbers that can forcefully push back against the recession narrative until next Thursday, so this may be with us for the next week or so.

Indicators to Watch: Weekly Jobless Claims (Thursday, Aug. 8), Retail Sales/Empire Manufacturing/Philly Fed/ Industrial Production (Thursday, Aug. 15).

Second, the technicals. While the financial media may try and quantify the size of the Mag 7 longs and firms utilizing the yen carry trade, the truth is they are just guessing because firms can “hide” positions all across their balance sheet (and off it) via numerous methods. Because of that, it’s best to follow indicators close to the epicenter of these technical forces and, in this case, that is the SOXX (iShares Semiconductor ETF) and the yen (which you can follow on any financial website or just use FXY).

Indicators to Watch: Both SOXX and FXY finished off their lows yesterday. Respectively, those were 193.09 in the SOXX and 63.79 in FXJ. Both of those levels need to likely be tested and hold before we can believe the technical factors driving this selloff are ending, so I will be putting alerts at those levels.

Bottom line, as is usually the case in violent market declines, there are numerous causes and for markets to stabilize and for us to believe this pullback may be ending, we need to see stabilization in the fundamental and technical factors that are driving stocks lower and important economic data (next Thursday) and SOXX and FXY are key indicators to watch for signs this is ending.

Economics

ISM Services PMI

- The July ISM Services PMI rose to 51.4 vs. (E) 51.0.

The July services PMI pushed back on growing recession fears as it rose back above 50 and beat expectations, hitting 51.4. Additionally, details of the report were also solid as New Orders rose to 52.4 from 47.0 while Employment jumped to 51.1 from 46.1.

Importantly, the ISM Services PMI getting back above 50 did not give us a third month of the ISM Manufacturing and Services PMIs below 50 and while that doesn’t mean the economy won’t continue to lose momentum, it does avoid getting another significantly negative signal on the economy.

The ISM Services PMI isn't an important enough number to stop yesterday's selloff. But if we step back from the short-term noise, this is an important indicator that growth is not cratering and the bottom line of the "Big Three" July economic reports (ISM Manufacturing PMI, Jobs Report, ISM Services PMI) is that economic growth is clearly and obviously slowing but with the exception of the ISM Manufacturing PMI, none of the other two indicators are screaming recession. For now, this continues to be a moderation of growth, not a collapse. While that market didn't accept that in the short term, that is an important distinction to make because it does push back on rising recession fears.

Commodities

Commodities maintained a risk-off tone to start the week, especially metals, which saw economically sensitive industrials test long-term support while precious varieties saw much more modest gains thanks to continued safe-haven demand amid the ongoing broad market volatility. Oil futures were little changed amid elevated geopolitical tensions in the Middle East. The commodity ETF, DBC, dipped 0.18%.

WTI crude oil futures fell below $72/barrel for the first time since early February to start the week. The broad risk-off money flows across global markets and asset classes related to the material rise in recession fears in recent sessions remained the main bearish influence on the market and those fears were compounded by reports of fading diesel demand out of China whose economic strength is in question.

Market	Level	Change	% Change
Dollar Index	102.46	-.53	-0.51%
EUR/USD	1.0950	.0039	0.36%
GBP/USD	1.2762	-.0039	-0.30%
USD/JPY	143.75	-2.78	-1.90%
USD/CAD	1.3834	-.0039	-0.28%
AUD/USD	.6485	-.0026	-0.40%
USD/BRL	5.7403	.0128	0.22%
Bitcoin	53,392.58	-5,928.61	-9.99%
10 Year Yield	3.785	-.007	-0.18%
30 Year Yield	4.072	-.037	-3.22%
10's-2's	-11 bps		
Date of Rate Cut	September 2024		
2024 YE Fed Funds	4.29%		

Prices taken at previous day market close.

Oil caught a bid ahead of the primary U.S. session, however, as a series of failed ceasefire talks between Israel and Hamas/Hezbollah left a geopolitical fear bid present. Additionally, news that protestors had caused one of Libya's largest oil fields to come offline added a supply side bid that saw futures rebound to end the day effectively flat, down 0.04%. Looking ahead, the next move oil makes is likely to be influenced by the broader recession concerns as even a combination of a resurgence in geopolitical tensions, new stimulus measures in China, and/or imminent Fed rate cuts wouldn't be able to offset the negative impact of a potentially severe global economic downturn. For now, the outlook for oil remains neutral with WTI holding just above key trading range support at $72.50.

Copper was the worst performer among the major commodities yesterday as futures fell 2.55% on the session. Copper was able to claw back from multi-month, intraday lows of under $3.95 to reclaim key support at $4.00 late in the day. Momentum remains bearish with copper in a downtrend which is consistent with the macroeconomic uncertainty that has begun to weigh considerably on stocks in recent weeks. For now, the fact that copper is holding on to the $4.00 market is a mild positive that offers a glimmer of hope to the risk-on bulls.

Gold fell a much less severe 0.76% yesterday as subdued market-based inflation expectations and a wave of profit taking after the latest all-time highs were established offset a further decline in the dollar amid a stable bond market. The trend in gold remains decidedly bullish after the latest highs were reached although there have been signs of fading bullish momentum amid the last few runs to record highs, which suggests pullback risks are elevated.

Currencies & Bonds

The Dollar Index dropped sharply and hit the lowest intraday level since January as investors priced in very aggressive Fed rate hikes between now and year-end, while the yen continued to strengthen vs. the dollar, fueling the unwind of the yen carry trade which is undoubtedly involved in this selloff. The Dollar Index fell 0.48% but ended off the worst levels of the day, when it was down 0.70%.

The easiest way to explain why the Dollar Index crashed through the lower bound of the 103-106 month-long trading range can be seen in rate cut expectations. Prior to last Thursday, the market expected 50 bps of rate cuts in 2024, split between a 25-bps cut in September and a 25-bps cut in December.

Now, following three days of equity market declines, the market expects an absolute minimum of 100 basis points of easing with a solid chance of 150 basis points of easing between now and January 2025. More specifically, the market is pricing in 100% chance of a cut in September and an 84% chance that cut is 50 basis points. Then, for the November meeting, the market is pricing in a 93% chance of at least another 25-basis-point cut with a 45% chance of a 50-bps cut. Finally, the market fully expects another cut in December and there is a 94% chance the Fed cuts at least 100 bps by the year-end.

These expectations are far, far beyond anything that was expected as late as last Wednesday and because of these extreme dovish expectations, the Dollar Index dropped into the lower 102 range before bouncing along with other risk assets to finish with moderate losses.

Looking internationally, the yen remains the single most important currency in the world right now. Put simply, the surge in the yen is contributing to a serious unwind of the yen carry trade and that unwind is pressuring stocks and other risk assets, just like it always does (for anyone who missed it, we covered the yen carry trade and the risks around it 10 days ago in the July 26 Sevens Report, link here).

To give the needed context, less than a month ago the yen hit a multi-decade low vs. the dollar at 161.75 yen to the dollar. Since then, the yen has rallied hard and hit a high of just 141.75 yen/dollar. That's more than a 10% move in less than a month, which is <u>unheard of</u> in the currency space and given the extreme leverage permitted in currency trades, this is causing some material reverberations across leveraged investment firms and that will continue until the yen stabilizes.

Looking at Europe, those currencies saw more reasonable moves. The pound declined 0.3% while the euro rallied 0.4% thanks to better-than-expected July PMIs.

Bottom line, the dollar has dropped through the lower bound of the 103-106 trading range but the drop is so violent that it's not helping stocks, because the drop implies rising recession risks and Fed rate cuts that may be too late—not the best thing for stocks. So, the best outcome for stocks from a dollar standpoint is to have the dollar rally back into that 103-106 trading range and stabilize between 103-104, implying solid rate cuts are coming, but they may not be too late.

Turning to Treasuries, we saw both the 2- and 10-year yield decline at the open in a knee-jerk, risk-off move as investors bought U.S. government bonds but the rally didn't last following solid economic data. The 10-year yield started the day down 6 basis points but the better-than-expected ISM Services PMI and the relative stabilization of stocks post-open saw some selling in Treasuries and the 10-year yield closed down just 1 bps at 3.78%.

The 10s-2s yield spread rose to a high of -4 basis points before closing -11 bps, but it's more just a question of when 10s-2s un-inverts, not "if." Stepping back, yields have been extremely volatile and that's not a positive for stocks.

The best outcome for stocks near term would be to see the 2- and 10-year yields rise modestly with the 10 year moving back towards 4% and then stabilizing, as that would imply looming rate cuts but not collapsing growth. Bottom line, currency and bond markets are influencing stocks and the sooner they stabilize, the better.

Have a good day,

Tom

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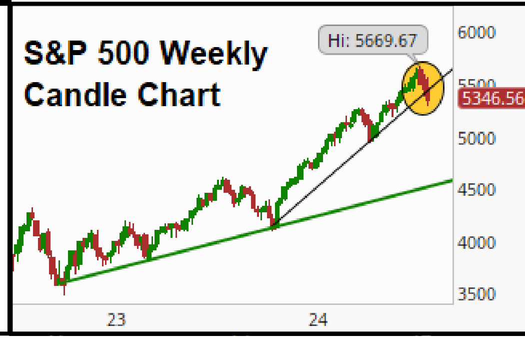
Technical Perspectives (Updated 8/4/2024)

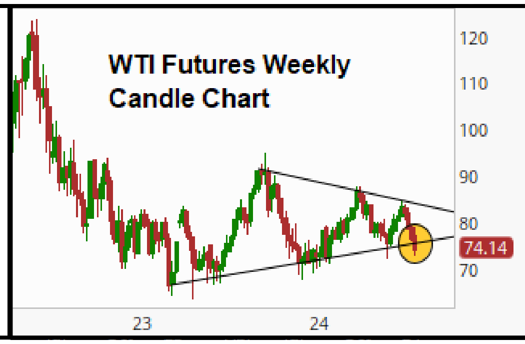
S&P 500

- Technical View: **The medium-term trend in the S&P 500 has shifted from bullish to neutral** as the uptrend line off the October 2023 lows was violated last week.
- Dow Theory: **Bullish (since the week of July 10, 2023)**
- Key Resistance Levels: 5399, 5479, 5537
- Key Support Levels: 5302, 5235, 5116



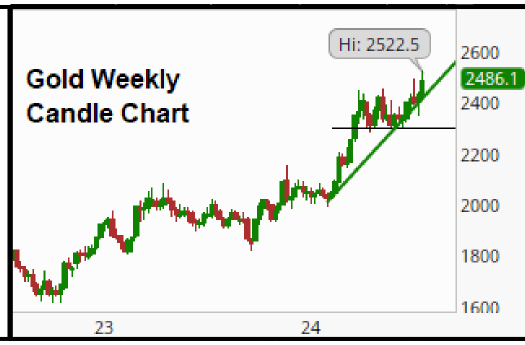
WTI Crude Oil

- Technical View: The price action in the oil market has become heavy late in the summer as the uptrend off the early 2023 lows was violated to start August.
- Primary Trend: **Neutral (since the week of July 15, 2024)**
- Key Resistance Levels: $75.28, $76.93, $78.64
- Key Support Levels: $72.92, $71.32, $$69.87



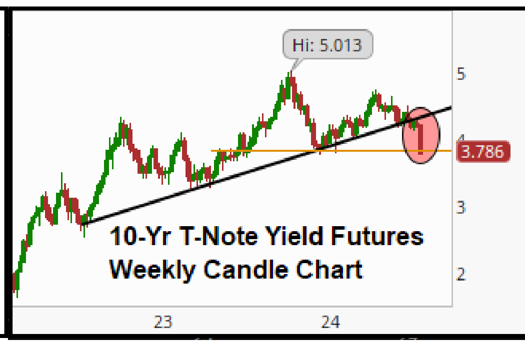
Gold

- Technical View: Gold hit new record highs to start August reaffirming the long-term uptrend remains in place with the path of least resistance still higher.
- Primary Trend: **Bullish (since the week of November 27, 2023)**
- Key Resistance Levels: $2493, $2523, $2,590
- Key Support Levels: $2474, $2433, $2363



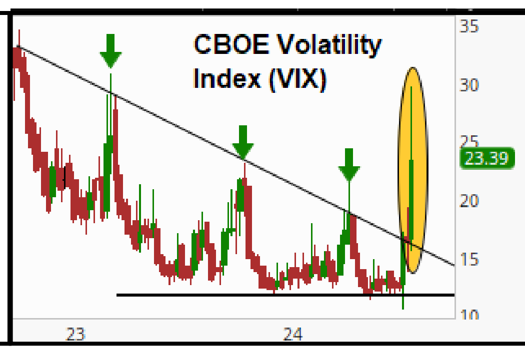
10-Year T-Note Yield Futures

- Technical View: The 10-year yield collapsed further below the uptrend line off the late-2022 lows and fell to a fresh 52-week low last week, notably reversing the trend.
- Primary Trend: **Bearish (since the week of July 29, 2024)**
- Key Resistance Levels: 3.84, 3.931, 3.98



CBOE Volatility Index (VIX)

- Technical View: The VIX surged to new 52-week highs last week shifting the technical outlook from neutral to bullish suggesting elevated risks of more volatility ahead.
- Primary Trend: **Bullish (since the week of July 29, 2024)**
- Key Resistance Levels: 25.97, 28.56, 9.66
- Key Support Levels: 20.52, 18.59, 16.74



SEVENS REPORT

Fundamental Market View
(Updated 8/4/2024)

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 fell sharply last week thanks to disappointing economic data as the economic growth scare finally arrived and pushed the S&P 500 to multi-week lows.*

Tactical Allocation Ideas:

- **What's Outperforming: Defensive sectors, minimum volatility and sectors linked to higher rates have relatively outperformed recently as markets have become more volatile.**
- **What's Underperforming: Tech/growth and high valuation stocks have lagged as yields have risen.**

Long Term Fundamental Outlook for Other Asset Classes

	Fundamental Outlook	Market Intelligence
Commodities	**Neutral**	*Commodities continued to trade with a clear risk-off tone last week with oil leading declines into Friday's jobs report. The sharp drop in the dollar paired with safe-haven money flows helped drive gold to record highs while copper recovered to end the week with a slight gain.*
US Dollar	**Neutral**	*The Dollar Index dropped sharply thanks almost entirely to Friday's soft jobs report, as that spiked slowdown worries and increased expectations for a 50-basis-point rate cut in September.*
Treasuries	**Turning Positive**	*Treasury yields collapsed last week in the face of disappointing economic data and they are signaling an economic slowdown. The 10-year yield plunged below 4% while the 10s-2s yield spread rose to –8 basis points, all worrisome signals from a growth standpoint.*

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.