7:00's Report

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

November 17th, 2014

Pre 7:00 Look

- Futures are modestly lower this morning as Japan's surprisingly bad GDP report weighed on Asia and that is pulling global markets lower. The Nikkei fell 3% o/n.
- Japanese Q3 GDP fell -1.6% vs. (E) 2.2%, reminding everyone that global economic growth remains at risk. The report almost certainly will result in a delay of the sales tax and snap elections in December.
- Econ Today: Empire State Manufacturing Survey (E: 10.36), Industrial Production (E: 0.2%).

Market	Level	Change	% Change
S&P 500 Futures	2033	-5.00	-0.26%
U.S. Dollar (DXY)	87.73	.137	0.16%
Gold	1190.40	4.80	0.40%
WTI	75.33	.-49	-0.65%
10 Year	2.322	-.025	-1.07%

Equities

Market Recap

Stocks rallied small but hit fresh all-time highs in what turned out to be a very slow trading week, with the S&P drifting sideways in a mere 15-point range peak to trough. The S&P 500 gained 0.38% last week and is now up 10.36% this year.

Basically all of last week's gains came Monday, as stocks rallied on positive Chinese export data and an in-line CPI report that suggested there is more room for economic stimulus if needed. Also from China came the news that Chinese stock exchanges would link with Hong Kong and allow foreign investors access to domestic stocks for the first time.

Stocks basically treaded water for the remainder of the week as Tuesday-Friday saw the S&P 500 trade virtually unchanged. Tuesday was the slowest day of the week thanks to Veterans Day and the bond market closure.

Wednesday was a little more active as declines in European shares initially weighed on futures (Europe was down on earnings and news of the bank settlement), but stocks rebounded to again close flat.

Thursday was the busiest day news-wise, with soft economic data from China, multiple earnings from big-name companies (WMT, KSS, CSCO) and a strong U.S. JOLTS report. And, stocks actually moved intraday Thursday on a guidance cut by UPS at an investor conference. But the declines were short-lived and the market finished flat again before drifting sideways quietly on Friday to another virtually unchanged close. Overall it was a very, very quiet week of consolidation.

Trading Color

Internals were mixed as the Russell finished flat (slightly underperforming the S&P 500) while the Nasdaq handily outperformed as large-cap tech surged. Tech bellwethers like AAPL, MSFT, CSCO (off earnings) and others led markets higher last week, and that sector has clearly become a market leader ever since the "V" bottom started in mid-October.

From a sector standpoint, results were mixed with no well-defined trend to speak of. Those sectors that did move traded off of earnings and sector-specific news.

Utilities were the big underperformer last week, mostly on profit-taking following the announcement of the cli-

Market	Level	Change	% Change
Dow	17,634.74	-18.05	-0.10%
TSX	14,843.10	64.33	0.44%
Brazil	51,772.40	-73.63	-0.14%
FTSE	6,636.80	-17.57	-0.26%
Nikkei	16,973.80	-517.03	-2.96%
Hang Seng	23,797.08	-290.30	-1.21%
ASX	54,412.55	-41.80	-0.77%

Prices taken at previous day market close.

mate agreement between China and the U.S. The negative thought is that it will further reduce emissions from power plants and hurt margins. But, that's a pretty quick and broad extrapolation, and while we may see some more profit-taking over the net few days, if you think rates are going to stay low, this may be an opportunity to buy utilities down in the mid-$43s on XLU if it gets there (about 1.5% from current levels).

Market	Level	Change	% Change
DBC	21.60	.19	0.89%
Gold	1190.00	28.50	2.45%
Silver	16.285	.664	4.25%
Copper	3.0460	.0515	1.72%
WTI	75.90	1.69	2.28%
Brent	79.48	1.99	2.57%
Nat Gas	4.028	.051	1.28%
RBOB	2.044	.0424	2.12%
DBA (Grains)	25.85	-.05	-0.19%
Prices taken at previous day market close.			

Conversely, retailers traded well last week thanks to earnings from WMT and JWN, and RTH (the retail ETF) rallied nearly 3% and hit a new 52-week high. The consumer finance names I mentioned last week as part of my "Return of the U.S. consumer" thesis also traded well (SFY and LEAF). As oil continues to plunge and US economic data stay firm, I believe there's continued upside in that strategy.

Turning to energy, XLE declined 2% last week as oil continued to fall. Rumors of a HAL bid for BHI (which were just confirmed this morning) helped the space stabilize Thursday and Friday, but I continue to be cautious on energy stocks here. While I recognize there is a value argument for the sector, I want to see some sort of stabilization in crude before catching this knife. As I said Friday, if I were to trade it, I'd be inclined to sell XLE puts or a put spread with expiration a few months out.

Bottom Line

Despite impressive buoyancy from the market, I remain cautious on stocks here because I believe the last 3%-4% move in the S&P 500 (from 2000) was mostly underinvested longs "chasing" stocks higher after the surprise stimulus by the BOJ and bigger than expected Republican victory.

If stocks continue to move higher from here absent a legitimate positive catalyst, I think it'll be because more managers are "chasing" markets higher into year end, which isn't particularly healthy. And, that's simply not a rally I want to buy into because from a risk/reward standpoint, I think we're looking at a few potential percentage points on the upside and risking more than that on the downside if we get another dip.

While positioning has been a positive for stocks, the fundamentals over the past two weeks haven't gotten better and risks are re-emerging:

First, global growth isn't as bad as feared back in October, but we were reminded by Japan this morning, global growth remains a risk and Europe specifically remains a weak spot. ***Second, Washington is back as an influence on markets*** and President Obama's decision to use executive orders on immigration will almost certainly create an acrimonious backdrop in Washington. Importantly, the Republicans won't shut down the government or stage another fiscal cliff showdown. But, the likelihood of anything positive coming out of Washington is significantly reduced compared to two weeks ago. ***Third, we are starting to see divergences again in bonds***. JNK did not trade well last week and is starting to roll over again—*keep in mind this ETF predicted the last two sell-offs*. ***Fourth, any further economic growth raises the prospects of Fed rate hikes sooner than expected***, and the December Fed meeting is going to be important from a market expectation standpoint.

Finally, at 17X 2014 EPS and 15.5X 2015 EPS, the market is mostly fully valued. I'm not sure there's a major positive catalyst that could send us materially higher from here, and I continue to think a period of consolidation or decline back toward the 2,000 level isn't out of the question, although that's obviously not the consensus view.

Economics

Last Week

The most important reports last week were international, as concern about the pace of global growth remains the No. 1 risk to this stock rally (and we are being reminded of that fact by Japan this morning). To that end, the data were generally in line with expectations and further solidified that the global economic recovery is inching forward. I'm not going to go too in depth on these numbers because they basically will be obsolete when the November flash PMIs come out this Wednesday/Thursday, but the data from last week are worth a quick rundown.

Starting in China, October credit growth and industrial production both slightly disappointed. Meanwhile retail sales were in line and exports slightly beat. On balance, the data were slightly disappointing but not bad enough to materially change anyone's outlook on Chinese economic growth. As a result, data didn't move markets.

In Europe, the first look at Q3 GDP was a little bit better than expected, with German GDP rising 1.2% yoy and EMU GDP rising 0.8% yoy in Q3. But, although both numbers technically beat expectations by 0.1%, it's not like growth of 1.2% or 0.8% is good in an absolute sense. The best you can say about this number was that it wasn't as bad as feared. But, given that it's a dated report (remember this is through September), it really isn't changing anyone's outlook on the EU economy.

Domestically the highlight last week was retail sales number, which hit Friday and was a positive surprise. Not only did the headline beat for October (up 0.3% vs. (E) 0.2%) but the "control" group of retail sales—which is sales less autos, gasoline and building products—saw a 0.3% gain. Most importantly it saw the soft September number revised to flat (0.0%) from -0.2%.

This not only makes the September dip in consumer spending less concerning, but also reinforces our bullish thesis on the U.S. consumer, which we've emphasized the last two weeks. Case in point, the gains in the control group of retail sales were led by Internet purchases (up 1.9%) and food and beverage establishments (eating and drinking out). Those discretionary activities should continue.

The other noteworthy piece of data last week was the "JOLTS" report (Job Opening and Labor Turnover Survey). The headline was a slight miss but more importantly job "quits" rose 243K to 2.8 million in September. That's important because more people quitting jobs implies greater confidence in finding another job. This is further anecdotal proof of a tightening labor market (which is good for the economy and "hawkish" for the Fed). By itself, it's not enough to make the Fed more "hawkish," but a growing number of anecdotal indicators imply there is real tightening in the labor market. Interest rates aren't reflecting this right now.

This Week

The two primary macro concerns for the market (and the two biggest risks to the rally) remain—**is the global recovery still ongoing** and **is the dis-inflation/deflation threat growing**—and we will get additional and important data with regard to both.

The most important data points of the week are the November global flash manufacturing PMIs, which come Wednesday night and Thursday morning. As a reminder of how important these releases can be, it was the October flash PMIs that initially helped stop the relentless selling in early October, as the data implied the global economic recovery was still intact. And again, the key is that the data show the global recovery is indeed still a recovery—regardless of how slow it is progressing.

In China and Europe, the 50 level remains key. Any drop below 50 in Chinese or EMU PMIs, or a drop materially toward 50 in Germany, will be taken as a negative.

After the global PMIs, the Fed minute release from the October meeting, due Wednesday, is the next most important event this week. The outlook for Fed policy remains pretty stable (first rate hike anticipated in June '15), but keep in mind this was the meeting where QE ended and the FOMC was a bit more "hawkish" than expected. If the details of the minutes show a Fed more committed to normalizing policy than the market expects, that could be perceived again as more "hawkish" than expected.

Market	Level	Change	% Change
Dollar Index	87.49	-.262	-0.30%
EUR/USD	1.254	.0065	0.52%
GBP/USD	1.5692	-.0017	-0.11%
USD/JPY	116.15	.42	0.36%
USD/CAD	1.1266	-.0099	-0.87%
AUD/USD	.8759	.0039	0.45%
USD/BRL	2.5984	.0097	0.37%
10 Year Yield	2.322	-.025	-1.07%
30 Year Yield	3.049	-.027	-0.88%
Prices taken at previous day market close.			

Turning to inflation, October CPI is also released Thursday. Given the recent drop, that will be an important release as far as gauging the risk of dis-inflation. Inflation metrics have bounced lately and a confirmation of that by the core CPI (which excludes energy) will be an important positive for markets, as it'll imply the dis-inflation threat is receding outside of the commodity sector.

Those are the "Big 3" events this week, but we also get Industrial Production as well as the first look at November economic activity this morning via the Empire State manufacturing survey. (However, the flash PMIs later this week will make this report significantly less important than last month, when a big drop caught markets off-guard.) Finally, we'll start getting October housing data this week, with Housing Starts Wednesday.

Commodities

Commodities were mixed last week as energy prices continued to slide, but precious metals bounced on a late-week correction in the dollar. Grains also rallied as snow blanketed 6 major grain-producing states last week. The benchmark commodity tracking index ETF, DBC, fell 1.5% to a fresh multi-year low while the agriculture index DBA saw a weekly gain for the first time in 5 weeks.

Oil and the energy sector remains the primary focus of the commodities markets as futures declined for the 7th consecutive week (note that futures have fallen 13 of the past 15 weeks). The fundamentals have remained largely the same as supplies remain abundant/demand stagnant, and everyone is speculating as to whether or not OPEC will take *enough* (or any) action at the Nov. 27 meeting. Many analysts believe $70/barrel is the line in the sand that will provoke production cuts both globally within OPEC and domestically because of high fracking and exploration costs.

Moving to the metals, it was a pretty quiet week until Friday when the Retail Sales report beat expectations and St. Louis Fed President Bullard made dovish comments during a morning speech on the U.S. economy and monetary policy. Those two things caused a sharp sell-off in the dollar and subsequent short-covering rallies in both precious and industrial metals.

Based on the longer-term fundamentals and the idea that the dollar is poised to continue rallying once this consolidation period (in the greenback) comes to an end, the outlook for precious metals remains lower. We continue to advocate selling gold short anywhere between $1,180 and $1,220 with an initial downside target of $1,120.

Currencies & Bonds

The U.S. dollar was left flat on the week as euro strength was offset by pound and yen weakness. The greenback mostly traded off other currency fundamentals last week as economic data in the U.S. were quiet.

The yen was the big mover vs. the dollar as it fell to fresh 7-year lows, down 1.28%, and the dollar/yen broke decisively through 116. But, the terrible GDP report out last night (which puts Japan in recession) is the focus of markets this morning. And, counter to what you would think, although the data was bad the yen has rallied off the news and is flat, as bad economic data like that is initially taken simply as a "risk off" catalyst. I would expect the yen to bounce over the next few days off this news.

The pound was the second-biggest mover vs. the dollar last week as it fell 1.28% to new lows following the release of a "dovish" inflation report. Inflation is forecast by the BOE to be just 1% in Q1, lower than expected, and that further implies the BOE may delay expected rate hikes into the second half of 2015.

The euro saw an oversold bounce of 0.5% vs. the dollar last week after GDP numbers weren't as bad as feared. But the euro remains broadly under pressure and any material strength should be looked at as a shorting opportunity.

Bonds were flat last week as they remained buoyant despite three poor Treasury auctions. The 3-, 10- and 30-year auctions last week failed to impress, but that was partially a function of just a slow trading week (bonds were closed Tuesday for Veterans Day). Bottom line is economic data continue to improve and the domestic fundamentals get more bond-negative. But until we see German bunds begin to decline and the European economy get better, Treasuries will remain well-bid.

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 11.17.14)

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**	*Stocks chopped sideways last week during quiet trading, and while the market remains buoyant, I continue to be skeptical about how much more is left in this "V" bottom. Most of the recent buying has been underinvested longs chasing stocks higher, and while that could continue for another 10-30 points in the SPX, the risk/reward for new capital at these levels isn't attractive.*
Best Idea: Buy Regional Banks (KRE). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Bearish**	**Bullish**	*Commodities continued to decline last week, led lower by crude oil, which simply can't seem to find a bottom. Metals were flat all week before catching a big short covering bid on Friday following "Dovish" comments by Fed President Bullard, and the grains (DBA) remain the best performers in the commodity space recently.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index traded mostly flat last week as strength in the euro was offset by weakness in the yen and Pound. The dollar remains short term overbought and is in need of some consolidation, but the trend remains decidedly higher, and any dip is a buying opportunity.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries saw very mild declines last week in quiet trading. Economic data in the US was anecdotally "hawkish" but Europe remains firmly under a deflationary threat, so Treasuries remain well supported and any material decline is unlikely.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			