7:00's Report

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

October 10th, 2014

Pre 7:00 Look

- The selling continued overnight as there was widespread global weakness in shares (most everyone down 1%) while futures here are modestly lower, but off the lows.
- News wise it was a quiet night. Economically, French and Italian IP actually both beat estimates, but frankly no one cares this morning.
- Econ Today: No economic reports today.
- Fed Speak: Plosser (9:00 AM), George (1:00 PM), Fisher (1:30 PM), Lacker (3:00 PM)

Market	Level	Change	% Change
S&P 500 Futures	1914.50	-10.50	-0.55%
U.S. Dollar (DXY)	85.82	.165	0.19%
Gold	1222.00	-3.30	-0.27%
WTI	84.54	-1.23	-1.43%
10 Year	2.327	-.003	-0.13%

Equities

Market Recap

The roller coaster continued Thursday as stocks dropped sharply, erasing virtually all of Wednesday's gains on greater general growth concerns and technical trading. The S&P 500 declined -1.96%.

Futures were higher initially Thursday thanks to carry-over from a dovish Fed and a strong AA earnings report. But sellers appeared early and despite generally decent news (the 4-week moving average for jobless claims hit a new 8-year low), stocks opened modestly lower as markets digested Wednesday's rally.

The move lower gradually gathered steam throughout the morning, as the S&P 500 broke back below the 100-day moving average at 1,960 (violating it for a third time). Interestingly, unlike previous sell-offs, stocks held up into the European close. But shortly after 11:30, futures came under heavy selling pressing. In less than an hour the S&P 500 was down an additional 20 points, sitting just above 1,930.

There wasn't any particular catalyst for the declines, but they did seem to accelerate as ECB President Mario Draghi was making comments (more on those later) and, if anything, that was the "reason." After Draghi and jobless claims, news-wise Thursday afternoon was quiet. There were numerous Fed presidents speaking throughout the afternoon, but nothing they said moved markets (most of the afternoon speakers were second-tier Fed officials).

Stocks hit their (basically) lows for the day by 1:30 and spent the rest of the afternoon drifting on either side of 1,930. Several attempts were made to mount a rally throughout the afternoon, but none gathered any steam and stocks closed not far off the lows.

Trading Color

Once again there's not much to say with regard to market internals given the "risk on/risk off" nature of the market the last few days. The Russell 2000, as you'd expect, badly underperformed, falling -2.5% to notch a new 2-month closing low (although not an intraday low, which still sits at 1,065). The Nasdaq, surprisingly, outperformed slightly yesterday, but that was almost entirely due to the AAPL outperformance thanks to the Carl Icahn investor letter roadshow that occurred across CNBC yesterday.

Market	Level	Change	% Change
Dow	16,659.25	-334.97	-1.97%
TSX	14,460.60	-205.87	-1.40%
Brazil	57,267.53	209.05	0.37%
FTSE	6,341.57	-90.28	-1.40%
Nikkei	15,300.55	-178.38	-1.15%
Hang Seng	23,088.54	-445.99	-1.90%
ASX	5,188.25	-108.43	-2.05%
Prices taken at previous day market close.			

All 10 of the S&P 500 sub-sectors were down, and with the exception of consumer staples, they were down big. Energy, though, took the cake as XLE collapsed -3.6% on the new lows in crude. Meanwhile basic materials, consumer discretionary and industrials also were down just about -2%. Not even utilities or tech were spared, as each fell -1.5%. So, there was nowhere to hide yesterday, as you'd expect.

Market	Level	Change	% Change
DBC	22.67	-.27	-1.18%
Gold	1224.30	18.30	1.52%
Silver	17.345	.281	1.65%
Copper	3.0335	.03	1.00%
WTI	85.24	-2.07	-2.37%
Brent	89.54	-1.84	-2.01%
Nat Gas	3.868	.013	0.34%
RBOB	2.2567	-.0617	-2.66%
DBA (Grains)	26.47	.07	0.27%
Prices taken at previous day market close.			

Looking at the charts, the bullish outside reversal we saw in the market Wednesday remained intact despite the sell-off yesterday but, based on where futures are looking as of this writing, that support at 1925 is going to be violated, invalidating the signal. So, the technical picture on this market remains ugly and implies we're haven't found a bottom yet.

What Happened to JNK?

Perhaps the most unnerving thing I saw yesterday was the big drop in JNK and rally in EUM. Given what the Fed did Wednesday, that is the exact opposite of what should have happened. And, this tells me yesterday's sell-off was a lot more about escalating concerns about Europe and growth than dis-inflation.

JNK didn't violate the lows of last week, but it completely failed to break that downtrend I pointed out yesterday. That's concerning, because if we get money streaming out of even risky credit and debt instruments like junk and emerging-market bonds, then this sell-off has the potential to get a lot worse. Again, it's not time to sound an alarm yet, but yesterday was the first equity sell-off of the last two weeks that was accompanied by a drop in higher yielding bonds. If we see JNK down materially again today, I will be concerned this is going from a typical equity pullback to something more broad.

Bottom Line

The S&P 500 is now 4.5% from the mid-September highs but (for now) is still more than 1% higher than the early August lows. And, sentiment surrounding this tape is absolutely horrible (everyone seems to be resigned to at least testing the 200-day at 1,904, if not the mid-1,800s before they want to buy this dip).

A lack of volume and aggressive positioning by day traders and algo is making this market a lot more volatile than the fundamentals warrant, but there are several "grey areas" as I called them yesterday that continue to weigh on sentiment (it's the same list as yesterday ,just framed differently):

1. Lagging European growth and lack of confidence in ECB/policy-makers (i.e., is Europe failing?).
2. The thought of no QE and confusion about the Fed as the FOMC minutes were surprisingly dovish but multiple Fed speakers yesterday said rate hikes in mid-'15 seems right. The Fed message is muddled, and in the context of QE ending, it's making things worse.
3. Plunging oil prices (and by association, worries about global economic growth and dis-inflation here in the U.S.).

Again none of these issues in their current state are bearish, but combined with a current news vacuum (no important economic reports) isn't helping — **we need good earnings or good data to re-direct the market and remind everyone things aren't so bad. Good earnings next week are now critically important.** And, until we get some more clarity on those three issues or something good to distract the market, we can anticipate continued volatility. The Fed confusion and fear of the end of QE aside, **this sell-off is about global growth and Europe (if it were really worries about the Fed, then Treasuries wouldn't be at highs for the year). So, to keep things simply, when oil and HEDJ or VGK (Europe ETFs) stabilize, broader market volatility will subside.**

Economics

Central Banker Comments

A litany of central bankers spoke yesterday, but nothing really new was revealed. Fed members Bullard, Lacker, Vice Chairman Fischer, Tarullo, and Williams all made comments on various topics, but no one really rocked the boat, although there was some mild reiteration that "mid 2015" seemed like an appropriate time for rate hikes, given the current environment.

ECB President Mario Draghi also spoke, and he mostly reiterated what he said last week, namely that the measures employed by the ECB will begin to have an effect, and that the ECB Governing Council is unanimous about being ready to employ more unconventional measures (read: QE) if inflation doesn't start to rise.

But, the problem is that most people don't believe him, seeing as there were three dissents over the most recent ABS purchase guidelines at the latest ECB meeting. So, again, it's a confidence issue with regard to the ECB's will.

Additionally, if I had to pinpoint one specific catalyst for yesterday's sell-off (and this didn't cause it, but it wasn't a good comment), it was the Draghi comments not about monetary policy, but instead about euro-area nations' fiscal policies.

First, Draghi said that there can be no recovery in Europe without fiscal reform. As we know, getting the various European nations to do anything in concert is a Herculean task.

Second, Draghi said that those countries with room to fiscally stimulate their economy (he means Germany) need to do it.

So, underlying all this is an escalation of a tiff between Germany and the ECB, and the underlying fear is things will have to get worse economically before rich countries like Germany spend to stimulate growth, and Southern European countries are allowed some fiscal freedom from the rest of Europe. So, it may get worse before it gets better.

Bottom line, while nothing incrementally bad happened, it wasn't a good day for confidence in Europe, and the market needs confidence right now.

Market	Level	Change	% Change
Dollar Index	85.655	.248	0.29%
EUR/USD	1.2687	-.0046	-0.36%
GBP/USD	1.6117	-.005	-0.31%
USD/JPY	107.89	-.19	-0.18%
USD/CAD	1.1169	.0064	0.58%
AUD/USD	.8778	-.0062	-0.70%
USD/BRL	2.3942	.0177	0.74%
10 Year Yield	2.327	-.003	-0.13%
30 Year Yield	3.062	.000	0.00%

Prices taken at previous day market close.

Commodities

Both gold and crude oil futures were in focus in the commodity space yesterday as growing concerns over the health of the global economy weighed heavily on risk assets. As you might expect, energy was lower while metals (namely precious) outperformed, closing the day well in the green. The benchmark commodity ETF, DBC, fell another -1.22% on the session.

Gold futures rallied most of the day yesterday as the fear bids flowed in while stocks and most other risk assets sold off sharply. Gold did drift away from the morning highs as the day went on; however it was still able to impressively close up +1.60% despite the dollar reversing morning losses to finish the day higher by +0.27%. Bottom line is that investors are looking to gold here as a safe haven and that will likely continue as both the market turmoil and global growth fears continue. On the charts we are looking for initial support at $1,220 while some more substantial resistance hovers above at the $1,240 level.

Energy was the worst-performing sector yesterday thanks to the market's focus on growth concerns. Both the futures of our domestic benchmark, WTI crude oil, and the European benchmark, Brent crude, fell to the lowest levels since 2012 yesterday, down -2.35% and -1.88% respectively. Nothing materially changed yesterday and traders will continue to watch crude oil, waiting for some support to form while looking for direction in other risk assets. As long as oil prices are falling, it will be very difficult for stocks to rally. On the charts, there is support between $84 and $85 while $88 marks initial resistance.

Elsewhere in energy, natural gas futures finished nearly flat after a volatile session. Futures sold off ahead of the EIA inventory report, but a "miss" of expectations in the release (+105 Bcf vs. E: +108 Bcf) helped futures rally 15 cents (mostly on speculative short-covering). But, the rally ran out of steam, reversed, and futures ended the day right near support in the lower end of the current trading range at between \$3.80 and \$4.10. We are currently at a "tipping point" in the natural gas market and if futures close materially below support at \$3.87, we could see long liquidation move this market down upward of 50 cents. The levels to watch are initial support at \$3.87 and the summer lows of \$3.72. If support holds, we will remain range-bound.

Currencies & Bonds

It was a pretty standard "risk off" day in the currency markets yesterday as the dollar was higher against every currency vs. the yen (both the dollar and yen are the "risk off" currencies. The Dollar Index finished they day up +0.3%.

Thursday started out as a pretty quiet day in the currency space, as the Dollar Index was flat, the euro was down small on the soft German export data (it wasn't as bad as feared) and the yen was higher on some generally positive comments from BOJ Governor Kuroda.

From a fundamental news standpoint, the Aussie was mildly higher on an Australian jobs report (which was actually worse than expectations, but there has been so much statistical noise in their data, most people ignored it). The pound was little-changed after a Bank of England meeting went as expected (the BOE literally just released a few sentences about the decision, so we'll have to wait a few weeks for the minutes to find out if the number of dissenters has increased from the previous meeting's two).

But, it was the stock market, not economic fundamentals, that were in charge yesterday. As the stock sell-off got worse, currency markets moved to a traditional "risk off" setup, as the Aussie and Loonie both fell the most (down -0.6% each) while the euro and pound were both off -0.3%.

So, for the first time in a while it was the equity markets driving currencies, but that's generally what happens when the Dow goes down 300 points in a day.

Unless this stock sell-off accelerates materially, though, I think we will see a resumption of a correction in the U.S. dollar and a bounce-back from virtually all other currencies, as the Dollar Index remains very overbought, even after this recent correction.

Bonds, surprisingly, did not rally yesterday, as the 30-year was down -0.02% while the 10-year was flat on the day. And, that's a bit odd considering the declines in stocks, although we have to consider the huge rally we've seen in bonds over the past week (so a move like this is largely priced in).

Helping put a lid on bonds were multiple Fed speakers again implying that "mid-2015" remained an appropriate time for the first rate hike.

Also weighing on bonds was a second-straight subpar auction, as there was lackluster demand for the 30-year Treasuries. The bid to cover was 2.40, tied for the lowest in three months, while the actual yield matched the "when issued." But, again, like the 10-year Wednesday, this lack of demand implies that bond investors are "rate sensitive," as this was the lowest auction yield of the year, so fundamental buyers are definitely less interested in yields this low on longer-dated paper (which goes to my point about being a structural bond bear, not that it means anything at the moment or makes my account look any better).

Bonds are basically at the highs for the year, and with the market trading so poorly, it is likely only a matter of time until the highs at 141'21 are taken out, as fear of volatility and deflation again trump fundamentals.

Have a good weekend

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 10.6.14)

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 looks to have completed another typical 4%-5% pull back last week, as stocks temporarily violated the 100-day moving average before recovering late in the week. Going forward global economic growth is becoming a greater risk to equity prices, but as of now the benefit of the doubt remains with the bulls.*

Best Idea: Buy Regional Banks (KRE).

Best Contrarian Idea: Buy Consumers Stocks (XLY)

	Near Term Trend	Long Term Trend	Market Intelligence
Commodities	**Bearish**	**Bullish**	*Commodities again tried to stabilize last week, but the surge in the dollar Friday weighed on the space as both gold and oil traded to new lows last week. The outlook remains dim near term: Slowing global growth and a surging US Dollar is not a good recipe for commodities.*

Best Idea: Buy Natural Gas (UNG)

Best Contrarian Idea: Buy Grains (DBA)

	Near Term Trend	Long Term Trend	Market Intelligence
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index surged to another 4 year high last week thanks to a massive Friday rally off the strong jobs report. The divergence in economic growth and policy between the US and Europe/Japan/China continues to grow, and that will continue to support the dollar.*

Best Idea: Sell the Yen (YCS)

Best Contrarian Idea: Long Canadian Dollar (FXC)

	Near Term Trend	Long Term Trend	Market Intelligence
Treasuries	**Neutral**	**Bearish**	*The Treasury bounce accelerated last week, as a "risk off" move Wednesday caused a big short covering rally, a "disappointing ECB" sent European money back into Treasuries, while the sluggish wage number in the jobs report kept Fed policy expectations anchored. The bond market is threatening a new uptrend, but for now remains neutral.*

Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)