# SEVENS REPORT

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

*September 12, 2024*

## Pre 7:00 Look

- Futures are modestly higher mostly on momentum from Wednesday's impressive reversal and following encouraging Japanese inflation data.
- Economically, the only notable number overnight was Japanese PPI and it rose 2.5% vs. (E) 2.8%. That may take some pressure off the BOJ to hike rates and also weigh on the yen and the Nikkei rose 3% in response.
- Econ Today: ECB Rate Decision (E: 25 bps cut), Jobless Claims (E: 230K), PPI (E: 0.2% m/m, 1.8% y/y),
- Earnings: KR (E: $0.91), ADBE (E: $4.53).

| Market | Level | Change | % Change |
|---|---|---|---|
| S&P 500 Futures | 5,571.50 | 10.25 | 0.18% |
| U.S. Dollar (DXY) | 101.73 | 0.05 | 0.05% |
| Gold | 2,546.00 | 3.60 | 0.14% |
| WTI | 68.43 | 1.10 | 1.63% |
| 10 Year Yield | 3.68% | 0.03 | 0.69% |

## Equities

*Market Recap*

Stocks staged an impressive reversal on Wednesday as initial intense weakness following a firm CPI report was offset by a jolt of AI enthusiasm and broader positive corporate commentary combined with belief that the Fed will still aggressively cut rates between now and year-end. The S&P 500 rose 1.07%.

Equities initially sold off hard yesterday with the S&P 500 down nearly 2% in early trade in the wake of the August CPI report as rates markets largely priced out the possibility of a 50-bps rate cut at next week's FOMC meeting.

However, like they did on Tuesday, sell-side conferences moved markets. First, at the Goldman Sachs Communacopia conference, NVDA CEO Wong again touted the growth potential and intense demand for AI chips. That, combined with follow through from ORCL earnings earlier in the week, boosted tech names and they were the first to rally yesterday.

Strength in tech then combined with more positive economic commentary from the Barclays Financial Services Conference, and with tech stocks leading the way the major averages (including the Russell 2000) moved steadily higher throughout the late morning and turned positive during the afternoon.

From there, momentum pushed the major indices higher basically into the close as they finished near the best levels of the day, as microeconomic positives (AI enthusiasm) countered macroeconomic negatives (firm CPI report).

*What CPI Means for Markets (Rate Cuts Still Coming, but the Fed May Be Further Behind the Curve)*

Yesterday's Core CPI reading was firmer than expected and it rightly reduced expectations that the Fed will cut 50 bps next week. That caused the early decline in stocks yesterday.

Importantly, however, the CPI report does not imply inflation is bouncing back. I say that because the main contributor to the firm Core CPI reading was shelter costs. Shelter Costs include tenant's rents and "owners' equivalent rent," which are the CPI's efforts to model housing costs. Those models are not accurate and it is widely believed they are overstating housing inflation and artificially boosting CPI. Here are two examples to illustrate this point: First, if we excluded housing from Core CPI, yesterday's Core CPI reading would have increased just 0.1% (not 0.3%).

| Market | Level | Change | % Change |
|---|---|---|---|
| Dow | 40,861.71 | 124.75 | 0.30% |
| TSX | 23,211.17 | 208.08 | 0.90% |
| Stoxx 50 | 4,829.43 | 65.86 | 1.38% |
| FTSE | 8,262.42 | 68.48 | 0.84% |
| Nikkei | 36,833.27 | 1,213.50 | 3.41% |
| Hang Seng | 17,240.39 | 131.68 | 0.77% |
| ASX | 8,075.73 | 87.86 | 1.10% |

Prices taken at previous day market close.

Second, Blackstone's CFO (Blackstone owns billions in real estate in the U.S.) stated that if CPI reflected current housing price metrics, it would be rising around 1.8% y/y (not the 2.5% headline reading).

| Market | Level | Change | % Change |
|---|---|---|---|
| DBC | 21.21 | .19 | 0.90% |
| Gold | 2,539.30 | -3.80 | -0.15% |
| Silver | 28.91 | .30 | 1.05% |
| Copper | 4.159 | .061 | 1.48% |
| WTI | 67.14 | 1.39 | 2.11% |
| Brent | 70.49 | 1.30 | 1.88% |
| Nat Gas | 2.267 | .035 | 1.56% |
| RBOB | 1.8955 | .0255 | 1.36% |
| DBA (Grains) | 25.01 | .52 | 2.14% |
| Prices taken at previous day market close. | | | |

Bottom line, while Core CPI was firm, there is nothing in this inflation report that will make the Fed re-think a rate cut in September or the start of a rate cutting cycle. So, CPI was not a major negative for this market.

That said, it does reduce the chances of a 50-bps cut and that increases the risk the Fed falls behind the curve and increases slowdown chances. Here's why.

Real interest rates are high and moving higher. Real interest rates act as a headwind on the economy. The higher they are, the stiffer the headwind. I calculate real interest rates as follows: Effective fed funds minus the 5 year TIPS/Treasuries breakeven rate (the market's inflation rate). The Fed last hiked rates in July 2023 to 5.325%. Back then, the 5 year TIPS/Treasuries yield was 2.22%. <u>So, real interest rates were 5.325% - 2.22% or 3.11%.</u>

The Fed has held rates steady since then (14 months) but inflation has fallen pushing real interest rates higher and increasing the headwind on the economy. Yesterday, the 5 year TIPS/Treasuries breakeven was 1.88%.

<u>So, as of today, Real Interest Rates are 5.325% - 1.88% or 3.45%.</u> That's the highest they've been throughout this entire tightening cycle. **Real interest rates are now putting more pressure on the economy than they have at any point during the Fed's tightening cycle.**

This reality <u>guarantees</u> the Fed will cut rates next week, but yesterday's CPI means they are more likely to cut 25 basis points because cutting aggressively with Core CPI above 3% will likely not sit well with Fed members who were trashed two years ago for letting inflation get out of control.

**The net takeaway is real interest rates are going to stay higher for longer because of yesterday's CPI. That means headwinds on growth will be stronger for longer. That increases the possibility the Fed is behind the curve and ultimately does not cut rates fast enough to prevent a worse-than-expected slowdown.**

That is the biggest takeaway from yesterday. It's not that inflation is bouncing back (it's not) and it's not that the Fed won't still be cutting rates (they will). Instead, it's that rates likely won't decline as fast as markets had expected and that means a greater chance the Fed finds itself behind the curve on cutting rates to support growth.

*What does this mean for you?* It means we should expect more volatility and continue to not be surprised if there is a legitimate growth scare that lasts more than a few trading days (like the one in August).

To be clear, the long-term outlook for markets remains broadly positive. But at these valuations and with these Goldilocks expectations priced into stocks, this market remains vulnerable to a real growth scare that results in a real correction (10% or more decline). And, I believe it remains prudent for investors to position for that by continuing to reduce beta via lower-volatility ETFs (USMC/SPLV), defensive sectors such as utilities (XLU), staples (XLP) and healthcare (XLV) along with longer-dated Treasuries (TLT) and high-quality corporate bonds (LQD).

Finally, I understand I've been talking about growth for a while, but I was talking about it slowing long before it was the consensus chatter on Wall Street. I do not think we've seen the end of the slowing growth risks, but when I do, I will change my stance and advocate re-allocating to beaten-up sectors, just like I did in late-2022 and early 2023. I am not a perma bear and I'm not hoping for a slowdown. These are what the facts are telling me, and it's my job to communicate that to you until the facts tell me something different. And they are not telling me something different (in fact, they're confirming what we've all been talking about for a while).

## Economics

CPI

- August CPI rose 0.2% m/m and 2.9% y/y, meeting expectations.
- August Core CPI rose 0.3% m/m vs. (E) 0.2% and 3.2% y/y, meeting expectations.

August CPI gave investors a mixed reading but disappointed vs. expectations for a continued, steady decline in inflation and, most importantly, put a 50-bps rate cut in doubt and pressured stocks as a result. Now, to be clear, the CPI report was not a bad report, but it was not as good as investors un-realistically expected. Headline CPI fell to 2.5%, the lowest level since early 2021, but that was due almost entirely to weakness in energy prices.

The more important metric, Core CPI, was unchanged from July at 3.2% y/y and rose 0.3% m/m, higher than the 0.2% expectation. This was the first disappointing Core CPI reading since earlier in 2023 and the lack of a further decline in Core CPI was the reason stocks dropped early Wednesday. Bottom line, yesterday's CPI report was not a "bad" report and inflation is likely continuing to trend lower towards the Fed's target.

But we are not seeing the type of consistent and large declines we saw in Core CPI earlier this year and because of investors' aggressive rate cut expectations (50 bps next week) this report was disappointing and did pressure equities on Wednesday, because it reduced the chances of that 50-bps cut.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dollar Index | 101.64 | .04 | 0.04% |
| EUR/USD | 1.1024 | .0004 | 0.04% |
| GBP/USD | 1.3047 | -.0033 | -0.25% |
| USD/JPY | 142.23 | -.21 | -0.15% |
| USD/CAD | 1.3571 | -.0039 | -0.29% |
| AUD/USD | .6672 | .0020 | 0.30% |
| USD/BRL | 5.6495 | -.0107 | -0.19% |
| Bitcoin | 57,602.63 | -13.98 | -0.02% |
| 10 Year Yield | 3.653 | .007 | 0.19% |
| 30 Year Yield | 3.963 | .008 | 0.20% |
| 10's-2's | 3 bps | | |
| Date of Rate Cut | September 2024 | | |
| 2024 YE Fed Funds | 4.51% | | |
| Prices taken at previous day market close. | | | |

## Commodities

Commodities were mixed as the risk-off theme that has dominated the price action in the commodity complex reversed with economically sensitive oil and copper futures posting solid gains while gold took a breather from its recent rally. The commodity ETF, DBC, jumped 0.90% from Tuesday's two-and-a-half-year lows.

Beginning with the metals, it was a pretty straightforward and classis risk-on day with copper rebounding with stocks and oil while gold pulled back on easing safe-haven demand. Copper ended higher by 1.54% while gold pulled back a modest 0.10% on the day with still stubbornly elevated inflation metrics keeping an inflation-hedge bid in the market. Looking ahead, the outlook for copper is neutral at best and that will remain the case until we see futures break beyond resistance at $4.33/lb. while the gold rally is still very much intact with futures holding comfortably above key 2024 support at $2,500/oz.

*EIA Data Takeaways*

The oil market showed signs of at least temporarily stabilizing yesterday after the recent downside acceleration in the market saw futures prices hit fresh 52-week lows. A weather-bid related to Hurricane Francine's impact on production in the Gulf was the key bullish catalyst driving prices higher though, not the weekly EIA report, as the headlines and details of the inventory release were mostly disappointing. WTI crude futures gained 2.39% yesterday, but still remained comfortably below the psychological $70 mark, closing with a $67 handle.

Looking at the EIA data, commercial crude oil stockpiles rose by +800K bbls, just under the consensus estimate of +1.05MM but a surprise relative to the API's reported draw of -2.8MM bbls. In the products, gasoline and distillate inventories both rose by +2.3MM bbls last week to perfectly match their respective consensus estimates but the product builds were both much larger than what the API reported (gas: -500K bbls, disty: +200K bbls), which had a bearish market impact.

Based on the details, the headline build in crude stockpiles made sense considering refinery runs slowed by 0.5% to 92.8% of capacity but that should have supported smaller builds or unforeseen draws in the products and therefore the increases in refined product inventories hinted at fading demand.

The proxy for consumer demand at the pump in the weekly dataset, gasoline supplied, fell sharply last week, down 460K b/d to 8.478 million b/d, the lowest since the week of April 12. That dragged the smoother look at the data via the four-week moving average down by 142K b/d to 8.979MM b/d, the lowest since May 17, before the summer driving season began in earnest. The early September drop-off in consumer gasoline demand is not unusual, however, and it is actually typical to see consumer demand drop off by roughly 1 million b/d in early September, and the fact that we only saw a less-than-500K b/d slowdown to start September this year could have been a subtle but market-moving detail in yesterday's EIA release.

Bottom line, yesterday's bounce in oil prices after the roughly 15% drop since the highs seen in the final week of August can so far only qualify as a relief rally in an otherwise still downward trending market as this week's drop to fresh 52-week lows saw the primary trend in oil shift from neutral to bearish. And it will take much more than a dead-cat-bounce style rally in the middle of a trading week to begin to look for a more lasting bottom to form.

Fundamentally, the impact of Hurricane Francine played a role in the move higher in prices yesterday as the news likely triggered some profit taking by short-sellers while oil also participated in the broad risk-on move across asset classes yesterday. On the charts, there is initial support between $65.50 and $66/barrel while the previous 2024 lows of $72.50 will continue to be looked at as initial resistance.

## Currencies & Bonds

The 10-year Treasury yield staged a solid comeback on Wednesday following the firm Core CPI report, rising 2 basis points on the session.

Prior to the CPI report, the 10-year Treasury yield was testing a break below 3.60%, as investors did expect a soft CPI release later yesterday morning. However, the opposite happened and the 10-year yield popped 7 basis points following the report. After a brief dip back to flat, the yield rose again and, importantly, stayed elevated even after a very strong 10-year auction (that saw elevated demand and should have pressured yields).

Here's why this matters. Treasury yields, for the first time in weeks, look like they are trying to stabilize. As we and others have been saying, stability in yields would be a near-term positive for stocks and if yields can stabilize and stop dropping so quickly, that will be a mild positive for stocks near term. Looking ahead to next week, that means a Fed that cuts rates but doesn't imply material concern with the economy (that's the best case for next week's Fed decision).

Turning to the dollar, it was little changed on Wednesday as the CPI report didn't materially alter the outlook for Fed policy. The Dollar Index rose 0.1%.

Consensus expectation for the Fed next week has been a 25-bps rate cut (50 bps has been mostly a minority view, although it's obviously possible). So, yesterday's firm CPI didn't alter that 25-bps outlook materially (it just made 50 bps even more of a minority opinion). As a result, the dollar didn't move much because the outlook for the Fed didn't really move much compared to consensus.

Looking internationally, the yen was the most notable mover as it dropped below 142 for the first time since early August in morning trade. But like so much else yesterday, it reversed and ended the day flat vs. the dollar. Like Treasuries, "calm" in the yen will be welcomed near term by investors and yesterday was a mild positive in that direction.

Elsewhere, the euro was flat ahead of today's ECB decision (the ECB is expected to cut rates 25 bps and signal more cuts are coming) while the pound declined 0.3% after the UK GDP report slightly missed estimates (boosting the case for a rate cut, which is expected). Bottom line, the CPI report largely reinforced current rate cut expectations and as a result, currencies were little changed. Additionally, CPI may have "stopped the bleeding" in Treasury yields and if yields can stabilize that will be a mild tailwind for stocks.

Have a good day,

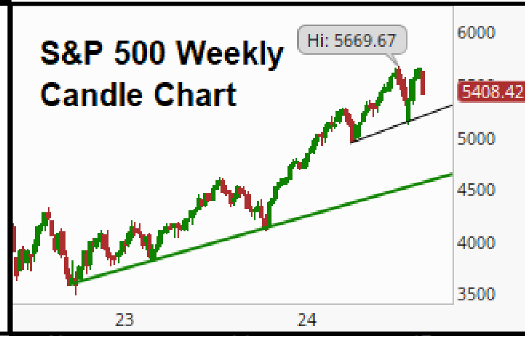
Tom

# SEVENS REPORT

## Technical Perspectives (Updated 9/8/2024)

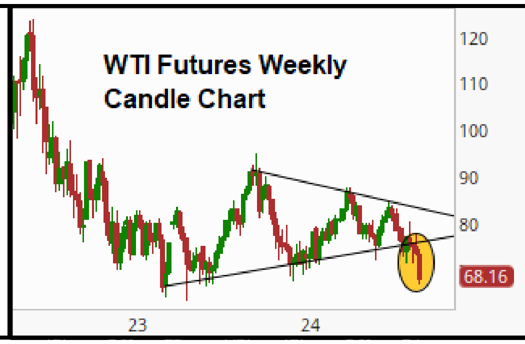
### *S&P 500*

- Technical View: **The medium-term trend in the S&P 500 remains neutral** as the broad market index has so far failed to breakout beyond the July record highs.
- Dow Theory: **Bullish (since the week of July 10, 2023)**
- Key Resistance Levels: 5503, 5571, 5648
- Key Support Levels: 5352, 5186, 5018



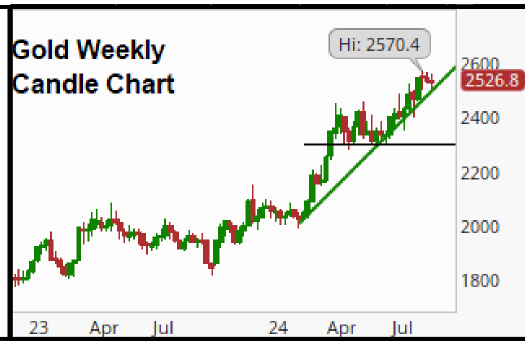

### *WTI Crude Oil*

- Technical View: The price action in the oil market has become heavy late in the summer as the early 2024 lows have been repeatedly tested in recent weeks.
- Primary Trend: **Neutral (since the week of July 15, 2024)**
- Key Resistance Levels: $69.25, $70.13, $71.94
- Key Support Levels: $66.80, $65.65, $64.36



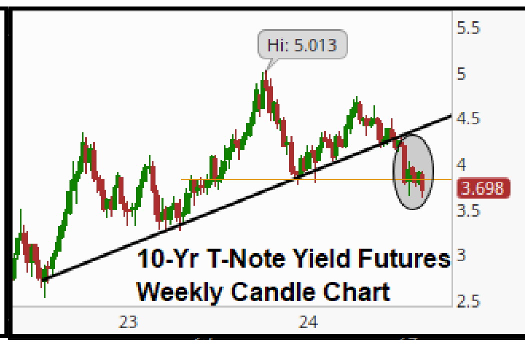

### *Gold*

- Technical View: Gold hit new record highs in 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: $2560, $2570, $2600
- Key Support Levels: $2521, $2495, $2424



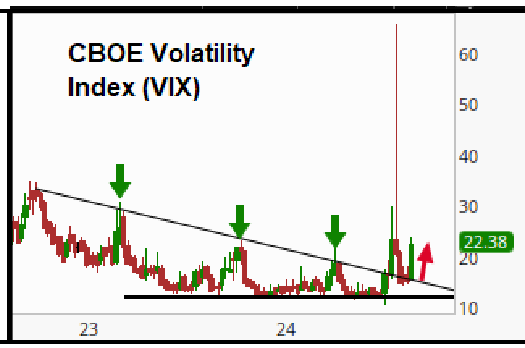

### *10-Year T-Note Yield Futures*

- Technical View: The 10-year yield fell to fresh multi-year lows at the start of September and the path of least resistance remains lower for the benchmark yield.
- Primary Trend: **Bearish (since the week of July 29, 2024)**
- Key Resistance Levels: 3.751, 3.795, 3.857
- Key Support Levels: 3.638, 3.591, 3.507




### *CBOE Volatility Index (VIX)*

- Technical View: The VIX has rapidly retreated from the summer spike to multi-year highs, but has also held above the mid-August lows leaving upside risks elevated.
- Primary Trend: **Bullish (since the week of July 29, 2024)**
- Key Resistance Levels: 24.77, 27.85, 33.71
- Key Support Levels: 19.90, 17.55, 15.00



# SEVENS REPORT

**Fundamental Market View (Updated 9/8/2024)**

## 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:**<br>**Cautious**<br>**SPHB: 25% SPLV: 75%** | *Stocks saw a volatile start to the month as global economic data largely disappointed, which stoked simmering recession fears and subsequently heavy risk-off money flows. The S&P 500 dropped 4.25% on the week and is now up 13.39% YTD.* |

### 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** | *Global growth concerns were apparent in commodities last week as oil and industrial metals declined while gold relatively outperformed but still declined. The commodity ETF, DBC, fell 3.80% to a 52-week low.* |
| **US Dollar** | **Neutral** | *The Dollar Index fell 0.6% last week thanks to lackluster U.S. economic data. Notably, the euro was also under pressure following the soft inflation data of two weeks ago and last week's slightly underwhelming growth data. That euro weakness prevented the Dollar Index from falling more materially.* |
| **Treasuries** | **Turning Positive** | *The 10-year yield fell to a new one-year low last week in the low 3.70%, confirming slowing economic growth. Importantly, last week the 10s-2s yield spread un-inverted as the 10-year yield is now higher than the 2-year yield for the first time since 2022.* |

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.