SEVENS REPORT

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

September 4, 2024

Pre 7:00 Look

- Stock futures are lower again this morning as global equity markets sold off overnight following the tech-led declines in the U.S. yesterday amid mixed economic data.
- Economically, China's Composite PMI was unchanged at 51.2 in August but the Services Index fell to 51.6 vs. (E) 52.1 while the EU Composite PMI rose to 51.0 vs. (E) 51.2.
- Econ Today: Factory Orders (E: 4.6%), JOLTS (E: 8.1 million), Monthly Motor Vehicle Sales (E: 15.4 million).
- There are no Fed officials scheduled to speak today.
- Earnings: DLTR (E: $1.03), HPE (E: $0.47).

Market	Level	Change	% Change
S&P 500 Futures	5520.75	-21.00	-0.38%
U.S. Dollar (DXY)	101.654	-.119	-0.12%
Gold	2516.10	-6.90	-0.27%
WTI	70.87	.53	0.75%
10 Year Yield	3.811	-.024	-0.63%

Equities

Market Recap

Stocks began the month of September with a thud yesterday as all major U.S. equity indices sold off by between 1.5% and 3.5% amid a resurgence in global growth concerns reminiscent of the volatile start to August. The S&P 500 dropped 2.12%.

The stock market was heavy from the start Tuesday as S&P 500 futures were solidly lower thanks to several factors including (in order of importance): 1) Start-of-month positioning ahead of the jobs report (out of tech and into defensives), 2) More disappointing Chinese economic reports and 3) The mild uptick in geopolitical concerns in the Middle East.

A short-squeeze in the increasingly popular "Short-Volatility Trade" that returned over 100% in 2023, similar to the squeeze we saw at the start of August, strongly influenced the price action in stocks yesterday and remains a major near-term risk to equities.

The selling intensified after the release of the ISM Manufacturing PMI, which showed lackluster activity and higher prices (which is the opposite of what investors are looking for). Stocks hit fresh lows following that report and continued to grind lower throughout the remainder of the session amidst quiet news wires. The S&P 500 finished just off the lows of the day.

Why Stocks Dropped

Yesterday's decline in markets was due, in part, to disappointing economic data from China and the U.S. (the ISM Manufacturing PMI) but neither number substantially increased slowdown risks. Instead, the biggest "reason" for yesterday's decline was positioning: Start-of-month money flows clearly favored more defensive sectors ahead of this week's important economic data, as the consumer staples and real estate sectors were higher on the day while utilities and healthcare were only slightly

Market	Level	Change	% Change
Dow	40,936.93	-626.15	-1.51%
TSX	23,042.45	-303.73	-1.30%
Stoxx 50	4,861.83	-50.69	-1.03%
FTSE	8,245.43	-53.03	-0.64%
Nikkei	37,047.61	-1,638.70	-4.24%
Hang Seng	17,457.34	-194.15	-1.10%
ASX	7,950.48	-152.75	-1.88%

Prices taken at previous day market close.

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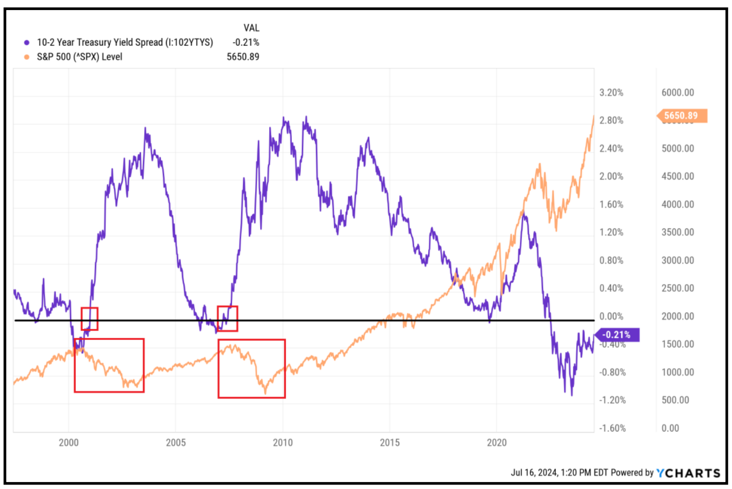
lower. Conversely, laggards included tech (XLK down 4.6%) and cyclicals (energy, materials, industrials). Bottom line, there was negative economic data yesterday but the real reason for the sell-off was positioning, not a major, negative fundamental event.

Market	Level	Change	% Change
DBC	21.67	-.44	-1.99%
Gold	2,523.70	-3.90	-0.15%
Silver	28.41	-.73	-2.51%
Copper	4.0890	-.1225	-2.90%
WTI	70.26	-3.29	-4.47%
Brent	73.70	-3.82	-4.93%
Nat Gas	2.225	.098	4.60%
RBOB	1.9793	-.1139	-5.44%
DBA (Grains)	24.65	-.23	-0.94%
Prices taken at previous day market close.			

Another Month, Another Short-Volatility Squeeze

The short-volatility trade is something we have covered extensively on an as-needed basis since it first blew up in spectacular fashion back in early 2018 and had a meaningful impact on the markets, dragging the S&P 500 lower by nearly 12% peak-to-trough in a matter of just two weeks in February of that year.

The short-vol trade is essentially a bet against market volatility as measured by the VIX. The easiest way hedge funds and other sophisticated trading houses get exposure to the short-vol trade is by selling VIX futures short and buying them back near their expiration at a lower price. The returns can be hugely positive like they were in 2023 when the short-volatility ETF, SVIX, returned well over 100% that year.



The 10s-2s yield spread has risen to multi-month highs and is threatening to turn back positive. However, according to market history, that will not be a good signal for stocks.

The reason the short-volatility trade matters right now is it remains "overcrowded" like it was in early August and susceptible to a squeeze that pushes the VIX meaningfully higher. The higher VIX, in turn, pressures the S&P 500 due to "market mechanics" and how derivatives markets are correlated (or inversely correlated).

Bottom line, the VIX surged by 33% yesterday to close at the highest level since August 8. And with the understanding that the short-volatility position in this market is still very crowded, a further move to the upside in the VIX in the sessions ahead is a significant threat that could influence intensifying market volatility and weakness in equities.

As such, the VIX is something to monitor closely. Yesterday's high of 21.99 will be a key level to watch to the upside as a break above would almost certainly coincide with heavy pressure on the broader stock market while a drop below yesterday's intraday low of 15.71 would open the door to another rapid rebound in equities like we saw into the middle of August with the potential to drive the S&P 500 to new record highs.

The Yield Curve Is Getting Close to Un-Inverting. Is That a Good Thing? (Republished from 7/17 Issue)

Since 1998 there have been six inversions of the 10s-2s yield spread: June 1998, February 2000, January 2006, June 2006 and, more recently, August 2019 and July 2022.

Three of those inversions, June 1998, January 2006 and August 2019 were extremely limited to around a month in 1998 and January 2006, and just a day or two for the August 2019 inversion. Because the current inversion is over two years old, I don't think analyzing those three instances is particularly useful, as they sent a much different economic signal than the longer inversions.

The inversions of early 2000 and 2006 were much longer (just under a year in both instances) and are more analogous to the current inversion, which again is more than two years old. Because of this, I think the conclusion is notable: **In both prior instances (2000 and 2006) the 10s-2s yield spread un-inverting (so turning back positive) was a decidedly negative signal for stocks.**

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Looking at the early 2000's inversion, the 10s-2s spread turned back positive on December 29, 2000, when the S&P 500 was trading 1,320. The S&P 500 declined for the next 22 months, bottoming out around 785 in October 2022. The S&P 500 didn't return to 1,320 until the third quarter of 2006!

Looking at the next example, the 10s-2s spread turned back positive on June 6, 2007, after being inverted for nearly a year. On June 6, the S&P 500 was trading at 1,517. The S&P 500 declined for the next 21 months, bottoming out around 670 in March 2009. The S&P 500 didn't trade back above 1,500 until the first quarter 2013.

I appreciate this is a somewhat simplistic look at things and that this era is not the same as the tech bubble burst of 2000 or the housing bubble burst of 2008. But I do think this is worth pointing out for a simple reason: 10s-2s turning back positive is both logically and practically a warning sign of an imminent economic slowdown. Here's why.

When 10s-2s turns back positive, it's usually because the 2-year Treasury yield is falling quickly as investors price in aggressive rate cuts. Rate cuts usually occur because the Fed is worried about economic growth. That's happening right now, as the market prices in 100% chances for a September and December rate cut and a growing chance for a third cut this year. The 2-year yield has declined from a high of 5% in April to 4.47% today (and more than half that decline has come in the past month). That's the market pricing in Fed rate cuts and the net result is a rise in 10s-2s.

Market	Level	Change	% Change
Dollar Index	101.76	.13	0.13%
EUR/USD	1.1041	-.0031	-0.28%
GBP/USD	1.3106	-.0040	-0.30%
USD/JPY	145.71	-1.21	-0.82%
USD/CAD	1.3544	.0050	0.37%
AUD/USD	.6717	-.0074	-1.09%
USD/BRL	5.6462	.0286	0.51%
Bitcoin	58,082.84	-417.41	-0.71%
10 Year Yield	3.844	-.067	-1.71%
30 Year Yield	4.131	-.065	-1.55%
10's-2's	-4 bps		
Date of Rate Cut	September 2024		
2024 YE Fed Funds	4.52%		
Prices taken at previous day market close.			

The point here is the yield curve is getting close to un-inverting and that may be heralded as a positive by the financial media. However, for inversions that are lengthy (and this one is extremely lengthy) the 10s-2s yield spread turning back positive is not historically a positive event and may, in fact, be a signal for equity market volatility.

As such, the rise in 10s-2s is reinforcing my concern that investors are under appreciating the economic risks facing this market in the coming quarters and instead are viewing the world through positively tinted glasses. I very much hope they are right. I hope this time is different than 2000 and 2006 and given how stretched the S&P 500 is on AI enthusiasm and how the rest of the market is trying to quickly catch up, it better be different this time, otherwise this is not a positive set up for investors.

Economics

ISM Manufacturing PMI

- The August ISM Manufacturing PMI rose to 47.2 vs. (E) 47.5.

The first of the "Big Three" monthly economic reports was a disappointment as it implied still weak manufacturing activity but buoyant prices (which is the opposite of what the market wants). The August manufacturing PMI rose from July's 46.8, but barely so and it still missed the expectation of 47.5. Regardless, the PMI remains in decidedly negative territory.

Looking at the details of the report, they were worse than the headline. New Orders, the leading indicator in the report, declined to a very weak 44.6 vs. 47.5. That's the lowest reading since May 2023. Prices, meanwhile, rose to 54.0 from 52.1, not a substantial amount but still going in the wrong direction.

Bottom line, stocks at these levels are assuming 1) Stable growth and 2) Falling prices. And, while just one report, the ISM Manufacturing PMI implied the opposite is happening. Moreover, this report did contribute to the decline in stocks on Tuesday, as cyclical sectors dropped following the release while defensive sectors outperformed. While yesterday's early declines in stocks weren't the direct result of this soft ISM Manufacturing PMI, those declines need to be taken

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as a clear reminder that "bad" economic news is now "bad" for markets and that's important context for the rest of this week's economic data (ADP today, ISM Services and claims Thursday and Jobs report on Friday).

Commodities

Commodities sold off hard to start the new trading month yesterday as traders returned from the long Labor Day weekend to a handful of negative headlines regarding the health of the Chinese economy and a subsequent surge in demand concerns. Oil led declines with copper not far behind while gold relatively outperformed, suffering only an incremental loss thanks to flight-to-safety money flows. The commodity ETF, DBC, dropped 1.99% to test its 2024 lows.

Beginning with the worst performer, the oil market plunged at the start of the holiday-shortened trading week with WTI crude futures settling with a steep loss of 4.36% at the lowest close since early January.

There were multiple bearish influences on the price of oil yesterday as reported progress towards a U.N. led deal to restore Libyan oil production saw some degree of the multi-faceted fear bid in the global oil market unwind. Additionally, OPEC+ supply cuts are beginning to expire this month, which raised uncertainty surrounding a potential surplus emerging in the global physical market. Meanwhile, GS analysts published research over the weekend materially reducing their Chinese economic growth outlook after a series of weak economic reports were released this summer that considerably dented the demand outlook for the world's largest crude importer.

Technically speaking, as we noted two weeks ago when WTI futures first quietly closed at multi-month lows, the price action had begun to deteriorate meaningfully in late August and the path of least resistance had shifted to the downside. And the negative fundamental news flow from the weekend served as the multi-pronged catalyst for yesterday's heavy selling pressure. On the charts, $72.00-$72.50 will now offer initial resistance while support from late-2023 between $67 and $69/barrel is likely to be tested in the sessions ahead.

Gold futures pulled back to test support of their own at $2,500/oz. yesterday, but reversed direction to end off the lows with only a modest loss of 0.14% as safe-haven money flows amid the otherwise broad risk-off money flows overseas supported the yellow metal. The uptrend in gold remains intact as support at $2,500 was defended, although there remains a relatively elevated risk of a profit-taking pullback in gold in the weeks ahead.

Currencies & Bonds

The global currency markets did not trade off the soft ISM Manufacturing PMI as falling global inflation pushed global rate cut expectations higher, preventing a dollar decline. The Dollar Index rose 0.17%.

Swiss CPI rose less than expected year over year (1.1% vs. 1.2%) and it was flat month over month, and that became the latest EU-related inflation report to show a smaller increase in inflation than expected and that further opens the door to a September ECB rate cut and, perhaps, larger or more frequent cuts than previously expected. As a result, the euro declined 0.3% and the pound fell 0.4%, largely in sympathy. The euro declined to a three-week low vs. the dollar although it remains solidly higher vs. the greenback on a monthly basis.

In Treasuries, the entire yield curve moved lower on Tuesday following the underwhelming ISM Manufacturing PMI. The 2-year yield fell 4 basis points while the 10-year yield dipped 5 basis points. The 10s-2s spread remained on either side of flat, as the yield curve continues to generally un-invert and it's likely just a matter of time until the 10-year yield sustainably overtakes the 2-year yield (which is the normal condition in the bond market).

Yields have fallen on a combination of growth concerns and expected Fed rate cuts. So far, markets have welcomed these yield declines but they remain more of a mixed message than an outright positive signal because at 3.85%, the 10-year yield is signaling slower growth than most investors seem to expect.

Have a good day,

Tom

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9/4/2024

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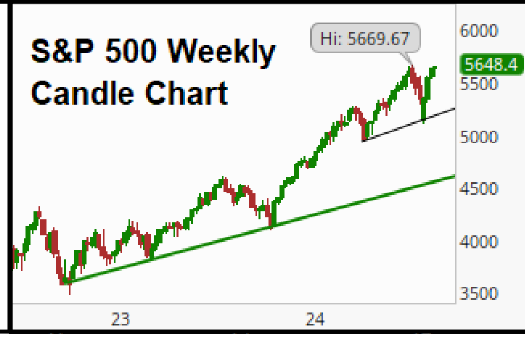
Technical Perspectives (Updated 9/1/2024)

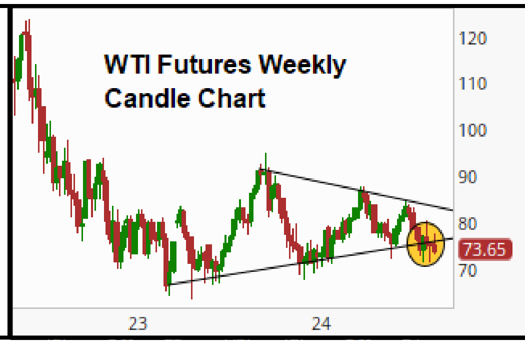
S&P 500

- Technical View: **The medium-term trend in the S&P 500 is poised to shift back to bullish from neutral** if the rebound off the August lows produces new record highs.
- Dow Theory: **Bullish (since the week of July 10, 2023)**
- Key Resistance Levels: 5667, 5700, 5750
- Key Support Levels: 5571, 5455, 5352



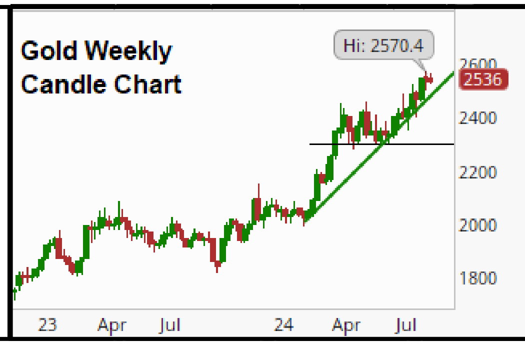
WTI Crude Oil

- 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: $75.76, $77.22, $78.66
- Key Support Levels: $72.98, $71.94, $70.50



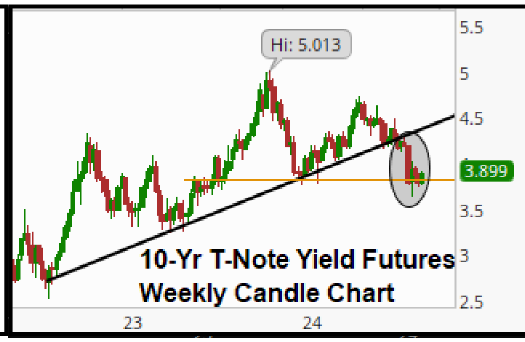
Gold

- 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: $2555, $2570, $2600
- Key Support Levels: $2521, $2495, $2424



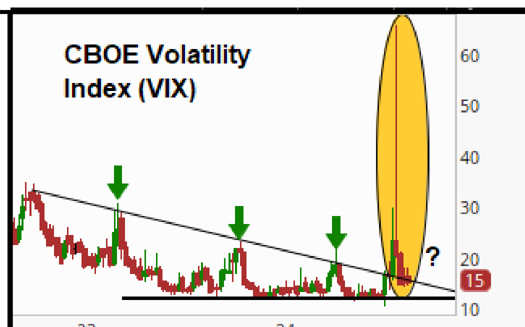
10-Year T-Note Yield Futures

- Technical View: The 10-year yield fell to multi-year lows in August but has since stabilized and is threatening to begin a counter-trend rally.
- Primary Trend: **Bearish (since the week of July 29, 2024)**
- Key Resistance Levels: 3.911, 3.987, 4.156
- Key Support Levels: 3.815, 3.775, 3.657



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: 17.11, 20.06, 23.78
- Key Support Levels: 14.65, 13.85, 12.91



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Fundamental Market View (Updated 9/1/2024)

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%**	*Stocks wavered between gains and losses last week as traders digested the last of the major Q2 earnings reports, including results from NVDA, which were solid, and more economic data that supported both a September start to the Fed's widely anticipated rate-cutting cycle and ultimately a soft economic landing.*

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 traded with a bias to the downside last week as an upside reversal in the dollar and rising interest rates spurred modest profit taking in gold while simmering recession worries weighed on oil prices and capped slight gains in industrial metals.*
US Dollar	**Neutral**	*The Dollar Index stabilized last week after its recent drop to 52-week lows as "cool" inflation data overseas and resilient labor market and growth data in the U.S. saw very dovish Fed policy expectations get dialed back while overseas central bank expectations became more dovish.*
Treasuries	**Turning Positive**	*Treasury yields were mixed last week as short-duration yields fell back towards the multi-year lows established in early August while longer-duration yields rose modestly amid solid economic data.*

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.

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