7:00's Report

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

August 18th, 2014

Pre 7:00 Look

- Futures and international markets are higher this morning following improvement in the situations in Iraq and Russia/ Ukraine over the weekend. Outside of geo-politics it was a quiet weekend.
- Iraqi forces retook the Mosul Dam, and Sunni leaders made encouraging remarks about the new Iraqi government, raising hopes for unified response to IS.
- In Russia, the drama from Friday subsided and importantly Ukrainian forces are inching closer towards taking Donetsk.
- Econ Today: Housing Market Index (E: 53.0).

Market	Level	Change	% Change
S&P 500 Futures	1962.00	9.50	0.49%
U.S. Dollar (DXY)	81.515	.046	0.06%
Gold	1303.00	-3.20	-0.24%
WTI	94.47	-.85	-0.89%
10 Year	2.345	-.055	-2.29%

Equities

Weekend Geo-Political Recap

Weekend headlines were almost entirely about the situations in Iraq and Russia, and the bottom line is we've seen further incremental progress in both situations.

In Iraq, US airstrikes helped Kurdish fighters re-take the important Mosul Dam, and it's definitely fair to say that airstrikes have halted the IS advance. More importantly, though, Sunni leaders made positive remarks regarding the new Iraqi government, and those leaders may call on Sunnis to take up arms again IS (making it a "united" Iraqi opposition).

Turning to Russia/Ukraine, we obviously all got a scare Friday with the "Ukraine attacks Russian convoy" headline, but it appears that the Ukrainians attacked a Russian separatist convoy trying to take advantage of all the miss-direction regarding the other humanitarian Russian convoy.

Over the weekend Russian called it a "fantasy" that Russian armor entered Ukraine, and Ukrainian forces are tightening their grip around Donetsk. Despite the scare Friday, it's generally viewed that neither Putin nor Ukraine want an all out war, and as a result only a full on invasion makes this a major bearish influence on stocks.

Market Recap

Stocks bounced back last week, as the S&P 500 rallied +1.2% on the combination of a reduction in Fed and central bank angst and marginal geopolitical improvement. The S&P 500 is up +5.77% year-to-date.

Stocks started last week higher thanks mainly to "dovish" comments by Fed Vice Chair Stanley Fischer in Stockholm and U.S. airstrikes halting the ISIS advance. Markets were flat Tuesday, although that was the first day we learned of the dreaded Russian humanitarian convoy. The rally resumed Wednesday despite several pieces of disappointing economic data: Chinese IP/retail sales/fixed asset investment and U.S. retail sales/M earnings. But, a Reuters article highlighting Fed Chair Janet Yellen's fears of raising rates too soon countered the bad data. Stocks moved higher before finally breaking through key resistance at 1,950 Thursday—thanks mostly to positioning, a "conciliatory" speech by Putin regarding Ukraine, and news that former Iraq PM Nouri al-Maliki would not foster more protest over his ouster (meaning he likely got paid off, but that's just my opin-

Market	Level	Change	% Change
Dow	16,662.91	-50.67	-0.30%
TSX	15,304.24	13.06	0.09%
Brazil	56,963.65	1183.24	2.12%
FTSE	6,726.46	37.38	0.56%
Nikkei	15,322.60	4.26	0.03%
Hang Seng	24,955.46	0.52	0.01%
ASX	5,587.10	20.58	0.37%
Prices taken at previous day market close.			

ion).

The S&P 500 finished the week flat after starting Friday higher, but the headline about the bombing of a Russian convoy sent stocks temporarily lower before the headline was clarified.

Market	Level	Change	% Change
DBC	24.94	.10	0.40%
Gold	1305.50	-10.20	-0.78%
Silver	19.55	-.36	-1.80%
Copper	3.11	.018	0.58%
WTI	95.19	1.11	1.18%
Brent	105.55	-.41	-0.39%
Nat Gas	3.786	-.12	-3.07%
RBOB	2.6988	.03	1.21%
DBA (Grains)	26.27	.22	0.84%
Prices taken at previous day market close.			

All About Positioning

The events listed above did drive trading last week, but it's also important to realize the effect investor positioning had on the rally last week. Simply put, last week's rally caught most managers off-guard, as they had reduced long exposure and found themselves somewhat under-invested. The No. 1 reason stocks were able to reclaim 1,950 in the S&P 500 Thursday was because managers were "chasing" to add back long exposure. So, positioning remains a key (and likely will be a further tailwind on stocks as sentiment remains pretty negative right now). Bottom line, the "pain trade" probably remains higher at this point, but it won't have the force it did last week, meaning I doubt positioning alone can push stocks materially higher from here.

Bottom Line

The backdrop for stocks remains positive and things got incrementally better last week on two fronts: First, geopolitical situations largely improved: Israel/Gaza, Russia/Ukraine (Friday's headlines notwithstanding), and Iraq/ISIS. Second, global central banks sounded incrementally more "dovish" with the Fischer comments/Yellen article, BOE inflation report, and soft data in Europe and Japan making chatter louder regarding potential further stimulus (in particular, more calls for QE in Europe).

Additionally, valuations remain largely the same (S&P 500 still trading near 16.3X 2014 EPS, and 14.9X 2015 EPS). On the corporate front, there were some give/takes last week (CSCO CEO John Chambers had some more cautious comments about emerging markets, and there were some earnings misses), but broadly corporate America remains healthy and a bright spot.

But, that said, I don't think the market has what it needs to move decidedly higher toward the old highs. I view the declines of two weeks ago and last week's rally as a continuation of the correction/consolidation we've seen since early/mid-July. And, until we get some material clarity from the Fed regarding the outlook for policy changes, I think we can expect more of the same type of chop.

On the charts the S&P 500 is back above resistance at 1,950 and into the 1,950-1,985 trading range. But we've seen investors apply longs over the past 6 trading days, and positioning won't be the tailwind it was the past week. 1,950 is now support while 1,965 is resistance.

Economics

Last Week

Economic data from last week, both domestic and international, were universally slightly disappointing. But in a way it's an odd positive, as the absolute levels of growth everywhere in Europe remain healthy. The slight moderation in economic activity is viewed as providing the Fed and other central banks a bit of breathing room when it comes to tightening policy.

Looking at the data, with the exception of July industrial production, every release was a slight miss. July retail sales were flat vs. (E) 0.2%, and the "control" group, which is the best gauge of consumer spending, was up just +0.09%. But, overall the retail picture remains mostly healthy.

Jobless claims popped back above 300K last week, but the four-week moving average—which is a much better measure of the trend in the labor market—remains below 300K at 296K, which remains near multi-year lows.

Finally, the Empire State manufacturing survey, the first data point from August, missed estimates last Friday. It declined nearly 10 points from July's 25.60 to 14.69, missing estimates of 20. But, the absolute level of Empire remains very healthy at 14, and the July number was never sustainable, anyway.

Turing to the foreign data, it was more of the same.

Chinese July Fixed Asset Investment, Retail Sales and

Industrial Production all slightly missed estimates but remained solidly positive. The one real negative was a plunge in Chinese credit creation (new loans) for July—but broadly the data isn't bad enough to imply that the stabilization in the pace of growth in China is in jeopardy.

Finally in Europe, preliminary 2Q GDP readings all slightly missed, with EU GDP flat-lining vs. (E) 0.1% and German 2Q GDP declining 0.2% vs. (E) 0.0%. But, while a miss, the numbers weren't as bad as feared, and only confirm the EU recovery has lost steam. Europe remains, as it was, an area to watch closely and it's still the most fragile major economy. But, with the ECB's stimulus measures starting to take effect in September, the benefit of the doubt remains that the EU economy will continue its slow recovery, even despite the weak data.

This Week

The doldrums we have endured from an economic/Fed standpoint for the last two weeks come to an end this week, as we get more insight from the Fed regarding their current thoughts on "normalization" of policy, and a lot of economic data.

Seeing as this market remains all about the Fed, though, the two key events of the week will be the release of the Fed minutes on Wednesday, and Fed Chair Yellen's keynote address from the Jackson Hole central bankers conference, which starts Thursday.

As mentioned, we saw levels of "Fed angst" recede a bit last week, and they will be in flux again this week. I'll preview both as we get closer, but generally the market will be looking for color from the Fed minutes about just how "hawkish" the discussions on policy were at July's Fed meeting. Several "hawks" including Dallas Fed President Richard Fisher hinted in interviews that the committee may be slightly more "hawkish" than the statement read.

In Jackson Hole, the market will be looking for hints from Yellen about her opinion of the economy and proper policy. At this point, I'd be shocked if she dropped any surprises (like the "6 months" comment from her first Q-and-A), but you never know.

Turning to the economic data, things get busier. Staying in the context of Fed policy, inflation remains one of two main concerns of the market (the other being growth). July CPI is released tomorrow and that will be watched to see whether the recent uptick in inflation pressures moderated in July like they did in June.

Turning to economic growth, we get the August global flash manufacturing PMIs Wednesday night/Thursday morning. Given the moderation in the data last week, these figures will be watched even more closely (especially in China and Europe).

The July housing data also arrive this week, and that's particularly important from a Fed standpoint because the Fed remains unconvinced that housing is in a solid recovery. June housing data were disappointing—if we get another round of "misses" that will be viewed as dovish, because the Fed wants housing on solid ground before starting to normalize policy in earnest. Housing starts come tomorrow, and existing home sales come Thursday.

Internationally, things are pretty quiet. The Bank of England's minutes from their July meeting are released Wednesday, and like the FOMC minutes, investors will be looking to see how "hawkish" the conversation was. Remember, last week's Inflation Report dialed back rate hike expectations for the BOE and the pound suffered as a result. So, there is risk of a surprise and volatility in the pound out of this meeting.

Market	Level	Change	% Change
Dollar Index	81.475	-.172	-0.21%
EUR/USD	1.3403	.0003	0.02%
GBP/USD	1.6690	-.0003	-0.02%
USD/JPY	102.37	0.00	0.00%
USD/CAD	.9137	-.0007	-0.08%
AUD/USD	.9301	-.0005	-.05%
USD/BRL	2.2650	-.0006	-.03%
10 Year Yield	2.345	-.055	-2.29%
30 Year Yield	3.135	-.057	-1.79%

Prices taken at previous day market close.

Bottom line with this week is that it remains all about the Fed, and we'll get the best insight into the mindset of the committee and Chair Yellen, so expect there to be some movement in the levels of "Fed angst" this week, and in turn the markets.

Commodities

Commodities traded heavy last week as focus seemed to shift from geopolitics to disappointing economic data worldwide. On a low time frame, geopolitical headlines still have a clear effect on the market; however, the pullback in recently strong global economic data has become the major underlying theme in the space. DBC fell -1.46% last week while the dollar was unchanged.

Crude oil fell -0.31% last week and remains in a fairly steep technical downtrend that dates back to the frothy, geopolitically fueled highs of mid-June. A surprise build in supplies reported by the EIA as well as easing geopolitics certainly added some downward pressure to futures last week. However, the mostly "bad" economic data reported worldwide last week really took away from the "econo-bulls" argument. This week, focus will again be on economic data as well as the Fed as traders scour the details for clues on the health of the economy (both domestic and globally). Going forward we continue to like the fundamental value play in oil; however the technical downtrend is rather discomforting. And, as we mentioned last week, a sell-off in crude prices is often a leading indicator for a pullback in other risk assets (namely stocks), so it remains something to watch closely.

Natural gas saw nice gains to start the month of August as longer-term short-covering/profit-taking fueled a rally. But, a lot of those gains were given back last week as futures fell -5.1% ahead of Thursday's EIA inventory report (which was actually bullish). The real reason prices sold off was a result of adjustments made to weather forecasts that had originally called for warmer temperatures across the nation. Now expectations are more mild, and that led a large number of spec longs to close positions. But, an opportunity remains in being long nat gas as stockpiles remain 18.9% below the 5-year average as we approach the end of the "build season."

Moving to the metals, copper futures underperformed last week, falling -2.3% in direct correlation with bad Chinese economic data (specifically credit data, which spurred fears about growth). Poor economic data in China is becoming a concern now that there have been several "misses" and we will keep a close eye on data going forward. And, if we don't see improvement, we will be forced to the sidelines in the long copper trade.

Gold bounced around just above the $1,300 mark for most of last week as traders positioned ahead of important market catalysts this week, including the July CPI report as well as Jackson Hole.

Currencies & Bonds

Treasuries surged to news highs for the year last week on a trifecta of events. First, the incrementally "dovish" comments/article from Fischer & Yellen. Second, lackluster European data, which caused German bunds to move to new highs and sent the yield on the German bund below 1% for the first time ever. Third, the headline Friday about the attack on the "Russian" convoy in a flight to safety/short-squeeze that sent the 30-year rocketing higher before it gave back some ground. Despite being in total contradiction to the trend in fundamentals, the bond rally is still very much intact short term, and I believe the key to this rally breaking remains in Europe. Until German bunds start to decline, Treasuries will continue to rally solely on money flows.

Turning to currencies, the most interesting action came from the euro. The euro closed the week down slightly, but importantly it didn't really decline following the poor 2Q GDP reports. This implies most of the bad news in the euro is "priced in" and as a result I think we could see a halt in the decline—at least until data get materially worse or the ECB starts teasing QE. If I were solely trading, I'd buy euro for a bounce here.

The Dollar Index was flat last week and continues to consolidate its recent gains, and data and Fed-speak this week will be the next major catalysts as to whether the dollar continues to rally.

Finally, the biggest mover last week was the pound, which declined to a two-month low, falling -0.5% vs. the dollar on the "dovish" inflation report. Bottom line is rate hike expectations for the pound have been dialed back, and as the spread between the Fed and BOE are expected to raise rates narrows, the bullish tailwind on the pound subsides. BOE minutes will be key this week, but if support at the 200-day MA is broke (1.665), declines could accelerate materially.

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	UNG	20.98	None	*We are replacing the "long copper" trade on the tactical sheet with our "long natural gas" call because of the time frames of the two trades. Copper is a long term fundamental play dependent on continued global economic growth (namely in China) while buying nat gas is a medium term trade based on smaller supply injections and warming weather patterns. "Long Copper" has been moved to the ACD. 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 8.18.14)

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 bounced back into the 1950-1985 trading range last week thanks mainly to a reduction in Fed "angst" and also some marginal improvement in geo-politics. The outlook remains favorable for stocks, but this market remains all about the Fed. "Dovish" clarity on the outlook for policy is the catalyst we need to challenge the old highs.*

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

Best Contrarian Idea: Buy Retailers (XRT)

Commodities	**Neutral**	**Bullish**	*Commodities traded lower again last week as WTI Crude is again acting as an anchor on commodity indices. But, most other commodities also declined given the reduction in geo-political tensions and after lack luster Chinese and EU economic data, which is casting some (small) doubt on the global recovery.*

Best Idea: Long Oil (USO), Long Copper (JJC)

Best Contrarian Idea: Buy Grains (DBA)

U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index was up small last week as concern about the Fed becoming "hawkish" receded a bit. The outlook for how quickly the Fed will normalize policy remains the key influence on the Dollar Index. Longer term the trend is higher, but I'd expect some consolidation in the very near term.*

Best Idea: Sell the Yen (YCS)

Best Contrarian Idea: Long Canadian Dollar (FXC)

Treasuries	**Bullish**	**Bearish**	*Treasuries skyrocketed to new highs for the year last week off of 1) Receding of "hawkish" fears of the Fed, 2) new highs in German Bunds, and 3) the geo-political scare. The fundamentals continue to turn bond negative, but that doesn't matter in the short term—the trend remains higher.*

Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)