7:00's Report

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

October 14th, 2014

The S&P 500 closed below the 200 day moving average for the first time since November 2012. We are oversold and due for a short term bounce, but beyond that the technicals are ugly.

Pre 7:00 Look

- Futures are cautiously higher again this morning despite broad international weakness as focus turns to earnings.
- It was another bad night of economic data in Europe. The German ZEW Business Sentiment Survey expectation component went negative to –3.6 vs. (E) 0.8. It's the first negative print since November 2012. Also in the EU, August IP fell –1.8% vs. (E) -1.7%.
- On the inflation front, both Italian and French CPI fell more than expected, dropping –0.4% each vs. (E) -0.3%.
- Econ Today: No economic reports today.
- Earnings: C (E: 1.12), JNJ (E: 1.42), WFC (E: 1.02), INTC (E: 0.65).

Market	Level	Change	% Change
S&P 500 Futures	1871.25	5.75	0.31%
U.S. Dollar (DXY)	85.90	.173	0.20%
Gold	1233.30	3.30	0.27%
WTI	84.87	-.86	-1.00%
10 Year	2.286	-.021	-0.91%

Equities

Market Recap

Stocks sank again as the S&P 500 went out on the lows for the third-straight day, despite the absence of any incrementally bad news yesterday. The S&P 500 gave up -1.65%.

Stocks started out OK Monday, as there was a bit of a relief rally following stronger than expected Chinese trade balance data (both exports and imports).

But, the rally was weak from the outset and at 10 a.m., the major indices had rolled over. Both the 200-day moving average at 1,904 and 1,900 were violated. But, like the early rally, there wasn't much conviction to the selling and markets stabilized around 1,900.

News-wise it was a very quiet day, and stocks reflected that by spending the majority of the late morning/early afternoon around flat (the S&P 500 was on either side of 1,900 for several hours midday). But then an erroneous headline about Ebola in Logan Airport saw the selling accelerate (although I think honestly the market would have sold off even without that headline).

When the early morning low at 1,890 was violated, things accelerated to the downside and the market went into a nosedive during the last 20 minutes of trading. It closed on the low ticks for the third-straight day and through all major levels of support (the 200-day and 1,900). It was another very ugly close.

Trading Color

I suppose there was a bit of a silver lining in the market yesterday as the Russell 2000 spent most of the day pos-

Market	Level	Change	% Change
Dow	16321.07	-223.03	-1.35%
TSX	14227.36	-233.24	-1.61%
Brazil	57958.53	2644.94	4.78%
FTSE	6319.31	-46.93	-0.74%
Nikkei	14936.51	-364.04	-2.38%
Hang Seng	23047.97	-95.41	-0.41%
ASX	5207.43	51.93	1.01%
Prices taken at previous day market close.			

itive and relatively outperformed (down just -0.38%), but things were still pretty ugly.

Market	Level	Change	% Change
DBC	22.61	.02	0.11%
Gold	1233.40	11.70	0.96%
Silver	17.42	.117	0.68%
Copper	3.0475	.0125	0.41%
WTI	85.23	-.59	-0.69%
Brent	88.22	-1.99	-2.21%
Nat Gas	3.915	.056	1.45%
RBOB	2.2447	-.0128	-0.57%
DBA (Grains)	26.45	.01	0.04%
Prices taken at previous day market close.			

Sector-wise it was again as you'd expect: Energy was the worst performer, down -3% (!) while basic materials couldn't catch a bid off the good Chinese trade numbers and finished down -2%.

On top of that, consumer discretionary, healthcare (hospitals got hit on Ebola), industrials and tech were all down more than -1%.

Utilities (as expected) benefited from a defensive bid and were fractionally lower, while banks relatively outperformed (KRE was up on the day) ahead of the start of earnings this morning).

Finally semiconductors, which I said yesterday were a sector worth watching closely, fell another -2%. That's another disconcerting sign for the broader market (I would have liked to see some sort of a bounce or value buying yesterday, but it wasn't there).

On the charts, it's downright ugly. Support at the 200-day has been violated for the first time since November 2012 ... both the Dow Transports and Industrials are making lower lows (Dow Theory) … and 1,850, basically because it's a round number, is now the next major source of support.

Bottom Line

Yesterday's selling during the final hour was more panicked and anxious than we saw last week (which short term can be a good thing, as it gets us closer to short-term capitulation), but we're not out of the woods yet.

Fundamentally things didn't change yesterday, although we did get some good news from the Chinese trade balance numbers. Regarding those, the China bears derided them as "rigged" due to inventory overbooking in Hong Kong, but the bottom line is it was a decent report. (All Chinese data have to be taken with a grain of salt and yesterday was nothing different.)

Focus now turns to earnings, and we need a good start to the earnings season to calm this market down. JPM earning were leaked early and they were a slight miss, although there are multiple other important reports out.

As far as today goes, it looks like we're going to see a modestly higher open, which isn't what we need to put in a bottom. Odd as it sounds, it would have been better to see the futures sharply lower this morning, get some capitulation selling immediately following the open, then try and form a bottom. I would be surprised, albeit pleasantly, if this market doesn't turn negative within the first 90 minutes of trading.

Economics

No reports yesterday.

Commodities

Commodities finished the session strong yesterday with most components of the space closing well off the lows of the day. Crude oil and the refined products, however, failed to rally back to flat and finished the day slightly lower. The broad-based commodity tracking index ETF, DBC, added +0.20%.

WTI crude oil opened the Nymex session deep in the red yesterday, down over -2%, but futures held Friday's lows and steadily traded higher throughout the day to finish down -0.70%. Brent however sold off -1.65% (note Brent is in the process of rolling from the November to the December contract, which can heavily affect price movement).

On the charts, WTI is in a sideways consolidation pattern as the market digests the most recent move lower. Initial resistance is above at $87 while support lies below at $84 even. Crude oil prices will continue to be in focus as the market digests the recent increase in concerns over global growth. And, as I said last week, until we see crude oil prices bottom, it is unlikely the stock market will be able to materially rally.

Continuing on that point, what is important to figure out is whether or not this colossal 20%+ sell-off in crude oil prices has been more of a result of rising global supply and production levels, or a genuine drop-off in demand.

Natural gas was among the best performers yesterday as futures rallied +1.5% and closed above former support at $3.90. Natural gas prices, however, remain largely range-bound between $3.80 and $4.10, with futures recently favoring the lower end of that range.

The fundamentals of the natural gas market have somewhat balanced out in recent weeks, as stockpiles are only 10.5% below the 5-year average now. And although that may initially be interpreted as bullish (lower supply), if you pair that data with the majority of weather forecasts that are predicting a more-moderate winter this year, it makes sense that nat gas is trading steadily in a range here.

GLD: Gold has been one of the few places to hide since this sell off started, and while the backdrop isn't totally bullish beyond the short term, there's still room to rally further.

Going forward. it will be important that weekly builds remain above 100 Bcf, as a drop below that threshold will likely be taken as bullish. At the same time, if they remain high and temperatures remain mild, natural gas futures could materially decline. Bottom line, we are in "wait and see" mode with regard to natural gas.

Gold rallied +0.87% yesterday to close at a one-month high largely thanks to continued dollar weakness (the dollar fell -0.45% yesterday). Overnight, gold futures approached resistance at $1,240 but buyers became exhausted and futures failed to hold the gains.

Looking at the near term, gold has broken through some (down) trend resistance and has some room to move higher. The next level of material resistance lies at the June lows around $1,240 (remember, previous support zones generally become resistance once violated).

The direction of gold prices continues to be largely dependent on the dollar, and if we continue to see weakness in the dollar as longs are liquidated, gold could approach the $1,275 area in coming weeks. However, as I have said before: Because of the bullish fundamentals of the dollar, such a rally in gold would be relatively short-lived and seen as a good opportunity to initiate shorts in gold.

Also, gold is clearly trading with a pretty strong reverse correlation to the stock market as investors look to hedge this recent "free fall" in equities. So, as long as the weakness in stocks continues, so too will the strength in gold.

Currencies & Bonds

The dollar fell against all of its major peers to start the week yesterday as the "pullback" in the greenback continued. The Dollar Index fell -0.45% on the day.

The Dollar Index correction continued Monday, as the Dollar Index declined -0.52% and every major currency traded higher, led by the Aussie and yen (up +0.7% and +0.6%, respectively).

Despite the big moves, it was a very quiet day from a news standpoint, and really it was selling of the dollar that was the driving factor. The dollar was about -0.5% lower from the outset of trading yesterday, and it barely budged the entire day, as most of the damage was done during the European session early Monday morning.

News-wise Fed Chair Evans was on the tape yesterday saying he didn't think interest rates would rise until early 2016, but he's a well-known uber-dove and the dollar didn't really move off the comments. Really we're just seeing a continued unwind of a very crowded "long dollar."

Market	Level	Change	% Change
Dollar Index	85.575	-.456	-0.53%
EUR/USD	1.2689	.0062	0.49%
GBP/USD	1.607	-.0005	-0.03%
USD/JPY	107.12	-.53	-0.49%
USD/CAD	1.1196	-.0002	-0.02%
AUD/USD	.8769	.0088	1.01%
USD/BRL	2.3907	-.038	-1.56%
10 Year Yield	2.286	-.021	-0.91%
30 Year Yield	3.014	-.021	-0.69%

Prices taken at previous day market close.

The surprisingly dovish FOMC minutes were the catalyst for the reversal, and with concerns about Europe and global growth still high, we're seeing the dollar longs booking profits. The collapsing market is providing some support to the

Dollar Index here (it would be much lower if that weren't the case) and 85.43 (the 20-day moving average) is near-term support. But, I would be surprised if that level holds, barring a continued nasty decline in stocks, as it's likely this correction in the Dollar Index has further to go.

Looking at the other currencies, the euro rallied almost exclusively on dollar strength (although we did get our seemingly daily dose of European official bickering). ECB member Peter Praet (a Belgian) was on the tape describing deflation as a threat to the economy, while German Bundesbank President Jens Weidmann made comments that the EU needs to punish countries who don't stick to fiscal targets. (He said France should be punished if its 2015 budget doesn't meet standards.) So, par for the course in Europe.

The yen continued its rebound, rallying +0.7% vs. the dollar in general "risk off" trade (the yen surged late yesterday afternoon as the stock market declines intensified). Like the "long dollar," the "short yen" trade got very overextended and overcrowded, and we're seeing that unwind now – and I imagine it has quite a bit more to go. A dollar/yen back into the high 105 range would not surprise me before a bottom is in.

Finally, commodity currencies also caught a rebound yesterday on dollar weakness and the positive Chinese manufacturing data. Given the number of shorts in the Aussie, I expect that rebound can continue in the short term. Although, if global growth is indeed slowing, then the Aussie is in for a big, big decline (selling the Aussie is one of the better hedges for a global slowdown, but you need to do it with leverage given the volatility differences). This rally is almost certainly one to short.

The Aussie dollar was the best performer against our dollar yesterday, rallying +0.63% thanks to increased investor demand for Australian government debt. Yesterday, Australia's equivalent of our 10-year note saw yields fall to a 16-month low due to the rising demand.

The bond markets were closed yesterday but that did not stop the futures from rallying. The 30-year rose +0.55% while the 10-year note added +0.52%, with the majority of those gains coming during the afternoon session as the stock market sold off. Treasuries continue to benefit from European inflows and a "fear" bid, and are at new highs for the year.

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	59.35 24.67 16.44 41.34	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.*
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 (10/13/14): The yen hit our target of 110 vs. the dollar and DXJ traded basically to its all time highs in early October, but now we are seeing a much needed correction. Longer term, I remain a bull on Japan/bear on the yen, but this trend will likely pause for some time, and I'd book any profits in those positions for accounts that don't have a very long time frame (and can stomach a correction).			
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 (10/13/14): Treasuries are once again at new highs for the year, as a floundering European economy and worries about a stock market correction trump better economics here in the US. The fundamentals for this trade remain decidedly negative, but once again money flows have trumped fundamentals in the near term.			

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 10.13.14)

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 had its worst week in years last week as concerns about global growth, dis-inflation and the end of QE pushed stocks below key support levels. The markets re-silency can't be discounted, but stocks are acting "different" than previous corrections, and we advise caution in shorter term, more tactical accounts.*

Best Idea: Buy Regional Banks (KRE).

Best Contrarian Idea: Buy Consumers Stocks (XLY)

Commodities	**Bearish**	**Bullish**	*Oil continued to drag commodities lower last week. Global growth concerns continued to weigh on the space, although with the dollar declining we are seeing some dichotomy: grains and gold are trading better, but energy remains a major concern.*

Best Idea: Buy Natural Gas (UNG)

Best Contrarian Idea: Buy Grains (DBA)

U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index traded lower for the first time in 13 weeks, as a dovish FOMC minutes broke the dollar rally fever. The Dollar needs to correct, and although it'll be supported somewhat if the stock sell off continues, I believe we're seeing the start of a needed correction in the US Dollar.*

Best Idea: Sell the Yen (YCS)

Best Contrarian Idea: Long Canadian Dollar (FXC)

Treasuries	**Neutral**	**Bearish**	*The Treasury bounce accelerated last week and the 30 year traded to a new 52 week high, as worries about global growth (especially in Europe) sent money pouring into Treasuries, as money flows again trump deteriorating economic fundamentals.*

Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)