7:00's Report

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

September 8th, 2014

Pre 7:00 Look

- Futures are drifting mildly lower after a quiet weekend as markets further digest the news of late last week (ECB and jobs report).
- The British Pound is the big mover this morning, plunging more than 1% after a poll showed a majority of those surveyed favor a "yes" vote on Scottish independence (the vote is Sept 18th).
- Economic data was Asia centric o/n, and the results were mixed but markets stayed quiet. Chinese August trade balance saw imports miss (-2.4% vs. (E) 2.6%) while Japanese Q2 GDP also slightly missed (-7.1% vs. (E) 7.2%), raising more concern about the impact of the national sales tax (so yen negative).
- Econ Today: No reports today.

Market	Level	Change	% Change
S&P 500 Futures	2002.50	-3.50	-0.17%
U.S. Dollar (DXY)	93.945	.193	0.23%
Gold	1267.30	0.00	0.00%
WTI	92.69	-.61	-0.65%
10 Year	2.461	.013	0.53%

Equities

Market Recap

The S&P 500 closed fractionally higher last week, but that was mostly due to a Friday rally. Despite the gains, U.S. stocks traded heavy last week as they further consolidated recent gains. The S&P 500 rose +0.55% last week and is up +8.62% year-to-date.

Early last week U.S. stocks couldn't rally despite generally good news: ISM manufacturing was a solid beat Tuesday, Wednesday brought news of a potential cease-fire in Ukraine, and auto sales were much better than expected. But, twice last week the S&P 500 rallied to new intraday highs at the 2,010 level, but failed to hold the gains as there was no follow-through.

Thursday saw more of the same—despite the big ECB announcement and very strong ISM non-manufacturing PMI, stocks saw their worst day last week, with the S&P 500 closing down -0.15%, below 2,000.

But, Friday's rally helped save the week and although stocks were mixed on the open following the Friday jobs report, stocks were able to rally methodically in slow trading to get the S&P 500 slightly positive on the week. Again, despite the Friday rally, it wasn't a strong week for stocks (bad economic data won't send stocks materially higher from here, so Friday was a bit of a one-off).

Trading Color

There was massive outperformance by international markets vs. the S&P 500 last week, and that's a trend I think can continue. HEDJ (Europe w/ euro hedged) rose +3.25% last week and DXJ rallied +1.5% to hit a new 52-week high, compared to just +0.55% for the S&P 500.

Looking internally, further confirming that last week wasn't particularly strong for U.S. stocks despite hitting new highs, cyclicals badly lagged. SPHB was flat while SPLV rallied +0.82%, thanks mostly to a big Friday rally in utilities and other "bond proxy" stocks. More broadly, both the Russell 2000 and Nasdaq lagged the SPX.

Looking at the sector trading, one major theme last week was the continued decline in oil prices, which dropped on geopolitics and momentum. Energy was the worst-performing S&P 500 sub-sector; conversely transports saw significant outperformance and IYT (the Dow Transports ETF) hit a new 52-week high.

Banks also outperformed last week (KRE up just under

Market	Level	Change	% Change
Dow	17137.36	67.78	0.40%
TSX	15569.92	-6.87	-0.04%
Brazil	60681.98	-118.04	-0.19%
FTSE	6793.50	-61.60	-0.90%
Nikkei	15705.11	36.43	0.23%
Hang Seng	25190.45	-49.70	-0.20%
ASX	5576.97	-21.72	-0.39%

Prices taken at previous day market close.

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+1%) and continue to be close to materially breaking out to the upside. Interestingly, banks didn't get hit Friday despite the otherwise-"dovish" sector trading, and I take that as a good sign. Valuations, potential of rising rates and a strong loan market continue to make regional banks attractive, in my opinion.

Market	Level	Change	% Change
DBC	24.63	-.04	-0.16%
Gold	1267.30	.80	0.06%
Silver	19.156	.018	0.09%
Copper	3.1695	.0185	0.59%
WTI	93.29	-1.16	-1.23%
Brent	102.07	.12	0.12%
Nat Gas	3.793	-.026	-0.68%
RBOB	2.5834	-.0165	-0.63%
DBA (Grains)	26.43	.05	0.19%
Prices taken at previous day market close.			

Tech lagged last week but mainly because of selling in AAPL ahead of the new product announcement this week, while homebuilders (particularly TOL) also lagged on soft earnings results.

On the charts the S&P 500 made both new intraday and closing highs, so while mildly overbought, the technical outlook for the market remains very healthy.

Bottom Line—Is This As Good As It Gets for the S&P 500?

The outlook for U.S. stocks remains positive, as the "Four Pillars" of the rally remain intact: Global central bank accommodation (this was mildly solidified last week by the ECB and the soft jobs report), a clear macroeconomic horizon (also further solidified by the Ukraine/Russia cease-fire), global economic recovery and reasonable valuations.

But, one characteristic of last week's market that I didn't like is there was no real desire for buyers to push stocks higher. The two failed rallies at 2,010 in the SPX are representative of the sentiment that this may be as good as it gets in the U.S: Economic growth (according to most metrics) is accelerating, but any material improvements will be met with a "hawkish" Fed. Washington is coming back into focus via the mid-term elections (the absence of any tomfoolery from Washington has been an underappreciated tailwind for the market). And from a valuation standpoint, even if the economic data stay "Goldilocks," you're buying an SPX that is trading at 15.4X 2015 earnings—again not prohibitively expensive, but not cheap, either.

Now, to be clear, I'm not saying there's anything wrong with the market and/or to de-risk. But unless we get some additional multiple expansion by an uptick in earnings, I'm not sure what else out there is going to carry stocks higher in the near term. So, I think a consolidation/chop sideways is in order.

Adding to this is the growing attractiveness of Europe (and to a lesser extent Asia). European stocks, while mired in slow growth at the moment, are about to see the implementation of growth-stimulating programs. Meanwhile in Japan and China, both the respective governments and central banks are intent on helping their economies. And, the above regions trade at a significant discount on a valuation basis compared to the U.S.

So, point being, while I wouldn't materially decrease U.S. equity allocations, I would point any new or tactical capital toward some other regions (especially Europe) as there is just a lot more room for improvement over there than there is in the U.S. at this moment.

Economics

Last Week

There was a multitude of important economic releases and central bank meetings last week, making it one of the busiest weeks of the year. But at the end of the day, with the exception of the ECB taking bold steps to stimulate the EU economy, the deluge of data more confirmed the status quo than it did reveal anything new.

Starting with Friday's jobs report, it was obviously a headline miss (+142K vs. +225K). But despite the soft headline, the report by itself isn't changing anyone's outlook on the U.S. economy or the Fed.

First, the average monthly job gains for 2014 (prior to Friday) was 226K per month—so the average is very good so far this year. Second, the unemployment rate ticked down to 6.1% from 6.2% (and the Fed is focused on unemployment). Also, the U-6 unemployment rate, which includes the underemployed, dropped to 12.0% from 12.2%. Third, the annual wage increase rose just +2.1%, well below the +2.25% that would start to make the Fed think about getting "hawkish." Finally, the Au-

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gust reading is the most-revised reading of any of the monthly jobs reports (perhaps because of back-to-school).

So again, while disappointing on the headline, this report by itself isn't going to materially make the Fed more "dovish." It does, however, give the Fed some cover for next week's FOMC meeting to keep the "dovish" tone in the statement and press conference. So, look at this report not as making the Fed apt to be more "dovish" but instead just delaying the time when they have to get more "hawkish" to keep credibility.

Looking at other data in the U.S., it was good. ISM manufacturing and non-manufacturing PMIs for August surged above 59.0 on both readings, hitting respective multi-year highs. Also, weekly jobless claims ticked up slightly but remain at the 300K level, signaling continued (slow) improvement in the labor market.

Bottom line with the U.S. data last week: Jobs report aside, the recovery appears to be continuing to gain steam, and of note last week the strong ISM PMIs weighed very slightly on stocks as they caused a slight uptick in "Fed angst." The takeaway is this: Good economic data aren't bad, but they aren't a pure tailwind for stocks anymore.

Looking globally, composite PMIs were mostly in line with expectations. Starting with Europe, on an absolute level the EU economy is still in recovery (August composite 52.5, manufacturing 50.7—both above 50). However, the pace of that recovery has ground to a halt.

But, there were some silver linings in the data last week from Germany. Although the numbers were somewhat ignored, July manufacturers' orders and industrial production both beat estimates, breaking a long trend of disappointing economic data. Bottom line is even with the ECB enacting more stimulus last week, the EU economy remains the single biggest risk to the global recovery, at this point.

Market	Level	Change	% Change
Dollar Index	83.80	-.034	-0.04%
EUR/USD	1.2951	.0007	0.05%
GBP/USD	1.6327	-.0004	-0.02%
USD/JPY	105.09	-.18	-0.17%
USD/CAD	1.0880	.0005	0.05%
AUD/USD	.9378	.003	0.32%
USD/BRL	2.2418	-.0011	-0.05%
10 Year Yield	2.461	.013	0.53%
30 Year Yield	3.237	.032	1.00%
Prices taken at previous day market close.			

Turning to China, the data there met expectations of a stable pace of growth. Official Chinese manufacturing PMIs stayed above 51 (51.1) and importantly did not confirm the dip in the private Markit reading (down to 50.2). When those two start confirming weakness, that's time to get a touch nervous.

Bottom line with China is all the market cares about is that China doesn't have a "hard landing." The data show that while the economy isn't growing like gangbusters, the chances of a hard landing are slim (so it remains a positive for global risk).

Finally, turning to the ECB, they shocked markets this week by announcing basically a "private market" QE program. I covered the details of the program in Friday's Report if you want to review it, but bottom line is these measures, combined with the looming TLTRO, should put a big tailwind on the EU economy. More broadly, it shows the ECB is indeed committed to fighting off deflation and de-valuing the euro. Given the steps taken last week, their chances of succeeeding in both have increased significantly.

This Week

This week is going to be much more quiet, as there are few economic reports. The highlight in the U.S. is retail sales Friday, and that's important because consumer spending remains one sector of the economy that people remain slightly concerned about.

Internationally the focus will be on China, as that's the only region with materially important data out. We got August trade balance this morning, and the results were mixed (exports beat but imports missed). There are some headline about the miss in imports reviving concerns about the Chinese economy but that's a bit of a stretch—these numbers won't change any opinions. Wednesday night we get August CPI/PPI, which is always important because the market expects Chinese authorities to continue targeted stimulus to support the Chinese economy—but if inflation runs hot, that puts this stimulus at risk. But, at this point inflation isn't really a concern in China. We

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also get Industrial Production and Retail Sales Sunday (which is technically next week, but not in the *7:00's Report* time).

Bottom line is there are releases at the margin this week, but unless there's a big shock from China, nothing is going to change anyone's outlook for the global economy or central bank policy.

Commodities

Most commodity futures declined last week as the dollar continued rally against all of its major peers. Easing geopolitics and the lackluster economic reports from later in the week (namely the jobs number) weighed on the energy sector but caused some short-covering in precious metals. The benchmark ETF, DBC, fell -1.5%.

Crude oil futures fell -2.5% last week but prices remain largely range-bound between $93 and $96. WTI came for sale on Tuesday as traders unwound geopolitical fear bids on news that Ukraine and Russia had made progress toward a cease-fire agreement. Intra-week, strong data helped futures rally back toward resistance before the disappointing jobs report Friday caused an equal and opposite reaction, sending futures down to close near the lows for the week. But, importantly the technical picture continues to favor the bulls over the near term as support has formed toward $93. Going forward, economic data will remain in focus as traders speculate domestic demand estimates. The line in the sand for the bulls is still the multi-month low of $92.50 while a close above $96 would be a bullish move technically.

Natural gas futures also sold off early in the week thanks to the geopolitical progress between Ukraine and Russia and then took another leg down as the EIA reported a larger than estimated build in stockpiles. Nat gas futures fell -6.7% on the week. Going forward, supply will remain in focus and we remain bullish because weekly supply injections are not on pace to restore supplies to the levels necessary for entering the draw season in late October. On the charts, support is trying to form at $3.80 while $4.00 remains the initial target for the bulls.

Gold was trading off of economic data last week, selling off on the reports that were "too hot" early in the week but bouncing back later in the week on the weaker than expected employment reports. Gold traders continue to be primarily concerned with when, and how fast, the Fed will raise interest rates. After all, data that have been "too good" have been causing hawkish reactions from the market. And, as we have been saying for a while now, near term that is bearish for gold. However, longer term, rising inflation should cause gold prices to rally. Technical levels to watch are initial support at $1,260 and trend resistance toward $1,275.

Currencies & Bonds

Although the euro dropping -1.5% Thursday following the ECB announcement was the most-volatile thing to happen in the currency and bond markets last week, the most important thing was that the 30-year Treasury closed twice below the 2014 uptrend ... and that it was unable to rally Friday despite an ostensibly "dovish" jobs report (the 30-year finished down +0.14% Friday).

Additionally, the yield on the 10-year Treasury also closed higher Friday, and if it can break through 2.5% this week, we could see an acceleration higher.

I believe this 2014 uptrend in bonds is likely broken, thanks to the ECB moves last week appearing to break the manic buying in German bunds and European debt. However, we'll want to see more confirmation this week before going in too heavy on the short bond trade (we cautiously bought TBT last Thursday).

In the currency markets, the euro collapsed -1.5% Thursday post-ECB to trade to a 14-month low, while the Dollar Index surged to a 14-month high. Clearly a goal of the ECB is to weaken the euro. Although we'll see a short-term bounce of some sort, I imagine we'll see a test of 1.28 before too long (and it likely won't hold).

Lost amid the collapsing euro last week was the yen trading to a new 52-week low vs. the dollar. Although the BOJ meeting last week was a non-event, Governor Kuroda's comments seemed to almost welcome a weaker yen. Bottom line, although both oversold, trends in both currencies are solidly lower. This should continue to help support equities in those respective regions.

Have a good 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
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 a trading range, the yen has broken down to new lows as expectations for pension reforms (Japanese pension funds allocating 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 bonds 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 9.8.14)

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).

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

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