7:00's Report

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

October 6th, 2014

Pre 7:00 Look

- The rally is continuing this morning as futures are up moderately and global markets are almost universally higher on a continuation of Friday's move following a quiet weekend.
- German manufacturer's orders badly missed expectations (-5.7% vs. (E) -2.5%). But, it wasn't as bad as the headline and is only furthering ECB QE expectations.
- In Hong Kong there were clashes between police and protestors over the weekend, but the situation remains orderly, and as such wasn't a negative influence on stocks.
- Econ Today: No reports today. Jack Lew speaks at 3:00.

Market	Level	Change	% Change
S&P 500 Futures	1965.75	5.50	0.28%
U.S. Dollar (DXY)	86.42	-.274	-0.32%
Gold	1195.00	2.10	0.18%
WTI	90.21	.47	0.52%
10 Year	2.447	.009	0.37%

Equities

Market Recap

The S&P 500 declined .8% last week mostly on global economic growth worries, but the index saw a big bounce Thursday/Friday and encouragingly closed nearly 2% higher than the intra-week lows. The S&P 500 is up 6.47% year to date.

Stocks traded heavy from the outset last week, as the S&P 500 traded lower both Monday and Tuesday on general global growth concerns (especially from the emerging markets, the protests in Hong Kong and the rumor of capital controls in Russia weighed on markets).

Negativity and caution that had been building for weeks broke through Wednesday, as the S&P 500 smashed through multiple levels of support following disappointing global September manufacturing PMIs (Germany in particular). Support at the 100 day moving average (around 1958) was violated and stocks closed down more than 1%.

The selling continued Thursday as the S&P 500 hit an intra day low of 1926 Thursday morning following carnage in European markets as the ECB and Mr. Draghi "disappointed" markets at their ECB meeting. But, the S&P 500 was able to stage a nice rally that began almost the instant Europe closed, as people began to realize that the ECB measures weren't quite the disappointment they market initially thought. Stocks rallied impressively back to flat by the close Thursday.

The rebound continued Friday as the S&P 500 rallied more than 1% following the "goldilocks" jobs number, and importantly the S&P 500 was able to reclaim support at the 100 day moving average (1959ish) to cut it's weekly losses in half.

Trading Color

Despite the Thursday/Friday rebound the internals of this market are still not very encouraging. The Russell, despite a big bounce back rally Thursday, was down 1.4% on the week, nearly doubling the S&P 500 decline, while the Nasdaq was in line (down .8%). SPHB also saw huge underperformance against more defensive sectors, as SPLV outperformed SPHB by nearly 1.5% last week (SPLV finished the week positive thanks to a massive Friday rally).

Leading the defensive sectors higher were utilities, which benefitted from the sharp drop in interest rates

Market	Level	Change	% Change
Dow	17,009.69	208.64	1.24%
TSX	14,789.78	29.14	0.20%
Brazil	54,539.55	1020.98	1.91%
FTSE	6,543.39	15.48	0.24%
Nikkei	15,890.95	182.30	1.16%
Hang Seng	23,315.04	250.48	1.09%
ASX	5,292.91	-25.30	-0.48%
Prices taken at previous day market close.			

and also some stock specific news (D had a project approved by regulators).

Oddly, though, banks also traded relatively well last week, as both KRE and KBE were only modestly lower and outperformed the S&P 500, which is not what you'd expect given what happened with rates. So, there was no real "rate play" in the market last week despite the volatility in interest rates.

Market	Level	Change	% Change
DBC	22.84	-.21	-0.90%
Gold	1192.40	-22.70	-1.87%
Silver	16.825	-.222	-1.30%
Copper	3.0015	.003	0.10%
WTI	89.62	-1.39	-1.53%
Brent	92.13	-1.29	-1.38%
Nat Gas	4.038	.106	2.70%
RBOB	2.3797	-.0294	-1.22%
DBA (Grains)	25.74	-.08	-0.32%
Prices taken at previous day market close.			

Energy and materials were again the laggards last week as WTI Crude temporarily violated the $90 level. I'm reading a lot about the "value" in the energy space right now, and while from a contrarian standpoint it is attractive, I think we can afford to wait for some signs of strength.

On the charts the S&P 500 reclaimed the 100 day moving average (1959ish) and that should provide key support going forward (if this is a typical correction, that level shouldn't be violated again).

Bottom Line

Despite the volatility and gathering macro concerns (specifically surrounding global economic growth), this pullback is acting a lot like the previous four did. The S&P 500 violated the 100 day MA for part of two trading days, but it's now trading back above it (remember the 100 day MA has been critical support for this market for years).

On Thursday I cited three things that had to happen for markets to steady (and keep this a "normal" pullback): First, Draghi needed to be "dovish" (and although he wasn't at his press conference, the details of the ABS program were dovish, so that was satisfied. Second, the jobs report had to be good, and it was. Third, we had to see some return of normalcy in Hong Kong. This one remains not fully satisfied, but while there were reports of violence over the weekend, it seems the protests are losing momentum as they enter their second week.

So, while I think there are macro risks building (again global growth concerns, potential increase in Fed "hawkishness") at this point this looks like a typical pullback of the past few years, and as such doesn't yet require any major moves from a portfolio standpoint.

The coast isn't totally clear at this point, so I think we can expect a "chop" sideways for bit as the market gets more clarity on the Fed and global growth. So, I do not expect the market to grind higher to new highs from here in the near term.

From an allocation standpoint, my two favorite destinations for new capital remain Europe (for anything other than very short term accounts) and banks (both KRE and KBE). I think we are buying value in both at these levels, although admittedly they will require some short term patience in this environment.

Economics

The were multiple and varied important economic data points released last week, but the general takeaway is this: While the global economic recovery is clearly losing steam, data in the U.S. consistently show the recovery is not only solid but also gaining momentum. This dichotomy between the direction of the U.S. economy and other major global economies (Japan, Europe and China) is accelerating and will continue to have implications across asset classes (and it's the main reason the greenback continues to surge).

Looking then to the specific data from last week, focus was on last Friday's jobs report (which was almost perfectly "Goldilocks"), but the most important numbers last week were the global September PMIs.

By now you know they were universally disappointing, led by a surprise drop in the German reading to 49.9. The broader EMU number wasn't much better and is teetering above 50 (50.3, to be exact), while the official government number from China also barely stayed above 50. Even the U.S. PMI missed at 56.6, but on an absolute basis that's still pretty strong, so it isn't really that much of a negative.

Bottom line with the September PMIs (ex-U.S.) was that they were weak. They imply the EU economy is further decelerating and that it's inching closer to a triple-dip recession. Meanwhile both Japan and China are seeing the rate of growth slow—raising fears of a potential "hard landing," although that's a bit premature. Regardless, though, the data last week demonstrated that global growth is diminishing, and that's a risk for global stock prices if it continues.

Staying global for a moment, the second most important thing that happened last week was the ECB meeting, which was initially taken as "disappointing" mainly because ECB President Mario Draghi didn't further (and more forcefully) allude to "QE." Also, Bloomberg reported over the weekend there were three dissents to the measures announced—so while they were passed, that's not going to help alleviate concerns the ECB isn't truly committed to doing what's necessary in Europe (i.e., QE).

But, to focus for a moment on what the plans they actually implemented (which is more important than the soft analysis), the ECB did include "retained" covered bonds in its "private market" QE program, which begins later this month.

This means the "private market" QE program, which is the ECB buying Asset-Backed Securities and covered bonds, is going to be bigger than initially thought. That's important because size matters here — the bigger the private-market QE program, the larger the expansion of the ECB balance sheet. And, the larger the balance sheet expansion, the more help *should* be provided to the economy … and the greater the upward pressure on Europe. So, although the reaction was one of disappointment, the news from the ECB was bullish for European stocks beyond the very near term.

Finally, turning to the jobs report, it was almost perfectly "Goldilocks." The headline number was a strong beat (248K) and we also encouragingly saw positive revisions to August (from 142K to 180K).

Market	Level	Change	% Change
Dollar Index	86.805	1.115	1.30%
EUR/USD	1.251	-.0158	-1.25%
GBP/USD	1.5971	-.0171	-1.06%
USD/JPY	109.80	1.39	1.28%
USD/CAD	1.1257	.0103	0.92%
AUD/USD	.8665	-.0138	-1.57%
USD/BRL	2.4718	-.0231	-0.93%
10 Year Yield	2.447	.009	0.37%
30 Year Yield	3.134	-.019	-0.60%
Prices taken at previous day market close.			

So, clearly this number reflects that the jobs market continues to improve. But, what made the number "Goldilocks" was the fact that year-over-year wages increased only 2.0%, which implies the pop in wage inflation we saw earlier this year hasn't stuck. As such, the jobs number won't result in more pressure on the Fed (because the jobs gains are resulting in wage inflation). Also, the unemployment rate fell to 5.9% but that's because of the participation rate—not substantial job gains.

So, bottom line is the jobs number was a good report and came at the right time (we needed a reminder that the U.S. recovery is doing fine). But there is enough weakness in the details that this report (wages and the participation rate) that it's not going to cause the Fed to become incrementally more "hawkish."

This Week

It's a very quiet week, economically speaking. The most important event this week will be the minutes release from the September FOMC meeting (Wednesday). As usual, the market is going to be looking for any clues as to just how "hawkish" the discussion about policy was at the meeting. In particular, any sort of commentary on the anticipated pace of interest rate increases will be especially important (remember the "dot" projection for '15, '16 and '17 all increased at this meeting). So, it'll be important for stocks that the minutes reflect a "not too hawkish" Fed.

Outside of the FOMC minutes it's very quiet domestically, as weekly claims is the only other notable number. Internationally, composite Chinese PMIs are the highlight (Tuesday), while we also get a Bank of England meeting Thursday (there will be no change to policy) and some sporadic second-tier international economic data. But, nothing released this week should materially alter the economic outlook for Europe, China or Japan, even if there are positive/negative surprises.

Commodities

The surging dollar continues to be the overarching theme in the commodity space as the benchmark commodity ETF, DBC, fell another -2.8% last week and ended at a fresh 4-year low. Natural gas however remains one bright spot, as futures rallied despite a bearish supply report.

The big development in the global crude oil market was news that Saudi Arabia was going to cut prices, suggesting the Kingdom is more concerned with its percentage of market share than global oil prices. WTI crude oil fell -3.9% on the week. Technically, crude oil remains in a sharp downtrend with the next level of support at $87.50, while initial resistance hovers above between $90 and $92 per barrel.

Nat gas continues to be the best performer in the space as futures finished last week little-changed even after the EIA reported a larger than expected build in stockpiles. And, because supply is the focus of the market right now, last week's price action was rather encouraging. A full-blown uptrend has yet to form on the charts just yet, as prices remain in a large trading channel roughly between $3.90 and 4.10. But, that channel is angled higher (characterized by both higher lows and higher highs), which is obviously bullish. On the charts psychological support at $4 is back in focus while last week's high is the level to beat.

The gold bugs have been doing all they could in recent weeks to keep gold prices above the $1,200 mark. But Friday's solid jobs report, and the subsequent leap higher in the Dollar Index, forced futures down through that support level. Futures fell -2.37% on the week and closed at a multi month low of $1,191.10.

Gold is without a doubt getting near-term oversold. However, gold tends to "follow through" on moves like this, so we might see another leg down as the bears attempt to test the "line in the sand": the multi-year lows around $1,180. The technical picture is rather grim (for the bulls) and the surging dollar has proved to be the primary driver of the market. So, if we see an extension of the dollar rally, gold will remain under pressure in the medium term.

Copper is also testing psychological support as futures fell -1.22% last week, closing right at the $3.00 figure. The stronger dollar and rising concerns over the health of the global economy (specifically China) are the main bearish forces on copper currently. If there is not a material change in either one of those, the downtrend in prices will continue.

Currencies & Bonds

The dollar extended recent gains against most major peers thanks mostly to a big rally Friday as the Dollar Index to rallied +1.18% to a new multi-year high.

During the week, however, the dollar suffered moderate losses thanks to a euro and yen rally following a "risk off" trade Wednesday. But then on Friday, the dollar rallied to another fresh 4-year high after the better than expected government jobs report.

In Europe it was all about the ECB last week, and initially the market interpreted Draghi as hawkish on Thursday. But after further digestion, the modest gains were reversed and then, upon release of our BLS jobs report, the euro took another leg lower Friday to finish the week down -1.33%.

In Asia, there was a bounce in the yen largely thanks to the aforementioned, general "risk off" trade that following the big Wednesday sell-off. But, like most other assets, it reversed on the broad "risk on" trade on Friday and the yen finished the week down -0.44%. The general trend remains lower in the yen, but there is a BOJ meeting this week. Given the velocity of the rise in the dollar/yen pair these last few weeks, I'd imagine some consolidation below 110 dollar/yen is needed.

Bonds rallied last week, with the 30-year finishing up 1.36% and the yield on the 10-year declining below 2.5%. The catalyst was mainly Europe, as disappointment toward Draghi drove European money into Treasuries, although a short-squeeze Wednesday (as the stock market was dropping) also helped push Treasuries higher. Bottom line is the jobs report reminded everyone about the strength of the U.S. recovery, but I'd expect a churn in the bond market for the next few days as the market digests the ECB measures. I would be surprised, though, if the rally moved materially higher given the news of last week. Have a good week—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."*			
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)