7:00's Report

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

September 24th, 2014

Pre 7:00 Look

- Futures are bouncing a bit this morning following more dovish comments by Mario Draghi.
- Europe is flat after German IFO Business sentiment missed expectations at 99.3 vs. (E) 101.6, but Draghi was again on the tape pledging low rates for long, which is helping support stocks.
- In Japan Sept. manufacturing PMIs beat expectations, and we're finally seeing a bounce in the yen.
- Econ Today: New Home Sales (E: 430K). Fed Speak: Mester (12:05), Evans (1:00 PM)

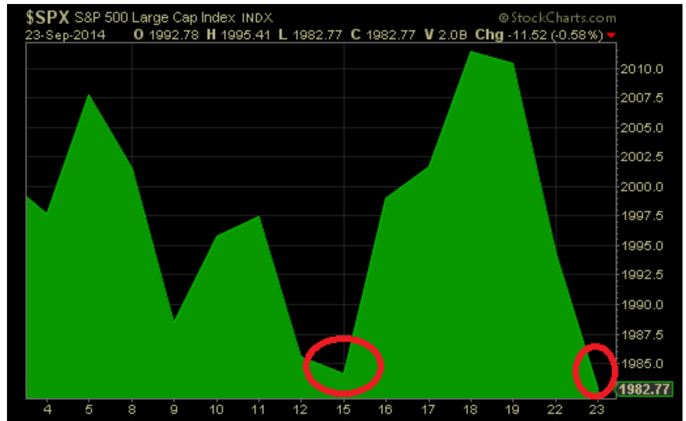
Market	Level	Change	% Change
S&P 500 Futures	1977.25	5.00	0.25%
U.S. Dollar (DXY)	84.82	.048	0.05%
Gold	1222.70	0.70	0.04%
WTI	91.42	-.14	-0.15%
10 Year	2.535	-.031	-1.21%

Equities

Market Recap

Stocks continued their slide Tuesday. Markets fell modestly, weighed down by European growth concerns, although markets finished off their worst levels of the day. The S&P 500 fell -0.58%.

Stocks were weaker from the outset Tuesday, falling after the German manufacturing PMI badly missed expectations (this overshadowed the positive surprise from China).



The S&P 500 has now totally retraced the pre-FOMC rally that started last Tuesday.

The S&P 500 bounced in early trading following the "Goldilocks" flash manufacturing PMIs here in the U.S. (stocks briefly turned positive). However, there was no follow-through and from 10:30 on, the market drifted lower in quiet trading.

News-wise, things were quiet and the declines were methodical. Buyers tried to hold up the S&P 500 at 1,985, igniting a small rally, although there was no follow-through and stocks rolled over during the final hour of trading and closed on the lows (not the best sign).

Bottom Line

As far as "why" stocks declined, "Europe" is the easiest answer, although it wasn't that big of an influence and simply there wasn't any fundamental reason behind the declines. The economic data were fine, and none of the multiple Fed speakers said anything new. (Powell and George both didn't comment on policy, and Bullard and Kocherlakota both stuck to their familiar scripts of slightly hawkish and very dovish, respectively.)

Instead, markets continue to be dominated by shifting positioning of traders: The market lifted to new highs

Market	Level	Change	% Change
Dow	17055.87	-116.81	-0.68%
TSX	15125.67	-3.33	-0.02%
Brazil	56540.50	-277.61	-0.49%
FTSE	6667.36	-8.72	-0.13%
Nikkei	16167.45	-38.45	-0.24%
Hang Seng	23921.61	84.54	0.35%
ASX	5375.77	-39.96	-0.74%
Prices taken at previous day market close.			

after traders were caught off-guard by a "not as hawkish as feared Fed." But that move, which had no substance to it, is now being unwound (we're back where we were in the S&P 500 before the Hilsenrath article of last Tuesday).

Market	Level	Change	% Change
DBC	23.46	-.02	-0.09%
Gold	1224.00	6.10	0.50%
Silver	17.795	.021	0.12%
Copper	3.033	-.0055	-0.18%
WTI	91.47	.60	0.66%
Brent	96.79	-.18	-0.19%
Nat Gas	3.826	-.024	-0.62%
RBOB	2.627	.0423	1.64%
DBA (Grains)	25.12	-.04	-0.16%
Prices taken at previous day market close.			

Going forward, I continue to be cautious on this market in the very short term. The calendar gets pretty quiet for a few weeks, and we're devoid of anything looming that could be materially "positive" and help push stocks significantly higher (again, my "As Good As It Gets" hypothesis).

1,980 is now key support. As I've been saying: If that gets materially broken, we could see an acceleration lower. Although it's a ways away, I'd not be totally shocked to see 1,950 if the sell-off gains momentum over the next few days.

Of note, JNK traded really poorly yesterday, as it's nearly at support at $40.46. If that's broken, it's a bad sign … and if it touches the spike low from early August (close of $40.54, low tick of $40.06), then that's a warning sign. Watch JNK; it is not acting well.

As far as positions go, Europe got hit yesterday and that wasn't pleasant, but it wasn't totally unexpected. (We only have half the total Europe allocation on, and I think we could see a bit more of a decline in the near term. But, we view that as a dip to buy.)

The one thing that has worked very, very well is EUM (inverse emerging markets ETF). It was +0.6% higher yesterday, and is up over +3% since we bought it about two weeks ago. The fact that emerging markets couldn't rally off that positive China number is a bad sign, and if we see a further decline in global equities, then emerging markets should get hit about as hard as everything else out there – so keep that in mind as a unique hedge.

Economics

September Global Flash Manufacturing PMIs

- U.S. PMIs 57.9 vs. (E) 58.1.
- China PMIs 50.5 vs. (E) 50.2.
- Germany PMIs 50.3 vs. (E) 51.2
- EMU PMIs 50.6 vs. (E) 50.5

Takeaway

There were gives and takes (as always). But the bottom line with the latest global flash PMIs was that they met current market expectations (and as such aren't rocking the global macro boat).

More importantly, growth remained strong in the U.S. While it was a "technical miss" vs. expectations, the September flash PMI was the second highest ever (although the data series only goes back to 2007). But more broadly, the average flash PMI for the 3rd quarter was the highest quarterly average ever – and since the number wasn't a lot better than expectations, it didn't raise levels of Fed angst.

In Europe, the region remains technically in recovery, but there are worrisome signs everywhere. The official EMU PMI stayed above 50 (so technically in expansion territory). But the German number was a big miss, and as Germany goes, so goes the EU. That number was definitely the biggest disappointment yesterday (and the reason European stocks got hit and the euro rallied), and it will only serve to strengthen calls for the ECB to do "more." Europe remains the biggest absolute risk to the global recovery.

Finally, if Germany was the disappointment, then China was the positive surprise. Despite loud "whispers" that PMI would drop below 50, it actually rose slightly. It confirmed what we know about China: Economic growth isn't particularly strong, but it's not about to implode either, as the China bears seem to think every time we get a couple pieces of weak data. Yes, China remains an area to watch closely, but at this point—unless we get news that GDP could fall below 7% growth for 2015—China won't be a major negative influence on stock prices (but it will continue to weigh on commodities).

Bottom line is there weren't any big surprises in the global manufacturing PMIs for September, and the expectations for growth and central bank policy remain unchanged following the data. The U.S. is still strong, China is "OK" and Europe remains in the economic ICU.

Commodities

Commodities were all over the board yesterday with palladium and RBOB gasoline futures rallying +1.5% apiece while natural gas forfeited morning gains to close negative on the day. DBC slipped -0.09%.

In crude oil, Brent was lower, falling -0.20% despite the better than feared Chinese manufacturing PMI (Brent did rally initially, but the gains were reversed o/n). Traders remain focused on historically high global production levels (and the fact that OPEC members seem unwilling to reduce output), comfortable supply, and possibly lower demand worldwide thanks to the struggling economic recoveries in Europe and Asia.

Meanwhile, the U.S. benchmark, WTI, rallied +0.70%, first on the stronger than expected PMI in China and then took another leg higher thanks to a geopolitical fear bid returning to the market on the U.S. airstrikes against IS in Syria. And although Syria is not a major oil-producing country, the campaign heightens tensions in the region and increases the potential for a disruption in production in neighboring countries. On the charts, WTI briefly traded above resistance at $92 (former support), but couldn't hold the level and futures drifted lower into the close. Today, the EIA report will be in focus and analysts are calling for a 500K barrel rise in crude oil supplies, a 200K barrel rise in gasoline, and a 300K barrel increase in distillate inventories.

RBOB gasoline was the best performer yesterday, rallying +1.64% as physical demand surged. According to a few colleagues on the physical side of the business, demand is hot right now and barrels are thin in the northeast, which led the front-month spread to surge. Today's EIA report will be even more interesting as traders focus on the RBOB figure and speculate the effects on crude oil prices.

Market	Level	Change	% Change
Dollar Index	84.785	-.078	-0.09%
EUR/USD	1.2847	.0002	0.02%
GBP/USD	1.6409	.0023	0.14%
USD/JPY	108.59	-.29	-0.27%
USD/CAD	1.1069	-.0006	-0.05%
AUD/USD	.8883	.0044	0.50%
USD/BRL	2.4126	.0013	0.05%
10 Year Yield	2.535	-.031	-1.21%
30 Year Yield	3.252	-.046	-1.39%

Prices taken at previous day market close.

Like WTI, gold rallied thanks to the airstrikes on the Islamic State in Syria and a slightly weaker dollar. Gold rallied as much as $22 overnight, but there were plenty of bearish traders selling into the gains and futures closed higher by just +0.50%. The geopolitical fear bids will likely be short-lived due to the nature of the conflict in the Middle East (geopolitical risk is limited with these so called "targeted airstrikes" when compared to a full ground assault). So, with the dollar holding on to recent gains for the most part, the path of least resistance in gold remains lower for the near term. $1,200 continues to be in focus.

Trading in copper was discouraging yesterday, as initially futures rallied on the Chinese data but failed to hold the gains (kind of a theme in the commodity markets yesterday) and closed down -0.13%. Copper continues to trade heavy and although we could see some near-term consolidation, the trend remains lower.

Currencies & Bonds

Tuesday started out like it was going to be another "reversal" day where we saw the Dollar Index continue to given back recent gains. Following the soft European data—which, despite missing expectations, were euro-bullish (remember that deflation is the consequence of a sort economy in Europe, and that's euro-positive)—we saw the Dollar Index down -0.5% early Tuesday, while the euro was up +0.5%.

But, neither move would hold. On second look the European PMIs weren't all that bad. And, helped by the good manufacturing PMI in the U.S., the dollar recouped almost all its losses vs. the euro throughout trading and finished very slightly lower (down 0.08%). Conversely, the euro drifted lower throughout the day, and closed only marginally higher vs. the dollar (up +0.15%) and well off the highs.

Going forward, the pace of the rise of the Dollar Index these past few months simply isn't sustainable. As I said earlier, we've got to see some sort of a correction—which it feels like we may be getting now. But, the overall trends of dollar strength/euro weakness remain dominant, even if we see them pause for a few weeks on European growth/deflation worries.

Turning to the commodity currencies, they simply can't catch a break as the Aussie and the "Loonie" continued to decline yesterday despite the better than expected Chinese manufacturing PMIs.

In what can only be described as depressing price action for the Aussie and Loonie bulls, both currencies initially spiked higher on the release of the Chinese data, but then began a methodical slide that continued throughout the day.

The Aussie broke down through $0.88 for the first time since March, while the Loonie is now teetering on support at $0.90, as a soft August retail sales report also weighed on the currency (retail sales declined 0.1% vs. (E) 0.4% last month).

I'd like to say you can step in and buy these here as some sort of a contrarian play, but the trend simply appears too strong. While the dollar may give back a bit vs. the euro because of European weakness, unless economic data turn negative domestically, it's hard to see why either the Aussie or the Loonie could rally materially. Rallies are to be shorted in both, as "value" levels lie much lower than current prices.

The bond rally continued yesterday as the 30-year Treasury rallied +0.45%, rising to a 12-day high. Bonds were stronger Tuesday morning following the soft European data (as mentioned, European deflation/economic growth expectations remain a big influence on Treasuries), but bonds took a decided leg higher following a strong 2-year Treasury auction.

The bid to cover on the $29 billion auction was 3.56, the second-highest of the year and the best since February. Also, the final yield was 0.589%, 1/2 a basis point below the "when issued," which signals decent aggressive bidding.

The 2-year auction is notable because it's much more sensitive to expected FOMC rates than 5s or 10s (for obvious reasons). Yesterday's 2-year presented the highest yields in a very long time, so based on the result, investors remain less than convinced about the Fed's commitment to moving the Fed Funds rate higher in the very near future.

Stepping back, we expected some sort of a bounce in bonds and we are getting it—and Europe is the main reason. Soft TLTRO demand and lackluster PMIs are helping stagnation/deflation worries resurface. When that happens, Treasuries will rise in the short term. But, the 2014 uptrend still is likely broken, and I view this lift in bonds as presenting a good entry point for more "bond short" positions in the coming days.

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 9.22.14)

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 rallied to new highs again last week after the FOMC was less "hawkish" than feared, which caused traders and faster money to chase indices higher. Broadly speaking the "4 pillars" of the rally remain in tact, but we continue to be cautious near term, as things in the US appear to us simply "a good as it gets" economically.*

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

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

Commodities	**Bearish**	**Bullish**	*Commodities continued to be under pressure, as a very strong dollar and concerns about Chinese economic growth weigh on the complex. Oil continued to slip last week and previous metals sold off hard as gold traded with currencies and bonds, taking the Fed as hawkish. With Chinese growth worries and a strong dollar, the near term out-*

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

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

U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index surged to a new 4 year highs (again) as both bonds are currencies took the FOMC as incrementally more "hawkish" due to the rise in the Fed rate forecasts (the dots). The Dollar Index is now very overbought, and consolidation is needed, but the trend remains clearly higher.*

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

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

Treasuries	**Neutral**	**Bearish**	*Treasuries actually bounced last week thanks to a big Friday rally, despite trading lower following the Fed (bonds took the meeting as hawkish). The trend in bonds is now downward but we could see a bounce this week on renewed European demand for Treasuries, but any material rally should be sold.*

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

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