7:00's Report

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

September 10th, 2014

Pre 7:00 Look

- Futures are flattish and international markets ex China are little changed following a mostly quiet night.
- China was the laggard globally as those markets re-opened after a holiday and declined by more than 1% on economic growth worries (there is important data out tomorrow).
- There was more disappointing data from Japan as machine orders and PPI missed, and the dollar/yen is now through 106, a multi-year low—which is good for DXJ.
- Econ Today: No economic reports today.

Market	Level	Change	% Change
S&P 500 Futures	1991.25	1.50	0.08%
U.S. Dollar (DXY)	84.27	-.15	-0.18%
Gold	1254.80	6.10	0.49%
WTI	92.85	-.10	-.11%
10 Year	2.500	.031	1.26%

Equities

Market Recap

Stocks traded heavy again Tuesday as a new AAPL product failed to provide a boost and fears continued to build regarding a "hawkish" Fed at next week's meeting. The S&P 500 fell -0.65% in mostly quiet trading.

Futures were modestly lower Tuesday but stocks opened with a "thud" as this market simply continues to trade sluggishly. It was a very quiet morning session and stocks spent most of it drifting in mildly negative territory. Support at 1,890 (Friday's low) seemed to be holding, as investors started to focus on the AAPL product release. As the event neared, stocks caught a bid after lunch going into the AAPL event (the announcement of "Apple Pay" seems to have been the most-positive event from yesterday's trading). But, what "Apply Pay" giveth, the "iWatch" taketh away, and stocks rolled over on the announcement in a textbook "buy the rumor/sell the news" reaction.

The 30 Year Treasury: A Trend Line (Finally) Broken? The long bond has closed multiple times below the 2014 uptrend, the strongest signal yet that this bond rally of 2014 has finally ended.

With the AAPL event out of the way, support at 1,890 couldn't hold, and stocks again hit their lows later during the afternoon session (down nearly -1%). Unlike Monday, the market couldn't really manage to catch any sort of a material bounce during the last hour of trading, and stocks drifted just off the lows into the close.

Trading Color

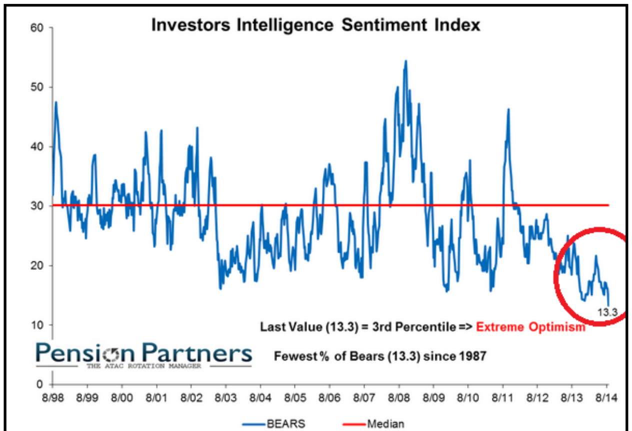
The internals yesterday weren't very encouraging, but it'd be more accurate to say the selling was broad-based rather than just focused on cyclicals. The Russell 2000 dropped by more than -1% and the Nasdaq fell -0.9%. (AAPL finished down -0.4% so it wasn't that big of an

Market	Level	Change	% Change
Dow	17013.87	-97.55	-0.57%
TSX	15536.81	27.42	0.18%
Brazil	58676.34	-516.41	-0.87%
FTSE	6842.04	13.04	0.19%
Nikkei	15788.78	39.63	0.25%
Hang Seng	24705.36	-485.09	-1.93%
ASX	5574.28	-33.62	-0.60%
Prices taken at previous day market close.			

influence on the index.) But that's not much worse than the -0.65% for the SPX. Likewise, SPHB dropped -1% while SPLV was down -0.7%, so again there was broad selling yesterday (confirming the "heavy" feeling of the market).

Market	Level	Change	% Change
DBC	24.30	-.21	-0.86%
Gold	1250.60	-3.70	-0.29%
Silver	18.945	-.016	-0.08%
Copper	3.1035	-.065	-2.05%
WTI	92.69	.03	0.03%
Brent	99.30	-.90	-0.90%
Nat Gas	3.98	.104	2.68%
RBOB	2.5498	-.0121	-0.47%
DBA (Grains)	26.13	-.04	-0.15%
Prices taken at previous day market close.			

Sector-wise, banks and financials got hit as worries about capital ratios were rekindled after some "negative" comments from Fed Governor Daniel Tarullo (he spoke mostly about the risk of structurally important financial institutions and didn't say much about policy). Interestingly, despite the focus on bigger banks, it was the regionals that underperformed. (KRE down -1% vs. KBE down -0.9%. However, considering small caps lagged yesterday, that's not all that surprising.)



This is the Investors Intelligence survey I mentioned yesterday. Percent of bears is at a 27 year low—and while there isn't "irrational exuberance," the inevitability of stocks going higher is palpable.

Interestingly, although financials lagged yesterday, we also saw interest-rate-sensitive stocks get hit. Utilities were actually worse performers than the financials, as XLU fell -1.15% on higher rates, while consumer discretionary also lagged. Again the selling was broad, as all 10 S&P 500 sub-sectors finished the day in decidedly negative territory.

On the charts, as mentioned support at 1,890 was broken and now 1,885 is squarely in view (this is the old high and the 20-day MA, so this should be decent support).

<u>Bottom Line—It's About "Considerable Time"</u>

If there was one specific reason stocks have traded "heavy" for over a week now (Friday's rally aside), it's Fed expectations. This market remains Fed-dominated, plain and simple. And, levels of Fed angst are slowly on the rise as we near the Sept. 17 FOMC meeting.

In particular, there is the worry that the Fed will remove the term "considerable time" from the official statement. This "considerable time" pertains to when the Fed will raise rates after QE stops this October. So, the current statement says the Fed won't raise rates for a "considerable time" after QE ends in October.

But, quietly there has been a movement gaining steam in the FOMC to remove that phrase from the statement. If that happens next Wednesday, it'll be taken as mildly "hawkish" because logically markets will assume rates will rise sooner than later.

That growing expectation, along with the apparent break in the European bond buying fever, is what's weighing on Treasuries and stocks—and it underscores a very important point.

If we are in for a sell off/ correction of some sort, then it likely will come with both stocks *and* bonds going down—so the expectation that even if stocks drop we can hide in bonds will no longer be valid in the short term - assuming this bond rally of 2014 really has broken (which I believe it has).

Bottom line is you have to respect this rally, but this market continues to feel heavy to me. I would not be adding any new long exposure here. JNK continues to be under pressure (down again yesterday and well below 41.00) and I maintain that is a leading indicator, and because there are so many "late longs" in this market that begrudgingly added long exposure during the last three weeks, the potential for a very ugly day between now and the FOMC meeting next Wednesday is on the rise.

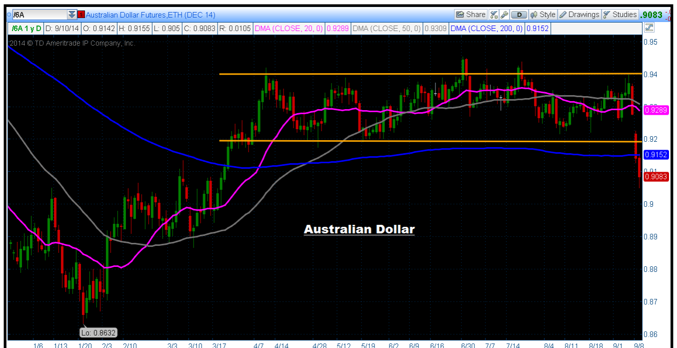
Economics

There were no economic reports yesterday.

Commodities

Commodities continued to decline in aggregate yesterday, this time weighed down by the grains, while oil and gold saw modest bounces. The commodity ETF DBC fell 0.86%.

As mentioned, grains were the big movers yesterday as corn and soybeans fell more than -1% while wheat declined just under -1%. The reason for the moves (and the reason for pretty much every move in the grains this time of year) was the weather. Grains had been bid up over the past several days as fears that an early frost (yes, we're getting toward winter again) might potentially damage what are expected to be potentially record crops. And, given how oversold these markets were, the potential was there for a big squeeze, which we got.



The Aussie Dollar broke down through support at .92 yesterday, and if it can close below that level a few more times, that will be a shorting opportunity.

But, yesterday some of that "frost fear" came out of the market—and unless weather turns decidedly cold over the coming weeks, the crops this year will simply be massive … and that will continue to weigh on prices.

Turning to energy, natural gas was again the star performer (benefiting from that early cold spell just mentioned) as it rallied another +2.5% to knock on the door of $4. We remain structural bulls on natural gas given the inventory levels, and maintain that buying gas in the mid-to high-$3s will prove to be a value as long as we don't have a very warm winter.

WTI crude bounced marginally yesterday (up +0.4%) but still remains under pressure as supply worries continue to trump demand from a growing economy. Of note, though, the Energy Information Administration lowered its WTI price forecasts for 2014 and 2015, from $100.45 and $96.08 to $98.28 and $94.67, no doubt in reaction to this recent declines and rising supplies.

Market	Level	Change	% Change
Dollar Index	84.42	.049	0.06%
EUR/USD	1.2919	.0023	0.18%
GBP/USD	1.6089	-.0015	-0.09%
USD/JPY	106.30	.28	0.26%
USD/CAD	1.1003	.003	0.27%
AUD/USD	.9190	-.0088	-0.95%
USD/BRL	2.2881	.0209	0.92%
10 Year Yield	2.500	.031	1.26%
30 Year Yield	3.233	.010	0.31%
Prices taken at previous day market close.			

Bottom line for now with WTI: $91.24 remains key support, and if that's broken, we open up a run toward $90.

Today is inventory day for oil and the products, and the estimates are as follows: -1.25 million barrels for WTI Crude, RBOB Gasoline unchanged, Distillates up by 600k.

Finally, precious metals were able to bounce yesterday as gold closed up marginally (+0.24%) while silver did a bit better (+0.71%). But, both rallies were mostly bounces following the Monday drop, and generally the outlook for the metals remains unchanged.

There is an inflation argument to be made here, but that's simply not a big, positive influence at the moment. $1,250 in gold remains key resistance, and for longer-term accounts I'd look to be an incremental buyer down at that level.

Currencies & Bonds

The bond market continued lower Tuesday, and Europe remains the main influence on Treasury prices. European bonds continued to decline, and although secession worries were cited as the "reason" by the financial media, the decline in bonds remains much more a reaction to the ECB last week than worries about European secession.

Specifically, there were worries yesterday morning that Catalonia in Spain might be emboldened by all this Scottish independence talk and hold a referendum of its own. But, to be clear, secession from the euro zone is simply not one of the bigger things we need to worry about right now.

European bonds and U.S. Treasuries continue to act as though the buying fever of 2014 has "broken," as has the uptrend of 2014.

Commodity currencies apparently must have been missing out—seeing the euro, pound and yen collapsing vs. the dollar over the past 5 trading sessions—and decided to play catch-up. The Aussie dollar broke (barely) through $0.92 yesterday following a lackluster Home-Loan Report. But, while that report was the catalyst yesterday, the Aussie is simply under heavy pressure from a strong U.S. dollar and renewed concerns about Chinese commodity demand, courtesy of the soft import numbers from Monday.

Likewise, the Loonie fell -0.36% yesterday to a new low for the year vs. the dollar, after housing starts missed expectations.

Interestingly, both commodity currencies fared decently well vs. the dollar throughout last week. But between the persistent commodity weakness and the bullish tailwind on the U.S. dollar, the trend in both the Aussie and the Loonie is lower over the longer term. We already expressed our shorter-term negativity on the Canadian dollar two weeks ago, when we pointed out the negative head-and-shoulders pattern forming, and we'd be sellers of the Aussie if it can close a few times under $0.92.

Looking to the developed markets, the Dollar Index rose fractionally (+0.06%) while the euro and pound were little-changed, as sellers took a breather. I think it's notable that the pound couldn't muster any sort of a bounce after Monday's declines and following "hawkish" remarks by BOE Governor Mark Carney (he implied rate hikes were coming in early 2015). For now though, as mentioned, Scottish independence remains the main influence on the pound, and it'll weigh on it until there's more clarity. (Although again, given where the UK is economically and the low probability of Scottish independence, the pound is likely a buy on any further dip—at least for a trade of some sort).

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
9/4/14	HEDJ EUFN EWI EWP TBT	59.35 24.67 16.44 41.34 56.59	None	*"Long Europe" Portfolio: The move by the ECB to start a private market QE program, combined with the impending TLTROs, should give the European economy a significant boost over the coming months. Given the sour sentiment towards the region and relative attractive valuation we are committing capital to the trade. HEDJ remains the best way to hedge out a falling euro, while higher beta sectors of the EU economy (financials, Italy, Spain) should rally the hardest. Finally, the moves should end the German bond mania, which should weigh on Treasuries.*
7/28/14	DBC	25.65	None	*We have initiated long positions in DBC here as we believe many components of the benchmark index have become oversold, namely in the energy space. The potential target to the upside is close to the $27 mark. 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*
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 (9/8/14): After spending most of 2014 in trading range, the yen have broken down to new lows as expectations for pension reforms (allocation more Japanese pension funds away from Japanese bonds and into stocks) as well as the rising potential for more stimulus have weighed on the yen. It appears after nearly a year of consolidation, this trade is back "on."

Date Initiated	Strategy	Position (s)	Investment Thesis
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 (9/8/14): One of the biggest positive influences on bods in 2014 has been buying from Europe, as German bunds and peripheral European debt saw mania buying on rising fears of deflation. Those money flows overwhelmed negative bond fundamentals in the US and sent Treasuries soaring. But, with the ECB engaging in QE, the European bond mania should break, and Treasuries should now resume their declines.

Asset Class Dashboard

(Updated 9.8.14)

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 traded to new highs again last week thanks to a big Friday rally in response to the softer than expected jobs report (it lowered levels of Fed angst). Despite the new highs, though, stocks traded a bit heavy last week and a period of consolidation looks in order, although beyond the very near term the back drop remains favorable.*
Best Idea: Buy Regional Banks (KRE). **Best Contrarian Idea:** Buy Small Caps (IWM).			
Commodities	**Bullish**	**Bullish**	*Commodities traded lower last week as a decline in WTI Crude oil and gold weighed on the complex. Both gold and oil are now at critical levels of support, but with the US economy accelerating and the growing potential for inflation, expect buyers to defend current levels.*
Best Idea: Long Oil (USO), Long Copper (JJC) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index surged to new highs for the year (again) after the ECB shocked everyone and unveiled private sector QE. Also helping the dollar rally was disappointing economic data out of Japan (the yen hit a new low for the year). While overbought, the path of monetary policy between the US and most of the rest of the world is diverging (US tight, everyone else loose), and that is dollar bullish.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long Canadian Dollar (FXC)			
Treasuries	**Neutral**	**Bearish**	*Treasuries declined last week despite the disappointing jobs report, as the positive influence from Europe waned after the ECB announced private market QE. The 30 year Treasury is now below the 2014 uptrend, but before getting outright bearish short term, I'll want to see it close a few more times below that support level—as this 2014 rally deserves the benefit of the doubt.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			