# 7:00's Report

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

***August 8th, 2014***


***S&P 500: The S&P 500 has dipped temporarily below the 100 day MA several times over the past year, but each break was a buying opportunity (although obviously past performance is not indicative of future results).***

## Pre 7:00 Look

- Futures are slightly lower this morning but recovering from sharp declines seen o/n mostly due to Obama's authorization of airstrikes in Iraq. Int'l markets were lower o./n.
- Elsewhere in geopolitics, fighting resumed on the Gaza strip as the cease-fire expired. Ukraine/Russia remains in focus as well but there were no developments o/n.
- Economically, reports were a touch better in Europe as German Trade data improved m/m and French Industrial Production beat estimates (1.3% vs. E: 1.0)
- Econ Today: No economic reports today.

| Market | Level | Change | % Change |
|---|---|---|---|
| S&P 500 Futures | 1901.50 | -3.75 | -0.20% |
| U.S. Dollar (DXY) | 81.44 | -.165 | -0.20% |
| Gold | 1319.90 | 7.40 | 0.56% |
| WTI | 98.12 | .78 | 0.80% |
| 10 Year | 2.424 | -.050 | -2.02% |

## Equities

*Market Recap*

Stocks sold off on geopolitical tensions yesterday, breaking down through key technical support levels. The S&P 500 closed down -0.56%.

Like much of this week, trading yesterday was driven more by positioning and techincals than anything fundamental, as investors are more focused on support levels in the S&P 500 than anything else at the moment.

Stocks opened higher yesterday thanks in part to the particularly strong, and better than expected, weekly jobless claims report that was released pre-market (more on that in the Econ section). But the rally wasn't very strong and the bulls failed to hold the gains through the first hour of trading.

Stocks turned negative shortly after 11 a.m., breaching support at both 1,920 and 1,913 in the S&P by lunchtime as geopolitical headlines weighed on sentiment. Specifically, the downing of another Ukrainian fighter jet by rebels in the East spurred some more immediate selling. The drift lower was more a result of buyers remaining sidelined than over-aggressive selling, but investors were clearly spooked by the plethora of negative geopolitical headlines, namely those surrounding the Ukraine but also unrest in Iraq.

The bulls did circle the wagons shortly after lunch in an attempt at defending the 100-day moving average, which has historically acted as solid support. But the effort failed and stocks moved lower into the afternoon. It is worth mentioning however that there was a modest bounce as a result of tactical short-covering into the

| Market | Level | Change | % Change |
|---|---|---|---|
| Dow | 16,368.27 | -75.07 | -0.46% |
| TSX | 15,118.43 | -83.66 | -0.55% |
| Brazil | 56,188.05 | -299.13 | -0.53% |
| FTSE | 6,555.73 | -41.64 | -0.63% |
| Nikkei | 14,778.37 | -454.00 | -2.98% |
| Hang Seng | 24,331.41 | -56.15 | -0.23% |
| ASX | 5,435.31 | -73.70 | -1.34% |
| Prices taken at previous day market close. | | | |

close.

*Trading Color*

Looking to the internals, there was not a ton of conviction to yesterday's sell-off as volumes were the lowest of the week. It seems as though, which we have mentioned before, the weakness in stocks remains more a result of reluctant buyers as opposed to aggressive selling by "real money"—at least for now.

| Market | Level | Change | % Change |
|---|---|---|---|
| DBC | 26.39 | .04 | 0.16% |
| Gold | 1314.70 | 6.50 | 0.50% |
| Silver | 19.97 | -.054 | -0.27% |
| Copper | 3.174 | .008 | 0.25% |
| WTI | 97.59 | .67 | 0.69% |
| Brent | 105.71 | 1.12 | 1.07% |
| Nat Gas | 3.883 | -.05 | -1.27% |
| RBOB | 2.78 | .0403 | 1.47% |
| DBA (Grains) | 26.47 | -.41 | -1.53% |
| Prices taken at previous day market close. | | | |

Sector-wise, healthcare, consumer staples and materials were among the worst performers while utilities and industrials were able to finish higher. The former actually added more than 1% on the day finally catching an oversold bounce. Consumer discretionary, tech, financials and energy all finished the day in line with the S&P500.

On the charts, support at the 100-day moving average (1,913) was broken yesterday, which leaves the former resistance band of 1,898-1,902 in focus as the next level of support, and we will almost certainly test that area.

It is worth pointing out that a breakdown through the 100-day moving average is not an immediate technical sell signal. The past several times the S&P 500 has violated the 100-day moving average, it was short-lived and stocks reversed sharply to establish new all-time highs within the following month of the breach (two of these instances were the late-January sell-off, and again the mid-April sell-off).

*Geo-Politics Update*

Geo-politically we're seeing bonds surge this morning after President Obama ordered air strikes in Iraq to protect a religious minority. But, oddly, despite the pessimistic feeling we've seen incremental progress in the Ukraine/Russia situation and Iraq. First, the leader of the "Donetsk People's Republic" has stepped down as Ukrainian forces continue to shell Donetsk, and in Iraq we could finally see a replacement for PM Maliki in the next week (that political solution could be a major turning point against ISIS as it'll get the government fully behind fighting the group). Bottom line is the geo-political headlines aren't helping sentiment, but they still aren't the reason stocks are declining.

*Bottom Line*

Stocks keep declining because of a "buyers strike," not because of aggressive de-risking. As we said at the beginning of the week, the biggest problem for this market right now is the calendar—there simply aren't any opportunities for further resolution regarding the Fed for another two weeks (which remains the #1 concern of the market).

As a result a break below 1900 in the S&P 500 wouldn't be shocking, because at this point stocks aren't cheap enough to create a material "buy the dip" move from investors.

# Economics

Weekly Jobless Claims

- Claims fell to 289K vs. (E) 305K

*Takeaway*

Weekly jobless claim resumed the trend lower last week, falling -14K to 289K vs. estimates calling for 305K. Data from the week prior were revised slightly higher, up from 302K to 303K. The smoother look at the data in the form of the 4-Week Moving Average continued lower, down -4K from the prior week to now sit comfortably below the 300K mark at 293.5K. The 4-week moving average is now roughly 20K lower than the trend a month ago.

It is worth noting that the Labor Department had recently cited "auto-retooling" issues as skewing the data for the better and possibly being responsible for the recent dip below 300K. Encouragingly though, the Labor Department says that issue is no longer affecting the data—meaning, the trend lower is genuine. Bottom line, weekly jobless claims are suggesting that the jobs market is improving. This is obviously a key component to continued domestic economic growth, supportive of the Fed continuing with current policy and is generally supportive of risk assets as well.

## Commodities

Commodities traded mostly higher yesterday led by crude oil and the refined products, which were higher on geopolitics and demand speculation respectively. Meanwhile natural gas and the grains badly underperformed. The benchmark commodity tracking index ETF (DBC) edged up +0.10% thanks to the heavy weight of energy in the index.

Beginning in energy, oil prices were higher yesterday, led by the global benchmark Brent contract, which added +0.91% thanks to escalating violence in Iraq. According to several news sources, ISIS seized the largest dam in Iraq yesterday in their most-recent push for control. President Obama responded by basically saying that "nothing is off the table" with regard to dealing with the most recent acts by ISIS.

WTI rose in sympathy with Brent as the "fear bids" flowed in and more shorts were squeezed out. Looking more at the domestic picture, however, both RBOB gasoline and Heating Oil futures rallied yesterday on a combination of follow-through buying due to Wednesday's bullish EIA report as well as the slim-but-increasing threat of a Russian invasion of Ukraine, which would likely disrupt EU energy supply and spur demand for U.S. exports to satisfy the balance.

Bottom line in energy: Geopolitics have stopped the recent bleeding on the charts, and near-term support has been established around the $97 area as the bears have lost momentum. We continue to believe oil is a value below $100/bbl, especially considering our domestic economic strength and the widespread geopolitical unrest. And, as the economy continues to grow, we should see demand for refined products grow, too. So, buying oil futures or oil ETFs such as USO should pay off in coming weeks/months.

Elsewhere in energy, natural gas was among the worst-performing commodities yesterday following a government supply data release that was mostly in-line. Natural gas futures fell -1.68% yesterday as tactical speculators took profits after the recent 20-cent rally we have seen, which itself was a result of longer-term short-covering. The reason for the sell-off yesterday was the weekly inventory report released by the EIA, which showed a supply injection of 82 Bcf vs. (E) 83 Bcf. The in-line report caused some short-term longs to take profits, and futures reversed off their highs.

Trading-wise, if you had bought natural gas as we recommended earlier in the week, and took profits near the initial target of between $3.95 and $4.00, you made yourself a quick 3% or so. However, if you have a longer-term outlook, we continue to like natural gas at these levels and believe prices have plenty of room to move higher from here. On the charts, there is initial support at $3.85 while $4.00 looks to be the level to beat.

Moving to the metals, gold managed to hold on to Wednesday's gains (and then some) as futures rallied +0.36% to a 2-week high yesterday. The reason behind the modest rally was the return of the geopolitical fear bid in the market, which was evident by the spike in prices at 11:45 a.m., around the same time headlines hit that another Ukrainian fighter jet was shot down by rebels in eastern Ukraine.

As far as where we go from here, the technical picture is a mess. But the low-time-frame trend has reversed and suggests there may be room to move higher. But, there are so many different influences on the market right now (geopolitics, the health of the economy, Fed policy, etc. …). With all of them being so unclear, the market will likely remain somewhat close to the $1,300 mark in noisy/volatile trade.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dollar Index | 81.585 | .078 | 0.10% |
| EUR/USD | 1.3363 | -.0018 | -0.13% |
| GBP/USD | 1.6834 | -.0019 | -0.11% |
| USD/JPY | 102.04 | -.05 | -0.05% |
| USD/CAD | 1.092 | .0007 | 0.06% |
| AUD/USD | .927 | -.0083 | -0.89% |
| USD/BRL | 2.2917 | .0187 | 0.82% |
| 10 Year Yield | 2.424 | -.050 | -2.02% |
| 30 Year Yield | 3.234 | -.043 | -1.31% |

Prices taken at previous day market close.

## Currencies & Bonds

Currencies were relatively quiet yesterday given the geopolitical influence on most other asset classes. Most major currencies failed to move more than 0.15% on the day. The sole exception was the Aussie dollar which plummeted -0.8% on weak employment data. Meanwhile the Dollar Index edged up to close higher by

+0.08% yesterday.

Beginning in Asia, the Aussie dollar came for sale overnight Thursday thanks to a substantial miss in the Labour Force Survey, which showed a larger than expected increase in the unemployment rate (6.4% vs. E: 6.1%) and a decrease of 300 employed persons vs. expectations of an increase of 12,000. One bright spot was the participation rate did edge up +0.1% to 64.8%, slightly higher than expected.

The big miss clearly fueled heavy selling and the Aussie traded down to a 2-month low overnight. More broadly, however, the Aussie dollar remains largely range-bound between $0.9200 and $0.9400—although if support is breached, a sharp move lower toward $0.9000 wouldn't be out of the question.

Elsewhere in Asia, the yen was little-changed but closed up near the highs of the day mostly as a result of the general "risk off" feel the markets had yesterday. The dollar-yen pair tested the 102 level, which is in focus as support. If geopolitics continue to affect markets the way they did today, the level will be broken (with the next level of support being the 101.60 mark). On the charts the yen, like the Aussie, remains range-bound between roughly 101 and 103.

Moving to Europe, focus was on the central banks as both the BOE and ECB had scheduled policy announcements yesterday morning. But everything printed as expected and the Central Bank-speak following the releases did not materially change anything or really affect markets.

Draghi did do his best to suggest that the ECB was doing everything it could to stay very accommodative. He referenced the June policy package as already being an effective step in easing policy, the upcoming TLTROs as enhancing the aforementioned first step, and of course the ongoing preparation of potential asset-backed securities purchases to come—if need be, of course. Lastly, Draghi emphasized that the ECB currently has rather different views and policies than other established central banks (highlighting the growing gap divergence in policy between the BOE and Fed, which should continue to weigh on the euro).

Bottom line, Mr. Draghi is continuing to do his best at verbally devaluing the euro without taking any more action than he needs to. However, it does appear that he is willing to take further steps to remain accommodative.

Meanwhile, the pound remains in consolidation mode as the British currency was little-changed yesterday, down just -0.11%. The pound has been trading sideways between 1.68 and 1.69 since finding support at 1.68 on the first of the month. If support can hold here, a continuation of the uptrend will likely ensue—with the initial target being back to the 1.70 level as expectations remain the same (i.e., that that the BOE is still set raise interest rates later this year).

Shifting to the bond market, Treasuries were higher yesterday led by the long bond, which closed up +0.65% at the high ticks of the day while the 10-year added +0.36%, also closing near the highs. The 10-year yield closed at a 13-month low of 2.424%.

Treasuries rallied as a part of a relatively broad "risk off" trade that occurred across asset classes yesterday thanks to geopolitics. Specifically, bonds were trading with sensitivity to headlines regarding Russia/Ukraine and the growing unrest in Iraq. Bonds did notice the upbeat weekly jobless claims report, taking a leg down to morning lows upon the release (as stocks hit morning highs). But the good economic data were quickly overshadowed by the aforementioned geopolitics.

JNK (our barometer for high-yield bonds) spent most of the day higher, but sold off into the close to finish slightly lower, down -0.05%. We continue to believe that whichever end of the $40.00-$41.00 range is broken first will forecast the next big move in stocks. Yesterday JNK closed at $40.52, so the next move remains to be seen.

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** | 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<br>IYM<br>PICK<br>DIA | 52.19<br>83.06<br>19.48<br>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<br>XOP | 18.97<br>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.* | | | |

# Asset Class Dashboard

**(Updated 8.4.14)**

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)**

| | Near Term Trend | Long Term Trend | Market Intelligence |
|---|---|---|---|
| **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)**

| | Near Term Trend | Long Term Trend | Market Intelligence |
|---|---|---|---|
| **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)**

| | Near Term Trend | Long Term Trend | Market Intelligence |
|---|---|---|---|
| **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)**