7:00's Report

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

August 21st, 2014

Dollar/Yen: After months of consolidation, there was a big, bearish technical break in the yen yesterday, which is positive for DXJ.

Pre 7:00 Look

- Hopes for a continued "dovish" Fed are trumping mixed economic data as futures and most international markets are slightly higher this morning.
- China's flash manufacturing PMI dipped to a 3 month low at 50.3 vs. (E) 51.5, while Europe was mostly in-line with expectations (German manufacturing PMI was a bright spot at 52.0 vs. (E) 51.5. But, none of the numbers are materially altering the current outlook for global growth.
- Econ Today: Weekly Jobless Claims (E: 300K), Flash Manufacturing PMI (E: 51.3) Philadelphia Fed Survey (E: 20.0), Existing Home Sales (E: 5.00M).

Market	Level	Change	% Change
S&P 500 Futures	1986.75	3.50	0.18%
U.S. Dollar (DXY)	82.310	.03	0.04%
Gold	1282.10	-13.10	-1.01%
WTI	92.79	-.66	-0.71%
10 Year	2.426	.021	0.87%

Equities

Market Recap

The S&P 500 rallied to a new all-time high Wednesday following mostly benign FOMC meeting minutes. The S&P 500 rose +0.25%.

Wednesday started quietly as global markets were flat ahead of the main catalyst for the week, although the market was able to shrug off lackluster retailer earnings from LOW and TGT. Stocks drifted very mildly higher throughout the morning, creeping closer to the highs of 1,985 by lunchtime.

The major "catalyst" for trading yesterday was the release of the Fed minutes. Stocks initially sold off as the release was taken as "hawkish," as the S&P 500 turned mildly negative on the release mostly on day trading. But, once the algos were done reading the transcript, the rally resumed and by 3 p.m., the S&P 500 was making new all-time highs. This prompted some mild covering/chasing into the close, before stocks gave a bit back into the bell.

Trading Color

The S&P 500 made new highs yesterday but, like Tuesday, it wasn't a strong rally. The Russell 2000 and the Nasdaq both finished negative on the day, and again there was no real definitive cyclical outperformance (SPHB up +0.48% vs. SPLV up +0.20%).

Retailers were again in focus given more earnings. Although LOW and TGT were both relative disappointments, there remains money flowing into the space and both names closed solidly positive. (SPLS was one of the few retailers in the red yesterday.)

Market	Level	Change	% Change
Dow	16,979.13	59.54	0.35%
TSX	15,561.95	84.78	0.55%
Brazil	58,878.24	428.95	0.73%
FTSE	6,777.75	22.27	0.33%
Nikkei	15,586.20	131.75	0.85%
Hang Seng	24,994.10	-165.66	-0.66%
ASX	5,638.86	4.26	0.08%
Prices taken at previous day market close.			

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Again, the retail space is under-owned and under-loved at the moment, and we could see continued outperformance as long as the broader market stays firm.

Market	Level	Change	% Change
DBC	24.85	.07	0.28%
Gold	1291.70	-5.00	-0.39%
Silver	19.470	.058	0.30%
Copper	3.1720	.0835	2.70%
WTI	93.39	.53	0.57%
Brent	102.21	.65	0.64%
Nat Gas	3.83	-.047	-1.21%
RBOB	2.7092	.0138	0.51%
DBA (Grains)	25.85	-.05	-0.19%
Prices taken at previous day market close.			

Sector-wise, industrials were the big outperformers (XLI up +1%) followed by consumer discretionary. Defensive sectors (utilities, staples and healthcare) all lagged, but it's not entirely fair to say there was a "higher rate" rotation going on.

Volumes and activity were very muted despite the new highs, while obviously the technical situation has once again become more positive.

Bottom Line

The rally continues to be driven by underinvested managers "chasing" to increase exposure. Yesterday was no exception, as evidenced by the mini ramp-up after the new highs.

Despite the new highs, I would again be pleasantly surprised if we can move materially higher through here, as Fed angst is now quasi-dangerously low (having swung completely opposite of two weeks ago). While the "pain trade" is higher given this underinvestment, sentiment isn't a large tailwind anymore. I don't think we're quite done with this 1,950-1,985 range just yet.

Argentina is Being … Argentina (And That's Not Good)

With all the focus lately on Fed angst and geopolitics, the fact that Argentina remains in default and still hasn't found a solution with holdout creditors has moved totally to the back burner. But, this situation is still serious and bears watching. After all, the longer this goes on, the more it becomes possible this switches from a "local" Argentine problem to a broader emerging-market problem.

Case in point, in an effort to circumvent the U.S. court ruling that is preventing Argentina's custodian (Bank of New York Mellon) from paying interest payments on debt before the holdout creditors are paid, Argentine President Cristina Fernandez announced Tuesday she is proposing legislation that will "swap" outstanding Argentine national debt for debt that will now be subject solely to Argentine laws—not international or U.S. law. The legislation will pass, and if this swap occurs, then basically Argentina will be able to pay other creditors without having to pay the holdouts.

If this seems too good to be true, though, it is.

First, who in their right mind would want to swap their international or U.S.-governed debt for the same debt now governed solely by Argentine law, with the sole custodian an Argentine bank? This is, after all, Argentina—a country that has defaulted twice since the turn of the century.

In reality this is mostly for show—I doubt many creditors will willfully give up protection of U.S. law just to get an interest payment—but there's a bigger problem here.

This move signals that Argentina has little desire to try and reach a settlement with the holdout creditors, and it's a simple fact that these situation don't age well.

Argentina is in default. While it's not a de-stabilizing event at this point, the longer it goes, the greater the chance Argentina gets locked out of international capital markets and some sort of currency reserve or bond crisis ensues. This will pose a threat to emerging markets (and given the leveraged carry trade that still exists in EM debt, there is the threat of contagion). Bottom line is Argentina is being Argentina, and while it's not a major problem now, this situation remains one of those "left field" events that you can count on us to keep watching.

Economics

FOMC Minutes

The FOMC minutes from the July meeting initially appeared to meet "hawkish" expectations as the Dollar Index traded to highs of the day following the release, Treasuries hit their lows, and stocks went from positive to negative.

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But, after the initial reaction, everything except the dollar retraced the move (by 3 p.m., the S&P 500 was positive again and bonds were basically flat). That's because in reality the minutes weren't materially more "hawkish" than feared—at least not from a timing and pace of interest rate hike perspective.

The reason for the "hawkish" interpretation was centered on the following sentence:

> *"Many participants noted that if convergence toward the [Fed's] objectives occurred more quickly than expected, it might become appropriate to begin removing monetary policy accommodation sooner than they currently anticipated," per the minutes of the July 29-30 meeting."*

What that sentence means is that—if the labor market further improves, inflation accelerates and the economy grows at a faster pace—the FOMC will have to react and pull tightening forward. That's not exactly "new" news.

As we've been saying, the important thing to keep an eye on with the Fed is not just the timing of the hike, but also the pace of rate hikes. And nothing in the minutes implies 1) we'll see rate hikes materially earlier than previously thought, and 2) the pace of hikes will still remain very gradual.

Commodities

The commodities space was again mixed yesterday. Crude oil saw modest gains on somewhat-bullish supply data, natural gas pulled back after Tuesday's solid gains, copper surged on a strong research report, and gold finished only slightly lower following the FOMC minutes release. The benchmark commodity tracking index ETF, DBC, added +0.28% on the day.

Market	Level	Change	% Change
Dollar Index	82.285	.348	0.42%
EUR/USD	1.3261	-.0058	-0.44%
GBP/USD	1.6596	-.0019	-0.11%
USD/JPY	103.75	.86	0.84%
USD/CAD	1.0965	.0025	0.23%
AUD/USD	.9285	-.0014	-0.15%
USD/BRL	2.2624	.0162	0.72%
10 Year Yield	2.426	.021	0.87%
30 Year Yield	3.220	-.001	-0.03%
Prices taken at previous day market close.			

Beginning with copper, futures saw the biggest rally in a year yesterday as prices jumped +2.7% thanks to a research report released by commodities trading giant Glencore PLC that was optimistic regarding the fundamentals of the industrial metal. A bit of a "squeeze" effect surely amplified the move higher as many speculators have been shorting copper on concerns that the Chinese economy is slowing despite the efforts of the government's "mini stimulus" package initiated in Q2.

Technically speaking, copper became overbought in early July, but then became oversold in the middle of this month. It is basically right back in the middle of the $3.00-$3.30 range it has been in since the spring. Bottom line, as the global economy continues to grow, demand should too. On the charts, the 200-day moving average ($3.173) is in focus, and a close above that level would be favorable for the bulls.

Moving to metals of the precious variety, gold futures fell -0.42% yesterday to close down toward the $1,290 level, but still very well within reach of $1,300. As mentioned in yesterday's Report, the risk in the market was for a hawkish reaction to the FOMC minutes. And, even though there were no material surprises with in the release, the strength in the dollar was enough to weigh on gold futures.

Technically, trend support was broken yesterday, but luckily for the bulls there is more, not far below. The 200-day moving average is sitting at $,1285 while there is more established trend support at $1,271. We maintain our long-term bullish stance on gold as inflation continues to loom on the horizon, and in the near term we will be keeping a close eye on the aforementioned support levels.

Moving to energy, crude oil traded relatively well considering the steep downtrend that is still intact on the daily chart. WTI rallied +0.57% and closed just off the highs of the day yesterday as the EIA reported a bullish draw of -4.5M barrels vs. (E) -900K. But, the data for the refined products were actually slightly bearish as gasoline stocks unexpectedly rose +600K barrels vs. a draw of (E) -700K. Distillate inventories declined a less than expected -1.0M barrels vs. (E) -1.3M barrels.

Bottom line, despite the fairly bullish fundamentals

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(namely economic growth fueling demand for refined products) and the fact that futures have become largely oversold in the near term, the medium-term technical outlook remains bearish as the now-two-month-old downtrend remains very healthy. Going forward, we will be watching downtrend resistance because, until that is broken, we can only expect to go lower or at best see further consolidation. The 2014 low ($91.24) is in focus as the "line in the sand" for the bulls.

The EIA will release the weekly inventory report for natural gas this morning at 10:30 and analysts are calling for an injection of 87 Bcf. Remember the supply situation remains delicate, and if we see a smaller than expected build, a rally back toward $3.95-$4.00 is a distinct possibility while a material build (say one in the triple-digits) could see futures test the 2014 lows ($3.72).

Currencies & Bonds

The dollar reigned supreme again yesterday, trading higher against all other major currencies and breaking through 82 for the first time since September of last year. The Dollar Index was modestly higher most of the day in anticipation of the FOMC minutes and thanks to weakness in the yen, but the greenback shot higher following the minutes release and held onto those gains into the close. Although short-term overbought, there's little resistance between current levels in the Dollar Index and 52-week highs at 82.78. If Yellen is "dovish" with her speech tomorrow (which she may well be), that weakness will probably be a buying opportunity in UUP.

The yen was the biggest mover in the currency markets yesterday, falling -0.75% and leading the dollar/yen pair to smash through resistance at 103 to close at 103.71, a four-month high. The reason for the yen weakness was mostly technical. Once resistance and 103 was broken, we saw yen longs begin to sell and yen shorts begin to pile on. (Soft import data, which throws further doubt on the health of the Japanese consumer, was the negative "catalyst" that started the yen selling.)

Keep in mind, we've been saying for 18 months now that the whisper "target" for the yen from PM Shinzo Abe and the BOJ was around 110/dollar. So, it's not like we're in unchartered territory here. Although there have been some false starts in 2014, if the dollar/yen moves through 104, we could be into the next phase of yen depreciation, which will be a positive for YCS and DXJ.

Turning to Europe, the big news yesterday was of the two dissenters at the August Bank of England policy meeting. It was the first dissent in two years, as Mssrs Weale and McCafferty favored raising rates in August by 25 basis points. Despite this surprising headline, the pound didn't really react vs. the dollar (it declined by -0.1%), and that's because the dissent wasn't a total surprise. (We were looking to see if there was going to be a dissent.) The vote occurred before the soft inflation data of this week, and the dissent was by two well-known "hawks," so the majority of the committee remains dovish.

But, it does again increase the chances for a rate hike in late '14, and underscores that there is a fundamental bullish case in the pound—especially vs. the euro and the yen (for the dollar, it remains unclear). For those with a futures account, you can sell euro/pound futures, and I think given the recent decline in the pound, that may be a trade worth investigating. While the outlook for the pound vs. the dollar is unclear, the pound will likely rally vs. the euro given the differing directions of central bank policy. For those interested, the Globex symbol is RP and the contract size is 125K euros (and remember, you would want to SELL that futures contract to get long the pound vs. the euro).

Looking to the bond market, Treasuries bounced around for most of the day yesterday as traders positioned ahead of the Fed minutes release. Upon release of the minutes, Treasuries dropped to new session lows as part of the generally hawkish initial market reaction. But, as was the case with all other asset classes (ex-DXY), both the 30-year bond and the 10-year note recovered back to finish the day little-changed. And, we will likely continue to see further sideways trading until Yellen's speech tomorrow.

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)**

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