7:00's Report

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

October 3rd, 2014

Pre 7:00 Look

- Futures are bouncing and global markets are higher as stocks extend yesterday's US rebound ahead of the jobs report.
- In Europe economic data was mixed but is being taken as a slight positive. EU retail sales handily beat estimates (E 1.2% vs. (E) 0.1%) while German Composite PMIs beat (54.1 vs. (E) 54.0). Other PMIs were mixed, but that was expected.
- In Asia, the Hang Seng (Hong Kong market) re-opened after being closed for a holiday and rose slightly, alleviating concerns the unrest might lead to more losses.
- Econ Today: Employment Situation (E: 215K), ISM Non-Manufacturing Index (E: 58.8).

Market	Level	Change	% Change
S&P 500 Futures	1947.00	8.50	0.44%
U.S. Dollar (DXY)	86.065	.375	0.44%
Gold	1207.10	-8.00	-0.66%
WTI	90.70	-.31	-0.34%
10 Year	2.438	.035	1.46%

Equities

Market Recap

Stocks staged a big rebound Thursday after initially falling to multi-week lows on a "disappointing" ECB, before they steadied and recovered the losses during afternoon trading. The S&P 500 finished the session virtually flat.

Yesterday's declines we all about Europe. Futures were flat as stocks tried to bounce after Wednesday's sell off, but things started to deteriorate from 8:30 onward (when Mr. Draghi began to speak).

HEDJ: The Europe Hedged Equity ETF is now sitting on a 2+ year uptrend, and given the steps the ECB is taking, I view this as a long term buying opportunity.

Draghi "disappointed' the markets by not teasing QE enough, and European market started to fall, and fall fast, as the press conference wore on. US stocks tried to steady at the open, but Europe was a weight that just pulled the indices lower throughout the morning, as the S&P 500 smashed through Wednesday's lows.

But, Draghi wasn't "hawkish" (more on this later) and once Europe closed selling pressure abated. The S&P 500 hit the lows of the day shortly after 11:30 and then began a methodical lift that lasted the entire day, gaining momentum throughout the afternoon, as stocks closed virtually flat, in what turned out to be an encouraging day for the bulls.

Trading Color

The internals were positive yesterday as the Russell 2000 had its best day in 6 weeks, outperforming the "flat" S&P 500 by +1.01%. Meanwhile the Nasdaq rallied a more modest +0.18%, but nonetheless outperformed the S&P.

Looking to sector trading, financials were among the

Market	Level	Change	% Change
Dow	16,801.05	-3.60	-0.02%
TSX	14,760.64	-44.80	-0.30%
Brazil	53,518.57	660.14	1.25%
FTSE	6,501.31	54.92	0.85%
Nikkei	15,708.65	46.66	0.30%
Hang Seng	23,064.56	131.58	0.57%
ASX	5,318.21	20.51	0.39%
Prices taken at previous day market close.			

best performers yesterday, catching a bid thanks to higher interest rates while REITs and utilities underperformed for the same reason.

Consumer discretionary/retail was the best-performing sector yesterday, adding +0.46% on M&A news and analyst upgrades.

Energy was the worst-performing sector, falling -0.52%. But it was able to close well off the day's lows thanks to the ~$3 bounce back from 17-month lows in crude oil prices.

Market	Level	Change	% Change
DBC	23.05	-.09	-0.39%
Gold	1212.80	-2.80	-0.23%
Silver	17.025	-.234	-1.36%
Copper	3.008	-.028	-0.92%
WTI	91.26	.53	0.58%
Brent	93.60	-.56	-0.59%
Nat Gas	3.954	-.069	-1.72%
RBOB	2.4164	-.0333	-1.36%
DBA (Grains)	25.83	.20	0.77%
Prices taken at previous day market close.			

Technology, healthcare, materials and industrials all finished the day only marginally changed but, again, well off the lows of the day.

Bottom Line

The market followed a familiar pattern yesterday, repeating the pattern of the 4 other corrections: Violating the 100-day (meaningfully) but then rebounding right about the time everyone started to panic. Now, it's a question of whether that can continue today and the S&P 500 can retake the 100-day MA (currently at 1,958).

Fundamentally, the rebound yesterday made sense. European shares dragged U.S. stocks lower following disappointment over Draghi, but the fact is (as we explain next) he wasn't really disappointing and the moves should help the EU economy and EU stocks. And, as the day wore on yesterday, markets began to focus on that (especially once Europe closed, which basically marked the lows of the day for U.S. stocks).

Thursday I said three things needed to happen to stop the declines: a "dovish" Draghi, an "in line" jobs report, and Asia trading "OK" when markets reopened/Hong Kong protests disbursed. The first has, to a point, been met. Again, Draghi wasn't dovish in the traditional sense, but the ECB did make changes that will make their balance sheet expansion larger than anticipated (which is dovish).

Turning next to the jobs report, I'm not going to bother with the normal "Goldilocks" preview because here's the bottom line: **September job adds need to be better 175K – 250K to be "just right" and remind everyone the jobs market is recovering. And annual wage gains need to be 2.0%-2.2% year-over-year to help stop the rising fear of disinflation**. Finally, it'd be nice to see the bad August number revised higher. If those things happen, I would not be surprised to see the S&P 500 drift back into the 1,970-1,980 range, although getting materially higher from there is a bit of a bigger issue.

Bottom line, I am not materially reducing equity exposure at this point and am considering actually buying Europe via HEDJ today (perhaps with an SPY short hedge) for accounts with a time horizon longer than 2-3 months.

Finally, note that JNK has steadied this week after the drop Monday, and traded decently again yesterday (closing above $40). So, we are not seeing the continuing breakdown and confirmation of the break of the 100-day in the S&P 500 that would make me much more concerned that this decline in stocks is truly something different. So, while uncomfortable, I am holding equity positions.

Economics

ECB Decision

- Interest Rates Unchanged (as expected).
- Details of "Private QE" were mildly dovish.

Takeaway

The ECB meeting met with general disappointment yesterday, as evidenced by a drop in EU stocks and a rise in the euro. The ECB did release details of the "private market" QE program that **were dovish,** but the core of that disappointment came from Draghi not alluding more forcefully to eventual QE at this press conference.

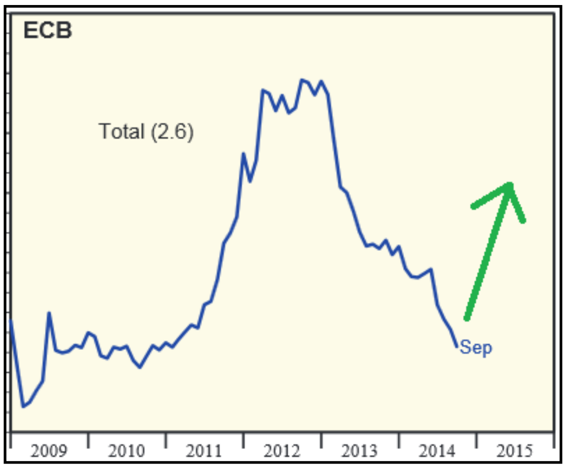
But, while sentiment was negative, actual policy announcements were positive. The ECB announced that "retained" covered bonds would be available for purchase, which is a positive because it means the total ABS program will be very big, which should help expend the

ECB balance sheet. Also, the ECB positively surprised by announcing it would accept lower-rated collateral than anticipated (BBB- and from Greece and Cyprus, with conditions).

Those details, while somewhat overlooked by the market, were dovish and responsible for the euro trading off the highs following their release at 9:30.

But, right now the market isn't fixated on the details of existing programs—it wants QE. Because Mr. Draghi didn't forcefully allude to future QE, the market was disappointed.

As far as what's next, it's all about how quickly the ECB can increase the size of its balance sheet. The TLTRO and ABS/covered-bond purchases will increase the size of the ECB's balance sheet starting this month, but the question of how quickly it increases it is the key. For European shares to advance, we need to see large-scale, quickly implemented programs. While the ECB is moving in the right direction, yesterday it left room for the doubters to continue to doubt.



European stocks got hit hard on the disappointment yesterday, and this is now a classic long-term vs. short-term problem. Short term, we could easily see more weakness in Europe. But longer term, the ECB will expand its balance sheet—and the history of the past few years has shown us that when that happens, stocks go up. So, I continue to view any material dip in Europe (including yesterday's) as a buying opportunity for accounts with a time horizon greater than 2 months. I will add small to my European holdings today as long as the jobs report isn't a total disaster.

Market	Level	Change	% Change
Dollar Index	85.755	-.321	-0.37%
EUR/USD	1.2663	.004	0.32%
GBP/USD	1.6137	-.0047	-0.29%
USD/JPY	108.44	-.043	-0.39%
USD/CAD	1.1158	-.0004	-0.04%
AUD/USD	.8798	.0061	0.70%
USD/BRL	2.4896	.0091	0.37%
10 Year Yield	2.438	.035	1.46%
30 Year Yield	31.53	.040	1.28%
Prices taken at previous day market close.			

Commodities

Commodities were mostly lower again yesterday despite the weakness in the dollar (-0.50%). Natural gas was the worst performer thanks to both technical selling and a bearish EIA report while grains, gold and WTI all outperformed.

Both WTI and Brent futures sold of to 17-month lows overnight, partially thanks to a general risk-off move in the markets, but mostly as a result of traders in Asia and Europe waking up to headlines saying the Saudis were looking to cut prices in an attempt to save their market share. The news did not print until after traders in Asia and Europe had gone home the previous day, so there was some "catch up" selling when they got into the office yesterday morning and clearly, they began to trip stop orders in WTI below $90.

But, futures bottomed, reversed and actually turned positive in the last hour of trading yesterday to gain +0.61% on the day and importantly close back above support at $90.

Fundamentally, supply continues to outpace demand metrics globally and the general trend remains lower. On the charts, $88.18 will be looked at as the new "line in the sand" while there is resistance between $91 and $92. It is worth noting that is rather encouraging for the bulls that futures recovered from a nearly $2 deficit to finish the day positive and well above the $90 mark.

Natural gas futures did not see the "bounce back" that WTI enjoyed yesterday, as NG futures finished the day down -2.01%—back below $4 for the first time in a week. The reason for the move was twofold.

First, there was a bearish outside reversal on the daily chart on Wednesday, which certainly caused some low-time-frame traders to reposition (both closing longs and opening shorts). And secondly, the EIA reported a larger than estimated build in supplies of 112 Bcf vs. (E) 106 Bcf. Bottom line, we saw a quick 20-cent drop in two days.

However, it is important to note that it was psychological support at $4 that was broken, while the more material support levels at the 50-day moving average ($3.91) and important trend support ($3.94) remain intact.

Bottom line, we continue to see value in owning natural gas here; however, a further leg down and a close toward $3.80 would see us reconsider that position.

Copper futures traded down through the $3 level yesterday for the first time since mid-April but were able to close back above it at 3.0085 for a loss of -0.91% on the day. Copper trading remains largely dependent on China, and concerns that the Chinese economy is losing steam continues to weigh on the industrial metal. On the charts, the path of least resistance remains lower with weak support at $3 and resistance above at $3.055.

Trading in gold yesterday was not very encouraging, as a sharp sell-off in the dollar failed to spur any material rally in gold. Futures actually finished the day lower, down -0.16%. Going forward, the series of "lower highs" (bearish) on the daily chart—combined with the steep declines in silver prices—suggest that a test and potentially big breakdown through $1,200 may be coming in gold. However, we do need to respect the longer time frame support band between $1,180 and $1,200 that has been tested twice in the past 18 months and held. So, bottom line, it is all about the $1,200 level right now.

Currencies & Bonds

Currencies were mixed around the globe yesterday as the euro and yen rallied while the Loonie and pound were both materially weaker. The Dollar Index had its worst day in two weeks, falling -0.41% on the session.

Beginning in Europe, all eyes were on the ECB yesterday morning and the euro was slightly higher as traders positioned ahead of the announcement and Draghi's press conference. When all was said and done, the market interpreted the ECB as being hawkish because, as I said before, the market is not concerned with existing programs—the market wants to see outright QE. So, in a disappointed reaction, the euro extended gains after Draghi was done speaking, finishing the day higher by +0.50%.

But, much of that gain is being unwound this morning as "cooler heads" are now correctly interpreting the ECB moves as expansionary (and mildly dovish). Obviously a lot depends on the jobs report today, but I would be surprised if we see a sustained rebound in the euro over the come weeks. There is resistance just above 1.27 while support lies below at 1.2610.

Elsewhere in Europe, the pound sold off 0.57% against the dollar as the BOE's Ben Broadbent said that the U.K. economy was not strong enough to see a hike in interest rates just yet. The pound dipped back to a 3-week low yesterday and that weakness is likely to continue until the U.K. economic data begin to improve. This will again stoke speculation of a rate hike by the BOE.

Moving to Asia, the yen rallied as much as +1% yesterday thanks to the general "risk-off" move in the markets. The yen's gains, however, were halted and reversed roughly around the same time that the U.S. stock market reversed its morning losses and began to rally. The "short yen" trade remains one of the more-crowded in the currency space, so some profit-taking after the most recent surge to 110 was inevitable. Going forward, we will likely see some consolidation here between 108-110 as traders digest the recent moves.

Moving to the bond market, Treasuries spent virtually the entire day in negative territory, although they were barely so when stocks were at their worst levels of the day.

Point being, unlike stocks bonds correctly interpreted the ECB moves as "dovish," and once stocks began to bounce the bond decline accelerated. The 10-year note finished the day down 0.16% while the long bond fell -0.40%. The trading day yesterday turned out to be somewhat encouraging, as all asset classes began to reverse some of the recently painful moves.

Focus now turns to the jobs report, and, as long as the report is somewhere in the "just right" range between 175K and 250K, I would expect we should see continued mild declines in the bond market today.

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 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."

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 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.

Asset Class Dashboard

(Updated 9.29.14)

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 faltered last week, dropping nearly 1.5% on general global growth concerns and after key support at 1980 was broken. Stocks bounced Friday but I remain cautious and would be surprised if we don't see a test of the 100 day MA at 1955 before this pullback is over.*
Best Idea: Buy Regional Banks (KRE). **Best Contrarian Idea:** Buy Small Caps (IWM).			
Commodities	**Bearish**	**Bullish**	*Commodities tried to stabilize last week despite a continued dollar rally, as better than expected Chinese data helped industrials and Thursdays sharp sell off put a bid into gold. Beyond the short term, though, with concerns about global growth and a stronger dollar, the outlook for commodities near term isn't good.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index surged to a new 4 year highs (again) on strong Q2 GDP and more dovish comments from ECB President Mario Draghi. But, the dollar continues to power higher against virtually all currencies as it hit new recent highs against the Aussie and Loonie.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long Canadian Dollar (FXC)			
Treasuries	**Neutral**	**Bearish**	*The Treasury bounce continued last week thanks to a big Thursday rally (a "risk off" move to plunging stock prices. We're also seeing renewed buying from Europe given doubts about ECB policies, but the near term trend remains down.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			