7:00's Report

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

October 24th, 2014

Pre 7:00 Look

- Futures are lower this morning (although well off the spike lows o/n) on general concern following the Ebola case in NYC.
- Economically it was a quiet night and earnings after the bell were mixed (AMZN missed big while MSFT beat).
- In Asia the US rally helped send most indices modestly higher, although Chinese shares underperformed following some disappointing housing data.
- Econ Today: New Home Sales (E : 460k).
- Earnings Today: CL (E: 0.75), F (E: 0.19), UPS (E: 1.28)

Market	Level	Change	% Change
S&P 500 Futures	1939.75	-6.25	-0.32%
U.S. Dollar (DXY)	85.925	-.021	-0.02%
Gold	1231.60	2.60	0.21%
WTI	81.36	-0.73	-0.89%
10 Year	2.275	.046	2.06%

Equities

Market Recap

Stocks staged another strong rally and broke through key technical resistance on the back of strong PMIs and good earnings. The S&P 500 rallied +1.23%.

Stocks were higher from the outset yesterday as global flash PMIs were almost universally better than expected (Germany was the highlight) and earnings pre-market Thursday were good, led by CAT, MMM, AAL and LUV.

Russell 2000: The late day decline on the Ebola headline made this chart not quite as positive as it had been earlier in the day, but markets did break through resistance yesterday. Now there needs to be follow through to confirm that breakout.

Markets opened throughout resistance at the 1,935-1,940 level and grinded steadily higher, shrugging off a slight miss from the U.S. flash October manufacturing PMIs.

With all the day's news out by 10 AM and the S&P 500 clear of resistance, the market grinded sideways until another flurry of buying pushed the S&P 500 up to the 100-day moving average (remember that's been a key technical level).

About the only complaint you could have on the day was that the SPX failed to materially break through that level after a headline about a doctor who treated Ebola patients being rushed to the hospital. Stocks staged a mini sell-off during the final 90 minutes of trading and the SPX finish well off the highs. But, overall it was obviously a strong day.

Trading Color

For the second out of three days, the cyclicals handily outperformed and led stocks higher. The Russell 2000 outperformed, up +1.8% while industrials were the best-performing S&P 500 sub-sector thanks to strong CAT and

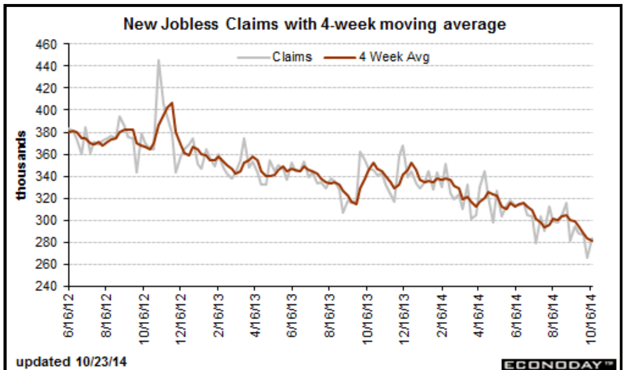
Market	Level	Change	% Change
Dow	16,677.90	216.58	1.32%
TSX	1,950.82	23.71	1.23%
Brazil	50,713.26	-1,697.77	-3.24%
FTSE	6,400.85	-18.30	-0.29%
Nikkei	15,291.64	152.68	1.01%
Hang Seng	23,302.20	-30.98	-0.13%
ASX	5,412.25	29.11	0.54%
Prices taken at previous day market close.			

MMM earnings (their macro commentary was also good).

Energy also outperformed thanks to the strong rally in WTI crude, rising +1.8%, while tech and consumer discretionary also rose by +1%.

Market	Level	Change	% Change
DBC	22.30	.26	1.18%
Gold	1229.10	-16.40	-1.32%
Silver	17.185	-.046	-0.27%
Copper	3.04	.0225	0.75%
WTI	82.09	1.57	1.95%
Brent	86.75	2.04	2.41%
Nat Gas	3.65	-.009	-0.25%
RBOB	2.20	.0444	2.06%
DBA (Grains)	25.92	.12	0.47%
Prices taken at previous day market close.			

Defensives clearly underperformed, as utilities were up slightly, while consumer staples were down (partly because of the T earnings miss and PG was flat on peripheral weakness from Unilever). But it's safe to say that those investors chasing stocks and adding long exposure were doing so into the cyclical names. The one exception was the basic materials segment, which declined yesterday on weakness in gold and gold mining shares.



The 4 week moving average of weekly jobless claims is now just above a 15 year low, implying continued progress in the labor market.

Finally, "Europe" handily outperformed yesterday, as HEDJ (my preferred way to play Europe) rallied +1.45% and EUFN (European financials) rallied +1.6%. (Keep in mind European stress tests results come out Sunday, so if they aren't too bad we could see a continued move higher in European financials on a relief rally next week.) Also of note, EWG was the best-performing European ETF, up +1.96% as the DAX rebounded hard.

Point being, Europe outperformed and if this correction really is over, that's a trend I believe can continue.

Bottom Line

Starting first with the Ebola news overnight (and hatchet attack on the NYPD officers), both are gripping headlines, and futures did spike lower initially last night, but at this point the Ebola case isn't the bearish influence it was last week. The market never discounts the same information twice, so unless we see greater then 2 cases pop up from this, it's a temporary headwind on the indices.

Turning back to the markets, I said in yesterday's issue that we got good fundamental news from the PMIs and stocks needed to rally, and rally they did. The late-day Ebola headline aside, stocks have now recouped nearly 7% of the 10% peak-to-trough declines in late September/early October, and sit just about 3% below recent all-time highs (what a difference a week makes).

Fundamentally the move has been at least partially justified, as economic data this week showed the global economy wasn't as bad as feared, while the rumors about covered bond purchases by the ECB and a firm CPI helped dispel some dis-inflation/deflation worries.

The two indicators we are watching to confirm the bottom are definitely acting better, as EWG is at a two-week high while oil seems to be holding $80 (although I do wish oil was "confirming" this move higher in stocks). And JNK, which has been the best leading indicator of this market for 3+ months now, continues to hold firm in the low-$40s, basically at a 1 month high.

The S&P 500 and Russell 2000 both broke through resistance yesterday, and now both indices need to hold those breakouts (1940 in the SPX, 1115 in the Russell) for another two or three closes, especially in light of Ebola headlines, to confirm the technical picture is again positive.

Looking ahead, although there has certainly been improvement in the macro landscape, I still remain somewhat wary of this rally. But, between the FOMC next week (which should be "dovish" in tone given recent Fedspeak) and the midterm elections the following week (odds are rising Republicans take the Senate), there are some potentially favorable events on the horizon.

As a result, while I am still skeptical in my gut of this rally, a move higher to the 1,970-1,980 region isn't an unreasonable expectation as long as there isn't another "one-off" Ebola outbreak or terrorism scare. But I maintain my stance that I do not see this market making material new highs into year-end, so I'm still not crazy about the risk/reward on the long side here for new capital (60 points to the old highs vs. 140 to the recent lows in the S&P 500 isn't terribly attractive to me).

Economics

Global October Flash Manufacturing PMIs

- China Oct. Manufacturing PMI 50.2 vs. (E) 49.9.
- German Oct. Manufacturing PMI 51.8 vs. 49.5.
- EMU Oct. Manufacturing PMI 50.7 vs. 50.0.
- U.S. Oct. Manufacturing PMI 56.2 vs. (E) 57.0.

Takeaway

The important October flash PMIs yesterday further confirmed that the near-hysterical fears about the pace of global economic growth last week were overblown.

The October flash PMIs yesterday showed that global growth in fact *isn't* slowing, as expected. All the major manufacturing PMIs stayed above 50, despite expectations that the Chinese and German numbers would show slight contraction.

The German number was the biggest positive surprise, and it reinforces (for now) the notion that the horrible economic data we saw from Germany in August was filled with a bunch of "one-offs" and on the ground things weren't that bad.

The U.S. number was the only disappointment, but the details were generally constructive. It's important to realize that, on an absolute basis, growth in the manufacturing sector remains strong in the U.S. and some loss of momentum from the high growth of the summer was expected.

Bottom line is the market needed these reports to be "ok" and indeed they were. And, combined with the Chinese GDP and firm CPI reading, the economic data have helped to significantly reduce concern about the two headwinds that took stocks lower over the past two weeks: global growth, and deflation/dis-inflation.

I'm not saying the global recovery is roaring; it is still at risk. But compared to expectations last week, things do look better from a global economic growth standpoint, and this move higher in stocks is fundamentally justified by the data this week.

Commodities

Commodities were mixed yesterday with energy, industrial metals and grains trading higher while precious metals and natural gas continued to sell off. The benchmark commodity tracking index ETF, DBC, gained +1.18% yesterday thanks mainly to a strong rally in WTI crude.

The most important thing that happened in the commodity space yesterday was WTI crude oil futures held critical support at $80 and closed higher by 2.20%. Support being defended was encouraging to other asset classes, most notably stocks, and this contributed to yesterday's equity gains.

Crude rallied on a combination of the positive global manufacturing PMIs as well as a report out that one of Saudi Arabia's biggest production companies cut production by 300k barrels in September, implying they may be finally getting more price sensitive. Remember, this plunge in crude has been partially fueled by a mini 'price war" in the Middle East and confusion at OPEC. Signs of that ending (it's got to be getting a little painful for a lot of Middle Eastern producers compared to recent years) will be a positive on the market.

Market	Level	Change	% Change
Dollar Index	85.94	.12	0.47%
EUR/USD	1.2647	.0004	0.03%
GBP/USD	1.6028	.0001	0.01%
USD/JPY	108.27	.02	0.02%
USD/CAD	1.1228	.00	0.00%
AUD/USD	.8758	-.0002	-0.02%
USD/BRL	2.4975	.0115	0.46%
10 Year Yield	2.275	.046	2.06%
30 Year Yield	3.046	.046	1.53%

Prices taken at previous day market close.

But, for now, the technical picture remains neutral at best right now as prices are failing to make new highs and remain "stuck" here between $80-$84. If WTI Crude can break out to new highs over the coming days, that will be an important positive confirmation of this move higher in stocks.

Natural gas futures traded down -1.37% toward our initial target of $3.55-$3.60 yesterday. The EIA reported a build in supply of 94 Bcf, a touch higher than the consensus estimate of 93 Bcf. This caused some speculative longs who were hoping for a "miss" to sell out. Bottom line: The natural gas market is trending lower with relatively low volatility (especially considering some of the intraday moves we saw last year). We remain bearish technically and neutral on the fundamentals in the near term, although we are now getting close to levels of somewhat compelling "value" in natural gas—assuming we have some sort of a winter this year.

Moving to the metals, gold continued to trade lower, falling -1.32% on follow-through selling from Wednesday's CPI report (which is causing "dovish/dis-inflation trades" to be unwound) and the decent global PMI data from yesterday. Near term the trend remains lower with initial support at $1,220.

Industrial metals rallied on the global PMI data being in line to better than expected yesterday. Notably, copper gained +0.66% and approached resistance at $3.05. Copper however remains in a well-defined downtrend and until the aforementioned resistance at $3.05 is broken, the benefit of the doubt remains with the bears.

Currencies & Bonds

Despite the big moves in the equity markets and release of the global manufacturing PMIs, the currency markets were pretty quiet yesterday. The Dollar Index was only fractionally higher, up +0.08%.

The euro also traded flat despite the good data—which would normally be bullish for the EU, but the relationship among the euro, economic data and the dollar is about as convoluted as I've ever seen it.

Yesterday, though, the euro initially rallied hard around 3:30 AM on the strong German PMIs, because if the German economy can start to recover and grow again, the Germans will more forcefully voice their opposition to QE (which is hawkish).

After an initial big rally from 1.2615-ish to 1.2675-ish, though, trading in the euro became driven by the dollar. The euro rolled over on the release of the good jobless claims data and gave back roughly half of the German PMI rally, before reversing and heading higher following the U.S. manufacturing PMI miss. From 10 o'clock on, the euro chopped around to finish virtually flat on the day.

I would expect more of that "chop" in the euro around the 1.2650 level today and early next week as we head into the FOMC minutes, and it'll be from there that we get a good look into the next direction of the euro.

The yen was the big mover yesterday, though, as the dollar/yen surged higher (so yen weaker) by nearly 1%. The Japanese October flash PMIs were better than expected, and that, combined with the multiple other "yen negative' news this week (pension re-allocation, exports beating expectations) caused a buying flurry yesterday as the dollar yen broke through technical resistance.

At the heart of this move is economic data showing the Japanese economy may be gaining steam, which is positive for Japanese stocks and negative for the yen. Again, I am a bit cautious on adding new positions here given the shorter term risk/reward (I think 110 dollar/yen will be stiff resistance), but I remain a stout yen bear/DXJ bull longer term. I'd just like better entry points for incremental capital.

Despite the big stock market rally and easing of global growth concerns, though, the bond market remained relatively buoyant yesterday. The 30-year Treasury declined -0.5% (the yield rose back above 3%) while the 10-year yield rose back above 2.25%. So, bonds did decline on the better than expected data, but not all that much considering the huge rallies we've seen.

Also of note, there was a 30-year TIPS auction yesterday and it was met with less than enthusiastic demand. The bid to cover was 2.29 while the actual yield was 1 full basis point over the "when Issued." So, it's safe to say based on this result that, while economic data were better this week and investors are again embracing some risk, inflation fears remain extremely subdued, and traditional bonds remain well supported as inflation fears remain very low.

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).*

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 (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 10.20.14)

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 most volatile week in years last week thanks to more concern about global growth, dis-inflation and the end of QE. Despite hitting a low of 1820, though, there are signs a short term bottom is in at that level, although I remain broadly cautious on the market and expect a volatile chop sideways over the coming days.*

Best Idea: Buy Regional Banks (KRE).

Best Contrarian Idea: Buy Energy (XLE)

	Near Term Trend	Long Term Trend	Market Intelligence
Commodities	**Bearish**	**Bullish**	*Commodities were lower but tried to stabilize last week as gold moved higher on a general "risk off" trade, while oil appears to have held support at $80.00 and is trying to put in a bottom. The dollar correction is also helping commodities and short term we could see a further bounce if global growth metrics improve this week.*

Best Idea: Buy Gold (GLD)

Best Contrarian Idea: Buy Grains (DBA)

	Near Term Trend	Long Term Trend	Market Intelligence
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar correction continued last week as dovish comments and lack luster economic data resulted in a big decline last Wednesday. Broadly fundamentals remain dollar positive, but it remains short term overbought and more of a correction/digestion is needed, although the trend remains higher.*

Best Idea: Sell the Yen (YCS)

Best Contrarian Idea: Long British Pound (FXB)

	Near Term Trend	Long Term Trend	Market Intelligence
Treasuries	**Neutral**	**Bearish**	*Treasuries traded with historic volatility last week as a lower stock market and European angst saw Treasuries put in a "blow off' top Wednesday morning. Europe remains the key to the Treasury rally, and despite the end of QE being less than two weeks away, as long as European growth disappoints, there will be support for Treasuries.*

Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)