7:00's Report

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

November 20th, 2014

Russell 2000: It's not fair to say the Russell is rolling over in here, but certainly it's declined more than the S&P 500 over the past week.

Pre 7:00 Look

- Futures and foreign equities are lower as global flash manufacturing PMIs disappointed markets o/n.
- China and German Nov. manufacturing PMIs both fell to 50.0, missing expectations and upping concerns about global growth.
- It wasn't all bad, though, as importantly the broader EMU manufacturing PMI beat estimates at 51.3 vs. (E) 50.9.
- Econ Today: Jobless Claims (E: 284K), CPI (E: -0.1%), Flash PMI (E: 56.5), Philly Fed Survey (E: 18.0), Existing Home Sales (E: 5.15M).
- Fed Speak: Tarullo (7:45 AM), Dudley (10:00 AM), Mester (1:30 PM), Williams (8:30 PM) .

Market	Level	Change	% Change
S&P 500 Futures	2036.75	-10.50	-0.50%
U.S. Dollar (DXY)	87.74	.029	0.03%
Gold	1194.90	1.30	0.11%
WTI	74.62	.12	0.16%
10 Year	2.351	.029	1.25%

Equities

Market Recap

Stocks declined Wednesday but in many ways it was another "failed sell-off." Early weakness brought out more dip-buyers, and stocks closed well off their lows of the day. Despite more Washington shenanigans and mildly "hawkish" FOMC minutes, the S&P 500 declined 0.15%

Stocks opened lower Wednesday despite good retail earnings from TGT, SPLS and LOW (all up nicely yesterday) and a good Housing Starts report (the headline missed but it was actually a good number).

There wasn't any real "reason" for the early declines yesterday, but if I had to point to one thing it was a double-header of Washington-related headlines. First, it was announced that President Obama would go forward with executive action on immigration, and this elicited a multitude of threats and gnashing of teeth from Republicans. Second, the Keystone pipeline again failed to pass the Senate (although that should pass in early January).

Neither of these events were enough to really "cause" the sell-off, as it likely would have happened anyway. But it is a good reminder that 2014 was a year devoid of Washington foolishness, and we won't be so lucky in 2015.

As has been the case for weeks, through, stocks rebounded as dip-buyers bought the market into the FOMC minutes. After initially being taken as "dovish," the S&P 500 turned positive briefly, before everyone kept reading and realized the minutes were slightly "hawkish." The S&P 500 turned back negative during the final hour of trading but finished with mild declines.

Market	Level	Change	% Change
Dow	17,685.73	-2.09	-0.01%
TSX	14,980.15	7.18	0.05%
Brazil	53,402.81	1,340.95	2.58%
FTSE	6,654.31	-42.29	-0.63%
Nikkei	17.300.86	12.11	0.07%
Hang Seng	23,349.64	-23.67	-0.10%
ASX	5,316.24	-52.60	-0.98%
Prices taken at previous day market close.			

This morning futures are lower on the disappointing global PMIs which are reminding everyone the global recovery remains at risk. These numbers aren't a material negative game changer, but they do present a headwind compared to the last few weeks.

Market	Level	Change	% Change
DBC	21.34	-.10	-0.47
Gold	1183.10	-14.00	-1.17%
Silver	16.12	-.054	-0.33%
Copper	3.0305	.0285	0.95%
WTI	74.46	-.18	-0.24%
Brent	78.22	-.25	-0.32%
Nat Gas	4.383	.139	3.28%
RBOB	2.0376	-.0056	-0.27%
DBA (Grains)	25.64	.00	0.00%
Prices taken at previous day market close.			

Trading Color

Despite their resiliency, the internals of the broader market weren't as strong as the S&P 500 would imply. First, the Russell 2000 fell more than 1% yesterday and frankly is starting to look like it's rolling over on the charts, which is a bit disconcerting. The Nasdaq and cyclical stocks also underperformed, as the Nasdaq and SPHB both fell by 0.5%.

Looking at the sector trading, retail was in focus as good earnings by the aforementioned LOW, TGT and SPLS helped RTH continue to massively outperform, as RTH rose 1% and hit a new 52-week high despite the broader market trading lower.

Homebuilders (XHB) also outperformed on the back of the housing starts number, which again was better than the headline. After consolidating for the last two weeks, XHB closed at a near-6-month high yesterday on the back of the good starts number and positive Housing Market Index from Tuesday. And, if XHB can hold these levels for another few closes, it will have broken out to the upside on the charts.

Turning to the more general sector trading, there weren't any material moves as none of the S&P 500 subsectors moved more than 1%. Seven out of 10 were lower on the day with consumer staples, consumer discretionary (thanks to retail earnings) and energy (on a dead cat bounce in oil) all trading 0.5% higher to the upside.

Tech was the laggard, down 0.65%, as Internet stocks again traded heavy (TWTR was down 2%) while semiconductors also were lower on the day.

Like the small caps, QNET (the Internet stock index) looks like it may be rolling over, and it's important to keep in mind that the recent Nasdaq outperformance has come on the back of a small group of large-cap tech names rallying to new highs (AAPL, CSCO, MSFT, etc.).

Point being, the breadth isn't what you would typically want to see.

Bottom Line

There are small, subtle signs of non-confirmation appearing: The Russell looks like it may be rolling over and JNK is trading poorly (and remember, that ETF led to the downside in both July and September). A client wrote in yesterday asking whether the JNK declines were different this time, and wondered if the drop in JNK was due to the selling of junk oil company bonds, which have gotten hit hard as crude has sold off. The answer to both, I think, is "no."

First, junk bonds remain the leading edge of "risk" in the market, given still-low global rates. As such, like subprime, they are the most fundamentally mispriced risk asset in the markets right now. But, it's not just junk that's selling off. Investment-grade spreads to Treasuries are also widening, so there are some signs of risk aversion in the bond market at the moment.

With regard to whether the sell-off is energy-related, JNK is the ETF for the Barclays High Yield Bond Index, and the breakdown of that index is 89% industrials, 8% finance companies and 3.5% utilities. And, while there are some oil and gas "industrials" in that index, they aren't big enough to cause a decline of this magnitude.

The sell-off in JNK is one of the reasons I remain cautious on markets here and don't like the risk/reward setup in the S&P 500 at these levels. I simply don't see how junk bonds and emerging markets can sell off and stocks continue to rally over the medium term. That's because, for all the financial sophistication, global central banks have created an enormous sloshing pool of liquidity, and October showed us that this market remains very much "risk on/risk off" from an asset standpoint.

Despite the small non-confirmation signals, though, liquidity continues to be the main driver of this market and clearly there are more managers who need to chase stocks to get more "long." But, I continue to believe the rest of the year may not be the easy "melt up" that seems to be the wide consensus at the moment.

Economics

FOMC Minutes

The FOMC minutes didn't contain many surprises, but on balance they did confirm that the FOMC is more committed to normalizing policy than the market thought before the October meeting.

Yesterday I focused on the difference between market-based and sentiment-based inflation expectations, and so too did the Fed in its minutes. The takeaway is that "most" Fed officials looked at the declines in market-based measures of inflation expectations as "noise" rather than a rising deflation threat.

The FOMC also cited that sentiment-based indicators of inflation expectations remain stable. While inflation likely would decline in the near term thanks to commodity prices, the committee remained confident they would reach their 2% goal sooner than later.

I know this is somewhat tedious, but it's important, because the bottom line is that, as long as sentiment-based inflation expectations remain stable, the drop in market-based inflation expectations will not make the Fed more dovish.

Housing Starts

- October Housing Starts were 1.009M (saar) vs. (E) 1.028M (saar).

Takeaway

The housing starts number was a miss on the headline but the details were actually good.

As always with housing starts, the two key numbers are single family housing starts and single family building permits (which led starts by 3-6 months).

Single family "starts" rose 4.2% in October and the September number was revised higher to 4.2%. Also, single family permits rose 1.4% in October.

The drop in the headline number was due to multi-family housing units declining 15.4% in October. But, the reason we look at this number is to get a gauge of the single family housing market, and yesterday's data implied that demand for housing (specifically new homes) remains very healthy, and nothing in the number would make us doubt the housing recovery.

Commodities

Commodities were mostly lower yesterday with the exception of natural gas and copper, which rallied on cold-weather-driven demand and the rate of Chinese purchases, respectively. Precious metals underperformed, first on physical headlines and then the FOMC minutes that confirmed the "hawkishness" from last month's FOMC announcement. DBC fell 0.51%.

The energy sector, which remains the primary focus of the commodities space, was quiet yesterday. WTI crude oil futures finished the day down just 0.29%.

The EIA reported inventories yesterday and the data were somewhat bearish as crude stockpiles increased +2.6M barrels vs. an (E) -1M draw, RBOB gasoline inventories grew by +1.0M vs. (E) +.6M barrels, and distillate supplies fell by slightly more than forecast, down -2.1M barrels vs (E) -1.4M. But, the report was not bearish *enough* as support at $74/barrel held and futures rallied back toward flat by the end of the day.

Bottom line, crude is continuing to chop around with technical day traders driving the market while investors continue to speculate what OPEC will do on Nov. 27. On the charts, WTI failed at a downtrend resistance level at $74.65, which moves down to $74.25 today. And with support at $74, a break one way or another is imminent.

Natural gas rallied as much as 6% to approach a 4-month high yesterday before buyers became exhausted midday. Futures closed higher by 3.65%. The market remains very volatile with a lot of spec traders creating momentum in the market while cold weather continues to spur physical demand.

Market	Level	Change	% Change
Dollar Index	87.73	.085	0.10%
EUR/USD	1.2543	.0007	0.06%
GBP/USD	1.5675	.0044	0.28%
USD/JPY	118.00	1.14	0.98%
USD/CAD	1.134	.0046	0.41%
AUD/USD	.8614	-.0102	-1.17%
USD/BRL	2.5715	-.0205	-0.41%
10 Year Yield	2.351	.029	1.25%
30 Year Yield	3.067	.024	0.79%
Prices taken at previous day market close.			

Today, the EIA will be in focus and analysts are expecting a supply **draw** (the first of the season) of -4 Bcf. The near-term trend remains higher with last week's high of $4.54 being the "level to beat" while there is support below at the 200-day moving average (former resistance, $4.30).

Volatility spiked in the metals market yesterday as gold whipsawed from $1,200 to $1,175, back to $1,200 and then settled back down near $1,180. The reason for the first move was a headline that showed 47% of voters in a Swiss TV poll were seen as rejecting a measure that would require Switzerland to hold 20% of its $547 billion in assets in gold (they currently hold about 8% in gold) while 38% were in favor and 15% were undecided. The most recent poll is nearly opposite from the results of the same poll just last month that showed 44% in support, 39% against and 17% unsure. So, needless to say, that surprise headline spurred a sharp sell-off in gold. Expect gold to remain volatile as we approach the vote on November 30th.

But, gold rallied to $1200 mid-day back as many managers needed to reposition themselves ahead of the FOMC minutes and there were conflicting reports about how accurate the Swiss poll was. Then once the FOMC minutes confirmed the statement's "hawkishness" from last month, futures fell back toward the lows of the day where they closed. Bottom line, the recent short-covering rally in gold seems to be fading out here. As the dollar approaches trend support, which will very likely hold, gold is poised to fall again. So, we remain bearish precious metals for the medium term.

Shifting gears to industrial metals, copper rallied 1% yesterday as a report showing an uptick in Chinese purchases eased concerns over demand worries. Technically, copper futures tested downtrend resistance at $3.05 for the second time this week, but they failed to close above it again as traders remained hesitant ahead of the PMI data released last night.

Bottom line, a long opportunity remains in buying the break of the aforementioned downtrend resistance line with an initial target of $3.10.

Currencies & Bonds

Wednesday was a volatile day in the currency space. The Dollar Index spent most of the day lower but rallied following "hawkish" FOMC minutes to close slightly positive, up 0.06%. Currency markets are flat this morning despite the disappointing global PMIs.

The Aussie was the biggest mover yesterday, plunging more than 1% after iron ore prices saw their collapse accelerate overnight. Iron ore is a major export of Australia, and as that base metal goes, so goes the Aussie economy. But, with Chinese demand waning and prices falling, an underperforming basic materials industry will weigh on the Aussie economy, the trend is lower and-CROC remains the best way for non-currency traders to benefit from an Aussie decline.

Switching from the worst to the best, the pound rallied 0.6% vs. the dollar yesterday after the BOE minutes weren't as "dovish" as feared. Once again, two BOE members, Mssrs McCafferty and Weale, again favored a 25-basis-point increase by the BOE (the 3rd consecutive meeting they have voted for a rate increase).

That wasn't why the pound rallied and the meeting was taken as "hawkish," though. Instead, it was because there was much more discussion about the potential for inflation to surprise to the upside as the labor market tightens in the UK. As important context, keep in mind that expectations for the first rate hikes in the UK have been pushed out a year by the market, from late 2014 to late 2015, so a lot of bad news and low inflation has already been priced into the pound at these levels. And, as a result, the pound rallied yesterday because the BOE wasn't as "dovish" as feared.

Bonds declined markedly yesterday, as the 30-year Treasury fell 0.42% while the 10-year yield rose back above 2.35%. The Washington shenanigans caused the initial weakness early, and then slightly "hawkish" FOMC minutes caused weakness late in the day as bonds closed near the lows.

But, that is being unwound this morning as Treasuries are up .4% following the disappointing German PMI data, as bunds rally had and Treasuries rise in sympathy.

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	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 fundamen-			

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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)			