# 7:00's Report

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

***August 12th, 2014***

## Pre 7:00 Look

- Futures are drifting slightly higher while int'l shares were largely flat o/n as geopolitics remain stagnant while economic data in Europe was disappointing.
- Economically, the German ZEW Survey badly missed estimates (8.6 vs. E: 17.0) and the Euro hit new lows for the year off the news.
- Geo-politically there has been incremental positive progress in Iraq and Ukraine, but both remain larger risks to monitor.
- Econ Today: No economic reports today.

| Market | Level | Change | % Change |
|---|---|---|---|
| S&P 500 Futures | 1936.25 | 3.75 | 0.19% |
| U.S. Dollar (DXY) | 81.72 | .185 | 0.23% |
| Gold | 1313.50 | 3.00 | 0.23% |
| WTI | 97.23 | -.85 | -0.87% |
| 10 Year | 2.420 | .005 | 0.21% |

# Equities

*Market Recap*

Stocks rallied to start the week yesterday as geopolitical tensions eased over the weekend. The S&P 500 added +0.28% on the session.

Stocks opened slightly higher yesterday morning as global shares were universally higher Monday. The main reason cited for the strength in equities was an easing geopolitical backdrop as all three of the current, major issues worldwide (Ukraine/Russia, Israel/Palestine, ISIS/Iraq) had made apparent turns for the better over the weekend.

Stocks opened higher and the squeeze that we saw on Friday continued throughout the morning yesterday, as the S&P 500 hit its high for the day just before the European close at 8:30.

But, after rallying more than 30 points from the Thursday lows (1904) the rally ran out of gas in the afternoon yesterday mainly because the buyers "chase" stopped, but also because of new headlines from NATO regarding a potential Russian invasion of Ukraine veiled as "humanitarian mission."

*Trading Color*

Generally cyclicals again outperformed yesterday and the rally was of "higher quality" given that fact, but a lot of that is a result of shorts covering higher volatility sectors as opposed to real money being added into the market.

To that point, the rally of the last two days has come on low volumes and really is more a reflection of how overly negative sentiment became last Thursday, not a material, fundamental positive change in Iraq or Ukraine.

Sector wise tech, consumer staples, consumer discretionary and energy all led markets higher, while banks we positive but underperformed (due to the fact that interest rates remained low yesterday). Interestingly, utilities finished negative on the day despite lower rates, and that sector continue to trade very heavy, even after the Friday bounce.

*Iraq & Ukraine Update*

There were some headlines yesterday and overnight so I wanted to update where we are with both situations.

In Iraq, a new Prime Minister has been appointed and the old PM, Nouri al-Malaki is out. The new PM is

| Market | Level | Change | % Change |
|---|---|---|---|
| Dow | 16,569.98 | 16.05 | 0.10% |
| TSX | 15,261.64 | 65.33 | 0.43% |
| Brazil | 56,613.32 | 1,040.39 | 1.87% |
| FTSE | 6,631.91 | -.91 | -0.01% |
| Nikkei | 15,161.31 | 30.79 | 0.20% |
| Hang Seng | 24,689.41 | 43.39 | 0.18% |
| ASX | 5,530.32 | 73.29 | 1.34% |
| Prices taken at previous day market close. | | | |

Haider al-Abadi. A new PM is important because one of the reasons IS (Islamic State) has been able to so easily gain ground in Iraq is because the government is deadlocked on how to fully respond, as Sunnis in the Iraq Parliament wouldn't work with al-Malaki. Now that there is a new PM, the hope is the government will become un-tied in an effort to stop the largely Sunni IS.

| Market | Level | Change | % Change |
|---|---|---|---|
| DBC | 25.32 | .04 | 0.18% |
| Gold | 1309.90 | -1.10 | -0.08% |
| Silver | 20.08 | .139 | 0.70% |
| Copper | 3.176 | .0025 | 0.08% |
| WTI | 98.02 | .37 | 0.38% |
| Brent | 104.62 | -.40 | -0.38% |
| Nat Gas | 3.975 | .013 | 0.33% |
| RBOB | 2.752 | -.0017 | -0.06% |
| DBA (Grains) | 26.44 | .29 | 1.12% |
| Prices taken at previous day market close. | | | |

But, al-Malaki isn't going quietly. He is protesting his removal and his supporters are protesting. So, that's not what we want to see if we're hoping for a united government.

Bottom line is this is a good step in the right direction, but by no means a major positive. In the meantime, US bombing appears to be at least halting the rapid IS advance. From a market standpoint, this is still about Southern Iraq. Unless IS moves into Baghdad and towards Basra (the major oil export terminal) this remains a "local" issue and won't materially affect markets.

Turing to Ukraine, the Ukrainian army has surrounded Donetsk, and there is talk of a cease fire as the city is getting relentlessly shelled. Russia is sending humanitarian aid into Donetsk in the form of an 840 truck caravan, but importantly this came with the blessing of the Ukrainian government. But, what spooked markets yesterday was that NATO warned Ukraine accepting humanitarian aid as it may be a pre-text for a full on invasion.

Bottom line, despite the worries of an invasion, that remains a low probability event, and with Donetsk surrounded, this situation could materially improve once the rebels surrender in the coming weeks.

*Bottom Line*

As mentioned yesterday the geo-political marginal improvement provides a nice excuse to explain the rally, but nothing material has changed (the events were never that much of a negative influence and now aren't that much of a positive one), and I don't see the headlines from Iraq or Ukraine as being enough to propel the S&P 500 back towards the old highs.

Instead, this remains all about the Fed, so the most important thing that happened yesterday was commentary by new Fed Vice Chair Fischer. The key takeaway from Fisher's speech in Stockholm early Monday morning was his view that much of the labor market weakness is a result of **cyclical** factors as opposed to **structural** factors, suggesting that accommodative policy will continue to help the situation.

That's important, because it wasn't clear whether Fischer was a "hawk" or a "dove" given he's so new to the Fed, but comments yesterday imply he leans towards the later.

Bottom line is I'd expect more of chop here in the near term and would be surprised if resistance at 1950 is broken in the very near term, while the 100 day MA (1914) remains critical support.

## Economics

There were no economic reports yesterday.

## Commodities

The commodities market began the trading week in a quiet manner yesterday as crude oil, the refined products, precious metals and industrial metals all finished the day with less than a 0.5% move in either direction. The benchmark commodity tracking index ETF gained +0.12%.

Natural gas was the big mover yesterday morning as futures briefly broke through the psychological $4.00 level in early trade, hitting a 3-week high of $4.012. However, due to the quiet nature of the markets and the lack of any real catalysts yesterday, technical forces took over and there was a "gap fill" down to the $3.97 area. At that point, more longs took short-term profits and futures retreated to just above $3.92 before buyers came in on the dip and futures rallied back to flat into the close.

Bottom line, there are clearly a lot of speculative traders in the natural gas market at the moment. But the underlying fundamentals—namely supply injections that have been trending lower in recent weeks, as well as warmer weather forecasts—are both supportive of the bulls over the medium term. But, we did see futures trade up into some longer-term trend resistance yesterday and would like to see a close above the $4 mark before adding much more to our positions.

WTI crude oil futures traded well yesterday considering the geopolitical setting calmed over the weekend, which has been a major supporting factor of the energy sector recently. Crude closed right in the middle of the day's trading range, up +0.35%. Fundamentally, we remain bullish crude oil (more so our domestic WTI contract as opposed to Brent) as the U.S. economy continues to improve. We expect refined product demand to increase accordingly, which will obviously support crude. On the charts, initial support lies below at the $97 area while last week's high of $98.67 is the level to beat for the bulls.

Moving over to the metals, gold futures were little-changed yesterday, closing down just -0.03% after a very uneventful trading session, again despite the progress in the multiple geopolitical conflicts that would normally have a bearish effect on precious metals as fear bids begin to unwind. Regardless, futures seemed to spend yesterday's session in consolidation mode as traders digested the volatile moves from last week, which included a near-$20 spike on Wednesday as safe-haven bids flooded the precious metals market while stocks fell to 9-week lows.

So, it is apparent that gold is hanging on to the reverse correlation with equity markets that has been in place most of the year. However, the relationship is not quite as distinct as it was in Q1. And, the technical picture with gold is a bit of a mess, but there is a fair chance we may be back to the "magnetic" $1,300 level environment. This is where gold wavers ahead of the next big catalyst, which could realistically be next week with CPI on Tuesday or the FOMC minutes due out Wednesday the 20th.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dollar Index | 81.53 | .076 | 0.09% |
| EUR/USD | 1.3383 | -.0027 | -0.20% |
| GBP/USD | 1.6787 | .0015 | 0.09% |
| USD/JPY | 102.21 | .17 | 0.17% |
| USD/CAD | 1.092 | -.0051 | -0.46% |
| AUD/USD | .9262 | -.0015 | -0.16% |
| USD/BRL | 2.2745 | -.006 | -0.26% |
| 10 Year Yield | 2.420 | .005 | 0.21% |
| 30 Year Yield | 3.232 | .006 | 0.19% |
| Prices taken at previous day market close. | | | |

Copper began the day higher yesterday as futures were up +0.36% at the Comex open. But the gains were slowly given back over the course of the day as traders positioned ahead of some key Chinese economic data due out later tonight (Industrial Production (E: 9.0%), Retail Sales (E: 12.4%)). Copper will continue to trade as a good proxy to the health of the Chinese economy. And as long as data remain "good," we can expect to see copper future continue to rally. On the charts, there is support at $3.16 while the first level of (light) resistance has edged down to $3.20.

## Currencies & Bonds

As was the general theme across asset classes yesterday, currencies moved primarily as a result of geopolitical news. Also, economic data were sparse across the globe with the exception of a strong housing report in Canada, which helped the Loonie outperform. The Dollar Index was little-changed yesterday, up just +0.09%.

Beginning in Canada, the Loonie was among the best-performing currencies against the dollar yesterday, rising +0.46% as a result of a housing report that beat analyst estimates. Canadian housing starts rose by +200.1K last month vs. (E) +193K, which spurred a session-long rally in the Loonie that saw the currency close just off the highs. Housing starts have topped analyst forecasts 4 months in a row in Canada.

Looking at the bigger picture, though, the Canadian dollar is well off the early-July highs, and it's trading in a rather sharp downtrend. Near-term support has formed at the $0.91 level; however, it appears there is room for the currency to fall further over the medium term, especially given the recent outperformance of the U.S. dollar.

Looking overseas, the yen fell back from a near-3-week high, dropping -0.17% thanks to the general "risk on" trade in the market. The yen appreciated in recent weeks on weakness in the stock market paired with the geopolitical unrest. But now that the "dust is settling" and equities are bouncing back, the yen shorts are also coming back.

The pound was slightly higher as traders positioned ahead of the Bank of England's inflation Report, which is due out early tomorrow morning. Currency traders will be paying close attention to the report as they look for hints and speculate as to when the BOE will begin to raise interest rates. (Consensus remains November.)

Looking to the bond market, trading in Treasuries was about as slow as the commodity markets. The 30-year bond fell -0.04% while the 10-year note slipped -0.05%. With all the chatter about global geopolitical relief on the wires yesterday morning, most investors would have expected Treasuries to be down much more than the modest losses seen yesterday.

Have a good day,

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<br>IYM<br>PICK<br>DIA | 52.19<br>83.06<br>19.48<br>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<br>XOP | 18.97<br>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** | *The S&P 500 suffered its biggest weekly decline in a long time last week, and although fears of faster than expected Fed tightening were the main "cause," really this remains part of a larger correction/consolidation that has been going on since early July. Stepping back, though, the outlook for Fed policy didn't change, and with still strong fundamentals the benefit of the doubt remains with the bulls.* |

**Best Idea:** **Buy global industrial miners (PICK, FCX, RIO, etc.)**

**Best Contrarian Idea:** **Buy Retailers (XRT)**

| | | | |
|---|---|---|---|
| **Commodities** | **Neutral** | **Bullish** | *Commodities broke down badly last week after WTI Crude plunged 4% on general "risk off" sentiment and dollar strength. The stronger dollar is becoming a headwind for broad commodities in the near term, but with global growth improving further and inflation bottoming, longer term the set up is still bullish.* |

**Best Idea:** **Long Oil (USO)**

**Best Contrarian Idea:** **Buy Grains (DBA)**

| | | | |
|---|---|---|---|
| **U.S. Dollar** | **Bullish** | **Bullish** | *The Dollar Index traded basically to the highs of the year last week before giving some back after Friday's jobs report. The Dollar Index is overbought here and in need of some very short term digestion, but with inflation now squarely in focus of the market, the upward trend should continue.* |

**Best Idea:** **Sell the Yen (YCS)**

**Best Contrarian Idea:** **Long Canadian Dollar (FXC)**

| | | | |
|---|---|---|---|
| **Treasuries** | **Bullish** | **Bearish** | *Treasuries actually declined last week on rising inflation concerns, although the 30 year again held a test of the 2014 uptrend thanks to Friday's jobs report. Fundamentals continue to turn negative for Treasuries, but the near term trend remains higher.* |

**Best Idea:** **Short "long" bonds (TBT)**

**Best Contrarian Idea:** **Short High Yield Bonds (SJB)**