7:00's Report

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

August 22nd, 2014

Pre 7:00 Look

- Futures have turned slightly negative this morning on geopolitics, and for the second straight Friday we've gotten a surprise negative headline out of the Ukraine.
- The mysterious Russian "aid" convoy has crossed into Ukraine without permission. Futures dipped on the headline and while there have been no reports of violence so far, clearly this bears watching.
- There were no economic reports o/n and none scheduled for today.
- Fed Speak: Yellen (10:00 AM), Draghi (2:30 PM).

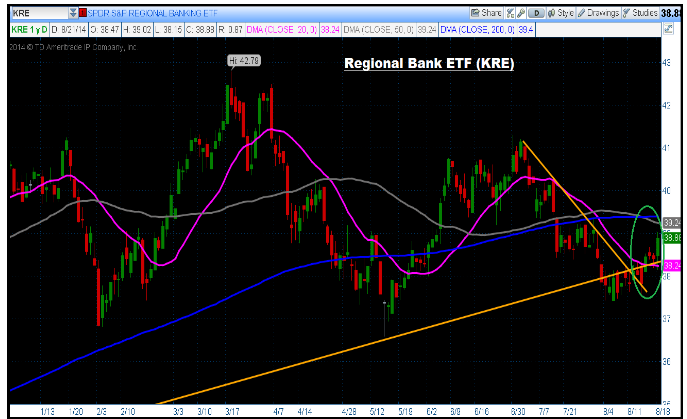
Market	Level	Change	% Change
S&P 500 Futures	1986.75	-2.75	-0.14%
U.S. Dollar (DXY)	82.25	.042	0.05%
Gold	1281.80	6.40	0.50%
WTI	93.60	-.36	-0.38%
10 Year	2.407	-.019	-0.78%

Equities

Market Recap

Stocks rose to new highs again Thursday, as the S&P 500 broke through 1,990 thanks to better than expected economic data and positioning ahead of the Janet Yellen's Jackson Hole speech. The S&P 500 rose +0.29%.

Stocks were stronger from the outset yesterday as the economic data were universally better than expected (jobless claims, flash manufacturing PMIs, Philly Fed, Existing Home Sales), but not so good that they increased Fed "angst." And so, this morning everyone expects Ms. Yellen to remind us just how dovish she is.



KRE: Banks caught a bid on the BAC settlement news yesterday, and KRE looks to be breaking out on the charts.

The S&P 500 shot above 1,890 right out of the gate Thursday, but then traded back to flat on some quick profit-taking (the decline in New Orders in the Philly Fed report was cited as the "reason," but that was more coincidental). Stocks almost immediately resumed the rally though, and it continued throughout the late morning/early afternoon.

Fed President Williams' interview on CNBC was slightly dovish (in particular he said he wouldn't consider inflation a threat until annual wage inflation got around 3.5%, and we're just over 2% currently). But the market didn't really move off the comments, as it's already priced in a more "dovish" Fed at these levels. The grind higher continued throughout a quiet afternoon and stocks hit their highs at 1,994 during the last hour of trading, before giving back a bit into the bell.

Vacation

Next week I'll be taking what amounts to my vacation, but I'll still be producing the Report each day and Tyler will be in the office to handle any problems should they arise. The Report will just be a bit more succinct than usual.

Market	Level	Change	% Change
Dow	17,039.49	60.36	0.36%
TSX	15,556.09	-5.86	-0.04%
Brazil	58,992.11	113.87	0.19%
FTSE	6,768.49	-9.17	-0.14%
Nikkei	15,539.19	-47.01	-0.30%
Hang Seng	25,112.23	118.13	0.47%
ASX	5,645.62	6.75	0.12%

Prices taken at previous day market close.

Trading Color

For the third day in a row the market rallied without cyclical leadership, as the Russell and the Nasdaq both finished positive but lagged the Dow and S&P 500. Additionally, SPHB was flat on the day while SPLV rallied +0.37%.

Market	Level	Change	% Change
DBC	24.91	.06	0.24%
Gold	1278.80	-16.40	-1.27%
Silver	19.455	-.042	-0.22%
Copper	3.1770	.00	0.00%
WTI	94.03	.58	0.62%
Brent	102.68	.40	0.39%
Nat Gas	3.879	.056	1.46%
RBOB	2.7524	.0398	1.47%
DBA (Grains)	25.87	.0305	0.12%
Prices taken at previous day market close.			

Sector-wise the day belonged to the financials, as XLF was by far the best-performing S&P 500 sub-sector while both KBE (banking ETF) and KRE (regional bank ETF) rallied +1.3%. The catalyst was the news of final resolution for Bank of America regarding mortgage settlements, and with that the regulator risk across the banking space appears to have diminished materially.

Outside of the strength in banks (which have a lot more room to run if we can ever get yields to back up a bit), sector trading was pretty muted as no other S&P 500 sub-sector moved more than 0.5% (and all but healthcare moved less than 0.25%).

More important than the sector trading, though, was the fact that once again the rally came almost entirely because of a lack of selling – so any buying created an outsized positive effect on the averages. The lagging cyclicals tell me that we aren't seeing material new exposure put on at these levels. Again, if we ever get sellers to reappear this market could dip a bit, because there's not a lot of buy demand that's taken us up the last 20 points in the S&P 500.

Nonetheless, the market is at new highs, so obviously that's positive from a technical standpoint. Resistance now sits at the old highs of 1,985.

Jackson Hole Preview

The topic of the much-anticipated Jackson Hole central banker conference is "Re-evaluating Labor Market Dynamics," and we can expect Ms. Yellen's comments to stay on that topic—with specific emphasis on labor market slack. The idea of labor market slack, and what is causing it, is so important that a single comment about it by Fed Vice Chair Stanley Fischer two Mondays ago at a speech in Stockholm stopped the two-week decline in stocks.

Fischer said in that speech that he believed the problems affecting the labor market (the "slack") were **cyclical** problems, not structural. That's important because cyclical problems (like a depressed level of economic activity) can be fixed by monetary policy. Structural problems, which are mostly demographic (like the population is aging so we have fewer workers) can't be fixed by monetary policy.

The difference is this: Cyclical problems mean a "dovish" Fed. Structural problems mean a "hawkish" Fed.

So, the expectation is for Yellen to categorize current slack in the labor market as cyclical, which will be slightly dovish—and as long as she does that, there should be little reaction out of the market. (In fact we could see a "sell the news" reaction as stocks have already rallied in anticipation of her being dovish.)

A Thought on BAC's Settlement

As I'm sure you are aware, BAC agreed yesterday to settle with the Justice Department regarding various mortgage fraud claims to the tune of $16.65 billion, which I'm sure has to be some sort of a record.

I'm no cheerleader for the banks, and certainly they share in the blame for the financial crisis, but to see AG Eric Holder trotting out to do a victory dance was a little disconcerting, seeing as no one really wins here. And, while certainly there is culpability on the part of the banks, I have a hard time celebrating the fact that shareholders and employees of BAC will now get penalized by this fine. And the people who benefited the most from the lending practices that contributed to the financial crisis, remain relatively unscathed. Meanwhile thousands of employees at Merrill, Lehman, Bear Stearns, Washington Mutual, Wachovia, etc. got financially crippled for life.

If the Justice Department really wanted to do some good for the economy *and* punish BAC, they should have made BAC pay the fine in the form of a special dividend.

There are about 10.5 billion shares outstanding of BAC stock, so making BAC pay out the 16.65 billion in a special "I'm sorry" dividend would have given shareholders $1.65/share.

That, by itself, would almost certainly generate more economic activity than what will come out of the Justice Department getting the money and distributing it to various programs, flunkies, lobbyists, etc.

Not only would it give every BAC shareholder $1.65/share, but the government would recoup some of it at (most likely) 15% in taxes next year—not to mention any sales tax that would come from people potentially taking that dividend out and spending it on something. Obviously this is a quasi absurd example, but I'm trying to make the point about helping the economy vs. punishing corporations, and it's by no means a political statement…..it's about relative waste of that capital.

Punishing current shareholders and employees for sins committed by other people so the Justice Department can do a victory dance isn't the way to move this economy forward. If you really want to right past wrongs, go after Stan O'Neil, Angelo Mozilo (criminally, not civilly) and others who put their interests ahead of shareholders and employees, and laughed all the way to the bank.

Economics

Economic data were universally good in the U.S. yesterday, as manufacturing showed continued signs of acceleration, July Existing Home Sales confirmed the strength in housing starts earlier this week and jobless claims dropped below 300K again. The data were mostly "Goldilocks" as they were good, but not great. So, this didn't cause any uptick in Fed "angst" on the eve of Fed Chair Yellen's Jackson Hole address.

Market	Level	Change	% Change
Dollar Index	82.205	-.075	-0.09%
EUR/USD	1.3280	.0022	0.17%
GBP/USD	1.6581	-.0013	-0.08%
USD/JPY	103.79	.06	0.06%
USD/CAD	1.0938	-.0028	-0.26%
AUD/USD	.9299	.0013	0.14%
USD/BRL	2.2663	.0046	0.20%
10 Year Yield	2.407	-.019	-0.78%
30 Year Yield	3.192	-.028	-0.87%
Prices taken at previous day market close.			

<u>Global Manufacturing PMIs & Philly Fed</u>

- August Flash Manufacturing PMI 58.0 vs. (E) 56.3.
- Philly Fed Manufacturing Survey 28.0 vs. (E) 20.0.

<u>Takeaway</u>

Manufacturing activity continues to accelerate in August, as the Philly Fed hit a new multi-year high and the flash August manufacturing PMI rose as well. But, helping with the "Goldilocks" assessment, New Orders—the leading indicator of the Philly Fed report—fell precipitously to 14.7 vs. 34.2 in July. Clearly the jump higher in July needed to be reversed, but this was more than expected. Nonetheless, on the whole the numbers confirm the manufacturing sector of the economy is continued to see accelerating growth.

Looking at the international data, China was the surprise disappointment, falling to 50.3 vs. (E) 51.5, a three-month low. This follows on the heels of some previously disappointing economic data from China, but at this point won't be enough to make people worry too much about the stability of the Chinese economy.

In Europe, the data were mixed (German manufacturing PMI beat; the broader EU number slightly missed), but without getting into the minutiae, basically the PMIs confirmed what we know: The EU recovery is teetering at the moment and has definitively lost momentum—and yesterday's numbers confirm that.

Yesterday's global PMIs largely reinforced current market expectations; that's why we didn't see much of a reaction. Europe has lost momentum but is still in a slow recovery, China remains volatile but concerns about a "hard landing" have receded, and U.S. growth is accelerating.

Commodities

Commodities were mostly higher yesterday with energy specifically trading well while the precious metals fell, mostly as a result of technicals even though many sources blamed the "hawkish FOMC minutes" (which were not actually hawkish). The benchmark commodity tracking index ETF, DBC, gained +0.25%.

Gold was the worst-performing commodity yesterday, falling -1.4% after technical support was broken on Wednesday although most news outlets were citing a "hawkish Fed" as the reason for the declines. Only problem was the FOMC minutes were not any more hawkish than expected.

We mentioned earlier in the week that the near-term risk was to the downside in gold (in anticipation of a hawkish Fed reaction), even though the longer-term situation remains favorable for the bulls, primarily because of the inflation argument. Going forward, trend support at $1,272 will be in focus.

Moving to energy, there was a material technical development in crude oil futures as there was a bullish outside reversal yesterday on the daily chart. Futures rose +0.63% after dipping to yet another 8-month low in premarket trade. Crude oil has become rather overextended to the downside and this, paired with the outside reversal, is favorable for the bulls. However, buyers have more work to do, as two steep downtrends remain intact on the daily chart. Getting long crude here is a good risk/reward set-up; however, we would like to see that downtrend broken (a close above $95.25) in coming days to confirm the move.

Moving over to natural gas, futures rose +1.44% yesterday despite a slightly larger than expected build in supply levels, an encouraging day for the NG bulls. The EIA report a weekly injection of 88 Bcf vs. (E) 86 Bcf. Futures initially sold off a sharp 10+ cents on the news, but there were plenty of buyers into the weakness and prices recovered to close up near $3.90. Looking ahead we continue to like the fundamentals in natural gas and the technical picture is also encouraging.

Currencies & Bonds

The dollar took a breather yesterday from the nearly straight-line rally that has been in place since late June. The dollar fell back a modest -0.08% after making a fresh 11-month high yesterday as traders digested the FOMC minutes, which turned out to be largely a non-event. Also, there was a lot of profit-taking and positioning in the currency space yesterday ahead of Chair Yellen's speech this morning at 10 a.m.

Looking overseas, currency trading was relatively quiet as global PMI data was more or less in line with expectations. The euro bounced +0.13% after crashing through psychological support at the 1.33 mark on Wednesday, although that move was largely a result of the strengthening dollar. Despite the slight "pop," the euro remains in a downtrend. However, it is getting slightly overextended and some consolidation may be in order over the near term.

The pound quietly fell to a 4-month low during yesterday's session on a miss in the July Retail Sales report. But, the British currency is into support here around the 1.650 area. If that can hold, we could potentially see a break in the counter-trend sell-off that has been ongoing since late July.

The yen was little-changed yesterday as traders digested the big break through 103 we saw on Wednesday. The USD/JPY pair looks strong on the chart. However, there is some resistance here toward the April highs in the 104 area that needs to be broken to see the rally (weakening of the yen) continue.

Bonds rallied Tuesday ahead of the expected "dovish" speech by Fed Chair Yellen, ignoring the strong economic data. The 30-year traded up +0.27%, mostly as a result of the weak European data, which caused German bunds to rally and the yield differential between bunds and Treasuries to widen.

And, as I said earlier this week, unless we get a legitimate "hawkish" surprise from the Fed, Treasuries are going to have a very hard time declining as long as German bunds continue to rally (and the next major data point for that will be September, when we get some numbers on the takedown of the first TLTRO, and the higher the better). Fundamentally, there was a 5-year TIPS auction that saw decent demand, with a bid to cover (measure of demand) of 2.48 and an actual yield that was 1 basis point below the "When Issued" of -0.281%, reflecting somewhat aggressive bidding. So, even though Treasuries remain strong, clearly investors with a longer view are still positioning for a future environment that is much less bond-favorable. For now, though, money flows continue to trump deteriorating fundamentals in bonds.

Have a good weekend—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)			