7:00's Report

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

October 17th, 2014

Pre 7:00 Look

- Futures are bouncing over 1% this morning as global markets try to stabilize. Asia was mixed but Europe is broadly higher.
- There was no economic data out o/n and news wise it was very quiet. Stocks are higher just on an oversold bounce that started in the US yesterday.
- Positively, though, ECB member Benoit Coeure stated ECB bond purchases will begin within "days," and while not a panacea, at least it's some good news that will help sentiment.
- Econ Today: Housing Starts (E: 1.01M). **Yellen (8:35 AM)**
- Earnings: MS (E: 0.54), HON (E: 1.41).

Market	Level	Change	% Change
S&P 500 Futures	1874.25	23.75	1.28%
U.S. Dollar (DXY)	84.99	-.051	-0.06%
Gold	1237.70	-3.50	-0.28%
WTI	83.36	1.41	1.73%
10 Year	2.153	.063	3.01%

Equities

It was another volatile session but stocks recovered from early losses, thanks to dovish comments from Fed officials, and managed to close fractionally higher. The S&P 500 rose +0.27%.

Things started out ugly again yesterday. A spike higher in Greek 10-year bond yields and a poorly received Spanish debt auction sent Europe down sharply again early Thursday, and that dragged U.S. futures down with it.

But unlike Wednesday, there wasn't any real panic at the open. Futures began to drift mildly higher after jobless claims moved to a 14-year low, and after September Industrial Production and the October Philly Fed report slightly beat expectations.

But, comments by Fed President Bullard provided the major positive catalyst on the day. He said in an interview that the Fed should consider pausing the tapering of QE, given the weakness we're seeing in the global economy.

That helped shares rebound and by 11:30, the S&P 500 turned mildly positive. It spent pretty much the rest of the day trading around the unchanged level.

News-wise, things quieted during the afternoon, as focus was on CDC Director Tom Frieden's testimony before Congress regarding Ebola (nothing material there) and general hypothesizing about the Fed's next moves.

Stocks, for the first time in over a week, drifted quietly during the final hour of trading to finish basically unchanged.

Bottom Line

There were more signs of tentative stabilization yesterday. The most beaten-up sectors continued to rebound, as the Russell 2000 handily outperformed again. It rallied +1.3%, while energy and semiconductors (the SOX) also were both up well over +1%.

Meanwhile, for the second straight day, defensive sectors lagged. Utilities were flat and consumer staples were down -0.75% on the day.

So, we are seeing some internal suggestion that this market is due for a bounce of some kind, and that makes sense. And, yesterday's chop makes this much more likely than if the market had staged some sort of knee-jerk rally.

And, not to look a gift horse in the mouth, but futures

Market	Level	Change	% Change
Dow	16,117.24	-24.50	-0.15%
TSX	14,052.97	183.09	1.32%
Brazil	54298.33	-1,836.94	-3.27%
FTSE	6,256.37	60.46	0.98%
Nikkei	14,532.51	-205.87	-1.40%
Hang Seng	23,023.21	122.27	0.53%
ASX	5271.72	16.83	0.32%
Prices taken at previous day market close.			

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are up 25 as of this writing, and I'd much prefer to see some more consolidation today than some "melt up" short covering rally, but again I guess we'll take what we can get.

Market	Level	Change	% Change
DBC	22.22	.25	1.14%
Gold	1240.30	-4.50	-0.36%
Silver	17.43	-.034	-0.19%
Copper	2.9785	-.0305	-1.01%
WTI	82.88	1.10	1.35%
Brent	85.94	1.82	2.16%
Nat Gas	3.80	.00	0.00%
RBOB	2.2102	.0615	2.86%
DBA (Grains)	26.40	.12	0.46%
Prices taken at previous day market close.			

Our two key indicators, oil and EWG, had mixed results yesterday and overnight. Oil traded better and appeared to trace out a bullish "outside reversal" on its chart, but EWG remained under heavy pressure. And this market decline, at its core, remains Europe-driven. So, I would expect a bit more of a bounce, but until oil and Europe act materially better, I remain broadly cautious.

Europe is getting a bounce today in sympathy with yesterday's US rally, but importantly it was just announced the ECB will begin its bond purchases within "days" according to ECB member Benoit Coeure. So, we'll be watching to see how the euro zone trades on that news today and early next week.

Economics

In a total reversal from yesterday, all three major economic reports yesterday beat expectations, with jobless claims dropping to a 14-year low! Industrial production and Philly Fed weren't blowout numbers, by any means, but they did serve to help at least temporarily break this negative cycle of bad news, and the reports helped markets to steady yesterday.

Industrial Production

- September Industrial Production rose 1.0% vs. (E) 0.4%

Takeaway

This was a better report than expected, although not quite as good as the headline would imply. The manufacturing component of the report (which is really what we want to look at) rose +0.5% in September vs. (E) of +0.4%, but the August number was revised down -0.1% to -5%, so really we're looking at an in-line number. The reason the headline IP report was so strong was because of a jump in utility production due to increased cooling demand, but obviously that's not exactly a positive for the economy.

Also, capacity utilization was higher than expected, and although I don't really focus on this, it's worth noting because capacity utilization is a leading indicator of inflation. The reading is still below 80, which is where you would expect to see inflation start to increase. But it did have a nice uptick to 79.3% from August's 78.8, and that's notable because it's at least one number that refutes the "dis-inflation" trend.

Philly Fed Manufacturing Survey

- October Philly Fed was 20.7 vs. (E) 20.0.

Takeaway

Thankfully this number was basically in line with expectations, and importantly didn't confirm the nosedive we saw in the Empire State manufacturing report from Wednesday. Philly Fed declined modestly from September (from 22.5) but still remains at a very high absolute level. Additionally, the details of the report weren't totally contradictory to the decent headline. Importantly, new orders, the leading indicator in the report, rose to 17.3 from 15.5 in August. However, inventories rose sharply as well, so that may hamper some future growth as inventories appear to be stockpiling a bit.

The rest of the details of the report were generally supportive and the bottom line is that, while not a blowout number (like the decent IP report), the in-line Philly Fed helped to remind everyone that the U.S. economy still has decent momentum.

Commodities

Commodities largely reversed direction yesterday as energy rallied and the metals declined. The benchmark commodity tracking index ETF, DBC rallied +1.12% thanks to the larger weight the energy sector carries in the index.

Beginning with the best performers, all of the major energy components—including WTI crude oil, Brent crude,

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RBOB gasoline and heating oil—finished the day higher yesterday as the stock market was able to post slight gains (thanks to the Fed's Bullard), which was encouraging for other risk assets including energy. Traders are also starting to realize just how oversold this market has become, and support at $80 looks like it could be a temporary bottom. But, yesterday's rally was widely referred to as a "relief rally" as sellers have simply become exhausted. WTI finished the day up +1.35%, comfortably above the $80 mark at $82.75.

Inventory numbers were released from the EIA yesterday, delayed because of the Columbus Day holiday Monday, and the results were mixed. Crude inventories rose +8.9M barrels vs. (E) just +2.2M barrels, which was rather bearish but somewhat expected after the American Petroleum Institute reported a +10.2M barrel build on Tuesday. And, the fact that the product supplies fell by more than expected, most notably the -4M barrel drop in RBOB vs. (E) of -1.7M barrels, canceled out the big build in WTI stockpiles.

Bottom line, traders are watching the supply data as they always do, but it is currently on the back burner as everyone remains focused on the market turmoil across asset classes. It is worth noting that we are currently in the thick of the transition period where many refineries are down for seasonal maintenance as they re-calibrate for the winter months.

Natural gas underperformed yesterday, finishing the day perfectly unchanged. The EIA reported a supply build of +94 Bcf vs. (E) +86 Bcf, and futures sold off to fresh 4-week lows toward $3.70. But, futures recovered back to $3.80 by the close on some short-side profit-taking.

Bottom line, the natural gas market continues to trade heavy, with futures testing medium-term lows and favoring the lower portion of the 3-month trading range between $3.80 and $4.10. Looking ahead, we can expect at the very least some further consolidation at current levels; however, the risk of a sell-off does exist.

The metals were the worst performers yesterday with both industrial and precious metals falling despite the weaker dollar (-0.24%).

Copper broke through psychological support at $3 early yesterday morning thanks to the disappointing EU merchandise trade data. According to the report, imports fell -3.1% in August, wiping out all of the previous 3 months' gains and spurring further concerns over demand for industrial metals, notably copper. Copper did creep back toward the $3 level over the course of the afternoon but fell short, finishing the day at $2.98. With support broken, we are looking to $3 as initial resistance, and the path of least resistance remains lower for industrial metals. And, that will continue for as long as the global economic growth concerns linger.

Gold failed to break through resistance at $1,245 and closed down -0.40% yesterday as the two primary influences on the precious metals market were in disagreement. Gold has been trading with a fairly strong correlation to both the dollar and the stock market. Yesterday, with the dollar falling and the stock market rallying, gold bounced sideways just below resistance at $1,245. Looking ahead, that level will be key and the situation is binary. If stocks continue to recover, and the dollar stabilizes, gold will return to the lower $1,200s. But, if stocks come for sale again and the dollar remains depressed, gold could see a sharp rally back toward $1,270-$1,280.

Currencies & Bonds

The Dollar Index finished trading yesterday down -0.23% following a volatile session, where two key catalysts resulted in large reversals in both the euro and the dollar.

Market	Level	Change	% Change
Dollar Index	85.065	-.176	-0.21%
EUR/USD	1.2795	-.0041	-0.32%
GBP/USD	1.6072	.0053	0.33%
USD/JPY	106.26	.36	0.34%
USD/CAD	1.1248	-.0005	-0.04%
AUD/USD	.8767	-.0057	-0.65%
USD/BRL	2.463	.005	0.20%
10 Year Yield	2.153	.063	3.01%
30 Year Yield	2.936	.060	2.09%
Prices taken at previous day market close.			

The first major influence on currencies yesterday was rising worry about Greek and Spanish sovereign debt— specifically the poorly received Spanish debt auction coupled with Greek 10-year yields rising about +1% in the course of a little over an hour. Those European sovereign debt concerns (I have to admit I didn't think I'd be using that phrase a month

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ago) rattled the euro, which promptly gapped lower on the news. Conversely, the Dollar Index rallied hard, rising back above resistance at 85.50 (which had been violated just yesterday).

But, the worries about the Greek sovereign debt issues were a bit overblown yesterday (although they remain a problem to watch). And after peaking shortly past 6 AM, the Dollar Index began to gradually drift lower while the euro rebounded.

The second major influence on currencies came from Fed President Jim Bullard, who as you know stated that perhaps the Fed should "taper the taper" in October given the weakness in the global economy. Those comments caused the exact opposite effect in the dollar and euro that occurred earlier yesterday morning.

Following Mr. Bullard's comments, the dollar promptly declined sharply, breaking back below 85.50, while the euro rallied hard. And, both currencies saw those moves extend in slow trading throughout the remainder of the day. The euro closed +0.2% higher vs. the dollar, an outcome that appeared all but impossible yesterday at 6 AM.

For all the noise, the bottom line with the Dollar Index and euro is this: We are seeing a continued unwind of the dollar rally, thanks mainly to worries about disinflation and a slowing economy domestically, and growing fears of an emasculated ECB in Europe. (Remember, an ineffective ECB will result in a stronger euro, which is the opposite of what the ECB wants.)

Both central banks are in a state of flux at the moment, and as a result I would expect this correction in the dollar to last a bit longer. But, despite Mr. Bullard's comments, I don't see the Fed materially changing policy yet. As such, this dollar decline should be viewed as a correction in a continuing uptrend. (I've said before that Bullard seems to enjoy the limelight more than most Fed officials, and he has a bit of a history of making quasi-bold statements in interviews—if for nothing more than the exposure it gives him. Besides, he's not a voting member this year—so his opinion, frankly, doesn't matter very much). Bottom line, expect continued headline volatility, but the overall trends of "higher in the dollar, lower in the euro "remain broadly in place.

Elsewhere in the currency markets things were quiet. The yen declined modestly as it took a breather from a big recent rally (there was no news out) while the commodity currencies were little-changed. The Aussie was down small (-0.11%), although it's worth noting the Loonie rallied .28% vs. the dollar despite a pretty bad manufacturing orders report.

That should have exerted more downward pressure on the Loonie and it didn't, so perhaps we may be seeing a short-term bottom in that currency. If you have trading shorts in the Loonie, now may be a good time to book some profits. Longer term, though, I imagine we'll see it eventually in the mid- to low-$0.80s vs. the dollar.

Turning to bonds, they largely followed the dollar yesterday. Treasuries were up nearly +1% early on Greek debt worries, but then began trading steadily lower throughout the day. (Keep in mind, given the absurd rally we saw Wednesday, some consolidation/declines were to be expected.)

Interestingly, the good economic data were the major influence on bonds yesterday, as the industrial production report, jobless claims and Philly Fed all resulted in bonds seeing moderate declines. (The real move lower started after the good IP report.) The 30-year finished the day down -0.87% while the 10-year yield is back solidly above 2%, at 2.15%. But, until European deflation fears begin to subside, there will be support for Treasuries. While I still believe that Wednesday's rally was indeed a "blow-off top" in bonds, I don't expect any sort of material decline in bonds until the situation in Europe improves.

Have a good weekend,

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
9/11/14	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.			

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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-siliency 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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

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