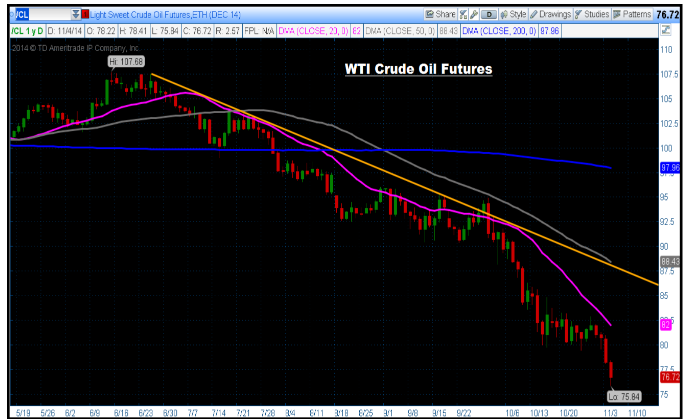
7:00's Report

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

November 4th, 2014



Oil: The plunge accelerated yesterday and continued overnight on Saudi price cuts. While a net positive so far, if the plunge continues, this will start to weigh on stocks.

Pre 7:00 Look

- Futures are slightly weaker for the second straight day as a further collapse in oil prices overnight has temporarily halted the rally.
- Oil fell below $76 overnight on news of Saudi price cuts to the US and word there may be a breakthrough in the Iranian nuclear negotiations (which will mean more supply).
- Economically the European Commission cut its forecast for '14 and '15 EU growth, but that was expected.
- Econ Today: Trade Balance (E: -40.7 B).

Market	Level	Change	% Change
S&P 500 Futures	2007.50	-3.50	-0.17%
U.S. Dollar (DXY)	87.75	-.132	-0.15%
Gold	1170.80	1.00	0.09%
WTI	76.61	-2.17	-2.75%
10 Year	2.348	.013	0.56%

Equities

Market Recap

It was a quiet day to begin the week as stocks drifted around flat during a quiet session Monday. The S&P 500 closed down -0.02%.

Despite the slow trading, there was no lack of macro catalysts Monday. First, the global October manufacturing PMIs were generally weaker than expected, although not materially so. Data from China, Germany and the EMU slightly missed but stayed above 50. But, if there was any one real "reason" for the early weakness Monday, it was that reading.

In the U.S., the data were mixed (ISM manufacturing PMI hit a multi-year high while the Markit manufacturing PMI hit a three-month low), but they offset and markets continued to hover around unchanged through the day.

October auto sales (better than expected) and factory orders (worse than expected) also offset, and by 11 a.m. stocks were almost perfectly unchanged.

It wasn't until the afternoon that the market actually moved off of news. Shortly before 1:00, news broke that the Saudis had increased prices to Asian customers and cut them to the U.S., and this initially led to a spike higher in the S&P 500, which hit its new all-time intraday high off the news.

But as oil began to nosedive, the market—upon further review—decided this may *not* be the best news and it began to sell off. The thought of the Saudis not defending the price of oil was more worrisome than the benefit of cheaper oil. (Remember, people are concerned about the economic impact of lower oil in the Bakken and oth-

Market	Level	Change	% Change
Dow	17,366.24	-24.28	-0.14%
TSX	14,537.62	-75.70	-0.52%
Brazil	53,947.21	-681.39	-1.25%
FTSE	6,479.62	-8.35	-0.13%
Nikkei	16,862.47	448.71	2.73%
Hang Seng	23,845.66	-70.31	-0.29%
ASX	5,519.92	13.04	0.24%
Prices taken at previous day market close.			

er shale plays.)

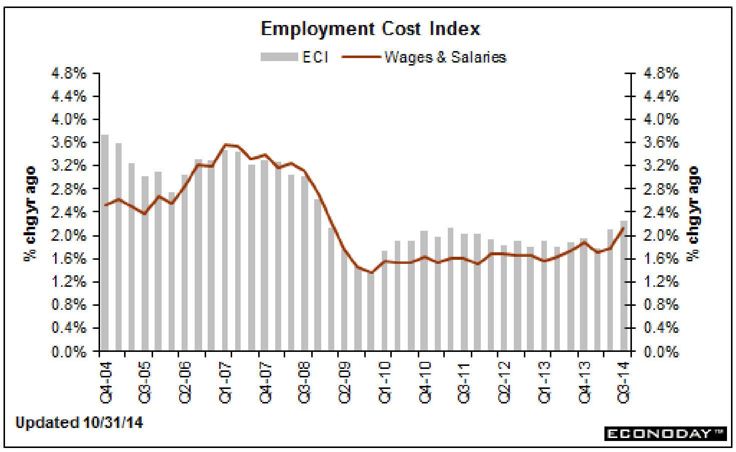
As oil descended downward, futures followed (to a point) and stocks declined into the bell, finishing not far off the lows of the day.

Trading Color

Market	Level	Change	% Change
DBC	22.12	-.20	-0.90%
Gold	1165.20	-6.40	-0.55%
Silver	16.120	.014	0.09%
Copper	3.063	.016	0.53%
WTI	78.21	-2.33	-2.89%
Brent	84.09	-1.77	-2.06%
Nat Gas	4.04	.167	4.31%
RBOB	2.1093	-.0385	-1.79%
DBA (Grains)	25.62	-.04	-0.16%
Prices taken at previous day market close.			

Sector-wise there were no big moves (except energy), but defensives continued to trade well (remember, last week defensive sectors didn't materially underperform the broader market). Utilities and consumer staples led yesterday, rising +0.70% and +0.43% respectively to hit new 52-week highs. Meanwhile tech and financials also outperformed.

On the downside energy was again the big story, as XLE fell -1.7% as crude plunged to new multi-month lows. Although we may see a dead-cat bounce in XLE on a Republican victory in the Senate, that would be a rally to sell.



Volumes and trading activity were depressed compared to the last few weeks, and the intraday gyrations were caused more by day-traders than anything else. On the charts the S&P 500 hit a new intraday high, which is obviously bullish, and technically this market remains in a solid uptrend.

Midterm Elections Spread Trade

This is not a political report as you all know, but when politics directly influence the markets, we cover it.

Bottom line with the midterms is that the "money" says the Republicans will win the Senate. Longer-term readers know I always follow the money on these sorts of events, and as such the odds listed on "Paddy Power" show an overwhelming likelihood that the Republicans will win the Senate. As of this writing, an $8 bet on the Republicans winning the Senate would win you $1, while a $1 bet on the Democrats would win you $4.50. (For those who follow odds, they are currently 1/8 for Republicans and 9/2 for Dems, so Republicans are heavy favorites.)

So, while I don't necessarily advocate this, here is a paired trade of sorts for a Republican win: Long energy (XLE), energy transport via MLPs, financials (XLF), aerospace and defense (ITA) and short healthcare (especially the hospitals) on a potential change to "Obamacare."

Again I'm not advocating this spread trade; just trying to point out what will rally/decline if the odds-makers are right.

Boring But Important: Employment Cost Index

Part of our job is to watch indicators that are important and often overlooked by financial media and other research sites.

To that end, an overlooked but important number came Friday via the Employment Cost Index (ECI), a quarterly reading of employment costs and wage trends. The ECI rose +0.7% in Q3 vs. (E) +0.5%, and is up +2.2% year-over-year. Specifically the wages and salary component rose +0.8% q/q, the largest quarterly gain since '08.

A similar jump in wages and employment costs caught the market off-guard in July and led to a temporary spike higher in yields. That didn't happen Friday because, as we've noted here, Treasuries remain more focused on international markets than domestic economics in the short term. But, it is important to note that for the 2nd and 3rd quarters of 2014, the annualized increase of employment costs was +2.8%, the highest since 2008.

This is important from a Fed standpoint because it means the Fed is closer to achieving its goal of repairing the labor market. Stagnant wages, despite improvement in the unemployment rate, have been a thorn in the Fed's side for years (it's the "underutilization" the Fed keeps referencing).

If that trend is ending (and the ECI implies it is) then that is potentially "hawkish" down the road, because it means the Fed won't have to keep rates *this* low to support the labor market that much longer.

Additionally, while all the world seems consumed by commodity-price-driven "dis-inflation," wage inflation begets real inflation, and this number further refutes the "dis-inflation" argument. Point being, an uptick in wages is dis-inflation, regardless of what commodities are doing.

The "need to know" on this is that while it's certainly not going to make the Fed more "hawkish" from a policy standpoint in the near term, wage inflation is bottoming. In the coming quarters (meaning into early '15), if wage inflation continues to increase, that *may* make the Fed get more hawkish than current expectations. This is an indicator we need to watch carefully in early '15, as the potential for a hawkish surprise from ECI is rising.

Economics

Global Manufacturing PMIs

- Chinese Official PMI slid to 50.8 vs. (E) 51.2.
- German Manufacturing PMI was 51.4 vs. (E) 51.8.
- U.S. ISM Manufacturing PMI rose to 59.0 vs. (E) 56.0.

Takeaway

Although slightly disappointing, the final October manufacturing PMIs generally supported the fact that global economic growth wasn't as bad as feared in October.

Importantly, while the Chinese, German and EMU PMIs declined slightly vs. expectations, they all stayed above 50—implying the global manufacturing recovery is still ongoing. That's enough to keep the worries about global growth at bay for the next few weeks.

Market	Level	Change	% Change
Dollar Index	87.45	.434	0.50%
EUR/USD	1.2485	-.0039	-0.31%
GBP/USD	1.5972	-.0023	-0.14%
USD/JPY	113.91	1.61	1.43%
USD/CAD	1.1356	.0091	0.81%
AUD/USD	.8684	-.011	-1.25%
USD/BRL	2.4962	.0183	0.74%
10 Year Yield	2.348	.013	0.56%
30 Year Yield	3.066	.006	0.20%
Prices taken at previous day market close.			

Here in the U.S., the manufacturing sector remains at the forefront of domestic economic growth. The headline was a beat and the details of the report were also strong, with New Orders rising 5.8 percentage points m/m to 65.8 in October while the Employment component also increased by 0.9% to 55.5%.

Oddly, though, there was a divergence between the ISM number and the private firm Markit manufacturing PMI (they both produce manufacturing PMIs). The Markit number declined to a 3-month low of 55.9, missing estimates of 56.1. But, both reports did indicate solid growth in the manufacturing sector, with indices remaining well above the expansion threshold level of 50. Bottom line is the divergence is a bit odd but doesn't undermine the data, as the manufacturing sector is in good shape and will continue to support the market. If anything, the divergence just made the November report a bit more interesting.

Commodities

Commodities were mixed yesterday but the money flows favored the downside, as energy prices collapsed to fresh 2-year lows. Meanwhile natural gas futures surged on prospects of more cold weather in the forecast. In the metals market, gold traded in a tight range and finished little-changed while the industrial metals outperformed on steady economic data. The benchmark commodity tracking index ETF, DBC, fell -0.9% to start the week.

After spending most of the day bouncing between $80 and $81 per barrel, crude oil futures crashed through support in the last 10 minutes of trade on heavy volume to close down just shy of 3% on the session at a 28-month low.

The primary reason futures fell so sharply was because Saudi Arabia made it clear once again that they *would not* be cutting output in order to help prices recover back toward $100. They also cut prices to the US further to put more pressure on shale production.

Bottom line, surging global production, especially from non-OPEC member nations—paired with softer global demand—has been putting pressure on crude prices since mid-June. With the world's "price mediator" (Saudi Arabia) willing to cut price to maintain market share, the trend remains lower.

On the charts, technical support at $77 was violated over night so a more plausible support band would be between $72.50 and $75.00.

Natural gas made a sharp move in the opposite direction yesterday as futures jumped +4.36% on colder weather forecasts. Prices closed above $4.00 for the first time since Oct. 3 as many physical traders were caught off-guard by the sharp increase in expected demand.

Volatility has certainly returned in a swift manner to the natural gas market. Until some sort of trend forms on the charts, we recommend staying sidelined for now.

Trading in the metals was quiet yesterday as gold consolidated Fridays break down, fluctuating in a tight range yesterday but notably closed down -0.55% near the lows of the day.

The industrial metals however rallied on the global PMI data that mostly met expectations which continued to ease investor concerns that global economic growth is slowing. Copper rallied +0.53% while silver (considered a "hybrid" metal because both of it's precious and industrial characteristics) gained +.09%.

Currencies & Bonds

We saw a continuation of the dollar rally as the Dollar Index was stronger across the board against all of the major currencies. There's a lot of follow-through from the FOMC meeting last week and the ISM number on Monday surprised the doubters, beating expectations. We saw the Dollar Index hit a multi-year high, rising +0.49% to 87.51.

On the flipside, the Japanese yen continues to fall on momentum from Friday's BOJ announcement. It was the worst performer against the dollar yesterday, dropping -1.3% and Dollar/yen through 114 before closing just below that level. With this momentum, 115 seems very reasonable and 120, which was thought to be out of the question, now seems like it's only a matter of time.

The Aussie came under some similar pressure yesterday dropping -1.3% mainly on soft Aussie housing data. Building approvals shockingly dropped month-over-month, while home prices also declined nationally. Housing remains a major concern for the Aussie economy, so this data weighed on sentiment and caused massive selling and shorting ahead of more economic data last night and the RBA meeting. Aussie is bouncing this morning as retail sales beat estimates and the RBA meeting wasn't as dovish as feared, but the trend in Aussie clearly remains lower.

The other commodity currency, the Loonie, also declined mostly in reaction to soft Chinese data and weakness in commodities. The oil markets seem to be pushing it along as it makes new lows on fears of the global glut pressing North American oversupply. The Loonie is now at multi-year low, and along with the U.S. dollar strength, it's heading lower (mid-low $0.80s seems reasonable at the moment).

Finally, the euro also traded well below 1.25 yesterday although the declines were mild compared to most other currencies. Euro FX Futures (6E) fell -0.37% on the EMU and German manufacturing PMIs, but really it was dollar strength that was the main negative influence. The euro is now again at 27-month lows and headed lower, although I'd expect some stabilization into the ECB meeting Thursday.

In the U.S., the 30-year Treasury note was down -0.11% and the 10-year yield rose above 2.35%, but bonds finished well off the worst levels of the day. The story remains the same: U.S. economic data are bond-negative (ISM PMIs) but European concerns (soft PMIs) and the BOJ continue to trump the naturally negative bond fundamentals. Until we see strength in Europe, that situation will remain.

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*
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.*
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 (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.

Date Initiated	Strategy	Position (s)	Investment Thesis
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 (10/13/14): Treasuries are once again at new highs for the year, as a floundering European economy and worries about a stock market correction trump better economics here in the US. The fundamentals for this trade remain decidedly negative, but once again money flows have trumped fundamentals in the near term.

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Asset Class Dashboard

(Updated 11.3.14)

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 completed a "V" shaped rebound last week as good earnings and a surprise announcement of massive new stimulus by the Bank of Japan propelled the S&P 500 to new all time highs. Despite the strength, though, I remain cautious on how much more upside there is, as valuations are now elevated, and any acceleration in the economy will be met with a more "hawkish" Fed.*
Best Idea: Buy Regional Banks (KRE). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Bearish**	**Bullish**	*Commodities were mixed last week as gold plummeted on dollar strength while natural gas prices popped on cold weather. Crude oil futures traded in a tight range to finish the week little changed but importantly held support at $80/barrel. The rallying dollar is continuing to weigh on the entire space, in some cases overpowering the fundamentals.*
Best Idea: Buy Oil (USO) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar moved to new multi-year highs last week thanks to a "hawkish" FOMC statement, a weaker euro (courtesy of soft HICP data) and a plunging yen (following the BOJ announcement. Bottom line is the Dollar Index is headed higher, as the euro and yen are being actively de-valued by their respective central banks.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries declined last week but only marginally so, and definitely less than you would have expected given the rally in the Dollar. Fundamentals were Treasury negative as the FOMC statement was hawkish and economic data good, but European and now Japanese money flows continue to trump fundamentals.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			