7:00's Report

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

November 5th, 2014

Pre 7:00 Look

- Futures are modestly higher following a larger than expected Republican victory in the mid-term elections.
- Economically, October composite PMIs were universally disappointing. Chinese, German, Great Britain and EMU readings slightly missed expectations, although importantly stayed above 50.
- Yen selling has resumed as BOJ Governor Kuroda again reiterated his commitment to do *more* stimulus if needed in the coming months.
- Econ Today: ADP Employment Report (E: 230K), ISM Non-Mfg Index (E: 58.0). Fed Speak: Kocherlakota (9:15 AM), Lacker (9:30 AM), Rosengren (10:00 AM).

Market	Level	Change	% Change
S&P 500 Futures	2012.00	6.50	0.32%
U.S. Dollar (DXY)	87.59	.498	0.57%
Gold	1143.80	-23.90	-2.05%
WTI	76.84	-.35	-0.45%
10 Year	2.342	-.006	-0.26%

Equities

Market Recap

The S&P 500 declined Tuesday in quiet trading as weaker oil prices and a lingering concern about the ECB's continuity weighed on stocks. The S&P 500 declined -0.28%.

Stocks spent most of the day modestly lower Tuesday, as a plunge in oil prices overnight weighed on markets from the outset.

Outside of oil, there weren't many catalysts. September trade balance showed a slightly larger trade deficit than expected on the back of a -15% decline in exports (so more evidence the stronger dollar is reducing exports, which should start to weigh a bit more on manufacturing data in October).

That led to some reductions in Q3 GDP estimates from the Street yesterday from 3.4% to sub-3%, but it wasn't a major negative and stocks spent the early morning basically drifting in mildly negative territory.

Other than weaker oil prices, the big catalyst yesterday hit mid-morning and sent stocks basically to their intraday lows just as I was appearing on Fox Business, with the S&P 500 down nearly -16 points or -0.7%. The negative catalyst was a Reuters article (link here) that implied there is a rift developing between ECB President Mario Draghi and much of the rest of the ECB. It implied there was going to be some sort of an argument about it at the working dinner tonight, prior to the meeting tomorrow.

But, the S&P 500 held support at 2,000 as there wasn't any real conviction to the selling, although it does remind us just how "Europe-sensitive" markets are at the moment.

With support at 2,000 holding, day traders covered and markets lifted into the close, jumping twice on a break of intraday technical resistance (day trader levels). The S&P 500 closed quietly in slightly negative territory.

Trading Color

There's not much to mention on a day when most markets were only marginally weaker. The Russell and Nasdaq both mildly underperformed (down -0.4%) while the Dow actually finished positive, helped by rallies in MMM and JNJ (both stocks at over $100/share).

Sector-wise, virtually all sectors were little-changed except for consumer discretionary (which got hit on some

Market	Level	Change	% Change
Dow	17,383.84	17.60	0.10%
TSX	14,390.43	-147.19	-1.01%
Brazil	54,383.59	436.38	0.81%
FTSE	6,512.99	59.02	0.91%
Nikkei	16,937.32	74.85	0.44%
Hang Seng	23,695.62	-150.04	-0.63%
ASX	5,517.88	-2.05	-0.04%
Prices taken at previous day market close.			

soft earnings by KORS and some fast-food retailers), and basic materials and energy, which continue their implosion. XLE was down another -2% on plunging oil prices, while XLB (basic materials ETF) was down on copper weakness. Gold miners (which were the worst performers in the market, again) were down nearly -4%.

Market	Level	Change	% Change
DBC	21.82	-.30	-1.36%
Gold	1168.90	-.90	-0.08%
Silver	16.01	-.191	-1.18%
Copper	3.0175	-.0475	-1.55%
WTI	77.21	-1.57	-1.99%
Brent	82.76	-2.02	-2.38%
Nat Gas	4.148	.102	2.52%
RBOB	2.0747	-.0429	-2.03%
DBA (Grains)	25.48	-.14	-0.55%
Prices taken at previous day market close.			

On the charts the S&P 500 held support at 2,000 while resistance now sits at the all-time highs from yesterday, 2,024.

Bottom Line

Not much has changed so far this week but the plunge in oil prices (which is supply-driven) and the negative articles about the ECB have stalled the rally.

Focus now is on the ECB, and this is a much more important meeting than meets the eye (more on that later). Bottom line, this market still is being driven by the outlook for Europe and, to a lesser extent, oil. And, over the last few days, we've seen some backsliding in both.

I still view the likeliest direction for markets as a sideways chop, but if the ECB does not deliver I would not be surprised to see the S&P 500 trade with a "19" handle again before the week is out.

Additionally, I'll point out that JNK, which has been the #1 leading indicator to watch for 5+ months now, is starting to trade a bit heavy again. While it's too early to say it's rolling over, it's definitely lost some upward momentum. I remain content on the sidelines from an incremental capital standpoint.

Economics

ECB Preview: *The Opportunity to Get a Lot of Reaction for Not a Lot of Easing*

Anticipation for this week's ECB meeting is ramping up despite the expectation of only marginal tweaks to any policies. Case in point, arguably the two biggest market-moving events this week have been two Reuters articles. The first, out Monday, threw cold water on the ECB altering its TLTRO program at tomorrow's meeting. That sent European and U.S. stocks lower Monday. Additionally, yesterday another Reuters article implied that much of the ECB was at odds with Draghi not over policy, but instead on his management style. Many governors think he is running the ECB as a dictatorship, making up policy objectives on his own.

That is important because if Draghi loses his ability to generate consensus at the ECB, then logic states that both the scope and size of ECB stimulus measures will suffer, which is bad for the EU economy.

Those two articles have presented the ECB with a pretty interesting opportunity to again show the market they are committed to doing what is necessary to help rid the EU of deflation, and that the ECB remains united in this front. Additionally, if the ECB were to be taken as "dovish" at this meeting, they may get more bang for their buck from a currency standpoint.

I say that because, given the surprising moves by the BOJ, if the ECB also incrementally eases (they won't do anything like the BOJ), they have to opportunity to further ally themselves with the BOJ from a policy standpoint. In doing so, they would further distance themselves from the Fed, thereby putting further pressure on the euro.

For the ECB to be viewed as "dovish" at this meeting, there need to be "tweaks" to the current TLTRO program. This timing is critical because this is the last opportunity to make changes (presumably) before the critical December offering. (Remember, banks need to borrow a lot of money at this December offering if the ECB is to gain some traction with expanding the balance sheet.)

There are four key areas where the ECB can change the TLTRO program and incrementally "ease" policy:

1. Remove the 10-basis-point spread between the TLTRO interest rate and the normal refinance rate.
2. Increase the amount of money able to be borrowed above the current 7% of a bank's non-mortgage

book.

3. Increase the amount of money able to be borrowed by a bank from the current 3X net lending book.
4. Increase the maturities of the TLTROs to 4 years.

If all (or most) of these measures are taken, then the market will embrace the ECB as slightly dovish. And we should see a positive reaction from stocks. If none of these measures are taken and Draghi just "talks" dovish, then markets will not react favorably as there will remain a lot of doubts about the ECB's commitment to stimulus. This is an opportunity for the ECB to quiet the critics; hopefully they view it as such.

Commodities

Commodities were almost universally lower yesterday with the sole outlier being natural gas, which extended cold weather-driven gains to a just shy of a 4-month high. The broad-based commodity tracking index ETF, DBC, fell 1.38%.

Energy was hit hard again yesterday on follow-through selling from Monday's technical breakdown. WTI futures fell -2.04% yesterday to close at a 3-year low. There has been a lot of miss-information about *why* oil is declining, so I want to take a moment and clearly lay out the reasons:

First, the Saudi Arabian price cuts on exports bound for the U.S. have put major selling pressure on domestic crude prices and are largely responsible for the most recent leg-down in WTI futures.

The key takeaway here is, OPEC made it clear that they are not only competing for global market share, but they are specifically targeting U.S. shale production, evident by the concurrent price increases to both Europe and Asia that were announced with the price cuts to the U.S.

So bottom line, Saudi Arabia is attempting to curb production/exploration by U.S. energy companies by crunching their margins and selling cheap oil to U.S. refiners. But, everyone needs to remember that Saudi Arabia has an immensely large budget for its national social programs. Although they can extract oil from the ground at a pretty low cost, their ability to satisfy all of their national expenditures with global oil prices below $70 to $80/barrel begins to get difficult. Point being, they don't have unlimited scope to push prices lower.

Second, because of our booming shale production, which has helped national output climb to a 30-year high, domestic supply levels are very healthy and are continuing to rise. A panel of Bloomberg analysts is expecting a supply build of 1.9M barrels to be reported by the EIA this morning, which would put inventories near a four-month high.

Third, much of the oil refined here in the U.S. is exported to other countries because we have the technology to refine at some of the lowest costs on the globe. But, because many of the world's other major economies (namely in Europe) are showing signs of slowing, there's falling demand for refined products, which is increasing inventories here in the US.

Finally, It is also worth noting that the recent surge the dollar has seen against most other currencies has surely had a bearish effect on energy prices.

Bottom line, so far the drop in WTI Crude is mainly a supply and pricing based phenomenon, and it is not because of massive demand destruction, which would imply a stalling global economy. That is important, because as long as that's the case, oil can continue to (gradually) decline and not be a major headwind on stocks.

Market	Level	Change	% Change
Dollar Index	87.13	-.277	-0.32%
EUR/USD	1.2548	.0066	0.53%
GBP/USD	1.5998	.0028	0.18%
USD/JPY	113.61	-.42	-0.37%
USD/CAD	1.1397	.004	0.35%
AUD/USD	.8735	.0057	0.66%
USD/BRL	2.4959	-.0003	-0.01%
10 Year Yield	2.342	-.006	-0.26%
30 Year Yield	3.053	-.013	-0.42%
Prices taken at previous day market close.			

As crude oil prices continued to fall yesterday, natural gas futures continued to surge, rising another +2.74% to within ticks of a 4-month high. Cold weather remains the primary driver of the volatile nat gas market as another cold spell is approaching the Northeast. However, futures are approaching resistance around $4.30. With the volatility in the market if the bulls get exhausted near that resistance level, futures could reverse in a sharp manner back toward support at $4.00 but due to the extreme level of volatility, we will remain sidelined in the trade.

Moving to the metals, it was another very quiet day in the gold market yesterday, but shortly after mid-night last night 1.5B dollars worth of gold futures were sold in electronic trading, pushing futures down 2.3% as of this writing. There was no specific catalyst for the drop, however the dollar moving to new highs on the GOP election victories and dovish Kuroda comments certainly played a role in the move lower. Moving forward, the path of least resistance for gold is lower and any rallies should be seen as an opportunity to short via futures or inverse ETFs.

Copper fell the most since early October yesterday on the EU growth cuts announced yesterday morning. Copper futures fell -1.52% but found support at the psychological $3.00 mark. Copper remains very sensitive to any economic data out of both China, the world's largest consumer of the metal, and Europe, the biggest threat to the global economy. And until we see clear stabilization in economic data, and a subsequent uptick in manufacturing outputs, copper will likely remain range-bound or under pressure.

Currencies & Bonds

The dollar rally took a break yesterday as the Dollar Index was declined .315% to 87.09. All currencies were stronger vs. dollar except Loonie.

The declines in the Dollar Index were due mostly to a general pause after two days of consecutive big rallies, but if there was one "catalyst" for the weaker dollar it was the Reuters article that talked about infighting at the ECB (which is short term euro positive).

But, the Dollar Index rally is very much back "on" this morning following almost universally disappointing global October composite PMIs, and much of yesterday's gains in various currencies are being undone this morning.

The Aussie was the best performer vs. the dollar yesterday, up .66%, although it's now given back all of that move as it's down 1.3% as of this writing, following the soft Chinese composite PMIs.

The big event in 'Oz Tuesday was the Reserve Bank of Australia meeting, and the RBA was slightly dovish in that it again referred to Aussie as "above most estimates of its fundamental value" a comment it omitted in the September, implying RBA wants lower Aussie even despite recent declines.

Also noted were continued risks around weakening property markets, so that dovetails with soft housing data from Monday.

Bottom line, between a central bank that *wants* a weaker currency, plunging commodity prices, a wavering property market and concerns about Chinese growth, Aussie is headed much lower and CROC remains the easiest way to play a continued decline in the Australian Dollar (which hit a new 52 week low this morning).

The Euro was the second biggest gainer yesterday vs. the dollar, rallying .49% on general covering ahead of the ECB announcement Thursday morning. But, the soft economic data is causing an unwind of that move, and the euro is now back below 1.25 on the eve the ECB.

Finally, the Pound and yen have also come under general pressure vs. the dollar this morning, as the Pound is down .7% after the disappointing UK PMI, while general selling has resumed in the yen after a day of pause yesterday. It would not surprise me to see Dollar/Yen trade through 115 in the next day or so.

The US Treasury market was slightly stronger yesterday as plunging oil led to peripheral fears of dis-inflation (good for bonds) and renewed ECB angst, courtesy of the Reuters article, also supported Treasuries. European and Japanese buyers continue to be a major supportive force for longer dated Treasuries, and until there are signs of progress in Europe or some confidence inspiring moves from the ECB, Treasuries will remain well bid, regardless of fundamentals in the US.

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)			