7:00's Report

"Everything you need to know about the markets by 7a.m. each morning, in 7 minutes or less."™

August 11th, 2014

Pre 7:00 Look

- Futures are higher this morning and global shares broadly rallied o/n as geopolitics eased over the weekend.
- In Ukraine, military officials are close to retaking the city of Donetsk which is currently occupied by pro-Russian rebels.
- Meanwhile, Israeli and Palestinian negotiators are set to have discussions early this week in Cairo in an attempt to end the month long conflict.
- The situation in Iraq largely the same as the U.S. military continued with targeted strikes over the weekend.
- Econ Today: No economic reports today.

Market	Level	Change	% Change
S&P 500 Futures	1931.75	8.00	0.42%
U.S. Dollar (DXY)	81.515	.061	0.07%
Gold	1308.90	-2.10	-0.16%
WTI	97.68	.03	0.03%
10 Year	2.415	-.009	-0.37%

Equities

Things weren't as bad as they seemed last week as the S&P 500 actually finished positive thanks to a big Friday rally, rising +0.31% on the week. The S&P 500 is up +4.50% year-to-date.

Stocks started last week higher as markets enjoyed an oversold bounce last Monday, but the selling resumed Tuesday and markets were under pressure until Friday.

Tuesday saw the biggest declines of the week as geopolitical headlines weighed on markets (specifically elevated fears of a Russian invasion of Ukraine, thanks to comments by Poland's foreign minister). The S&P 500 traded through the lows of the previous week but importantly held the 100-day moving average at 1,913.

Wednesday was a day of digestion but the selling resumed Thursday thanks to increased concern regarding the Islamic State (IS) in Iraq (formerly ISIS). We also saw soft European economic data (more on that later), and several recent potential mega-mergers fell apart (TWC/FOX, S/TMUS and the reversal of the WAG inversion).

The S&P 500 broke through support at the 100-day MA (1,913) Thursday. But just when it looked like a test of 1,900 was coming, two potentially positive developments occurred overnight Thursday that sent shorts covering Friday. First, the U.S. authorized air strikes against IS in Iraq, and (more importantly) there are signs the Iraqi parliament could vote on a new PM. This would be a major positive step because then the Iraqi government might actually formulate a response to IS.

In Russia, there were reports that Moscow is looking to de-escalate the situation in Ukraine. On top of that, there was a political change in leadership in the rebel city of Donetsk, where a Moscow-backed rebel gave up command (this is seen as improving chances for a dialogue).

As mentioned, shorts were caught off-guard Friday and the S&P 500 enjoyed a nice short-covering rally to end the week.

Trading Color

Cyclicals solidly outperformed last week as trading wasn't as bad as the market volatility implied. The Russell 2000 rallied more than +1% last week, handily outperforming the S&P 500, while SPHB rose +0.80% vs. SPLV +0.52%.

Market	Level	Change	% Change
Dow	16,553.93	185.66	1.13%
TSX	15,196.31	77.88	0.52%
Brazil	55,572.93	-615.12	-1.09%
FTSE	6,612.56	45.20	0.69%
Nikkei	15,130.52	352.15	2.38%
Hang Seng	24,646.02	314.61	1.29%
ASX	5,457.03	21.72	0.40%
Prices taken at previous day market close.			

Additionally, JNK rallied just over +1%. If JNK can bottom here (and break out above $41) that could be a good sign that this equity correction is drawing to a close.

More broadly, it's important to note that this decline in stocks has come purely as a result of a "buyers' strike." There are simply not a lot of reasons to buy stocks now as opposed to a few weeks from now, when there will be more Fed clarity. These declines are *not* coming because of large-scale de-risking, and that's an important difference.

Market	Level	Change	% Change
DBC	25.28	-.12	-0.47%
Gold	1310.60	-1.90	-0.14%
Silver	19.915	-.075	-0.38%
Copper	3.1805	.0045	0.14%
WTI	97.35	.01	0.01%
Brent	104.76	-.68	-0.64%
Nat Gas	3.975	.099	2.55%%
RBOB	2.7466	-.0257	-0.93%
DBA (Grains)	26.15	-.34	-1.28%
Prices taken at previous day market close.			

On the charts 1,914 (the 100-day moving average) remains key support in the S&P 500, while resistance is 1,950 (the lower bound of the previous 1,985-1,950 trading range).

Bottom Line

The geopolitical news is being used to explain the gyrations in the market, but they are not causing this correction in stocks. (Again, short of a full-on Russian invasion or IS taking control of Southern Iraq, these situations currently remain local events with little chance for contagion.)

Instead, uncertainty regarding the Fed ("Fed angst") is the actual "reason" for this decline, which at this point remains healthy and needed. The market has been consolidating since the first week of July, and last week's trading is a continuation of that process.

As mentioned, the market declines have come because of a "buyers' strike" not aggressive selling. While sentiment short term has gotten very gloomy and fundamentally there are threats to the rally, it's important to realize nothing in the market has really changed: The Fed is still accommodative (although obviously we're nearing a shift), the global recovery is ongoing (although there are concerns about Europe), the global macro horizon is clear (although Ukraine/Iraq are areas to watch), earnings season was good and valuations aren't too stretched.

All this equates to "steady as she goes" through this consolidation/correction.

That said, in the near term the calendar remains a challenge as far as the rally resuming in earnest. So, I think we could be in for more consolidation between 1,908-ish and 1,950-ish, as I don't think this consolidation/correction is over.

But, I do view it is presenting a buying opportunity for higher-rate-sensitive sectors (regional banks), SPHB and Europe. (Sentiment there has become very gloomy and while it has underperformed, keep in mind ECB policies will become a tailwind starting next month.)

Economics

Last Week

Last week was slow from an actual US data perspective (it was busier for Europe) but there was an important takeaway on how the market is reacting to economic data in the near term.

Specifically, I'm talking about whether good economic data points re now "bad" from a market standpoint (I heard that on the media a few times last week). To be clear: Good economic data points are not "bad" for the market … but good data likely won't elicit much of a positive reaction anymore until we get more clarity from the Fed. That's because good data are being extrapolated out as ultimately resolving this Fed-policy uncertainty in a more "hawkish" manner. (Meaning good data will pull forward tightening or quicken the pace once it begins.)

Bottom line, with the question of "Is the U.S. recovery for real" finally answered definitively "yes," then we can conclude that good data isn't "bad" for the market. But it just isn't as good as it was during the last several months when the answer to that question wasn't clear. Until we get some clarity from the Fed on the coming shift in policy (likely late August/early September), good economic data alone won't result in higher equity prices.

Turning to the specific data points last week, they were good: July non-manufacturing PMIs beat expectations

(58.7 vs. 56.5) and remain at a strong level; June factory orders rose faster than expected (1.0% vs. 0.6%); and weekly jobless claims hit a new low for the recovery (although we should see a bit of a revision higher due to some statistical factors). So last week's data further confirmed U.S. economic growth continues to accelerate.

The same cannot be said for Europe, though, as last week was a busy week of data and it further implied the EU economy is losing some momentum.

Italian GDP was surprisingly negative and entered a technical recession (two quarters of negative growth) while German data remain mixed (manufacturers' orders, their durable goods, was a big miss although industrial production beat on Thursday). Composite PMIs were a touch light across the EU but considered largely in-line with expectations.

Turning to central banks, both the ECB and BOE had rate meetings last week but both were relative non-events. With the ECB, Mario Draghi was again "dovish" at the press conference. But it's well-known the ECB is standing pat until some of the measures announced in June begin to take effect (i.e., the TLTRO, which starts in September). The BOE decision to leave policy unchanged wasn't a surprise, but there is some question about whether there were any dissenting votes. We'll know in a few weeks when the meeting minutes are released.

Bottom line in Europe is that between the recent lackluster economic data and the growing concern that sanction against Russia (and retaliatory sanctions *from* Russia) will weigh on a fragile EU recovery. Generally its recovery is viewed as ongoing, but there are growing concerns it's losing momentum. The market needs a confidence boost from the data or the ECB.

Finally, in China, the strong data "beats" ended last week as July service PMIs surprisingly dropped to 50.0 from 53.1 in June. But, this is basically the least-important monthly economic number to come out of China. While the drop was surprising, it won't endanger the assumption that the Chinese economy is stable.

This Week

It'll be another relatively slow week in the U.S., but there are some releases to keep an eye on. July retail sales is the highlight of the week, as sentiment around consumer spending remains mixed. (It's one of the few parts of the economy that isn't consistently showing good data.) So, a good report will be a confidence boost to the market.

Industrial production and Empire State manufacturing come Friday, with the latter being the first look at August data. (Although as we've noted here many times, the national flash manufacturing report, which will come out next week, has stolen much of Empire's thunder.) But, it will be watched for an initial view of the current pace of growth.

Like last week, the important data will come from Europe, as concern grows that the EU economy is losing momentum.

The German ZEW Survey comes tomorrow, but the key numbers will be German and EU flash Q2 GDP, which arrive Thursday morning. I read in a few places last week about growing concerns that the German economy contracted in Q2. If that's the case, look for more downward pressure on European markets and escalating calls for the ECB to do "more" now.

In China we get the July industrial production, retail sales and fixed-asset investment Wednesday morning. Given the service PMI miss from last week, there will be a little more focus on this number to further confirm the pace of growth is stable.

Market	Level	Change	% Change
Dollar Index	81.465	-.14	-0.17%
EUR/USD	1.3410	.0046	0.34%
GBP/USD	1.6773	-.006	-0.36%
USD/JPY	102.04	-.06	-0.06%
USD/CAD	1.0973	.0047	0.43%
AUD/USD	.9275	.0004	0.04%
USD/BRL	2.2833	-.0119	-0.52%
10 Year Yield	2.415	-.009	-0.37%
30 Year Yield	3.226	-.008	-0.25%
Prices taken at previous day market close.			

Commodities

Commodities traded better last week, as geopolitics helped lift gold and oil prices and natural gas rallied on techncials and short-covering. DBC bounced +0.24% while the dollar was little-changed on the week (+0.08%).

Crude oil began the week under some selling pressure as money continued to generally flow out of risk assets, including oil futures. But, late in the week, WTI caught a bid and established some support around $97, ending the week down just -0.32%. Geopolitics spurred the short-covering rally into the weekend as President Obama authorized the use of targeted airstrikes against IS forces in northern Iraq. In the near term, geopolitics and economic data will continue to move the market (per usual). But looking ahead, we continue to see value in owning oil sub-$100 as economic growth remains strong and refined product demand is set to continue rising as a result.

Natural gas was the best-performing commodity last week as futures rallied +5%. Tuesday we recommended buying nat gas, and futures rallied +3.5% over the rest of the week. Now, 3.5% in less than a week is very good, and if you were looking for a quick trade, you got it. However we do believe natural gas will continue to rally over the medium term, as weekly supply injections have been trending lower in recent weeks (last week's build was just 82 Bcf, and earlier in the summer there was nearly 2 months' worth of 100+ Bcf builds). Additionally, meteorologists are beginning to suggest some late-summer heat could be showing up in the forecasts. Bottom line, the fundamentals support the bulls, and now that the longstanding downtrend line has broken, the technicals have shifted to favor the bulls as well.

Looking to the metals, gold finished the week up +1.17% thanks to the geopolitical unrest, specifically in Iraq. But, the gold market is volatile right now with multiple influences moving the market, both bullish and bearish. So, for now we remain sidelined in tactical accounts; however we continue to hold gold in longer-term accounts based on the bullish inflation argument.

Copper underperformed last week, falling -1.04% because of last Monday's poor Chinese service PMI (which reiterates how sensitive copper is to Chinese economic data). But, we continue to like owning copper as one of the best "pure" ways to gain exposure to the global reflation trade. Bottom line, recent Chinese data have been "good to better," and one poor report on the service sector won't change our bullish stance on copper.

Currencies & Bonds

The 30-year Treasury hit a new high for the year last week and the 10-year yield sank below 2.4% as trading in the German bund continues to drive money into Treasuries on a yield basis. This continues to overwhelm bond-negative fundamentals.

Treasuries moved sharply higher Wednesday/Thursday on a combination of soft economic data from Europe (increasing deflation fears) and news of the U.S. authorizing airstrikes in Iraq. Although there was a mild sell-off Friday in bonds, clearly until we get some sort of indication the EU economic recovery is for real, the near-term trend in bonds will be higher.

Turning to currencies, it was a tale of two weeks. Prior to midday Wednesday, the trend of universal dollar strength was in place, as the Dollar Index hit a new high for the year and the euro hit a new low. But, midday Wednesday and Thursday there was sudden, massive selling of dollar/yen and dollar/Aussie pairs, which halted the rally in the dollar. The Dollar Index finished only slightly higher on the week. News-wise, the ECB decision was as expected while the surprise of the week came from a soft Aussie jobs report.

The one currency that traded poorly vs. the dollar all week was the pound, which all of the sudden has an ugly-looking chart. The reason for the declines was two-fold: First, there were some soft data (composite PMIs). Also, the expectation of a rate hike from the UK is starting to be questioned.

Generally though, the dollar was overbought heading into last week and the euro was oversold, so we may be seeing the start of a needed correction. But with expectations for the Fed shifting to *when* and *how fast* they will hike rates, the trend in the dollar should remain broadly higher vs. most currencies.

This week's data, especially from Europe and Japan, will be the main drivers of the currency markets, as the currency markets are much more reactive to data at this point than equities. This trend should continue for the next week or two.

Have a good week — Tom

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Position Sheet

Tactical Trading/Investment Account (Time frame of a few weeks to months).

Date	Position	Open Price	Stop	Strategy
7/28/14	DBC	25.65	None	*We are going to look to initiate long positions in DBC here as a low risk-high reward opportunity has presented itself. In DBC, support has formed at $25.50 while potential target to the upside is close to the $27 mark. So, you will be risking about 20 cents for a potential return of $2 dollars. Original Issue*
7/21/14	JJC	39.17	None	*Copper has benefitted from the rebound in the global economy and now there is an attractive entry point given last week's correction. We have initiated a position and look to add to it on further weakness. Original Issue*
6/11/14	SPHB	32.73	30.32	*Long domestic cyclicals. Part of the "Post ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
6/11/14	UUP	21.55	21.13	*Long Dollar. Part of the "Post ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
4/30/14	IYZ	28.99	28.32	*Telecom trading at a value to the market, has lagged other safety sectors. Original Issue*
3/3/14	XLI IYM PICK DIA	52.19 83.06 19.48 164.28	None	*Long Market "Losers." So far in 2014 the right strategy has been to buy beaten down sectors that offer some value, as opposed to the broad market. Original Issue*
12/13/13	FCG XOP	18.97 65.62	None	*Natural gas supplies low, increased demand, E&Ps at a value. Original Issue.*

Longer Term Macro-Trend Investment Account (Long term time frame of months/quarters).

Date Initiated	Strategy	Position (s)	Investment Thesis
November 2012	**Long Japan**	**DXJ/YCS**	*The election of Prime Minster Abe in late 2012 resulted in massive monetary and fiscal stimulus designed to break Japan out of decades long deflation and stagnation. The resulting efforts will be yen negative/Japanese stock positive for years to come.*
Strategy Update (6/4/14): Focus on this trade has shifted to Abe's "3rd Arrow" of fiscal reforms, and if enacted, it could lead to a material decline in the yen/rally in DXJ.			
April 2013	**Short Bonds**	**TBT/TBF/ STPP/KBE**	*The 30 year bull market in bonds is over, as the Fed begins to gradually remove stimulus, the economy recovers, and inflation slowly begins to increase.*
Strategy Update (7/21/14): Geo-political concerns and foreign money flows sent bonds to new highs for the year last week, and the gap between deteriorating fundamentals and price action is widening. For now, though, the trend is higher and more patience is required in this long term trade.			

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Asset Class Dashboard

(Updated 8.11.14)

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.

Near Term Trends are provided primarily for tactical and trading accounts (Time Horizon of weeks and months).

Long Term Trend is provided for longer term asset allocation models/retirement accounts (Time Horizon of Months/Quarters).

The "Best Idea" represents our best idea at the moment. Not all best ideas are trades we make—they are provided for idea generation.

	Near Term Trend	Long Term Trend	Market Intelligence
Stocks	**Neutral**	**Bullish**	*Trading was volatile but stocks finished slightly higher thanks to a big short covering rally Friday. Geo-politics weighed on sentiment, but really we are just seeing a continuation of the correction that's been on going since July. Fundamentally things remain positive for stocks, although given a quiet calendar I would expect a few weeks more of this range-bound trading between 1908 and 1950 in the S&P 500.*
Best Idea: Buy regional banks (KRE). **Best Contrarian Idea:** Buy Small Caps (IWM)			
Commodities	**Neutral**	**Bullish**	*Commodities bounced last week on general geo-political concerns and a reversal in the dollar. Near term the outlook remains mixed as the geo-political fear bid likely won't last long, but with inflation pressures starting to move higher across the globe, the longer term outlook for commodities is positive.*
Best Idea: Long Oil (USO) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index hit a new high for the year before reversing in the middle of last week. The dollar is short term overbought and in need of a correction, but with the Fed inching towards normalization of policy, longer term the Dollar Index is headed higher.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long Canadian Dollar (FXC)			
Treasuries	**Bullish**	**Bearish**	*Treasuries hit new highs for the year last week a German bund yield continue to decline thanks to geo-political concerns and disappointing data. Fundamentally though the outlook for Treasuries continues to decline, but until the 2014 uptrend is broken, the path of least resistance is higher.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			