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BENZINGA RESEARCH

YOUR EXCLUSIVE

BENZINGA INSIDER REPORT

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Happy Sunday, Pro Member!

"Never, ever argue with your trading system."

Michael Covel

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Market Overview (Member Only)

- Stocks fell to new lows for the recent correction, but then came back with a vengeance and closed up on the week across the board. The S&P 500 was up 1.90%, the Nasdaq gained 2.58%, and the Dow Jones Industrial Average rallied 1.75%. Now, we need to see them clear technical resistance. If they do, it's off to the races for the bulls.

- My inflation-trade / war trade thesis continues to work well. The defense (ITA) and steel (SLX) sectors both rallied to new multi-year highs last week.

- The U.S. Dollar rally paused last week, giving global equity markets some breathing room with respect to relative performance. This Dollar remains the biggest driver of global capital flows.

- The housing market showed some signs of cooling off last week, but it's far from being in crash mode right now. With the recent uptick in interest rates again, will homebuyers be scared out of activity as we head into prime real estate season?

Stocks I Like

1. Ferrari (RACE) – 34% Return Potential

What's Happening

- Ferrari NV (**RACE**) designs and manufactures luxury sportscars.
- The company brought in $5.1 billion in revenue in 2022, along with $932.61 million in earnings.
- **RACE** has an elevated valuation. P/E is at 48.72, Price-to-Sales is at 8.91, and EV to EBITDA is at 26.22.
- From a charting perspective, **RACE** is consolidating within a descending price channel. These are known to be continuation patterns, and the trend is clearly up. It's starting to break above the upper trendline of the pattern, look for another leg higher in prices.

Why It's Happening

- The luxury carmaker is more insulated against the industry-wide transition to EVs in the near-term. Nonetheless, the company plans to have full-electric and hybrid models make up 80% of its sales by 2023.
- Ferrari's first electric vehicle is set to be launched in 2025. It also plans to debut another 15 models between 2023 and 2026.

- **RACE** has one-of-a-kind pricing power and brand recognition, which will allow it to weather any time of significant economic slowdown – there is a segment of the wealthy that will purchase luxury goods regardless of economic conditions.

- Ferrari actually limits its annual vehicle sales. This creates an automatic backlog, and protects its profit margins, which are unparalleled to its competitors. For example, the company only sol 13,221 vehicles in 2022.

- Despite its future plans for EVs, Ferrari is also launching a utility vehicle, the Purosangue (pure blood). Its backlog was so strong, **RACE** had to stop taking orders in 2022.

- Analyst Ratings:
    - Credit Suisse: Outperform
    - Morgan Stanley: Overweight
    - HSBC: Buy
    - UBS: Buy

My Action Plan (34% Return Potential)

- I am bullish on **RACE** as long as the stock remains above $240.00-$242.00. My upside target is $365.00-$375.00.

2. Beacon Roofing Supply (BECN) – 22% Return Potential

What's Happening

- Beacon Roofing Supply (**BECN**) is a manufacturer of residential roofing and other homebuilding materials.
- The company generated $7.02 billion in revenue in 2022 along with $272 million in earnings.
- **BECN** has a fair valuation. P/E is at 11.84, Price-to-Sales is 0.53, and EV to EBITDA is 8.09.
- From a technical standpoint, **BECN** is testing resistance of a multi-month saucer formation. The duration of the pattern implies a big move could be close. If it clears resistance, look out above.

Why It's Happening

- Beacon just capped off a record year in 2022 by achieving their strongest fourth quarter and full-year sales in the company's history. Even if the housing market slows down, homeowners will need to keep up on maintenance, which should be a tailwind for a company like Beacon.
- The company has been methodically targeting inventory reduction since the second quarter of 2022. This has freed up additional cash flow and allowed Beacon to invest more in growth initiatives.
- The company acquired Coastal in the 4th quarter, which significantly expanded Beacon's waterproofing and restoration segments of the business. They also accelerated their greenfield investments, adding 16 locations throughout 2022.
- Residential roofing product sales, Beacon's bread and butter business, increased 17.5% in 2022. But its non-residential roofing product sales increased a whopping 41.6%. The company has been able to weather higher material costs by raising its prices. Clearly, this hasn't impacted the business much.
- Free quarterly cash flow is a solid $311 million.
- Analyst Ratings:
    - Deutsche Bank: Buy
    - Baird: Neutral
    - Stephens & Co.: Equal Weight

My Action Plan (22% Return Potential)

- I am bullish on **BECN** so long as the stock remains above $58.00-$60.00. My upside target is $82.00-$84.00.

3. Fortinet (FTNT) – 33% Return Potential

What's Happening

- Fortinet (**FTNT**) provides cybersecurity and networking solutions across the globe.
- The company produced $4.42 billion in revenue in 2022, along with $857.3 million in earnings.
- **FTNT** has a high valuation, but indicates that there's no shortage of demand for its shares. P/E is at 56.26, Price-to-Sales is 10.87, and EV to EBITDA is 42.25.
- At a technical level, FTNT is consolidating under resistance of a saucer formation. A close above the upper horizontal trendline of the pattern would be very bullish and could lead to an explosive rally higher.

Why It's Happening

- Fortinet just issued strong guidance for 2023 and expects revenue to rise between 24-28% in Q1, and 21-23% for the full-year. This significantly exceeded Wall Street estimates.
- The company is well-insulated from some of the global supply chain issues gripping the tech sector. Many of its clients include Fortune 500 companies, and it has around 16,500 customers globally now.
- **FTNT** expects to achieve $10 billion in billing revenues by 2025. This implies a CAGR (compound annual growth rate) of 21% from its $5.59 billion in billings in 2022.

- The company repurchased a significant number of its own shares last year. It spent roughly $1.99 billion on buybacks with an average price of $55.37 per share, which reduced outstanding shares by about 4%. This looks to have been a wise move as prices are comfortably above that mark now.
- **FTNT** has a strong free quarterly cash flow of over $1.44 billion.
- Analyst Ratings:
    - Goldman Sachs: Buy
    - Loop Capita: Buy
    - Barclays: Overweight
    - Morgan Stanley: Overweight

My Action Plan (33% return potential)

- I am bullish on **FTNT** so long as the stock remains above $52.00-$53.00. My upside target is $81.00-$83.00.

Market-Moving Catalysts for the Week Ahead

Demand Depends on Jobs

For readers of Benzinga's Insider Report, it's not much of a surprise that the economy is holding up better than expected so far this year. Instead, I was adamant how the biggest risk for markets this year was a resurgence in inflation. Recent reports have confirmed this as a very real threat, as various readings have come in above expectations.

This week, we have very important employment numbers. The economy's current strength is predicated on the labor market staying strong. Despite many large corporations laying off staff, we've seen small businesses maintain steady rates of hiring. This is no, surprise, however, as small businesses employ more people in the United States anyways.

But if the labor market starts to show sign of deterioration, it would threaten the base case of "no recession." This is because if unemployment rises, demand will fall. People will spend less, and consumption accounts for 70% of U.S. GDP.

How Much Debt Can Consumers Handle?

It seems counterintuitive at first, but money is literally debt in the current monetary system. For every unit of currency that is created, a unit of debt is created. It's essentially an IOU, or a promise to pay from the federal government. Look at your physical cash – it says Federal Reserve Note on it.

Thus, the healthiest economy is when credit grows at a slow and steady rate. We have an important consumer credit reading this week for the month of January. The previous reading was $11.6 billion. Given the inflationary environment, the closer this number comes into $11.6 billion, the better. If it grows too much, it could be a sign that consumers are borrowing more to cover living costs. But if it drops too much, it could signal a drop in demand.

Inflation Isn't Bad for Assets

One of the biggest misconceptions in markets is that a hawkish Fed is automatically bearish for stocks or even real estate. This simply isn't true. In fact, some of the strongest historical performances from stocks and real estate came during periods of a hawkish monetary policy.

Liquidity doesn't necessarily correlate to returns. All liquidity means is the ease at which a seller can convert an asset to cash. Low liquidity means high volatility. It means investors need to be even more responsible with risk management. Those that fail to manage risk will have the toughest time in a low liquidity environment. The key in an inflationary environment is to compare asset returns to the inflation rate.

If inflation outpaces nominal returns, then real returns are negative, but it's still better than cash. Risk averse individuals may even consider "risk-free" Treasury bills now, which are paying around 5%.

Monday

- Factory orders
- Earnings: AeroVironment (**AVAV**), Calavo Growers (**CVGW**), Ciena (**CIEN**), Lordstown Motors (**RIDE**), Nutanix (**NTNX**), Trip.com (**TCOM**), WW (**WW**)

Tuesday

- Wholesale trade
- Consumer credit
- Earnings: Dick's Sporting Goods (**DKS**), Casey's General (**CASY**), CrowdStrike (**CRWD**), Dole (**DOLE**), JinkoSolar (**JKS**), Latham Group (**SWIM**), Manchester United (**MANU**), Sea Limited (**SE**), Squarespace (**SQSP**), Stitch Fix (**SFIX**), Sumo Logic (**SUMO**), Thor Industries (**THOR**), W&T Offshore (**WTI**)

Wednesday

- ADP employment
- U.S. trade balance
- Job openings (JOLTS)
- Beige Book
- Earnings: Campbell Soup (**CPB**), ABM Industries (**ABM**), Brown-Forman (**BF.B**), Earthstone Energy (**ESTE**), Ebix (**EBIX**), International Money Express (**IMXI**), Korn/Ferry (**KFY**), MongoDB (**MDB**), Noodles & Co (**NDLS**), Proterra (**PTRA**), REV Group (**REVG**), SmartRent (**SMRT**), The Children's Place (**PLCE**), United Natural Foods (**UNFI**)

Thursday

- Jobless claims
- Earnings: Ulta Beauty (**ULTA**), Allbirds (**BIRD**), American Outdoor Brands (**AOUT**), BJ's Wholesale (**BJ**), DocuSign (**DOCU**), El Pollo Loco (**LOCO**), FuelCell Energy (**FCEL**), GAP (**GPS**), Genesco (**GCO**), JD.com (**JD**), National Beverage (**FIZZ**), Smith & Wesson Brands (**SWBI**), Toro (**TTC**), Vail Resorts (**MTN**), Wheaton Precious Metals (**WPM**), Zumiez (**ZUMZ**)

Friday

- Employment report
- Unemployment rate
- Earnings: Buckle (**BKE**)

The Longer the Trend, the Stronger It is

Principles are what helps guide us in markets. There are no certainties in life besides death and taxes, but we do have probabilities predicated off previous events. Markets are inherently mutable and constantly absorbing new information and world events. If you approach an inherently mutable entity without a solid framework, it's easy to get lost.

As a rule, the longer a trend has been in effect, the more powerful it is. Longer-term trends tend to overpower short-term trends. Thus, it's important to keep perspective in this equity environment. The secular trend is bullish. The bull market coming out of the March 2009 low ended the decade of secular equity deflation. Naturally, when the trends change, they always turn at the shorter time interval first. But when you zoom out, the correction since January 2022 looks to be just that. If October 2022 was a higher-low with respect to the intermediate-term trend, stocks could be much more bullish right now than many realize.

Capital Flows

I've said it before and I'll say it again: Capital is like matter. It is never actually created or destroyed; it merely flows from one asset class to another. When stocks crash, the value of cash appreciates – that's where the capital flowed. The problem is that there are those that inevitably get caught holding the bag. Such is the nature of markets.

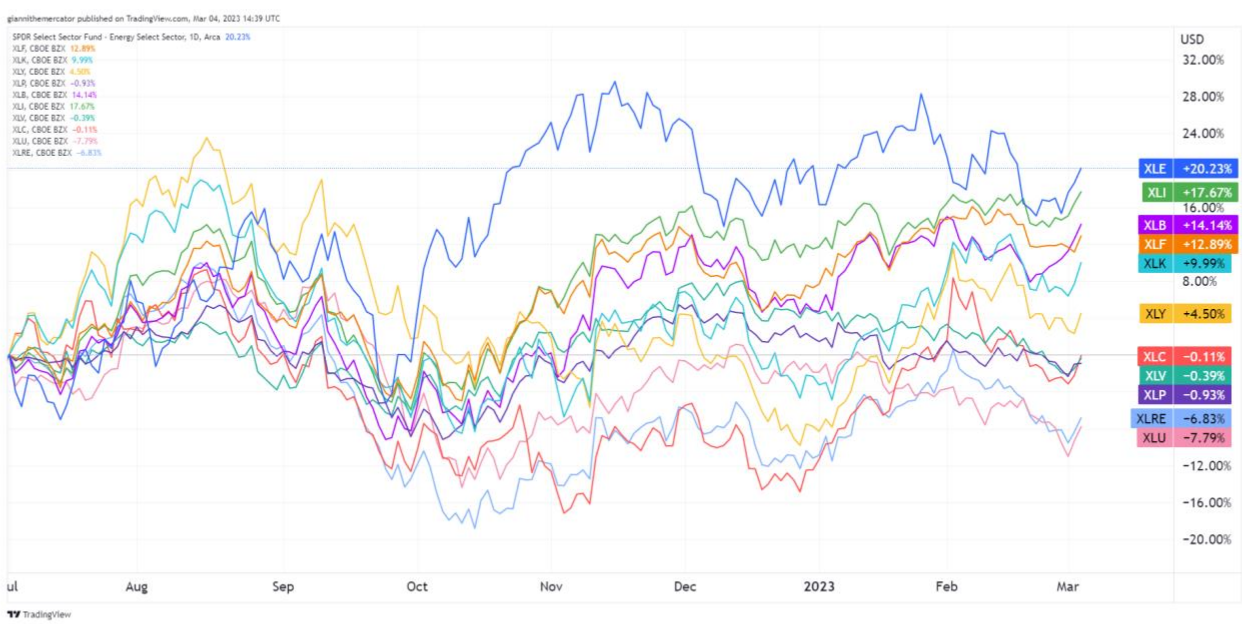
It's no secret that inflation is bearish for bonds. This means that capital is leaving the bond market, but where is it to go? The most likely candidate is equities. Commodities could and should benefit too, but stocks offer one thing commodities don't – cash flow. Businesses can raise their prices, innovate new products, and even reduce costs. Commodities are governed more by the laws of supply and demand. So, if the selloff in bonds accelerates here, it could turn into a tailwind for stocks going forward.

Energy is the Key

The biggest driver of inflation expectations is energy. This stems more from just gas prices, as crude oil is used in plastic products, medicine, and other key items as well. The biggest concern with the recent elevated inflation reports is the fact that crude oil is down significantly from its peak in March 2022. This means that inflationary pressures are still present even while the primary driver of inflation is subdued.

What happens if energy rebounds? Most likely, the inflationary problem will only compound. That's why I've said geopolitical tensions are the biggest risk for inflation. If crude oil keeps falling, it might finally lower inflation expectations, but that could also mean demand is waning, and that a recession is looming. If you compare energy stocks to crude oil, you'll see how the equities have held up much better and consolidated near their multi-year highs. It also implies that the pullback in crude oil was corrective in nature instead of the start of a new bear market.

Sector & Industry Strength (Member Only)



Energy (**XLE**) remains in first-place when it comes to performance since July 1, 2022. Basic materials (**XLB**) overtook financials (**XLF**) in third place. The top-3 sectors, **XLE**, **XLI**, and **XLB** all imply that the inflation trade is alive and well. Technology (**XLK**) is starting to show significant improvements too, which is bullish for the overall market.

Communications (**XLC**) also overtook healthcare (**XLV**) and consumer staples (**XLP**). This too is a risk-on signal, since many stocks key to the market fall into this sector. We continue to see weakness from the risk-off sectors like utilities (**XLU**) and consumer staples (**XLP**). Their laggard behavior is a risk-on signal in of itself.

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1 week	*3 Weeks*	*13 Weeks*	*26 Weeks*
Basic Materials	Basic Materials	Communications	Industrials

Editor's Note: Energy lost all its accolades, but we still see inflationary sector trends with basic materials and industrials.

High-Beta Over Low-Vol (Sector ETF: SPHB/SPLV)

The ratio between high-beta stocks (**SPHB**) and low volatility stocks (**SPLV**) is flashing a risk-on signal. The chart below shows how the ratio broke out from a rounding bottom formation earlier in 2023. It also looks to have just solidified a higher-low with respect to the trend, and it looks poised to continue higher.

When stocks are in a risk-on environment, it's common to see high-beta outperform low-vol. When low-vol outperforms high-beta, it's a risk off signal. Thus, bulls have some ground to stand on when it comes to this particular ratio. Note how it peaked back in November 2021, which was when the Nasdaq formed its all time high. This latest move higher is very much a welcomed development with respect to the bullish case for equities.

Emerging Markets Trying to Make a Stand (Sector ETF: EEM/SPY)

Last week, we placed our previously held notion of global stocks outperforming U.S. stocks on notice. That is, earlier in the year, I showed how capital flows indicated that U.S. stocks could be poised to outperform their global peers for the first time in a while. This was predicated on a correction in the U.S. Dollar.

This unfolded accordingly for a period of time, but now the Dollar is starting to look strong again. Thus, our previous thesis is at risk, and we can’t rule out U.S. stocks coming back with a vengeance at some point, especially if the Dollar continues to rally.

The chart below shows the ratio between emerging markets (**EEM**) and the S&P (**SPY**). **SPY** has outperformed for years, but the ratio broke above the downward sloping trendline a few months back. This signaled that the previous rate-of-descent was no longer in effect. It’s trying to make a higher-low now in favor of **EEM**. If successful, there might still be time left in the global equity trade. But if not, then we need to revert our attention back domestically.

Bonds Still Signaling Inflation (Sector ETF: TIP/IEF)

It’s time to check back in on our favorite inflation ratio in the bond market – the one between Treasury Inflation Protection Securities (**TIP**) and 7-10 Year Treasuries (**IEF**). A couple weeks back, I warned that the bond market was still sniffing out inflation in the economy.

With respect to the technicals of this ratio, I pointed out how it was resolving higher from a descending channel formation. These are known to be continuation patterns, and the longer-term trend between **TIP** and **IEF** remains higher.

The ratio is trading back at multi-month highs, and we just had a couple hotter-than-expected inflation reports in recent weeks. This is a testament to the notion that sentiment follows prices, not the other way around. Unless this ratio reverses and falls under the lows of 2022, it looks like inflationary pressures are here to stick around.

Editor's Take:

To put it simply, the Fed has its hands full here. Despite one of the fastest rate hike cycles in history, inflation is not making any significant strides lower. This begs the question: Is monetary policy tapped out in terms of effectiveness? Where does this lead us?

For years, accommodative monetary policy has allowed fiscal policymakers to be irresponsible. But time is running out. Federal deficits and out of control spending are inherently inflationary, and regulatory headwinds are largely preventing the private sector from flooding the economy with higher supply. Until that changes, brace for inflation to remain at elevated levels.

Time for a Tech Comeback? (Sector ETF: XLK/SPY)

The tech sector (**XLK**) continues to tread water in terms of relative strength against the S&P (**SPY**). A few weeks ago, it was threatening a breakdown from a multi-year rounding top formation. This is critical because technology (**XLK**) is the largest sector as a component within the S&P.

If this ratio were to break down, it would likely weigh heavily on the indices. But we see that it bounced off support, and even rallied higher in recent weeks. If this turns out to be a massive consolidation within a longer-term trend, then it's a strong possibility that the index resumes its uptrend.

Until we see other sectors increase as a percentage weighting in the S&P, **XLK** will continue to disproportionately drive index performance. Thus, it's important to keep a close watch on this ratio, and if you're a bull, you want to see this avoid a breakdown at all costs.

Cryptocurrency

This week, we're back to looking at Ethereum, the most important DeFi coin. I've discussed before how seeing Ethereum outperform Bitcoin is generally a risk-on signal for the crypto sector, and how it bodes well for the original intentions of cryptocurrency with respect to decentralization.

Ethereum continues to struggle at resistance in the 1650-1800 zone. It was rejected at this key technical level again this past week, but overall, continues to consolidate within the multi-month rounding bottom formation.

If and when Ethereum clears resistance at 1650-1800, a move as high as 2200-2300 could follow. Right now, support remains in the 1300-1400 zone. As long as prices don't close below there, bulls still have a solid foundation from which to mount a rally. But if it closes below 1300-1400, all bets are off and prices could collapse dramatically. It's key to be patient right now and let price guide our actions. If resistance at 1650-1800 clears, look out above.

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