7:00's Report

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

November 10th, 2014

Pre 7:00 Look

- Futures are flat this morning and global shares are drifting slightly higher in aggregate following a quiet weekend. Most of the news this morning is China related.
- China was the outperformer o/n (up 1%) after it was announced Nov 17th will be the date China opens up its stock market to more foreign investment (this was expected).
- Economically the only release of note was October Chinese trade balance, which was better than expected. Exports rose more than forecast.
- Econ Today: No economic reports today.

Market	Level	Change	% Change
S&P 500 Futures	2029.00	3.00	0.15%
U.S. Dollar (DXY)	87.450	-.276	-0.31%
Gold	1166.80	-3.00	-0.26%
WTI	79.70	1.05	1.34%
10 Year	2.312	-.063	-2.65%

Equities

Market Recap

Market volatility subsided last week but the S&P 500 still drifted to new all-time highs on the midterm elections, a "dovish" ECB and in-line economic data. The S&P 500 rose 0.79% last week and is up 9.93% year-to-date.

Last week market volatility subsided materially, as there were no days that the S&P 500 moved more than 1%. This was foreshadowed by a very slow Monday last week, as stocks were flat despite generally underwhelming global manufacturing PMIs.

Tuesday was the only down day. The S&P 500 dipped on Reuters articles about ECB infighting but closed well off its lows. The sell-off had little to no conviction.

Case in point, stocks rebounded Wednesday and had the best day of the week post-midterms and on a rebound in oil prices. Stocks continued higher Thursday post-"dovish" ECB comments before trading flat to finish the week on a decent jobs report. The S&P 500 closed just fractionally off new all-time highs.

Geopolitics: Russia/Ukraine

After a few months of calm, the situation in Ukraine is heating up. Russian tanks were reportedly crossing the border Friday and intense fighting between Russian separatists in Ukraine and government forces was reported over the weekend.

As has been the case, the truly negative event here is a full-on, blatant Russian invasion of Ukraine, but that appears unlikely still. In truth, the ruble has very quietly been crashing in the forex markets, and this move may be nothing more than a political ploy by Putin to redirect focus to Russian military might.

Regardless, an escalation of violence could be a slight headwind on stocks but nothing major, at this point. Energy, however, will be a big winner from even a slight uptick in tensions, as there is little geopolitical risk premium in the energy complex right now. If you like high risk/reward setups, energy is the way to play this right now (via XLE or XOP/FCG).

Trading Color

Last week's rally wasn't high-quality, as the S&P 500 and Dow outperformed while the Nasdaq lagged and the Russell 2000 finished slightly negative. Internally it was the same way, as defensive sectors outperformed: SPLV

Market	Level	Change	% Change
Dow	17,573.93	19.46	0.11%
TSX	14,690.83	127.45	0.88%
Brazil	53,222.85	585.79	1.11%
FTSE	6,586.91	19.67	0.30%
Nikkei	16,780.53	-99.85	-0.59%
Hang Seng	23,744.70	194.46	0.83%
ASX	5,523.96	-25.17	-0.45%

Prices taken at previous day market close.

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rose 1.2% and XLU (utilities ETF) rose 1.7% to hit a new 52-week high, while Internet stocks, biotechs and semiconductors all declined.

Banks continued to catch a bid but slightly underperformed, with KRE up 0.33%. And energy (XLE), managed to finally finish last week modestly positive thanks to a big rally Thursday/Friday.

Market	Level	Change	% Change
DBC	22.00	.12	0.55%
Gold	1171.00	28.40	2.48%
Silver	15.685	.272	1.76%
Copper	3.034	.0165	0.55%
WTI	78.66	.75	0.96%
Brent	83.37	.51	0.62%
Nat Gas	4.394	-.01	-0.23%
RBOB	2.1349	.0048	0.23%
DBA (Grains)	25.36	.06	0.24%
Prices taken at previous day market close.			

Bottom Line

Despite a lot of big headlines last week (global manufacturing data, jobs report, midterms) trading was quiet. The #1 "reason" stocks rose was underinvested managers chasing a market that is drifting relentlessly higher.

There are two specific events that are mainly responsible for the last 30 points in the S&P 500 (and the former more so than the later). First, the BOJ's "shock and awe" additional stimulus and second, stronger than expected showing from Republicans (they were expected to win Congress, but the magnitude of the victory caught people off-guard).

Those two events, while not fundamentally *that* positive, caused underinvested managers to "chase" stocks higher to add long exposure. As we near the end of the year, they fear missing a further rally, so this more than anything pushed the S&P 500 up the last 40 points.

Now with stocks so buoyant, calls for a continued "melt-up" into year-end are prevalent all over the Street.

Despite that, I remain cautious. The BOJ moves aren't enough to push the S&P 500 higher by themselves, and there is a article in the WSJ this morning downplaying the possibility of more stimulus, while the Republican victory doesn't mean Washington gets any less dysfunctional (already there is a fight brewing over immigration).

The S&P 500 has moved 11% higher from the Oct. 15 lows, completing a "V" recovery. But, with stocks at full valuations, any additional acceleration of the economy that brings more Fed tightening, a "bottom" in regard to Washington shenanigans, and sentiment toward higher stock prices an almost foregone conclusion, I'm still not a huge fan of dumping incremental money into the market here. I believe we may very well see a "19" print in the S&P 500 before we see 2,050 or 2,060.

If I were to allocate to domestic sectors, I think regional banks (KRE), consumer finance companies (which we briefly covered last week) and retailers (RTH) are attractive given current market dynamics. But, for those with longer time horizons (months/quarters), I continue to advocate HEDJ as the most-attractive risk/reward setup out there for incremental capital. That opinion was further solidified by the ECB last week.

Economics

Last Week

Global economic data were again mildly disappointing last week, but they didn't turn negative. Against the backdrop of global central banks becoming "more" accommodative, the data were good enough not to change the current outlook that the global recovery is (barely) continuing—but that outlook is enough to hold stocks up at current levels.

From a stock standpoint, global data are more important than U.S. data in the near term because everyone is comfortable the U.S. economy is getting better. How much better can be debated, but there's ample evidence to show it's gaining momentum.

The same can't be said for the global economy. Last week's manufacturing and composite PMIs from China and Europe were slightly disappointing in that they missed expectations. No global readings were above 52 (keep in mind 50 means no growth; even 52 represents slow growth), so none of the numbers were "good."

But, they did stay above 50 and the important distinction is that the global economy is still recovering (albeit slowly). The sell-off in late September/early October was partially predicated on the idea the global recovery was failing. Last week's numbers further refuted this

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concern; that's the important takeaway (stocks can hold these levels as long as the global recovery isn't failing).

Here in the U.S., manufacturing data and jobs were in focus. The October PMIs were generally fine, in that they showed the manufacturing and service sector continuing to expand at a good pace (both were above 57).

Turning to the jobs report, it was also generally in-line, with 212K job adds. This missed expectations of 240K but closely tracked the rolling 12-month average of 222K. So, it was in the middle of our "just right" range.

But, I do want to point out that the jobs report was a bit more "hawkish" than the market reaction. Importantly, the unemployment rate fell to 5.8%, which is not very close to the 5.5% "normal" unemployment rate. Also, U-6, which considers underemployment, dropped to 11.5% from 11.8%—the lowest levels in several years.

The "dovish" reaction came from the wage data, as wages rose 2.0% yoy (above 2.2% is "hawkish.") But, keep in mind wages always lag an improving jobs market. While this report won't cause expectations of the first rate hike to be pulled forward, it does solidify June as a target date for the first hike, and I'm not sure the bond market accurately reflected that on Friday.

Finally, the Fed and BOJ were quiet last week while the BOE made no changes to rates or policies (as expected). The ECB was the highlight of the week, and while it didn't change any policies, Draghi did as good a job as possible of "talking" dovish. He refuted various accounts of infighting at the ECB, explicitly saying economic risks were to the downside. He added that ECB staff are now researching alternative ways to stimulate the economy (which means corporate bond purchases and QE).

Bottom line, the ECB continues to slouch toward QE and more stimulus. While "euro bulls" wish they would hurry, the important thing is they are headed in the right direction. The ECB this week reinforced my bullish Europe thesis.

This Week

This week will be very quiet. First, keep in mind bonds and banks are closed Tuesday for Veterans Day. Second, there is really only one economic report of note this week domestically, and that's Retail Sales (Friday). There is now a month-plus of lower oil prices in the economy, so it'll be important to see retail sales (ex gasoline) increase *if* the U.S. consumer is really starting to come out of his/her shell.

Internationally, the latest round of Chinese economic data Thursday night (retail sales/industrial production) is obviously important from a global growth standpoint (these numbers need to continue to show incremental progress).

In Europe, the Bank of England's inflation report Wednesday is the highlight, but that really will only affect the pound. And, given the precipitous decline in the pound the last few weeks (it hit new 52-week lows vs. the dollar last week) there is the chance for a "hawkish" surprise. But that won't be a reason to be enthusiastically long the pound unless it's a real shocker.

Finally, the flash estimates for Q3 European GDP come Friday morning, and like the Chinese data earlier this week, it's important from a "Is the global recovery ongoing?" standpoint.

Bottom line, while there are numbers to watch this week (again, the Chinese data is the uncontested highlight) nothing this week should make anyone's outlook on the global economy materially worse or better, even with some big surprises.

Commodities

Market	Level	Change	% Change
Dollar Index	87.705	-.429	-0.49%
EUR/USD	1.2444	.0071	0.57%
GBP/USD	1.5868	.0039	0.25%
USD/JPY	114.49	-.71	-0.62%
USD/CAD	1.1324	-.0097	-0.85%
AUD/USD	.8636	.0079	0.92%
USD/BRL	2.558	-.0112	-0.44%
10 Year Yield	2.312	-.063	-2.65%
30 Year Yield	3.046	-.047	-1.52%
Prices taken at previous day market close.			

Commodities were mostly lower again last week pushing the benchmark commodity tracking index ETF, DBC, down 1.52% as the dollar rallied another 0.71%. There were fresh multi-year lows established in both crude oil and gold early in the week. Natural gas however was a notable outlier. It was the best performer in the space, as futures rallied over 13% on the week.

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Beginning with the primary focus of the commodity space, crude oil fell 2.81%—marking the 6th consecutive weekly loss. Traders are focusing on OPEC and whether or not it will cut production in order to defend the price of global crude oil prices at its Nov. 27 meeting. And as of now, most market participants don't feel it will do enough to tackle the oversupply issue (largely because of the Saudis' decision to maintain market share rather than curb production recently). Remember too that OPEC cut its demand outlook for the next 20 years last week. So, both the supply and demand sides of the fundamental equation remain bearish for crude oil prices. Going forward, we could see further declines in the next couple of weeks as the OPEC meeting approaches; however, if they take "adequate" action in the form of a production target cut, prices could quickly rebound toward the $90-$100 range. So, all eyes on Vienna on Nov. 27.

Natural gas was the big mover last week. Futures rallied every day to gain 13.24% on the week, mostly due to forecasts for much lower than average temperatures set to sweep across the country. The price of natural gas is now up 23% in just 2 weeks. With approximately half of U.S. households heated directly or indirectly (through nat-gas-burning power plants) by natural gas, speculators are expecting a big increase in demand over the coming weeks. From a supply standpoint, however, the EIA reported a 90+ Bcf build in stockpiles last week, which is around double the average for this time of year. Until we see the number start to agree with the speculation, we remain skeptical of this rally. Bottom line, until the froth comes out of the market and a clear trend develops on the charts, we will remain sidelined here.

Meanwhile gold rallied for the first week in 3 to finish higher by 0.44%. Gold futures traded to a fresh 4-year low early in the week on follow-through selling and more uber-dovish comments from the BOJ's Kuroda. This will further influence a stronger dollar and hence, lower gold prices. But, futures reversed direction Friday morning following the modest miss in the October government jobs report. The report really wasn't that bad, but the headline miss caused a short-squeeze reaction and prices rallied 3.28% on Friday. Both the fundamentals and the technicals of the gold market suggest prices will continue to fall. As soon as a near-term "top" forms on the daily chart, we will be opening short positions.

Moving to the industrial metals, copper fell 0.61% last week; however, futures are trading much better now. Copper traders continue to look at global growth metrics and forecasts, which have been grim lately, but the bottom that has begun to form on the charts suggests traders are more-optimistic (or at least less-pessimistic) about growth expectations. An opportunity to get long copper is in the works, but it is not time to buy just yet, as we need further confirmation on the charts.

Currencies & Bonds

The U.S. dollar rally continued last week as the Dollar Index traded above 88 for the first time in several years. The main reasons for the strength was weakness in the euro and yen, as the ECB and BOJ, as the firmed up their commitment to monetary stimulus sending those currencies lower.

The yen weakened vs. most of its 31 major counterparts and continued its fall after the BOJ's surprise addition to stimulus two Friday's ago. The yen declined about 2% last week and temporarily broke above 115 yen/dollar before bouncing late in the week.

The euro also declined more than 1% vs. the dollar last week following the ECB meeting as expectations for more stimulus continue to grow. But, like the yen, despite hitting multi-year lows before 1.24 last week, the euro bounced on Friday. That's because the dollar pared its weekly gain and fell the most in three weeks Friday after the jobs report and some general long liquidation. Going forward we may see some short term dollar consolidation, but the trend is still definitively higher against all currencies.

Bonds finished last week higher thanks to a big rally following Friday's jobs report. The market clearly took the data as "dovish" (although again I'm not sure that's the right take), and Treasuries surged to two week highs. Bottom line is Treasuries remain well supported near term by European and Japanese buying and now as geopolitical tensions tick higher. But, keep in mind domestic fundamentals continue to get worse for bonds, and at some point that will have to be reflected in the market. 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	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*
12/13/13	FCG XOP	18.97 65.62	None	*Natural gas supplies low, increasing 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
September 2014	**Long Europe**	**HEDJ**	*On a longer time frame, Europe is poised to outperform other major developed economies as the ECB is proving their unanimous commitment to increasing the Balance Sheet. HEDJ is the equivalent of Japan's DXJ ETF and is the best way to gain exposure to Europe while hedging against currency depreciation.*
Strategy Update (11/6/14): The ECB continues to slouch towards more stimulus and QE, and at the October ECB meeting Mario Draghi did as good of a job as possible to "speak" dovish and reiterate that the ECB remains unanimously for more stimulus if needed. Additionally, the ECB staff has begun work on modeling more stimulus, which is the most concrete sign yet the ECB is planning to do "more" in early 2015. We continue to view dips as buying opportunities.			
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 (11/3/14): The Bank of Japan shocked markets last week by announcing massive new monetary stimulus. I have been a Japan bull since late 2012, and I never thought the BOJ would go this far. The trend lower in the yen/higher in DXJ has clearly resumed, with a reasonable target for the dollar/yen now 115-120. This is a trend that will outperform over the coming months/quarters as the yen devalues and the BOJ/GPIF buys Japanese stocks.			
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 (11/6/14): Treasuries are finally beginning to roll over here on the charts. The fundamentals for this trade remain decidedly negative, but once again money flows (specifically European) have recently been trumping the fundamentals.			

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Asset Class Dashboard

(Updated 11.10.14)

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 rally continued last week as the S&P 500 moved to a new all time high following a "dovish" press conference by the ECB and a Republican victory in the mid-terms. Going forward the general outlook for stocks remains positive, but despite the near universal expectation of a "melt up" into year end, I remain more cautious on a risk/reward basis at these levels.*
Best Idea: Buy Regional Banks (KRE). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Bearish**	**Bullish**	*Commodities continued to decline last week as global economic data was lack luster and the dollar rally continued. Crude oil managed to stabilize, though, helped by an uptick in geo-political tensions, while natural gas surged on cold weather.*
Best Idea: Buy Oil (USO) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index surged above 88 last week before giving some ground back following the "dovish" October jobs report. Euro and yen weakness were main reasons for the dollar strength last week, and although we need to see some short term consolidation, the trend in the dollar remains firmly upward.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries staged another huge rally on Friday following the October jobs report, taking the reading as "dovish." Between that interpretation and continued foreign buying Treasuries remain well bid, despite deterioration bond fundamentals domestically. That will have to reconcile itself at some point, but it's not in the near term.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			

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