7:00's Report

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

September 18th, 2014

The Dollar Index equaled the "taper tantrum" high from summer 2013 following yesterday's Fed meeting.

Pre 7:00 Look

- Futures and most international markets are higher this morning as the Fed didn't really rock the boat yesterday.
- Focus is in Scotland where the independence vote is on going (official results will likely hit this evening or tomorrow morning, although the "No's" are expected to win).
- In Europe, the ECB released its first TLTRO and demand was much lower than anticipated—but stocks are up on the news as it increases the chances of QE.
- Econ Today: Housing Starts (E: 1.038M), Jobless Claims (E: 305k), Philly Fed Survey (E: 23.0).

Market	Level	Change	% Change
S&P 500 Futures	2001.00	7.25	0.36%
U.S. Dollar (DXY)	84.68	.194	0.23%
Gold	1224.50	-11.40	-0.92%
WTI	93.21	0.01	.01%
10 Year	2.60	.011	0.42%

Equities

Market Recap

Stocks rallied again Wednesday as the FOMC was initially taken as "dovish," although markets finished well off their best levels of the day. The S&P 500 closed up +0.13%.

Things were very quiet yesterday until the Fed meeting, despite some good "micro" news. Earnings by FDX and LEN were both good, and there was more M&A and hedge fund activism chatter Wednesday morning, but that was largely dismissed and stocks didn't venture far from flat ahead of the Fed.

Stocks rallied almost immediately following the release of the Fed statement, as it was taken initially as "dovish" seeing as "considerable time" was left in and wasn't qualified at all.

Much like Tuesday, given the expectation was for a potentially "hawkish" statement, the news caught traders off sides. We again saw a short-squeeze during the hour following the statement, as stocks rallied basically to the old highs.

But, the buyers ran out of steam and the FOMC wasn't "dovish" enough to push the S&P 500 through the old high, and stocks drifted lower throughout the final hour of trading as we saw a bit of a "buyers' strike" above 2,000. Stocks ended the day fractionally above that level.

Trading Color

Like Tuesday, there were no signs of conviction in the rally yesterday, as higher-beta sectors didn't outperform (the Dow, S&P 500, Russell and Nasdaq all basically traded in line with one another).

Market	Level	Change	% Change
Dow	17,156.85	24.88	0.15%
TSX	15,458.88	-51.66	-0.33%
Brazil	59,108.19	-6.47	-0.01%
FTSE	6,816.72	35.82	0.53%
Nikkei	16,067.57	178.90	1.13%
Hang Seng	24,168.72	-207.69	-0.85%
ASX	5,415.83	8.57	0.16%
Prices taken at previous day market close.			

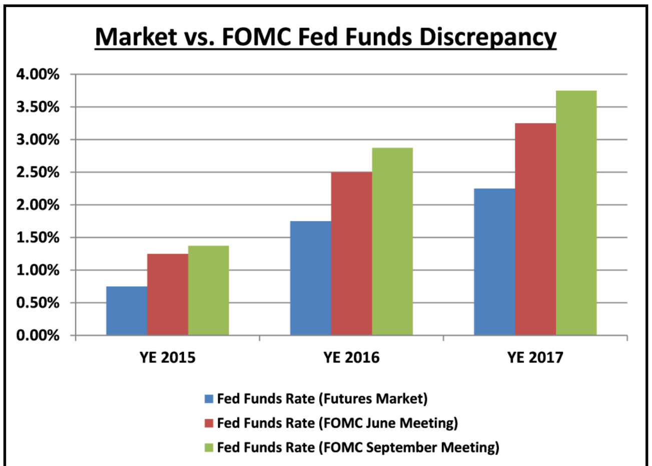
SPHB didn't outperform, either; nor did any of the "momentum" sectors (Internet stocks and biotechs), despite those sectors getting hit hard early in the week in anticipation of a "dovish" Fed.

Market	Level	Change	% Change
DBC	23.98	-.10	-0.42%
Gold	1224.20	-12.50	-1.01%
Silver	18.555	-.166	-0.89%
Copper	3.1355	-.0305	-0.96%
WTI	94.13	-.75	-0.79%
Brent	96.86	.23	0.24%
Nat Gas	4.016	.021	0.53%
RBOB	2.5666	.0078	0.30%
DBA (Grains)	25.52	.05	0.20%
Prices taken at previous day market close.			

Interestingly, the sector trading suggested the FOMC wasn't quite as "dovish" as the indices would imply, as there was a "higher rate" bias in the sector trading.

Banks outperformed, bouncing back from two days of weakness. So did tech, while utilities, consumer discretionary and REITs underperformed.

Other notable performances included the transports, which rallied off of the good FDX numbers, and homebuilders, which bucked higher rates thanks to strong earnings from LEN and the Housing Market Index hitting its highest level since November 2005.



The "dots" went up yesterday, widening the gap between the markets expectations for rate policy and Fed expectations. At some point, the gap will close.

Finally, energy also lagged, again, as WTI crude fell on a bearish inventory number. While that sector seems to be trying to bottom, I think it's a touch early to be buying the dip.

Bottom Line

There was some notable bifurcation yesterday. Stocks rallied, assessing the Fed as "dovish." But every other asset class did the opposite—bonds fell (hawkish), the dollar rose (hawkish) and gold fell (hawkish). And, given my belief that bonds and currencies are the "smartest" markets, I'm inclined to agree with them that the Fed was "hawkish."

But, that said, it's not like policy is changing anytime soon, so I can understand why stocks rallied initially. Despite the move, though, I remain cautious, as I continue to think we're simply "as good as it gets" for a while with U.S. stocks. I'm not sure how much more upside is left right now. So, while I wouldn't be de-risking at the moment—because this rally continues to deserve respect—I would continue to allocate new capital to "higher rate" plays and Europe and Japan (HEDJ and DXJ). That's because the opportunities there seem to be a better risk/reward setup.

Bad is Good in Europe

This morning the ECB released it's first tranche of TLTRO funding, and it flopped, badly. Takedown by banks of the offer was just 82.6 billion euro, a little over half of the 150 billion that was expected.

But, this low figure is seen as only further increasing the likelihood that the ECB will have to eventually launch a large scale QE program - and European markets are all sharply higher on the news.

Economics

FOMC Meeting

- The FOMC left interest rates unchanged yesterday, as expected.
- The FOMC tapered an additional $15 billion from the QE program and said QE would end in October (as expected).

Takeaway

I'll let the various financial blogs dissect the minutiae of the Fed statement, but the bottom line was that the Fed was "stealthily hawkish" despite leaving "considerable time" in the statement.

The "hawkishness" from the FOMC came in two forms. First, the "dots" moved up, and as I explained yesterday, the "gap" between market expectations for the Fed Funds rate, and the Fed's expectation of the Fed Funds rate, has now widened even further. This increases the chances for the "hawkish" surprise at some point, specifically that interest rates will increase faster than is currently expected.

Also, there were two dissents to the meeting yesterday – Plosser and Fisher. Both are known "hawks" so it's not like their dissent is that surprising, but clearly the FOMC is becoming much more bifurcated. As economic data continue to improve and we continue to hear "best levels for the recovery" with seemingly multiple data points, the "hawks" are growing in ranks, while the doves are losing members.

Bottom line is this doesn't mean rates will increase any sooner than was consensus before the meeting. (June is still the data of "lift-off.") Instead, think of Fed policy like a cruise ship – it takes a while to turn, but once it does it has a lot of momentum. Fed policy is turning incrementally more hawkish, and it's starting to gain some momentum.

Going forward, data become key. If the economic data stay good, the "turn" toward hawkish will become more pronounced – but I think it would take a very significant dip in activity to have the Fed alter from their current path at this point.

<u>CPI</u>

- August CPI was –0.2% vs. (E) 0.0%.

<u>Takeaway</u>

CPI was expected to be a non-event but it was anything but, as the number came in surprisingly weak (a dovish occurrence). The -0.2% drop in August CPI was the biggest since March 2013, and the unchanged core CPI was the lowest monthly reading since January 2010! This was definitely a "dovish" surprise, with a decline in energy prices taking a toll on the headline CPI, while airfares and healthcare expenses weighed "core" CPI down.

Market	Level	Change	% Change
Dollar Index	84.74	.509	0.60%
EUR/USD	1.2872	-.0087	-0.67%
GBP/USD	1.6276	.0001	0.01%
USD/JPY	108.30	1.18	1.10%
USD/CAD	1.1004	.0037	0.34%
AUD/USD	.8965	-.0129	-1.42%
USD/BRL	2.3554	.0237	1.02%
10 Year Yield	2.60	.011	0.42%
30 Year Yield	3.364	.010	0.30%
Prices taken at previous day market close.			

Overall this isn't a dovish game-changer, but it does give the doves some more cover on the FOMC. But unless this becomes a two- or three-month trend, it likely won't alter the expected course of Fed policy. Finally, it does reflect, at least statistically, that inflation is simply not a major threat yet.

<u>Commodities</u>

Commodities were mostly lower yesterday as the dollar approached 14-month highs after the "slightly more hawkish" FOMC announcement. Metals traded lower as a result while energy reacted to a mixed EIA report. The benchmark commodity ETF, DBC, fell -0.37%.

Beginning with gold, futures were trading in a very tight $5 range ahead of the FOMC and then sold off sharply as traders digested the "more hawkish" FOMC event. Futures finished lower by -1.03% at a 9-month low. The recent trend in the dollar has been lower thanks to the strengthening dollar being the primary driver of the precious metals market. And, yesterday's Fed news only solidified that market fundamental.

Also, the bullish influence of the "looming threat of inflation" we have been following over the past couple of months was somewhat discredited by yesterday's CPI report, which missed expectations. So bottom line, the primary bearish influence on gold was underscored yesterday while the main bullish one lost credibility.

Technically, futures breaking down toward the $1,200 level is being seen as "inevitable." However, the short side of the gold trade is getting crowded, so there is potential for a "short-squeeze pop." To the upside, former support at $1,240 has become solid resistance.

Elsewhere in metals, copper gave back a lot of Tuesday's surge due to the Chinese stimulus announcement and futures closed down -1.09%. The move lower was a result of digestion of the stimulus news as well as pressure from the stronger dollar. The path of least resistance in copper remains lower, with resistance at $3.18 and support below toward $3.08.

Moving to energy, yesterday was inventory day for WTI and the refined products, and the report was a surprise against expectations. Crude oil stocks rose +3.7M barrels vs. (E) -1.2M, gasoline supplies fell -1.6M barrels vs. (E) unchanged, and distillate inventories were mostly in line with expectations rising +300K barrels.

WTI crude oil fell -0.76% yesterday but is maintaining weekly gains and has been trading better since hitting a multi-month low last week. But, futures are approaching two-tiered resistance at $96. One of those tiers is the steep downtrend line that has been in place since mid-June, and until we see that decidedly broken, we will remain neutral in the space. But, bottom line, the "demand argument" based on our improving economy remains very much intact. Over the medium term, we should see prices move back toward the $100 level.

Natural gas rallied a modest +0.43% yesterday but importantly reclaimed the $4.00 mark ahead of this morning's EIA inventory report. Analysts are forecasting a build of 89 Bcf, and you know the drill—a surprise either way could materially move the market. Even if the build was larger than expected, however, we would see any weakness as an opportunity to get long given the fundamentals.

Currencies & Bonds

The currency and bond markets confirmed my "stealthily hawkish" interpretation of the Fed. Almost all currencies were little-changed vs. the dollar heading into the Fed meeting, although there was a very clear "hawkish" digestion that occurred following the releases and Fed Chair Yellen's press conference.

The dollar began to rally about 20 minutes after the Fed release and it gained steam throughout Yellen's press conference. And, that strength was universal, as the Dollar Index finished materially higher vs. every major currency except the pound (which was flat due to lingering uncertainty surrounding the Scottish Independence vote).

The Dollar Index traded to a new 14-month high, up +0.61%, while the euro fell to a new 14-month low, down -0.69%. But, the biggest movers vs. the dollar were in Asia, as the Aussie dollar continued to exhibit simply unbelievable volatility for a currency, falling 1.41% to hit the lowest level since March and is now teetering on support at $0.89. Bearishly, the Aussie couldn't even rally for more than a day on the "China stimulus" headlines, and simply the downtrend in Aussie is accelerating.

The yen was the second-worst performer vs. the dollar, as dollar/yen traded through 108 yesterday, hitting a new multi-year high. Obviously dollar strength was the primary influence, but Bank of Japan Governor Kuroda also made some "dovish" comments about doing what is necessary to hit their 2% inflation target—so unlike other currencies, the yen was already under some pressure.

Bottom line is the Fed was "stealthily hawkish" so unless we get a material turn lower in the U.S. dollar, the trend upward should continue, and it's just a matter of time until 85 is "taken." I'm not saying "King Dollar" is back with a vengeance, but clearly the trend is higher.

Turning to bonds, they were flat into the FOMC and actually were slightly positive following the retention of "considerable time." But, like the Dollar Index, they digested the information as "hawkish." Treasuries turned negative while Fed Chair Yellen was speaking, and actually managed to close on the lows of the day, down 0.35% in the 30-year. The yield on the 10-year Treasury closed right at 2.60%.

Much like the dollar, unless we all of a sudden get some soft economic data, yesterday's price action further reinforces that the bond market is adopting the view of a "hawkish" Fed and coming higher rates. Again, I don't think we'll necessarily see the velocity of the move that we've seen over the past few weeks, but this does further reinforce my opinion that the trend in bonds is now decidedly lower.

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
9/11/14	EUM	24.05	None	*Short Emerging Markets. With the dollar surging higher and the global bond yields rising, this should put pressure on the emerging markets, as money rotates out of those economies back towards developed markets. Original Issue*
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. 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. Original Issue*
7/21/14	UNG	20.98	None	*Natural gas is a supply/demand based trade. While injections over the summer have replenished supply, we are still 15% below historical levels, with the winter heating season drawing near, Natural gas in the highs $3.00's appears to be a value. 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."			
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.			

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Asset Class Dashboard

(Updated 9.11.14)

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 declined 1% last week as markets consolidated ahead of the FOMC meeting later this week. The main "reason' for the declines was concern the Fed may get incrementally more "hawkish" by removing the term "considerable timing" from the statement. Until there's more clarity from the Fed, I expect a continuation of the consolidation we saw last week.*

Best Idea: **Buy Regional Banks (KRE).**

Best Contrarian Idea: **Buy Small Caps (IWM).**

Commodities	**Bearish**	**Bullish**	*Commodities traded lower , again, last week as a decline in WTI Crude oil and gold weighed on the complex. Dollar strength is the main negative influence on the commodity space, as are renewed worries about Chinese growth. Longer term there is value here, but for now the trend is lower.*

Best Idea: **Buy Natural Gas (UNG)**

Best Contrarian Idea: **Buy Grains (DBA)**

U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index surged to new highs for the year (again) but it wasn't driven higher by euro weakness last week. Instead, a sharp decline in the yen and commodity currencies helped push the Dollar Index higher, as did fears of a more "hawkish" Fed. While very overbought and in need of a correction, the trend in the Dollar remains firmly higher.*

Best Idea: **Sell the Yen (YCS)**

Best Contrarian Idea: **Long Canadian Dollar (FXC)**

Treasuries	**Neutral**	**Bearish**	*The decline in Treasuries accelerated last week, as the thirty year bond dropped 1% while the yield on the 2 year hit it's highest level since June 2011. The declines in bonds were global, as European bonds also fell, as the fundamentals of a ECB targeting growth and inflation and a more hawkish Fed are finally setting in.*

Best Idea: **Short "long" bonds (TBT)**

Best Contrarian Idea: **Short High Yield Bonds (SJB)**