7:00's Report

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

October 9th, 2014

The S&P 500 printed a bullish outside reversal, which is a powerful technical indicator, and on the charts at least, there is reason to believe this pullback is over.

Pre 7:00 Look

- Futures are holding Wednesday's gains and global stock markets traded materially higher as the dovish FOMC Minutes and an earnings beat by AA spurred a global rally.
- Economically it was quiet night. German trade balance was (surprise!) worse than expected, as exports dropped 5.8% last month. But, the number is being somewhat disregarded as there were negative holiday effects.
- Econ Today: Jobless Claims (E: 293K).
- Fed Speak: Bullard (9:45 AM), Tarullo (1:10 PM), Lacker 1:15 PM, Williams (3:40 PM).

Market	Level	Change	% Change
S&P 500 Futures	1963.25	1.50	0.08%
U.S. Dollar (DXY)	85.155	-.252	-0.30%
Gold	1231.40	25.40	2.11%
WTI	87.33	.02	0.02%
10 Year	2.330	-.020	-0.85%

Equities

Market Recap

The volatility continued Wednesday as the S&P 500 surged back above the 100-day moving average following the release of the decidedly "dovish" FOMC minutes. The S&P 500 rose +1.75%.

Yesterday started off with stocks tentatively stable following Tuesday's declines, but news was quiet. With Europe negative again, stocks drifted lower throughout the morning and actually briefly broke through last week's lows of 1,926 within an hour of the open. But, shortly thereafter, the Kansas City Fed Labor Market Conditions Index came out and it was surprisingly upbeat. Between that and the general lift we've been seeing into the European close as selling pressure abates, stocks were able to claw basically back to flat by lunchtime.

The market drifted for another hour before stocks started to rally into the FOMC minutes release, and in an odd occurrence the S&P 500 was at the highs of the day right at the release. Now, the conspiracy theorists will say "someone" received the minutes early, but in all likelihood it was just nervous shorts covering in low volume that led to the rally pre-release.

By now you know the minutes were dovish, and stocks sprinted into the close from 2:00 on. Shorts rushed to cover and stocks closed just off the highs of the day, almost 9 points above the key 100-day moving average.

Bottom Line

As unsatisfying as it sounds, this market remains dominated by techincals, sentiment and fast money. Things didn't get materially better yesterday, when the S&P 500

Market	Level	Change	% Change
Dow	16,994.22	274.83	1.64%
TSX	14,666.47	90.02	0.62%
Brazil	57,058.48	-377.85	-0.66%
FTSE	6,513.22	30.98	0.48%
Nikkei	15,478.93	-117.05	-0.75%
Hang Seng	23,534.53	271.20	1.17%
ASX	5,296.68	55.42	1.06%
Prices taken at previous day market close.			

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rallied 30+ points—just like they didn't get materially worse Tuesday, when the S&P 500 fell just under 30 points.

Market	Level	Change	% Change
DBC	22.92	-.11	-0.48%
Gold	1219.60	7.20	0.59%
Silver	17.385	.145	0.84%
Copper	3.0355	-.0035	-0.12%
WTI	87.48	-1.37	-1.54%
Brent	91.53	-.58	-0.63%
Nat Gas	3.859	-.098	-2.48%
RBOB	2.3237	-.0446	-1.88%
DBA (Grains)	26.39	-.02	-0.07%
Prices taken at previous day market close.			

The bottom line here is the market is navigating and dealing with several fundamental "grey areas": 1. Is global growth materially slowing? 2. Is the ECB going to do what's necessary to stimulate growth? 3. Is a stronger dollar a dis-inflationary influence and is the Fed turning slightly more hawkish?

None of those events, in their current state, are enough to derail this rally—but all together, they could be. So, while most of us "wait and see" and hold firm, the intra-day movements are left to algos and day traders, leading to a volatile environment.

JNK: Although the fundamentals aren't any better, junk bonds will be a beneficiary of the dovish Minutes, and I'd expect a rally to ensue.

Bottom line is I still broadly expect a "churn" here and would be surprised if stocks could trade materially though the 1,980-1,990 level without positive resolution of the above issues. The Minutes and surprisingly dovish Fed may have succeeded in stopping the bleeding, but I don't think at this point it's enough to ignite a serious rally to new highs.

Economics

FOMC Minutes

The minutes were obviously dovish, given the stock market surge, dollar decline and bond rally. They were taken as dovish for three primary reasons:

- *First*, the FOMC voiced considerable concern about the state of the global economy and the potential negative impact on our economy.
- *Second*, the strengthening dollar was expressly cited as a potential headwind to growth and to the Fed meeting its inflation target of 2.0% (so the dis-inflation we've been talking about).
- *Finally*, with regard to the FOMC statement, the removal of the "considerable time" phrase (and more broadly, any material alteration of the language of forward guidance) was seen as potentially being interpreted as "hawkish."

Given the minutes, it was no surprise then that "Considerable Time" and "Significant Underutilization" stayed in the September statement – and it's clear from the minutes that the FOMC is still much more concerned about the various risks to the recovery. And this is totally trumping any urgency to begin to normalize policy.

The bottom line here is that is would appear the majority of the FOMC is more dovish than we previously believed, and their confidence in the economy remains low. This was a dovish event, and while it doesn't necessarily mean we're going to see expectations for the first rate hike pushed out from June 2015, it's certainly a step in that direction.

From an investment takeaway standpoint, although I don't think we're going to see stocks immediately move to new highs, **I think we will see money move back into more risky/higher yielding instruments**, so as a result if you own SJB I would take at least some profits, and I'm closing out our EUM hedge this morning, as the Fed's dovish will send money back into lower quality, higher yielding assets in the near term.

Commodities

Commodities were mostly lower yesterday as the energy sector fell amid bearish supply data and industrial metals traded heavy on continued global growth concerns. However, precious metals rallied on the dovishly inter-

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preted FOMC minutes. The benchmark commodity tracking index ETF, DBC, fell -0.61%.

WTI crude oil futures opened in the hole yesterday below $88/barrel and traded lower with other risk assets to start the day. Then, upon release of the weekly EIA inventory report, prices dropped to a fresh 17-month low of $86.83. The EIA reported a much larger than expected build in crude supplies (+5.0M bbls vs. (E) +1.9M bbls), a surprise build in gasoline inventories (+1.2M bbls vs. (E) -900K bbls), and an in-line number for distillate supplies (-1.07M bbls. vs. (E) -1.2M bbls).

Shortly after hitting the aforementioned lows, crude reversed direction and began to rally with the stock market as shorts covered ahead of the FOMC minutes. And, although WTI futures closed well off their lows, prices still fell -1.22% on the session.

Bottom line, crude remains under pressure because of global growth concerns and the subsequent "risk off" feel to the market. From a technical standpoint, the moving averages, trendlines and fact that we have seen a multitude of "lower lows" on the daily chart in recent weeks suggests the path of least resistance remains lower. And, as we mentioned earlier in the week, until we see the declines in crude oil stop, global growth concerns will likely continue to weigh on stocks.

Natural gas has been trading heavy in recent sessions, testing support and favoring the lower end of the current trading range between $3.80 and $4.10. Futures were beginning to show some life and trend higher. However, after further analysis, the picture has become less clear.

Market	Level	Change	% Change
Dollar Index	85.46	-.318	-0.37%
EUR/USD	1.2723	.0055	0.43%
GBP/USD	1.6151	.0058	0.36%
USD/JPY	108.27	.25	0.23%
USD/CAD	1.1112	-.006	-0.54%
AUD/USD	.8831	.0015	0.17%
USD/BRL	2.3812	-.0144	-0.60%
10 Year Yield	2.330	-.020	-0.85%
30 Year Yield	3.062	.006	0.20%
Prices taken at previous day market close.			

Natural gas may be trading in a similar pattern to how it traded during the consolidation period between March and July (see chart), which ended with futures falling over 60 cents. So, bottom line, we are getting more cautious on our long natural gas call, as many forecasts are calling for a mild winter (suggesting low NG demand) while stockpiles have been restored at a faster rate than initially expected (however, they are not yet back to "normal" levels for entering the draw season). If prices materially break through $3.80, we would have to abandon our bullish natural gas call and re-asses, as clearly the trend will have changed.

Moving to the metals, global growth concerns—reinforced by the miss in the Chinese composite PMI number—kept copper prices suppressed down toward the psychological $3.00 mark. That level will remain the focus of traders over the near term, as a break would see futures fall as much as 10 cents to $2.90. But, yesterday's sell-off in the dollar was the primary influence that prevented that from happening as copper futures were in a sharp sell-off up until the FOMC fueled losses in the dollar.

Precious metals however surged on the FOMC minutes release and sell-off in the dollar, reversing morning losses to close higher for the day. Gold and silver added +0.6% and +0.81% respectively. Again, precious metals traded nearly perfectly opposite to the dollar as both markets were focused on the "dovishness" in the FOMC minutes. Moving forward, if the dollar continues to consolidate or fall back slightly on some profit-taking, gold could continue to bounce into the mid to high $1200's, so there's probably money in a long gold trade on the long side, although I'm not willing to say we're fundamental bulls on gold (except in the very long term) as I expect the dollar to remain buoyant.

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Currencies & Bonds

Bonds had a volatile afternoon following a pretty quiet morning Wednesday thanks to two conflicting pieces of fundamental information – but at the end of the day, the long bond was little-changed, down just -0.11%.

The first piece of fundamental data mentioned above was the 10-year auction, which simply put was very bad. Rick Santelli gave it a "D" in his analysis, and it's easy to see why. First, the bid to cover (a measure of demand) was 2.52, which is the lowest since last August (of 2013). The actual yield was 1.4 basis points over the "when issued" (in bond auctions, that's a lot), showing that not only were there a low amount of bids, but the bids that were submitted weren't aggressive.

Finally, dealers (who are buyers of last resort at these auctions) bought 49% of the $21 billion auction, which is the highest since May 2013.

The key here is to consider the auction results with regard to the yield, which at 2.38% was easily the lowest of the year. So, bond buyers are "yield sensitive" in that, unlike bears past (2012/2013), they aren't interested in such low-yielding debt, implying they are negative on bonds and positive on rates. And, while it was overshadowed by the FOMC minutes, I think longer term that's something to consider.

Bonds dropped sharply on the auction results, and the 30-year traded to the lows of the day, down -0.33%. But, that drop was short-lived, as the FOMC minutes were released at 2:00 PM and were taken as decidedly "dovish" (and rightly so). The bond market retraced the earlier declines and by 2:30 the 30-year was flat.

So, the net effect was a stalemate yesterday, but momentum still rests in the short term with the bond bulls. Clearly the FOMC minutes reflect that the Fed is being made skittish by the stronger dollar and its statistical impact on inflation (which I think is a mistake and potentially only compounds the current QE addiction, but that's another story).

In currency markets, the dollar correction continued courtesy of the FOMC minutes as the Dollar Index finished down -0.44% on the day and is now more than 1% off the recent spike highs. Every other currency except for the yen knee-jerk rallied on the dollar decline (they were all flat going into the FOMC minutes). The euro ended as the best performer, up +0.6% (that is not going to make the ECB happy) while the Loonie was up +0.55%, which benefited from a better than expected September housing starts report (197K vs. (E) 196K). The pound and Aussie were up on general commodity weakness, rising +0.35% each.

The one currency that didn't rally vs. the dollar was the yen, which actually declined -0.13%, although it finished the day well off the lows. There wasn't anything specifically yen-negative out yesterday, but it's important to realize the yen saw a big rally the last few days mostly on a general "risk off" sentiment (which almost never lasts long). And, yesterday we saw some of those short-term yen longs booking profits as stocks stabilized.

Bottom line is with the Fed apparently focused on the dollar and potential dis-inflation, as per the minutes, it furthers my belief that the dollar is in for an extended churn in the low- to mid-80s, and I'd expect continued rebounds by most major currencies. Regardless of the minutes, the trend of a stronger dollar remains the dominant theme in currency markets, and any material strength by other currencies should be sold.

Have a good day,

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)			
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)			
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)			
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)			

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