September 17, 2024

FINANCIAL MARKET
INSIGHT
VANN EQUITY MANAGEMENT

HIGHLIGHTS

- **How to Explain This Market** (September Update)
- **Weekly Market Preview**: Two Key Central Bank Decisions (Fed on Wednesday, BOJ on Thursday)
- **Weekly Economic Cheat Sheet**: Important Growth Updates This Week

STOCKS

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: 5648, 5670, 5,700
- Key Support Levels: 5554, 5408, 5293

"Stocks rallied and the S&P 500 climbed close to previous all-time highs thanks to solid tech earnings from ORCL and increased expectations for a 50-bps rate cut from the Fed"

SOURCE: Factset and Vann Equity Management Research Team

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

How to Explain This Market

Over the weekend our investment team spoke to several investors who were in somewhat of disbelief that stocks remained so resilient in the face of political uncertainty and, what is to them a slowing economy; and in those discussions, we pushed back on some of their negative expectations, and it was very well received, so we wanted to share our points with you below.

First, and importantly, ***the burden of proof remains with the bears. Put simply, the news is not bad enough yet to cause a sustainable decline in stocks.*** Yes, there are anecdotal economic and earnings warning signs including the rising unemployment rate, the very weak ISM Manufacturing PMI[1], negative bank guidance, and an uncertain retail environment. Yes, there are negative macro risks out there: **Political uncertainty** (Harris or Trump?), **economic uncertainty** (soft or hard landing), and **geopolitical turmoil** (Russia/Ukraine, Israel/Hamas, Taiwan). However, those

[1] ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at manufacturing firms nationwide. It is considered to be a key indicator of the state of the U.S. economy.

potential risks and anecdotal negatives, while all legitimate, are not yet enough to distract investors from positive factors in this market.

Those positive factors are:

1) Still generally "ok" economic data (yes, it is clearly slowing, but as of right now it is still "ok").
2) Looming Fed rate cuts (investors often ignore the reality that Fed rate cuts do not always extend market rallies, so they initially welcome cuts as a bullish positive).
3) Expected earnings growth (still more than **10% y/y**).
4) AI enthusiasm (it has been reduced but is still alive as last week's price action showed us).

Second, while a "Wall of Worry" still exists, stocks remain resilient. Those risks of uncertainty we just laid out in our first point (**Political**, **Geopolitical**, and **Economic**) are negatives that could indeed happen **(and if they do, they would be bearish game changers)**; but right now, they are not happening. So, as data points and news fail to reinforce those concerns, we are seeing stocks grind higher.

Third, that leaves a market dynamic where the S&P 500 could easily hit a new high this month. If economic data this week does not confirm growth fears and the Fed cuts 50 bps (or cut a of 25 bps and promises of further aggressive rate cuts) we should not be shocked if the S&P 500 moves to a new, all-time high. However, new highs this week would not mean this market is not still facing serious risks. While the S&P 500 can grind higher in the short term, the reality is that 1) Growth is slowing, 2) Rates are falling, 3) Earnings growth is facing headwinds and 4) Political and geopolitical risks remain high.

The combination of these looming risks and the very elevated valuations make this market very exposed to 1) Dramatic negative shocks that could cause a sharp "air pocket" in stocks similar (or worse) to what we saw in early August and 2) A growth scare that would easily open up a 10%-20% sustainable and long-lasting decline in stocks.

Bottom line: The risks currently facing this market (economic growth, earnings, geopolitics) are tectonic risks. They do not present themselves all at once or in a flash, ***they evolve over time until they become sustainable and that is when bear markets occur***. This market is facing those risks but facing them does NOT mean they will happen. That is why our investment team believes the right way to navigate this market is that we closely monitor these risks, while not prematurely abandoning the long side. Our team has advocated this management strategy throughout 2024, and it has been working, and it is what we continue to believe is the right way to successfully navigate this current market. If and when the facts change, our outlook will change and you will hear it first, loudly and clearly.

Economic Data (What You Need to Know in Plain English)

Inflation was the focus of last week's data, and the message was remarkably consistent: The decline in inflation slowed, not to the point where it would be a problem for markets or the economy, but it could push back on any Fed member's desire to very aggressively cut rates (they are still going to cut this week, but maybe not as much as before).

The key inflation report was CPI, and it was firmer than expected. Headline CPI dropped sharply to **2.5% y/y (down from 2.9%)** but most of that drop was energy-related (lower oil prices). The more important Core CPI was flat vs. July, **rising 3.2% y/y.** The monthly increase was a touch high**, rising 0.3% vs. (E) 0.2%.** These inflation numbers are not bad in the broad sense, and they do not imply inflation is bouncing back (it is not) but for those hoping for very aggressive rate cuts.

Part of what is supporting stocks is investor expectations for aggressive interest rate cuts, and last week's inflation data legitimately reduces the case for 50-bps Wednesday. It may still happen, but the hawks on the FOMC have some fresh data to point to if they want to advocate "going slowly." The question "Is the Fed behind the curve" is becoming the most important question in this market. The freer the Fed is to cut rates aggressively, the smaller the chances it falls behind the curve and we get a deeper-than-expected slowdown. The firm CPI reduces some of the Fed's flexibility to be aggressive and while that is not a near-term negative, it reduces the margin of error for the Fed and that is something we need to keep in mind as we move towards the end of the year.

Looking at actual hard data, we have a lot of potentially important economic reports this week that will give us greater insight into the state of the economy. First, Retail Sales come tomorrow, and this number has been plateauing for several months. If it suddenly drops and implies the consumer is no longer just being discerning but not outright pulling back, that will be negative, and increase fears the Fed is behind the curve.

We are going to learn a lot this week about actual Fed rate cuts vs. expectations and the current state of economic growth. A dovish Fed and solid data will increase soft landing hopes and imply the Fed is not behind the curve, at least for now, and stocks should rally.

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[1] Consumer Price Index (CPI) measures the monthly change in prices paid by U.S. consumers, calculated by The Bureau of Labor Statistics (BLS) as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending.
[1] Core inflation is the change in the costs of goods and services, but it does not include those from the food and energy sectors.

COMMODITIES, CURRENCIES & BONDS

Gold

- Technical View: Gold hit new record highs in August reaffirming the long-term up-trend remains in place with the path of least resistance still higher.
- Primary Trend: **Bullish (since the week of November 27, 2023)**
- Key Resistance Levels: $2620, $2660, $2700
- Key Support Levels: $2587, $2547, $2495

"Commodities were mixed to start last week as demand fears persisted in the wake of several weak industry reports. However, dovish bets for a 50-bps cut from the Fed this week rekindled soft landing hopes and shored-up demand expectations, driving the complex higher into the weekend with metals and energy all notching weekly gains"

SOURCE: Factset and Vann Equity Management Research Team

The outlook for oil remains bearish despite a mid-September relief rally beginning last week. Fundamentals are pointing to an increased likely surplus emerging in the physical markets in the months or quarters ahead and recession fears continue to simmer despite a resurgence in soft-landing hopes. On the charts, last week's low close of $66.31 will be looked to for initial support while previous support at $72.50 will present initial resistance.

Turning to the metals, the big development has been the renewed push higher by gold, which launched to new record highs thanks to the dovish money flows resulting from the combination of a potential 50-bps cut this week and mostly cooler-than-anticipated inflation metrics released over the course of the week. The bottom line for gold, the trend is decidedly bullish, and it would take a materially hawkish reversal in broad market money flows to derail this advance.

Looking at the industrial metals, copper has been beaten up the most and had the most to recover during the relief rally. Copper ended the week higher by **3.84%.** Futures remain rangebound between **$4.05 and $4.30** for now.

"The Dollar Index declined modestly last week despite the slightly more firm CPI report as the ECB cut rates but was not any more dovish than expected and as expectations for a 50-bps cut rose."

Hopes for a 50-bps cut offset the firm CPI and PPI last week as the Dollar Index declined 0.25%. The dollar was initially flat-to-slightly higher through the middle of last week but the WSJ article by Timiraos and the Bill Dudley article on Friday (one hinting at 50 bps, the other calling for it) weighed on the dollar as expectations for 50 bps rose.

Those rising rate cut expectations from the Fed combined with an ECB rate cut that just met expectations (it was not forcefully dovish) boosted the euro and it finished the week flat vs. the dollar, despite the rate cut. The pound traded similarly, as it was flat on the week absent any major news.

The one notable mover vs. the dollar was the yen, which rose 1.3% vs. the dollar and dropped to a six-month low vs. the greenback (which means the yen got stronger vs. the dollar).

Bottom line: This was largely ignored by the financial media last week but the yen hitting a new one-year "high" (meaning it is the strongest it has been vs. the dollar in a year) will pressure the yen carry trade and just like in early August, this could become a source of volatility in the coming weeks.

Turning to Treasuries, yields hit fresh 52-week lows, again, but the 10-year yield stabilized in the mid-3.60% range and that helped stocks lift late in the week. The firm CPI/PPI data and low claims offset the dovish articles by Timiraos and Dudley (among others).

Bottom line: Stability is needed in the Treasury markets for stocks to lift and that is what we got in the back half of last week. Looking forward, more stability is needed in yields if the S&P 500 is going to test those old highs because a continued decline in yields will just be a louder warning on growth and increase concerns the Fed is behind the curve.