7:00's Report

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

August 13th, 2014

Pre 7:00 Look

- Futures are strong this morning and most international markets are higher despite several negative headlines.
- Starting with the data, Chinese retail sales/fixed asset investment/ Industrial production all slightly missed estimates, & credit creation numbers saw a surprisingly steep drop. In Europe, EU Industrial Production missed, falling –0.3% vs. (E) 0.4%.
- Geo-politically situations remain static although headlines are marginally negative: Ukraine is blocking the Russian humanitarian convoy, while ex Iraqi PM al-Maliki is fostering protest.
- Econ Today: Retail Sales (E: 0.2%). Dudley (9:00 AM), Rosengren (9:20 AM)

Market	Level	Change	% Change
S&P 500 Futures	1939.75	9.25	0.48%
U.S. Dollar (DXY)	81.70	.145	0.18%
Gold	1309.10	-1.60	-0.12%
WTI	97.34	-.02	-0.02%
10 Year	2.442	.022	0.91%

Equities

Market Recap

Stocks ran in place yesterday as the market moved between mild gains and losses during another quiet day before stocks closed very slightly lower. The S&P 500 declined -0.16%.

Stocks started the day slightly weaker on continued concern about the recovery in Europe (specifically the disappointing German ZEW Index) and on further warnings of a "humanitarian" convoy from Russia bound for Donetsk being a precursor to an invasion.

JNK: Junk bonds have rebounded into resistance around the $41.00 level, and if the rally can continue, that will be a good sign for equities.

But, neither event was a material negative, and a positive JOLTS report (which rose for the 5th straight month and hit a multi-year high) helped stocks rally to 1,940 midmorning before the mini-rally ran out of steam.

Stocks drifted lower through the rest of the morning as there simply wasn't enough buying interest to push stocks materially higher. Markets spent most of the rest of the afternoon trading in mildly negative territory.

News-wise the afternoon was sleepy, and while there was the obligatory focus on geopolitical headlines (nothing material came out, but concerns remained about the Russian humanitarian convoy), the market spent the final few hours of trading just drifting before closing quietly in the middle of the day's trading range.

Trading Color

For the first time in several days cyclicals and small caps underperformed yesterday, with the Russell and Nasdaq both lagging the S&P 500 (the Russell 2000 was down just over 1%, so it was decent underperformance).

Market	Level	Change	% Change
Dow	16,560.54	-9.44	-0.06%
TSX	15,274.23	12.59	0.08%
Brazil	56,442.34	-170.98	-0.30%
FTSE	6,647.41	14.99	0.23%
Nikkei	15,213.63	52.32	0.35%
Hang Seng	24,890.34	200.93	0.81%
ASX	5,514.72	-15.61	-0.28%
Prices taken at previous day market close.			

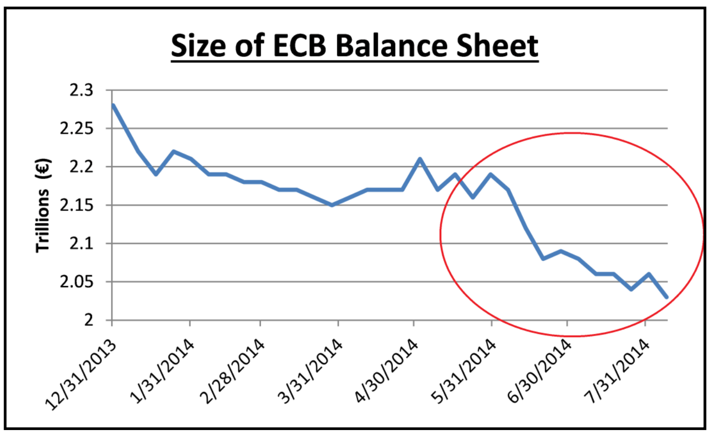
But, I'm inclined to chalk that up to short term profit taking as there wasn't any more broad "risk off" move in the market internals yesterday (SPHB declined .43% vs. SPLV's -.06%, but it's not like that was significant underperformance vs. the S&P 500, and other measures of risk appetite like JNK actually rallied).

Market	Level	Change	% Change
DBC	25.18	-.14	-0.55%
Gold	1310.90	.40	0.03%
Silver	19.955	-.14	-0.70%
Copper	3.1480	-.0265	-0.83%
WTI	97.39	-.69	-0.70%
Brent	103.12	-1.56	-1.49%
Nat Gas	3.979	.014	0.35%
RBOB	2.7373	-.0152	-0.55%
DBA (Grains)	26.035	-.375	-1.42%
Prices taken at previous day market close.			

Sector wise financials and basic materials were the only two S&P 500 sub-sector to finish positive, and financials were led by insurers as opposed to banks, which failed to rally despite the good JOLTS data and back up in Treasury yields.

Energy was the worst performer, dropping nearly 1% on profit taking and after demand estimates were cut by the IEA. But, again, after the big two day bounce XLE has seen, some profit taking was reasonable yesterday and that's just what occurred.

More broadly trading yesterday was on low volumes, slow and lacked conviction. In addition to it being a slow week from a news standpoint, it's also a very popular holiday week, so more desks are more empty than usual.



Nothing material happened yesterday geo-politically or fundamentally to alter the current outlook, and we remain in this 1904-1950 range in the S&P 500.

Futures are higher this morning as of this writing, and today we'll get the most important number of the week (retail sales), so expect some activity this morning, but after that I imagine it'll slow down again in the afternoon.

Economics

There were no economic reports yesterday.

__Are Central Bank Balance Sheets the Best Leading Indicator?__

The recent underperformance of Europe has largely been blamed on lackluster economic data and the negative influence of Russian angst and trade sanctions, and both of those are real reasons as to why EU stocks have lagged.

But, not as readily cited is the fact that since late May (about 1 month before EU stocks topped out), the size of the ECB balance sheet began to contract rapidly. For an economy battling a deflation threat, that's a big problem. The ECB balance sheet is declining because central banks and other borrowers are re-paying loans at an increasing rate – NOT increasing their lending like the ECB would prefer.

In particular, a lot of the LTRO loans made in late 2011 are now being repaid, which is draining liquidity from the system. As banks re-pay the loans, it causes an economic drag and a potential deflation threat.

And, based on the belief that basically the global stock market rallies of the last several years are almost solely the result of expanded central bank balance sheets (QE), it makes sense that once the ECB balance sheet started to materially decline, EU stocks would go with it.

But, the ECB knows this and it's part of the reason the central bank declined to act back in June. And, starting in September with the "Targeted Long-Term Repurchase Operations," we should start to see the ECB balance sheet expand, as banks and lenders take advantage of cheap money that should be lent directly into the economy.

Case in point, if the generally held thesis that expanding central bank balance sheets results in higher equity markets, then we should see European markets bottom a little after the ECB balance sheet bottoms—which should be in a next few weeks. From there, as the ECB balance sheet rises, so too should EU stocks—just like U.S. stocks rose when the Fed expanded its balance sheet, UK stocks rose when the BOE expanded its balance sheet, and Japanese stocks rose when the BOJ expanded its balance sheet. Again, the "easiest" way to buy Europe as a whole is via VGK, but if I'm right about this and we do see the ECB balance sheet expand and spur economic growth, then EUFN (the MSCI Europe Financials ETF) should also do very well.

Commodities

Commodities were mostly lower yesterday, led down by energy as traders positioned ahead of the weekly government inventory data due out later this morning. Meanwhile the industrial metals lagged ahead of Chinese economic reports, and precious metals were little-changed on the day. DBC fell -0.6%.

There is not a lot to talk about in the commodity space this morning as developments in the past 24 hours were limited. But, there are a few key market-moving catalysts coming up today, so we will discuss those in some detail.

Beginning with energy, crude oil has largely been treading water in the high-$90s since breaking down through $100 in the last week of July. Yesterday, futures tested the recently formed support level at $97, and the technical level held. Looking ahead, the EIA inventory reports for crude oil and the refined products will be in focus today and the analyst estimates are as follows: Crude oil stocks are expected to fall 1.7M barrels, RBOB gasoline supplies are expected to 1.3M barrels, and distillate inventories are expected to rise by 300K barrels. And, you know the drill, any surprises could materially move the respective prices.

Stepping back and looking at the bigger fundamental picture, the International Energy Agency released its Global Oil Market Report for August and the results were slightly bearish. The report weighed heavily on the Brent contract, which fell -1.5% yesterday (partly because of an upcoming contract change). But, our domestic WTI futures outperformed the international benchmark, Brent, only falling -0.7% on the day. That was partially a result of the fact that our domestic economy remains strong and is largely expected to outperform most other developed markets over the coming quarters. This leads us, among other U.S. economic bulls, to believe WTI prices will rally as the economy continues to grow. This would fuel a consistent rise in demand for the refined products, especially as more jobs are created and the labor market continues to improve.

Skipping over to natural gas, futures added +0.35% yesterday and remain one of the best performers in the space recently, adding more than +4% since we initiated a long call last Tuesday. Now, a lot of that 4% move was technical short-covering; however the fundamentals are starting to shift to favor the bulls as well.

First, weekly supply injections have been fading in recent weeks, now down into the low-80 Bcf area the past two weeks after spending the first 2 months of summer averaging north of 100 Bcf per week. Second, weather reports are beginning to show a rise in temperatures, which will weigh on the weekly inventory builds further as energy demand (via natural gas) increases to satisfy cooling needs. So, bottom line is we remain bullish natural gas, and a close above the $4 mark this week will further support that call.

Looking to the metals, copper futures have been slipping recently as investors have shown concern over the health of the Chinese economy. And they are under pressure this morning because of a soft report on credit creation that was released overnight. But, the overall trend of strong Chinese data is not broken because of just a few reports however that will continue to weigh on copper over the near term. Bottom line, we will remain bullish on copper going forward unless there is a material turn for the worse in Chinese economic data.

Market	Level	Change	% Change
Dollar Index	81.56	.025	0.03%
EUR/USD	1.3366	-.0019	-0.14%
GBP/USD	1.6813	.0027	0.16%
USD/JPY	102.22	.04	0.04%
USD/CAD	1.0919	-.0002	-0.02%
AUD/USD	.9274	.0013	0.14%
USD/BRL	2.2764	.0014	0.06%
10 Year Yield	2.442	.022	0.91%
30 Year Yield	3.266	.034	1.05%
Prices taken at previous day market close.			

Meanwhile, gold futures closed essentially flat yesterday as traders await important economic data in the July CPI report and obviously (and more importantly) Fed-speak in Jackson Hole next week. Until then, it is likely gold futures will continue to hover around the $1,300 level. But specifically, if inflation readings are hot, we will see gold prices spike.

Currencies & Bonds

The euro largely dictated trading in the Dollar Index yesterday, as the dollar rose early on Tuesday thanks to a drop in the euro following the disappointing German ZEW Business Expectations Index. But, the euro generally held the lows of last week around 1.3335, and once that support held, we saw a gradual rally in the euro throughout the trading day as shorts covered. The euro still finished lower by -0.11%, but it was well off the lows vs. the dollar.

There's still important data coming later this week from Europe (specifically 2Q EU and German GDP tomorrow), but unless those numbers are massively disappointing (for instance if German 2Q GDP goes negative), yesterday's price action in the euro may imply a short-term bottom, which does make sense given the declines we've seen over the past month-plus.

Longer term, have we seen the lows in the euro? No, not unless the ECB loses its nerve. But, every trend pauses, and with doubt about the EU recovery now solidly entrenched in investors' minds, we may need to see something incremental from the ECB to get the euro moving decidedly lower again.

Outside of the euro, most major currencies were little-changed as everyone looked ahead to important releases that came out overnight.

Starting first with the Pound, it's down .5% vs. the dollar despite a better than expected Labour Market Report, which showed unemployment claims declined 33k vs. (E) 30k.

But, the Bank of England's Inflation Report showed slower wage inflation than was expected, and during the press conference BOE Governor Carney again pledged that when rates do start to rise (and he said we were close) the pace would be very gradual.

It's important to note that the topics that we're watching with the BOE: wage inflation and the pace of interest rate increases vs. the date of the first one, are the same key topics the market is now watching with regards to the Fed. So, the situation in England and the BOE remains a good leading indicator of what we can expect from the Fed, and the takeaway is that the BOE remains largely dismissive of inflation threats, despite strong data. And, I expect the Fed will be the same way.

The Pound is breaking to two month lows on the news, and if support at 1.67 is broken, look for the declines to accelerate. At some point the pound will again be a "buy" vs. the dollar, but patience is required now.

Turning to Japan, the Q2 GDP figures there were awful on the headline: GDP fell 1.7% in Q2 and –6.8% Q/Q! But, in a good example of the fact that markets care more about expectations than absolute numbers, but results were slightly better than feared. The yen is down small on the news this morning, but keep in mind the Japanese sales tax was implemented last quarter, so a big drop was expected. Bottom line, by itself these GDP numbers won't be enough to pressure the BOJ to do more stimulus. And, the Dollar/yen remains in the broad 101-103 trading range.

Turning to Treasuries, the long bond declined yesterday modestly (.3%) and is down again this morning. As far as reasons, other than short term profit taking which is the real reason, yesterday's JOLTS reading of job openings likely played some part in the declines, as the report implied the jobs market is improving further.

Retail sales will be important today, and a beat vs. expectations will further pressure bonds, but until that 2014 uptrend is broken (sitting at 137'15 in the thirty year, which is decently below current prices) the near term trend is higher, even as fundamentals continue to become more bond negative.

Have a good day,

Tom

7:00's REPORT

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

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.			

7:00's REPORT

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

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)**