7:00's Report

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

September 25th, 2014

Pre 7:00 Look

- Futures are flat while international markets are higher on follow through buying from yesterday. News wise it was a quiet night.
- The euro is at new two year lows and European markets are higher after Draghi again made dovish comments o/n (although he didn't say anything really new).
- Economically EMU money growth met low expectations, while UK Distributive Trades (retail sales) was in line.
- Econ Today: Durable Goods Orders (E: -17.1%), Weekly Jobless Claims (E: 300K). Fed Speak: Lockhart (1:20 PM).

Market	Level	Change	% Change
S&P 500 Futures	1990.75	-.25	-0.01%
U.S. Dollar (DXY)	85.535	.38	0.45%
Gold	1209.00	-10.50	-0.86%
WTI	92.73	-.07	-0.08%
10 Year	2.569	.034	1.34%

Equities

Market Recap

The volatility continued Wednesday. Stocks swung back and staged a strong rally on positive sentiment surrounding the new head of the Chinese central bank and more dovish comments by ECB President Mario Draghi. The S&P 500 rose +0.78% and totally recouped Tuesday's losses.

Stocks were stronger early in the day thanks to several pieces of news:

JNK: Junk bonds again traded poorly yesterday despite the stock market rally, and if we get down toward $40, things will get very interesting.

- First, Chinese authorities are appointing a new head of the PBOC. And that news, correctly or not, is being taken as a sign that the government wants the central bank to do more to stimulate growth.
- Also, Mario Draghi was on the tape early again, reminding everyone the ECB is doing "more" to stimulate growth and will act again if needed.
- Finally, a strong new home sales report helped push stocks higher. (The housing recovery is still fragile enough in the minds of investors that even good data won't raise levels of Fed "angst.").

The day consisted of two "legs" higher yesterday that were mostly the result of short-term positioning and day trading (there were no fundamental reasons behind the rallies other than those mentioned above). After drifting a bit lower immediately following the open (shorts tested support at 1,980), the market began a march higher that took the S&P 500 into the low-1,990s, before the rally stalled following the European close at 11:30.

Market	Level	Change	% Change
Dow	17,210.06	154.19	0.90%
TSX	15,120.54	-5.13	-0.03%
Brazil	56,824.42	283.92	0.50%
FTSE	6,695.02	-11.25	-0.17%
Nikkei	16,374.14	206.69	1.28%
Hang Seng	23,768.13	-153.48	-0.64%
ASX	5,382.17	6.40	0.12%
Prices taken at previous day market close.			

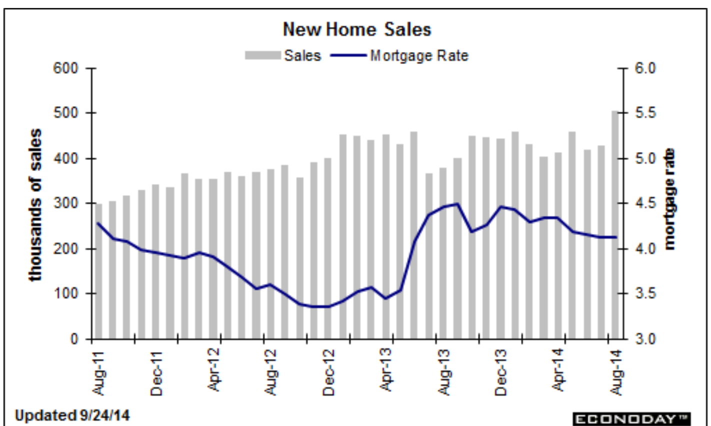
But, the buying resumed after a failed attempt by shorts to push stocks back down through 1,990. Once that didn't work, the market took a "leg" higher almost to 2,000. It stalled just below 2,000 and drifting sideways into the close.

Market	Level	Change	% Change
DBC	23.58	.10	0.43%
Gold	1217.60	-4.40	-0.36%
Silver	17.690	-.089	-0.50%
Copper	3.0540	.019	0.63%
WTI	92.86	1.30	1.42%
Brent	97.23	.38	0.39%
Nat Gas	3.90	0.84	2.20%
RBOB	2.6730	.0443	1.69%
DBA (Grains)	25.46	.35	1.39%
Prices taken at previous day market close.			

Trading Color

There was finally some modest cyclical outperformance on a rally day in the market Wednesday, as the Russell rose +0.84% and the Nasdaq jumped by more than +1%. SPHB also had a nice day, up +1.2% (doubling the +0.6% gain in SPLV).

More positively, the "growth" sectors did better Wednesday, as biotechs surged more than +2% (the best-performing sector in the market with the ongoing M&A mania in healthcare), while Internet stocks also surged (QNET rallied +1.22%). So, while not a super-strong day, there was at least some cyclical outperformance yesterday.



New Home Sales surged 18% in September, hitting the highest levels since 2005.

We also saw a return of the "higher rate" rotation, as utilities were the only S&P 500 sub-sector to finish lower (REITs were also in the red). Meanwhile banks and tech outperformed on higher rates (and tech would have even been better if it weren't for AAPL underperformance on the "bending" issues and rollback of iOS 8, which I can confirm has now reduced the battery life in my phone to about half of what it was before).

Single-stock news was mostly limited to earnings, and the definite highlight was BBBY, which beat earnings and helped pull the entire consumer discretionary sector up. (Of note, the stronger dollar could be an underappreciated tailwind for the consumer, and that's an idea we're in the process of researching.)

On the charts the S&P 500 again held at 1,980 and that was impressive. It seems like 2,000 is "magnetic" for the S&P 500 at this point, as it doesn't want to stray more than 15 points in either direction (2,015-1,985). Those levels remain key.

Bottom Line

At the risk of repeating myself, this market remains totally dominated by positioning—and, as I referenced earlier, stocks rallied yesterday mostly on short-covering. Once 1,980 held, there was a rush to cover (the first "leg" higher in the morning) and in the afternoon, once 1,990 held, there was a second rush to cover that led to the second "leg."

Nothing really positive happened yesterday (although some cited Fed President Evans' uber-dovish comments as helping push stocks higher. But they weren't anything new, as evidenced by the fact that the bond market declined yesterday).

Bottom line is it looks like we're in a 2,015-1,985 range for now, and we'll likely stay there until late next week (ECB meeting Thursday and jobs report Friday).

In the meantime, I remain cautious, despite the market again being very resilient (and I'm still long stocks so I'm happy). JNK traded poorly again yesterday, and is now in danger of breaking down to new lows. If JNK closes below $40.27 I'll go from cautious to nervous, and from nervous to scared if it breaks the spike low of $40.06. Perhaps there's some way we can see a material sell-off in junk bonds that doesn't spill over into equities. But in this environment, I can't see it.

Economics

There were no material economic reports yesterday other than Existing Home Sales (chart at left).

Commodities

Commodities were mostly higher yesterday despite the Dollar Index reaching new highs. The energy sector outperformed amid bullish supply data and bullish technicals while precious metals suffered mild losses thanks to the stronger dollar. The broad-based commodity tracking index ETF, DBC, added +0.47%.

WTI crude oil futures rallied +1.73% yesterday, initially jumping after the EIA reported a drawdown of -4.3M barrels in supply vs. (E) +500K barrel build. RBOB gasoline supplies fell -400K vs. (E) -200K and distillate inventories rose +800K vs. (E) +300K. WTI futures wavered after the initial gains and actually returned to negative territory before the offers dried up and prices surged to highs for the week. But, despite yesterday's impressive gains, futures still have a ways to go before breaking the sharp 3-month downtrend, and until then we will remain sidelined in the market. On the charts, former resistance at $92 will now be looked to for support while the resisting trendline edged down to the $95 area.

Natural gas futures fell into support at $3.80 in premarket trade but, for the 8th time since late August, the level held strong and a rally ensued. Natural gas futures finished the day up +2.25%, closing at $3.90—right in the middle of the 20-cent range that has been in place since prices bottomed in July. And, although support at $3.80 is proving to be solid, resistance at $4.00 has stubbornly held during the same time frame—that is, with the exception of a 3-day "head-fake" earlier this month.

Bottom line, natural gas futures are range-bound, but the technicals are favoring the bulls as there has been a series of "higher highs" and "higher lows" printed on the daily chart. And, with lower than average inventories still in focus, today's EIA report (+89 Bcf) will be closely watched.

Note that the recent trend has seen buying ahead of the number and then sharp selling after the report, but a material "miss" could buck that trend.

Precious metals were the only commodities to fall yesterday; however, the losses were less than you might expect given the new highs in the Dollar Index. Gold fell -0.3% while silver dropped -0.41%. The dominant theme in the market remains the same: As long as the dollar is making new highs, precious metals will have a hard time rallying substantially. That said, there is currently a large short interest in the market: Net long positions held by money managers in gold and silver are both at 3-month lows of 40.2K and 1.7K, respectively. Bottom line, the risk of a short-squeeze in the near term remains; however, such a move should be seen as a selling opportunity.

Copper futures bounced slightly yesterday, rising +0.60% partially thanks to some short-covering as prices have become oversold over the past week. News-wise, there was also chatter that the head of the People's Bank of China was going to be replaced soon, which the market digested as dovish. Looking ahead, we could see some sideways movement in the near term. However, the major trend remains lower and that won't change unless we see some progress in the Chinese economy or new and material stimulus measures unleashed by the incoming PBOC head.

Currencies & Bonds

Currencies markets were mixed Wednesday, but that didn't stop the dollar from staging a big rally. It rose back above 85.00 and hit a 4-year high following the dovish reiteration by Mario Draghi, soft German IFO Business Climate Index results and strong existing home sales report. The Dollar Index rose +0.41%, almost entirely on euro weakness.

Yesterday was a textbook case of "bad is good" in the euro as the IFO missed and Draghi was "dovish," causing a sell-off in the euro and rally in European stocks. Interestingly, Draghi didn't say anything new, but he has spent much of this week reminding the market the ECB will do QE if it's necessary.

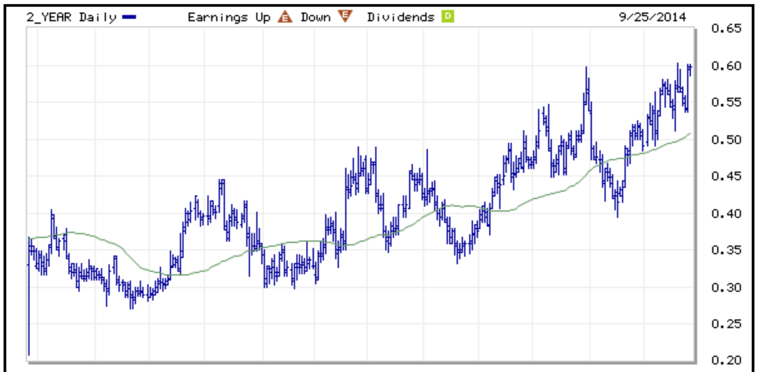
(I know there are various hurdles, but at the end of the day the Germans would rather see QE than the euro zone break up, so they'll kick rocks, but it'll be done if it has to be.)

Market	Level	Change	% Change
Dollar Index	85.15	.371	0.44%
EUR/USD	1.2781	-.0064	-0.50%
GBP/USD	1.6337	-.0049	-0.30%
USD/JPY	109.05	.17	0.16%
USD/CAD	1.1055	-.002	-0.18%
AUD/USD	.8879	.004	0.45%
USD/BRL	2.3831	-.0282	-1.17%
10 Year Yield	2.569	.034	1.34%
30 Year Yield	3.283	.031	0.95%
Prices taken at previous day market close.			

So, with the dollar hitting new highs and the euro hitting new lows, very clearly the trends remain in place, and 1.2750 (a near-2-year low in the euro) now is a critical line of support.

Commodity currencies actually (finally) bounced yesterday. The Aussie rose back above $0.88, rallying +0.47% on a dead-cat bounce, while the Loonie also held support at $0.90 (there weren't any real catalysts; it's just both those currencies needed to bounce and they did).

Shifting back to Europe, the pound also dropped moderately vs. the dollar (down -0.41%) as it's retraced almost all of the "Scottish independence scare" decline. But at the same time, with the market perceiving the Fed as incrementally more "hawkish," there simply isn't any really positive catalyst out there at the moment to sustain a rally in the pound. So, I'd be very surprised if we see materially more upside in the pound from here vs. the dollar (1.66-ish seems a decent cap at this point, maybe for the next few months unless something changes with the U.S. economy).



The 2 year Treasury yield has surged to multi-year highs, implying the market is more nervous about Fed Funds than stocks would imply.

Europe again showed its influence on the Treasury market yesterday, as dovish reiteration by Mario Draghi and a soft German IFO sentiment index (remember, "bad" is "good" in Europe) helped send European bonds lower and, in doing so, arrested the three-day bond market rally. Then, a good new home sales report, strong equity market rally and some quasi-"hawkish" comments by Fed official Loretta Mester helped push bonds lower throughout the remainder of the day. The 30-year finished down +0.4% while the yield on the 10-year closed back above 2.55%.

<u>It's Not Just About Europe and the Long Bond</u>

We focus predominantly on the long end of the curve here because that's where I see the biggest money-making opportunity given the ETFs we have access to. But, watching the entire yield curve is important in gauging the overall trend of bonds.

To that end, I want to point out that the yield on the 2-ear Treasury, which is most sensitive to Fed Funds rate expectations, rose 5 basis points to 0.59% (5 basis points is nearly 10% and the yield on the 2-year is at a multi-year high). This is important because while Europe is a major influence on the long bond, there appears to be something else going on here (European buyers wouldn't buy the 2-year in a "reach for yield").

As I've said, the short end of the curve is much more sensitive to Fed Funds expectations. So, the fact that the 2-year bond has declined/ yields risen to multi-year levels is significant. It implies the bond market is preparing for a more "hawkish" Fed – at least compared to what we're seeing in the equity market. Simply, the 2-year yield wouldn't be at multi-year highs if the market wasn't starting to price in the possibility of sooner than expected Fed Funds "lift off" (the date rates start to rise), or a faster than expected rise in rates. That, on the margin, further validates my idea the trend in bonds is now lower, and that's positive for our various "higher rate" positions.

Have a good day,

Tom

7:00's REPORT

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

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.			

7:00's REPORT

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

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 outlook for commodities remains unattractive.*
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)			