7:00's Report

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

August 20th, 2014

Pre 7:00 Look

- Futures are flat and the global rally is taking a breather after a quiet night as most international markets are little changed.
- There was a surprise in the BOE meeting minutes that showed two votes to raise rates at the latest meeting, breaking a long string of unanimous votes. But, the outcome wasn't totally shocking and the Pound up small.
- Geopolitically there were no material changes in Russia/ Ukraine or Iraq.
- Econ Today: FOMC Minutes (2:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1976.00	-1.25	-0.06%
U.S. Dollar (DXY)	82.145	.208	0.25%
Gold	1295.00	-1.70	-0.13%
WTI	93.12	.26	0.28%
10 Year	2.405	.018	0.75%

Equities

Market Recap

The rally continued Tuesday as "Goldilocks" economic data pushed the S&P 500 to within 5 points of the old all-time highs, while the Nasdaq hit new highs for the year. The S&P 500 rose +0.50%.

Stocks were flat early Tuesday and it looked like the bounce-back rally may take a pause, but then CPI and housing starts were released. Both data points were pretty "Goldilocks," as housing starts were stronger than expectations (but still relatively depressed on an absolute level). Meanwhile, momentum in statistical inflation appeared to cool a bit. So, it was another piece of data that helped give the Fed reason not to be as hawkish as had been feared two weeks ago.

Much like Monday, stocks gapped higher immediately following the open, and then spent the remainder of the day (from 10 a.m. till the close) basically treading water. Midday, a touch of positive geopolitical news hit the wires when it was announced that Vladimir Putin and Ukrainian President Petro Poroshenko will meet at a conference in Minsk, Belarus, next week. That by itself doesn't mean the crisis is over, but it does come on the heels of stepped-up diplomatic efforts to broker a cease-fire in eastern Ukraine. More and more it's looking like this 5+ month long saga will be winding down sooner than later.

As was to be expected, trading quieted materially in the afternoon as the S&P 500 drifted very slightly higher, hitting the highs of the day during the final hour of trading before closing just off the highs.

Trading Color

It was another broad and methodical rally, although we did not see definitive cyclical outperformance. The Russell and Nasdaq actually slightly underperformed the S&P 500, while utilities bounced back on short-covering/ dip-buying despite the uptick in interest rates yesterday. Utilities were the best-performing S&P 500 sub-sector, followed by consumer discretionary, healthcare and tech. Industrials, basic materials and financials (the outperformers from Monday) lagged, but all still finished positive.

Retailers were in focus yesterday with a lot of earnings results, and in general they were good. HD and TJX in particular traded very well (up +5.55% and +8.65% re-

Market	Level	Change	% Change
Dow	16,919.59	80.85	0.48%
TSX	15,488.25	149.78	0.98%
Brazil	58449.29	888.57	1.54%
FTSE	6756.57	-22.74	-0.34%
Nikkei	15454.45	4.66	0.03%
Hang Seng	25159.76	36.81	0.15%
ASX	5634.60	10.83	0.19%

Prices taken at previous day market close.

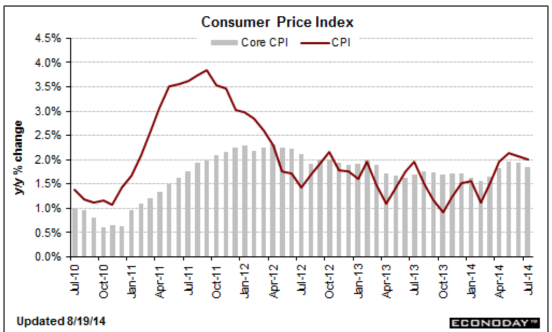
spectively). And RTH, which I pointed out Monday as being on the verge of a potential breakout, rallied +1.5% yesterday to close well above resistance at $61.48.

Market	Level	Change	% Change
DBC	24.77	.04	0.16%
Gold	1295.00	-4.30	-0.33%
Silver	19.40	-2.35	-1.20%
Copper	3.0875	-.0215	-0.69%
WTI	92.86	-.89	-0.95%
Brent	101.55	-.05	-0.05%
Nat Gas	3.875	.083	2.19%
RBOB	2.6941	.0381	1.43%
DBA (Grains)	25.91	-.30	-1.15%
Prices taken at previous day market close.			

As I said yesterday, retailers remain a relatively unloved space. Although it's short-term overbought, retail remains a contrarian play given challenges with the consumer and margin compression. But there's room for upside here if we see an uptick in wages (i.e., more discretionary income).

Bottom Line

The continued reduction in "Fed angst" and improvement in the geopolitical situations are positives in the market. But the rally this week has been much more the result of a lack of sellers rather than anything materially good happening to elicit buying demand. When the market gaps higher off news and then stays there the entire day, it shows buyers aren't willing to chase. So, I'm just trying to point out that this market isn't quite as stocks after the week-long rally would imply. (Again, a total lack of stocks for sale is making small buying have an outsized effect, just like the "buyers' strike" did on the way down.)



July CPI implied inflation lost momentum last month, giving the Fed a (temporary) reprieve from the "Behind the Curve" accusations.

Stocks are challenging the old highs, but I'll still be (pleasantly) surprised if the S&P 500 can break definitively above 1985 and then 2,000 mainly because levels of Fed angst have receded and sentiment isn't a tailwind anymore as it seems like 2,000 in the S&P 500 is now just as inevitable as a test of 1,900 was early last week.

Bottom line, I expect more of a "chop" here, as I'm not sure there's enough good news to propel stocks materially higher from here and would not be aggressively adding equity exposure. But, at the risk of sounding like a broken record, if you *have* to put money to work, you could buy VGK. It's still 5% off the highs of June while SPY is basically at the July highs – so if global markets are going to rally, Europe will need to play catch-up.

FOMC Minutes Preview

The first of two important Fed events comes today, with the release of the Fed minutes at 2 p.m. EST. The expectation is that the minutes will show a more "hawkish" discussion took place behind closed doors than the FOMC statement implied.

This belief is rooted mostly in comments by Dallas Fed President Richard Fisher, who said in multiple interviews that the reason he didn't dissent at the meeting was because he thought the discussion at the FOMC was going the direction he would like it to (i.e., hawkishly)

So, there is a bit of a "hawkish" expectation built into these minutes, which probably opens it up to a "dovish" disappointment. Bottom line is this FOMC has consistently surprised dovishly, and there's no real reason to expect that to end today. I'm sure there will be upgraded discussion about the economy and the bottoming of inflation, but look for extended discussion about the hazard of policy being too easy, for too long (from a policy standpoint). If that topic appears multiple times in the minutes, that will be "hawkish." Short of that, I'd expect these minutes to not result in a major change in the level of Fed angst in the market right now.

Economics

Housing Starts

- July Housing Starts were 1,093K vs. (E) 963K.

Takeaway

Given the huge plunge in housing starts in June, a snap back was expected and the data delivered. Headline housing starts for July crossed back above the 1 million mark, rising +16% from June. Single-family starts—

which is really the metric you want to track in this report because it's a better gauge of the "housing market"—also rose nicely, up +8.4%.

Also, the revisions to the June data were positive (it's always important to watch for revisions to economic data, as they often can tell you the direction of the larger trend), with June being revised up to 945K from 893K.

Bottom line, this was a (needed) strong data point in housing, implying the June data were a temporary "blip" in an otherwise-solid housing recovery. Importantly, though, this strong data point didn't raise any levels of "Fed angst" because, on an absolute basis, housing remains a long, long way from being strong enough to make the Fed think about trying to cool it down. So, this was a "Goldilocks" housing number.

Commodities

Commodities were mixed yesterday as natural gas continued to trade well, crude oil fell to a 7-month low (but the products rallied), and gold was little-changed thanks to the in-line CPI report. The broad-based commodity tracking index ETF, DBC, added +0.13% yesterday.

Natural gas was the best performer in the commodity space yesterday as futures rallied 2.14%. The move higher came in spite of weather reports that continue to suggest temperatures will be milder than initially thought. (The "heat wave" in the forecast was part of the reason prices rallied above the $4 mark last week.)

Fundamentally, national stockpiles remain a concern and something to be closely monitored over the next two months, and here is why.

Current inventories are approximately 2.5 trillion cubic feet, which is 19% below the 5-year average for this time of year. That comes out to 1.3 trillion cubic feet below the "normal" level for entering the draw season, which generally begins in mid to late October. So, we basically have around 11 weeks to reach that comfortable 3.8 trillion CF level, which would require weekly builds of more than 100 Bcf from now until October.

Market	Level	Change	% Change
Dollar Index	81.925	.294	0.36%
EUR/USD	1.3321	-.0041	-0.31%
GBP/USD	1.6619	-.0107	-0.64%
USD/JPY	102.89	.33	0.32%
USD/CAD	1.0939	.0054	0.50%
AUD/USD	.9300	-.0017	-0.18%
USD/BRL	2.2492	-.0083	-0.37%
10 Year Yield	2.405	.018	0.75%
30 Year Yield	3.221	.027	0.85%
Prices taken at previous day market close.			

Although it is possible, weekly supply injections have been trending lower recently. So, we are looking at some rather bullish supply-side fundamentals for natural gas prices as we approach the fall. On the charts, the "line in the sand" is down toward $3.72 while there is resistance up toward $4.

The weakness in crude oil prices continued yesterday with WTI futures falling another 1%+ on the day to close within $2 of the 2014 lows ($91.24). The already steep downtrend only seems to be getting steeper as geopolitics steadily improve and global supply news remains bearish. (Iraq increased production in the South to compensate for a potential drop in output levels in the north due to the military conflict, while Libya continues to export more crude by the day.)

Today, the weekly EIA inventory report will be in focus and analysts' expectations are as follows. Crude: -900K barrels, RBOB: -1.3M barrels, and Distillates (heating oil) -700K barrels. Bottom line, crude has been getting absolutely crushed in recent weeks and is approaching oversold territory. And, since we are fundamentally bullish, we will be watching very closely as we approach support in the $92 area, as a low-risk "buy" setup could present itself.

Gold finished the day down -0.28% yesterday after the "Goldilocks" economic releases in the morning led traders to continue positioning ahead of the Fed minutes that are due out this afternoon at 2 p.m. The July CPI report released yesterday was in line, while housing starts were better than expected—a perfectly "Goldilocks" scenario that left futures to drift around within arm's length of $1,300 yet again.

FOMC minutes are in focus today and if they are 'hawkish" that obviously will be near-term bearish for gold prices, as the dollar would rally sharply. However, at the end of the day, the reason for being hawkish would be largely due to inflation concerns, which is obviously bullish precious metals. So, a near-term sell-off in gold, although possibly being rather sharp, would be weakness to buy into for longer term accounts as the threat of inflation continues to be an underlying theme in the market.

Currencies & Bonds

The U.S. dollar reigned supreme in the currency markets yesterday (which were the most interesting of any asset market), as the Dollar Index rallied +0.4% to hit a new high for the year, sitting just under 82.00. The "Goldilocks" CPI and housing starts report certainly didn't hurt the dollar rally, but really the greenback was higher thanks to declines caused by negative news in most other major currencies.

Starting first with the British pound, it was by far the worst performer yesterday, falling -0.66% after July inflation surprisingly disappointed and added to the growing sense that the BOE simply isn't inclined to raise rates as soon as the market had been expecting. The pound crashed through support at the 200-day moving average and traded to a 4-month low.

Now, has the outlook for policy in Great Britain changed that much since mid-July, when the pound topped out? No, of course not. The BOE will likely still be the first major central bank to hike rates.

Case in point, overnight the BOE meeting minutes were released from the August meeting and there were 2 votes to raise interest rates this month (vote was 7-2). This is the first non-unanimous vote in a long time, and while it was somewhat expected by the market and the pound is still flat, the point remains the BOE is inching towards rate hikes.

But, the "long pound" trade ahead of that occurrence simply got way too crowded, and now we are seeing a (painful) righting of the ship. There will be an opportunity to buy the pound out of this decline (especially against the euro, for which the pound is starting to get cheap), but for now it's best to stand aside and let the longs get washed out.

The euro also declined yesterday to new lows for the year, dropping -0.31% after support at the 1.335 level was violated. The reason for the drop yesterday was dollar strength. It looked like the euro was trying to stabilize in the low 1.33 region, but we said last week if economic data in the U.S. were good, we could see renewed selling—not because of a more negative outlook on the euro, but instead because of dollar strength.

That happened yesterday as the euro, which was modestly weaker Tuesday morning, smashed through support on the release of CPI and the housing starts report. So, we definitely saw a "stronger dollar" influence pressuring the euro. 1.33 and 1.3294 are now key support in the euro heading into the key events of the week.

Finally, turning to Asia, the yen declined -0.3% and the dollar/yen pair is now bumping up against the upper end of the months-long 101-103 trading range. The specific reasons for the yen declines yesterday was disappointing department store sales data, which showed a -5.5% decline in July. This, by itself, isn't that bad a report. But, it joins a growing chorus of data points that implies the Japanese economy is losing forward momentum, and that's starting to result in rising expectations for "more" from the BOJ. I think that's a touch premature at this point, but bottom line is if the yen breaks out decisively from 103, we could see a pile-on effect, as this trade has been range-bound for months with everyone looking for a break one way or the other.

Bottom line in currencies is the dollar, after years of perennial weakness, seems to be trading better with each passing day. As long as economic data continue to stay "Goldilocks," I imagine that can continue.

Moving to the bond market, Treasuries rallied yesterday morning largely a result of trader positioning ahead of economic data. But, because we saw "Goldilocks" numbers in both the CPI report (in line) and new home sales (better than expected), Treasuries turned negative mid-morning and remained under pressure for the balance of the trading session. The long bond finished the day down -0.22% while the 10-year note closed down -0.10% with a yield back above the 2.40% mark.

Have a good day,

Tom

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)			