7:00's Report

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

November 13th, 2014

HEDJ: The rebound in European shares is now at a critical juncture, and tomorrow's GDP report could well decided is "Europe" breaks out or breaks down in the near term.

Pre 7:00 Look

- Futures and international market are mostly higher this morning as Japan hit fresh 7 year highs while strong telecom earnings are boosting EU stocks.
- Economically, Chinese Industrial Production missed (7.7% vs. E: 8.0%) and Retail Sales were in-line, but markets are shrugging off the data as there was an article out about more Chinese stimulus.
- Fed Vice Chair Dudley spoke o/n in the UAE but his comments didn't reveal anything new (they are being spun as "dovish" but they really weren't).
- Econ Today: Weekly Jobless Claims (280K) Fed Speak: Plosser (12:30 PM), Yellen (12:45 PM)

Market	Level	Change	% Change
S&P 500 Futures	2041.75	5.75	0.28%
U.S. Dollar (DXY)	87.765	-.141	-0.16%
Gold	1161.00	1.90	0.16%
WTI	76.69	-.49	-0.63%
10 Year	2.359	-.001	-0.04%

Equities

Market Recap

It was three in a row Wednesday in the markets. Despite multiple catalysts and potentially market-moving news events, markets once again ended the day little-changed. The S&P 500 closed down 0.07%.

Initially stocks were lower Wednesday, reminding everyone that markets can actually go down. Europe was the main excuse for the weakness as its banks were lower on the global currency manipulation settlement (Barclays was the hardest-hit) and some lackluster retail earnings from the UK.

Macy's reported earnings that sent the stock higher, but that was despite cutting guidance (the numbers weren't as bad as feared). As a result, the rally in the stock didn't help the broader market much.

Headlines aside, the real reason for lower stock prices initially on Wednesday was light profit-taking. And, as to be expected, the weakness in stocks didn't last all that long, as the S&P 500 was back to flat by lunchtime, recovering from being down 0.4% mid-morning.

Like Monday and Tuesday the afternoon was very quiet as the S&P 500 traded in a tight 3-point range before catching a late rally (again) into the close to finish very slightly positive. It was again another very uneventful day.

Trading Color

Yesterday's trading was actually stronger than the S&P 500 implied. The Russell rallied 0.6% and the Nasdaq 0.35%, and the former hit a new 4-month high and the

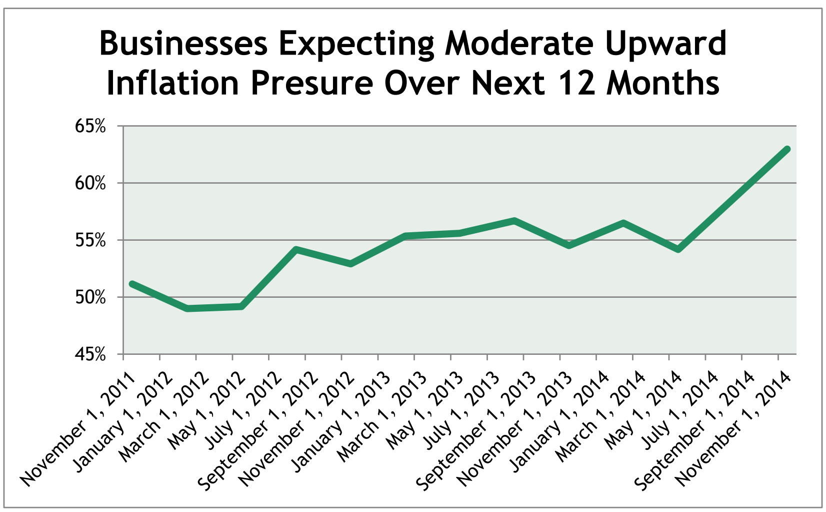
Market	Level	Change	% Change
Dow	17,612.20	-2.70	-0.02%
TSX	14,831.08	70.81	0.48%
Brazil	52,978.89	504.62	0.96%
FTSE	6,628.12	17.08	0.26%
Nikkei	17,392.79	195.74	1.14%
Hang Seng	24,019.94	81.76	0.34%
ASX	5,442.70	-74.40	-1.35%
Prices taken at previous day market close.			

latter hit a new multi-year high, inching toward that magic 5,000 mark we haven't seen in 14 years!

Market	Level	Change	% Change
DBC	21.81	-.07	-0.32%
Gold	1158.90	-4.10	-0.35%
Silver	15.635	-.043	-0.27%
Copper	3.0265	-.0065	-0.21%
WTI	76.86	-1.08	-1.39%
Brent	80.66	-1.73	-2.10%
Nat Gas	4.18	-.067	-1.58%
RBOB	2.0950	-.0086	-0.41%
DBA (Grains)	25.72	.08	0.31%
Prices taken at previous day market close.			

Sector-wise it was a mixed day with 4 S&P 500 sub-sectors higher and 6 lower. Utilities were the story yesterday as they got hit hard, dropping 1.7% on profit-taking as XLU fades away from recent 52-week highs. (The Atlanta inflation number weighed on the sector temporarily, but yesterday's declines weren't because of that report—XLU was sharply lower even before its release.)

Energy was also for sale again yesterday on lower oil prices (front-month Brent contracts dipped below $77 for the first time since 2010), and it continues to look like XLE is rolling over at the 50-day moving average.



On the positive side of things, retailers were some of the best performers in the market as M rallied after earnings while FOSL jumped 7% on legitimately good results (as opposed to M's better-than-feared print). RTH (retailer ETF) rose 0.62% and hit a new 52-week high.

Finally, banks continued to trade very well. KRE was up 1.6% and closed at a 7-month high, as U.S. banks ignored the currency manipulation settlement in Europe.

Very quietly there was a "higher rate" trade in markets yesterday as utilities/REITs underperformed while banks outperformed. That was the first time in a while we've seen a rotation like that.

Finally, "Europe" traded poorly yesterday and badly underperformed U.S. markets following more underwhelming data and spotty earnings. HEDJ is now at an important inflection point (chart on page 1) and the GDP print on Friday will be important—if it can surprise to the upside, especially in Germany, then HEDJ may be able to break through a multi-month downtrend.

Bottom Line

There have been some slight changes on the margin so far this week, but the overall market narrative remains the same: Under-invested managers continue to use dips as opportunities to get more "long" and the general outlook for the U.S. and global economy remains broadly the same (a weak recovery but a recovery nonetheless).

But, as stated, there are some marginal changes to monitor. First, crude continues to slide and Brent is now sitting at nearly a four-year low. This isn't dragging down stocks the way it did in late September/early October. But oil simply can't catch a bid and if the declines accelerate materially, that could weigh on stocks.

Also, the cease-fire in Ukraine continues to fray. There have been constant reports of Russian troops re-supplying separatists in Donetsk and there are fears Putin is trying to carve out a path through eastern Ukraine to Crimea. Again, this hasn't weighed on markets yet and won't unless the situation escalates materially from here, but the trend for energy is likely upward.

Finally, yesterday's soft European IP report was somewhat ignored by the market, but that may be a mistake. It was widely expected that EU industrial production would bounce back in September, and it really didn't. Remember, concern about Europe was the main driver of market weakness in late September/early October, and that makes Friday's GDP reports all the more important. If they are materially weaker than expected, then Europe could drag stocks lower again.

Bottom line, this market remains buoyant but I continue to be cautious here and think the most likely course is a sideways chop or dip. I'm not adding additional exposure at these levels.

Economics

Atlanta Fed Business Inflation Expectations

- YOY Business Inflation Expectations increased to 2.0% from 1.9% in October

Takeaway

Around 10 AM yesterday, the Dollar Index rallied and bonds sold off (a typically "hawkish" reaction). The reason was a slight uptick in the little-followed Atlanta Fed Business Inflation Expectations Survey.

What made the report "hawkish" wasn't the fact that expectations for year-over-year inflation rose to 2.0% (they were at 2.1% earlier this year). Instead it was that the percent of business executives who saw inflation as starting to trend higher over the next 12 months jumped from 54% in May (the last time the questions was asked) to 63% in November, which is a multi-year high.

Declining inflation expectations as measured by the bond market have been a big topic of discussion and are partially responsible for the "dis-inflation" talk here in the U.S. But actual expectations by business owners for inflation pressures over the coming 12 months are trending materially higher—not lower.

Combine that with the uptick in the Fed's quarterly wage inflation data, and there are growing signs that wage inflation has bottomed and is finally trending upward. (This is anecdotally confirmed by the U-6 underemployment index dropping to multi year lows at 11.5% in last week's jobs report.)

Bottom line, I'm pointing this out because there are very few people prepared for inflation. From a portfolio standpoint, while it isn't something we need to position for today, it is something we need to watch for. That's because there are signs emerging that inflation has bottomed, and is starting to (slowly) gain some upward momentum, led by wage gains.

This is something we will continue to watch over the coming months/quarter, because if we do see inflation, that's a major trend change few people are properly positioned for at this time.

Market	Level	Change	% Change
Dollar Index	87.91	.191	0.22%
EUR/USD	1.2435	-.0039	-0.31%
GBP/USD	1.5786	-.0132	-0.83%
USD/JPY	115.55	-.22	-0.19%
USD/CAD	1.1315	-.0015	-0.13%
AUD/USD	.8715	.003	0.33%
USD/BRL	2.5657	.0092	0.36%
10 Year Yield	2.359	-.001	-0.04%
30 Year Yield	3.080	-.012	-0.39%
Prices taken at previous day market close.			

Commodities

The commodities market was rather quiet again yesterday until the energy close (2:30 PM) when both Brent and WTI crude oil futures sold off to new session lows for no real apparent reason. The metals all suffered mild losses as the dollar rallied while grains continued to outperform. The broad-based commodity tracking index ETF fell 0.37% and the DB Agriculture ETF, DBA, rallied 0.31%.

Beginning with energy, crude oil prices rolled over shortly after the primary session closed yesterday (2:30) and finished the day down 1.36% at a fresh four-year low. There was some confusion in yesterday's Report and the weekly EIA inventory report is actually today at 11:00 AM, delayed a day because of the Veterans Day holiday. Again, analysts are expecting a +1.1M barrel build in crude stocks, a +350K barrel build in gasoline supplies, and a -1.5M barrel draw in heating oil inventories.

Bottom line, traders will be watching the EIA numbers and any surprises will move the market on a short-term basis. However, the real focus of the market remains the OPEC meeting on Nov. 27th, and any notable analyst estimates or chatter surrounding that topic is what is really influencing the price action. For now, the risk for some short-covering continues to exist; however, the broader trend is still lower.

Natural gas continued to slide yesterday, falling 1.95%. Futures continue to approach some solid support at $4.10, but until that level is reached, there are no clear opportunities in the market at this time.

It is worth noting that because of the Veterans Day holiday, the EIA will release the weekly statistics for natural gas stockpiles at 10:30 AM tomorrow morning, not today as is the normal schedule. On the charts we remain focused on the aforementioned support level at $4.10 while there is resistance above at $4.30.

Trading in the metals remained subdued yesterday as copper continued to hover just above the $3.00 mark amid no real market-moving news. Meanwhile gold drifted only slightly lower, down 0.3% as a direct result of dollar strength. There are a couple of FOMC members due to speak today as well as weekly jobless claims at 8:30 AM, but other than that the newswires should remain quiet and the market will likely do the same.

Looking ahead we remain bearish gold based on the direct correlation precious metals have with the dollar. The dollar appears to be in a "consolidation pattern." However, when the greenback begins to rally again, gold will likely begin an equal and opposite move to the downside.

Currencies & Bonds

Currency trading was more nuanced on Wednesday as moves were driven by country specific news as opposed to some macro force, but like Monday the dollar started the day lower but again reversed to finish up .22%.

The most direct catalyst for dollar strength was the aforementioned Atlanta Fed Business Inflation Expectations Index (again 71% of respondents expected moderate to strong upward pressure from labor costs and 62% from non-labor costs). That helped the dollar move higher as it's yet another sign of a subtle upward turn in labor costs, which ultimately proceeds an uptick in inflation.

The biggest mover vs. the dollar yesterday was the British pound, which dropped .7% to new 52 week lows following an employment report and the Bank of England inflation report. Both were mostly in line with expectations in actuality, but as the day went on the inflation report was viewed as more "dovish" than initially thought. Specifically, the outlook for Q1 '15 inflation fell to 1%, and that number is seen as giving the BOE cover to further delay rate hikes if needed. Additionally, slowing global growth and persistently low global inflation were specifically cited as risks to the downside (again dovish).

But, before we get too excited about a weaker Pound and book our tickets to London, the news wasn't all dovish and for those of us that dive into these types of reports, there was also an interesting signal in wage inflation in yesterday's employment report. The 3 month moving average of wage increases rose to 1% year over year, up from 0.7% in the previous employment report, and that's a pretty decent uptick. So, just like here in the US, there are signs that wages are finally starting to bottom and gain some upward momentum, and while it won't change anything in the near term from a central bank outlook standpoint, it does tilt risks further to a "sooner than expected" rate increase.

Bottom line, the dollar is universally strong and will continue to be so, but the Pound, despite hitting new 52 week lows yesterday, has the greatest potential to surprise to the upside. Futures markets now predict the BOE won't raise rates until August of '15, after moving that number out substantially over the past two months. But, risks remain for a sooner than expected increase, and I continue to advocate the Pound as the best potential "long" vs. the dollar among the major currencies, if you need that type of exposure.

Bond markets also reversed yesterday as Treasuries opened sharply higher following the Tuesday holiday but then quietly reversed as the 30 year finished down –4.% and the declines are continuing this morning. The Atlanta Inflation Expectation index was the main negative catalyst for the reversal in bonds, but there was also another uninspiring Treasury auction. Treasury sold 24 billion worth of ten year notes and the bid to cover was 2.52, which is tied for the lowest for the year (matching October). Today focus will be on the 30 year auction, but given European influence on the Treasury market, tomorrow's EU GDP report could be a big catalyst. Treasuries have retracted most of last Friday's jobs report rally, and if we see a break below last Friday's low in the 30 year (140'08) that could ignite some more selling.

Have a good day,

Tom

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)			