7:00's Report

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

September 2nd, 2014

Pre 7:00 Look

- Futures are drifting slightly higher and most international markets saw modest rallies o/n as investors shrug off negative geo-political headlines.
- Economically it was a quiet night, although yesterday saw the release of the August global manufacturing PMIs. While slightly disappointing, they mostly met expectations and global stocks largely ignored the releases.
- In Ukraine fighting rages on and there is little hope of a resolution as rebels made key gains over the weekend.
- Econ Today: ISM August Manufacturing PMI (E: 56.8).

Market	Level	Change	% Change
S&P 500 Futures	2005.00	3.50	0.17%
U.S. Dollar (DXY)	82.98	.197	0.24%
Gold	1272.30	-15.00	-1.17%
WTI	95.17	-.79	-0.82%
10 Year	2.343	.009	0.39%

Equities

Market Recap

Monday saw global markets mixed, but there weren't any major moves despite Russia/Ukraine headlines over the weekend and the release of the August global manufacturing PMIs.

Europe was very slightly lower yesterday and is modestly higher this morning, which isn't too bad considering the Ukraine headlines and the generally underwhelming August manufacturing PMIs (more on those later).

Asia, however, was modestly higher as Chinese manufacturing PMIs were in line with expectations (importantly the "official" manufacturing PMI didn't confirm the drop in the Markit PMI). Meanwhile Japanese manufacturing PMI was about the only positive "beat" at 52.2 vs. (E) 50.5 and the Nikkei surged 1.3% high overnight after PM Abe announced a cabinet reshuffle (it's thought this may lead to more pro-business structural reforms).

But again, with the U.S. closed, no major international markets showed much volatility, other than Japan overnight.

This Week: Geopolitics and Jobs

Focus this week will be on geopolitics and jobs. Starting with the former, we saw last week and during the weekend that the situation in Ukraine, at least according to the headlines, has deteriorated.

It appears as though there is ample evidence that Russian troops have entered parts of Eastern Ukraine—but there is a very important distinction we need to keep in mind.

It appears, at least as of this writing, that Russia's goal remains the same as it has been throughout this 4 month long conflict: to support rebels and generate unrest in Eastern Ukraine to continue exerting its influence over the country and preventing Ukraine from moving closer to Europe.

That's a big difference between Putin sending in tanks and troops to conquer Eastern Ukraine, although admittedly he is now walking a very, very fine line.

As I've been saying all along, there will be headline shock out of this crisis, but it only becomes a bearish game-changer if Russia full-on, and purposely, invades Eastern

Market	Level	Change	% Change
Dow	17,098.45	18.88	0.11%
TSX	15,625.73	67.56	0.43%
Brazil	61,141.27	-146.88	-0.24%
FTSE	6,839.93	14.62	0.21%
Nikkei	15,668.60	192.00	1.24%
Hang Seng	24,749.02	-3.07	-0.01%
ASX	5,658.51	28.68	0.51%
Prices taken at previous day market close.			

Ukraine. As long as they are "meddling" by supporting the rebels, this will remain a "local" conflict and not a major impediment to higher stock prices, despite the ominous headlines.

Turning to jobs, it's "jobs week." And, the jobs report will be the most-watched release of the week when it comes Friday, as usual. But, it'll be watched not as a number to prove the economy is recovering (we know that) but instead because it'll have an impact on the levels of "Fed angst" in the market if the jobs number is too good. And, as we saw in July/August, when levels of Fed "angst" rise (meaning the fear rates could increase faster or sooner than expected), the market will go down, at least temporarily.

Market	Level	Change	% Change
DBC	25.03	.05	0.20%
Gold	1288.00	.60	0.05%
Silver	19.52	.028	0.14%
Copper	3.152	-.0085	-0.27%
WTI	95.86	-.10	-0.10%
Brent	102.60	.59	-0.57%
Nat Gas	4.074	.009	0.22%
RBOB	2.6201	-.0028	-0.11%
DBA (Grains)	26.46	.06	0.23%
Prices taken at previous day market close.			

Bottom Line

Stocks are once again extended in the short term, but geopolitics aside, the general backdrop remains favorable: Central banks are still accommodative, the global macro horizon remains relatively clear (Russia/Ukraine notwithstanding), the global recovery is continuing (although Europe is quickly becoming the biggest risk to that statement), and valuations, while elevated, still aren't at "warning" levels (15X 2015 $130/share S&P 500 EPS).

We could see some more buyers "chasing" today as people get back to work, now that summer is over, but some consolidation/digestion is appropriate in the very near term—but the benefit of the doubt remains with the bulls.

Economics

Global Manufacturing PMIs

- EMU August Manufacturing PMI 50.7 vs (E) 50.8.
- German August Manufacturing PMI 51.4 vs. (E) 52.4.
- China "Official" Manufacturing PMI 51.1 vs. (E) 51.2.

Takeaway

With U.S. markets closed yesterday, most international markets traded off economic data. The results were mixed but nothing strayed too far from current expectations.

Positively, the August manufacturing PMI produced by the Chinese government—the "official" PMI—stayed above 51, and importantly did not confirm the dip we saw in the Markit Chinese PMI earlier this month (it fell to 50.3). Although there are obviously suspicions about the "official" number, the simple truth is this: Unless both are declining (and they do both decline when growth slows), then the market will continue to give the Chinese economy the benefit of the doubt. The pace of growth there remains largely stable.

Negatively, Europe remains a concern. The good German "flash" PMI we got 2 weeks ago was revised sharply lower, the French manufacturing PMI remains very weak at 46.9, and the larger EMU PMI is just positive at 50.7.

With the exception of the German number, most of these reports were in-line with expectations. But, they further confirm that the EU economy is barely still in a recovery, and this remains the single-biggest risk to the global rally in stocks. (If Europe "triple dips" into recession, that will hurt stocks somewhat.)

Bottom line with yesterday's PMIs is it largely confirmed market expectations: China is stable, but Europe is a growing concern. And while the recovery hasn't died yet, it is teetering.

EMU HICP

- Year-over-year "core" HICP rose 0.1% to 0.9% yoy.

Takeaway

This number was reported Friday morning but I wanted to point it out, as it is important. Deflation remains a major threat in the EU, and this flash HICP (their CPI) is encouraging. The ECB is trying to stoke inflation, and with the release of the first tranche of the TLTROs coming later this month, it's good to see some positive motion on inflation heading into it. Point being, not all the news out of Europe is bad, but it again remains a concern for the global economy.

This Week

Despite being a holiday-shortened week, things will be busy on the economic front.

First, it's jobs week, with ADP Wednesday, claims Thursday and the government jobs report Friday.

We all know by now that the latest correction in stocks was largely caused by rising levels of Fed "angst," namely that they will tighten more quickly or sooner than current expectations.

Because of that, economic data must continue to be "Goldilocks," which they have been over the past 2 weeks. So, the risk here is the jobs report is too good, and raises levels of Fed "angst."

We also get global composite PMIs Wednesday (for China and the EU) and non-manufacturing PMI Thursday for the U.S. Again there shouldn't be any shocks in these reports, but it'll help if they further confirm current market consensus: U.S. with solid growth, China growth stabilized, and Europe still (barely) hanging onto recovery.

The other data point to watch will be the Fed Beige Book, which is released tomorrow afternoon.

The market is looking for any current insight into the state of the economy from the Fed. I doubt it'll cause much of a market reaction, but again this is all about levels of Fed "angst." So, if the Beige Book is very positive on the economy, look for a bit of a "hawkish" reaction.

Finally, there are Bank of England and ECB meetings Thursday. The BOE meeting should be another non-event until we get the minutes from it in a few weeks to see if there was more dissent about raising interest rates now.

The ECB meeting will likely see another effort by Mario Draghi to "talk down" the euro and threaten QE if needed. But with the first TLTRO looming, they aren't going to introduce more accommodation until they see the effect of that first TLTRO. So, it'll be a lot of talk but no action, as has been the case since June.

Market	Level	Change	% Change
Dollar Index	82.77	-.013	-0.02%
EUR/USD	1.3129	-.0003	-0.02%
GBP/USD	1.6609	.0012	0.07%
USD/JPY	104.29	.24	0.23%
USD/CAD	1.0866	-.0009	-0.08%
AUD/USD	.9332	-.0001	-0.01%
USD/BRL	2.2459	.01	0.45%
10 Year Yield	2.343	.009	0.39%
30 Year Yield	3.080	.008	0.26%

Prices taken at previous day market close.

Commodities

Commodities were mostly higher last week in spite of a stronger dollar (+0.44%). Energy was in the spotlight, with crude oil and natural gas both breaking out through their respective resistance levels. Precious metals notched small gains amid more "Goldilocks" economic data and slightly "hotter" geopolitics while copper was the notable outlier, falling more than -1% on the week.

The energy sector enjoyed nice gains last week led higher by a 6.3% rally in natural gas futures. There were several key, bullish influences on natural gas prices.

First, the continued tight supply situation is a growing concern as stockpiles remain well-below the 5-year range, and weekly injections are *not* on pace to fully restore inventories by the start of the draw season (late October).

Second, as things heat up in Ukraine, there has been increased talk of Russia halting nat gas supply to Europe, which brought in some "fear" bids.

And lastly, temperatures across the U.S. remain warmer than initial expectations, suggesting power demand to satisfy cooling needs will remain elevated.

The aforementioned reasons all support the bullish natural gas argument. And the technicals agree, as another key resistance level was broken last week.

Bottom line, natural gas has broken through key resistance and is forming an uptrend on the charts, and we believe that will continue given the aforementioned bullish fundamentals.

Crude oil futures were in a consolidation pattern for the better part of two weeks, but like natural gas, crude broke through some longstanding trend resistance on Thursday and closed up +2.66% on the week.

More "Goldilocks" economic data, paired with escalating tensions in Ukraine, were responsible for most of last week's rally. But, the technical picture is also improving, as the first of two downtrends dating back to the June highs has been broken, and there is room to move higher (toward the upper $90s) before the next resistance level is reached. We remain fundamentally bullish given the economic improvement we have seen this year, specifically in the labor market, which should continue to keep demand for refined products rising.

In the metals, gold saw modest gains last week, up +0.48% thanks to fear bids surrounding Ukraine, while copper was the sole underperformer on the week, falling -1.34%.

In gold, we remain long-term bullish as rising inflation continues to loom on the economic horizon here in the U.S. Even though this could spur some near-term hawkish policy decisions out of the Fed (if inflation heats up too quickly)—which could in turn put some pressure on gold prices—gold has held up remarkably well during the recent rally in the dollar. This is a favorable sign for the bulls. On the charts, gold continues to be "drawn" toward the $1,300 level while trend resistance at $1,275 is the "line in the sand."

Meanwhile, copper was the worst performer last week, as trading in futures has become rather volatile recently. The volatility has been the result of two key influences: varying economic reports out of China (bearish) and a positive research report released by commodities giant Glencore (bullish). So, we will be looking to the charts for direction going forward. Support at $3.10 should not be violated while a close above $3.23 would be seen as bullish.

Currencies & Bonds

The dollar continues to reign supreme as the Dollar Index traded to a new one year high this morning (up .27%) while the euro it sitting on the lows for the year, just above 1.31. There's no specific "reason" for the dollar strength, although growing anticipation of the ECB doing "more" at Thursday's meeting is weighing on the euro, while a cabinet shake up in Japan (PM Abe is shuffling ministers) has the yen basically at January lows vs. the dollar (dollar/yen is trading just under 105). The yen is down .77% vs. the dollar this morning and is by far the biggest mover in the current space.

The only material currency related news out over the weekend was the Reserve Bank of Australia rate decision, which met expectations in that there was no change to policy. But, given the general dollar strength and slightly "dovish" tone from the RBA, the Aussie is down .5% this morning, although it remains in the .92-.94 multi-month trading range.

I'll preview the ECB meeting as we get closer to it later this week, but I do want to say that the market seems to be a bit aggressive here in pricing in the ECB doing "more" at this meeting. Broadly the trend of dollar strength/euro weakness will continue, but I think things may be getting a touch stretched short term and the euro bears may be setting up for some disappointment in 48 hours from the ECB.

Turning to the bond market, 30 year Treasuries are getting wacked this morning, down .62% as European bonds sell off (likely some profit taking into the ECB meeting, as the European bond market doesn't seem quite as confident the ECB will do "more" at this meeting).

US fundamentals continue to get increasingly more "bond negative" as the economy chugs along and the Fed moves closer to normalization of policy, but in the short term the Treasury market (especially at the long end) is being dominated by money flows. Because of that, and despite this dip, the trend remains higher until the 2014 uptrend is broken (support currently at 138'08 while last sale on the 30 year was 139'06, as of 6 am this morning).

Have a good short week,

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 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*
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 9.2.14)

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	Bullish	Bullish	*The S&P 500 traded to new highs last week as economic data was strong and the outlook for Fed policy remained stagnant. Positioning was the main reason stocks were higher last week, as investors chased and added long exposure. A period of consolidation is necessary (again) but the trend remains higher.*

Best Idea: Buy Regional Banks (KRE).

Best Contrarian Idea: Buy Small Caps (IWM).

	Near Term Trend	Long Term Trend	Market Intelligence
Commodities	Bullish	Bullish	*Commodities rose for the second week in a row last week, led by outperformance in the energy space. Both crude oil and natural gas have established near term support and the technicals are shifting more bullish. Fundamentally, the broad outlook for commodities remains bullish primarily based on the idea that as the economy continues to improve, we will see demand for commodities rise accordingly.*

Best Idea: Long Oil (USO), Long Copper (JJC)

Best Contrarian Idea: Buy Grains (DBA)

	Near Term Trend	Long Term Trend	Market Intelligence
U.S. Dollar	Bullish	Bullish	*The Dollar Index surged to new highs for the year last week on good data and increasing speculation the ECB will do "more" from a policy standpoint, perhaps as early as this week. The Dollar Index is now close to 83, and while we need to see some sort of consolidation in the Dollar, with the path of policy between the US and Europe diverging materially, the trend in the Dollar should stay higher.*

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 were flat again last week and exhibited some signs of fatigue, and although fundamentally the outlook is negative (better US economy, potentially more "hawkish" Fed) this trade remains dominated by European money flows, so until German Bunds Break down, the trend in bonds is higher short term.*

Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)