7:00's Report

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

November 6th, 2014

JNK (Junk Bond ETF): This ETF has been the leading indicator of the last two sell offs, so I wanted to point out that it appears to be stalling around the $40 level.

Pre 7:00 Look

- Futures are flat ahead of the ECB meeting following a mostly quiet night of news.
- Economic data was mixed o/n. German Sept. Manufacturers' Orders missed expectations, 0.8% vs. (E) 2.4%, but August data was revised sharply higher. Bottom line, the German economy remains in slow growth mode.
- Econ Today: Bank of England Rate Decision (E: No change), ECB rate decision (E: No change). Weekly Jobless Claims (283K).
- Fed Speak: Powell (12:45 PM), Mester (7:05 PM).

Market	Level	Change	% Change
S&P 500 Futures	2016.25	-2.50	-0.12%
U.S. Dollar (DXY)	87.355	-.212	-0.24%
Gold	1145.10	-.60	-0.05%
WTI	78.46	-.22	-0.28%
10 Year	2.350	.008	0.34%

Equities

Market Recap

Stocks rallied to new closing highs following the Republican takeover of Congress, a rebound in oil prices and the in-line economic data. The S&P 500 rose +0.57%.

Markets were higher from the outset Wednesday morning following the Republican victory in the midterms. While the capturing of the Senate was expected, the margin of victory and ancillary wins in governors' races made it a better than expected night. (And, although it's not validated statistically, markets like when Republicans win.)

Also contributing to higher prices early Wednesday were more dovish comments by Kuroda (more on that later). Between those comments and the elections, it was enough to overshadow yet another round of lackluster October Composite PMIs from China and Europe (although importantly all of the PMIs stayed above 50).

The economic data yesterday were more or less in-line with expectations (both ADP and ISM Non-Manufacturing), and that only added to the buoyant mood on the Street. Stocks jumped higher 10 points within 15 minutes of the open. Markets dipped temporarily around 10:30 on a headline that ISIS had sabotaged a Saudi Aramco pipeline, but that wasn't confirmed and stocks shrugged off the news. By 10:45, markets resumed a pretty methodical rally that lasted all morning and into the early afternoon.

There were multiple political speakers on the wires Wednesday afternoon, highlighted by President Obama, and they all made the same general "work together" remarks we always hear following elections. None of the comments really moved markets, and stocks drifted

Market	Level	Change	% Change
Dow	17,484.53	100.69	0.58%
TSX	14,548.26	157.83	1.10%
Brazil	53,698.42	-685.17	-1.26%
FTSE	6,519.35	-19.79	-0.30%
Nikkei	16,792.48	-144.84	-0.86%
Hang Seng	23,649.31	-46.31	-0.20%
ASX	5,506.11	-11.77	-0.21%

Prices taken at previous day market close.

higher into the close to finish the day basically at the highs.

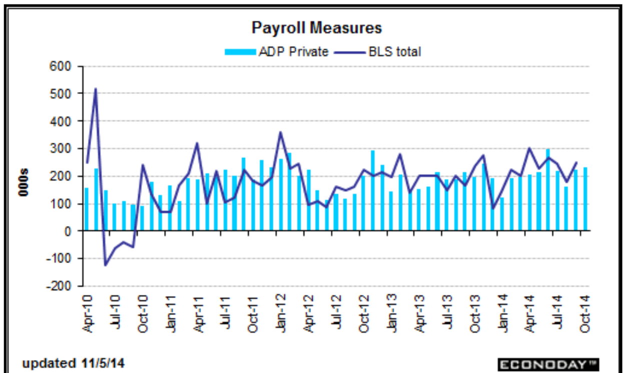
Trading Color

Market	Level	Change	% Change
DBC	21.85	.05	0.23%
Gold	1143.00	-24.70	-2.12%
Silver	15.32	-.633	-3.97%
Copper	3.002	-.0165	-0.55%
WTI	78.87	1.68	2.18%
Brent	83.25	.43	0.52%
Nat Gas	4.199	.07	1.70%
RBOB	2.0971	.0191	0.92%
DBA (Grains)	25.35	-.14	-0.55%

Prices taken at previous day market close.

Despite the good S&P 500 gains, it wasn't a strong rally yesterday. The Nasdaq finished down slightly and the Russell 2000 was only fractionally higher, both underperforming the S&P 500.

Sector trading was dominated by the midterms, and the ETFs I noted in Tuesday's issue performed generally as expected: Energy (XLE) , MLPs (AMLP) and Financials (XLF) all enjoyed nice rallies, rising +1.8%, +0.76% and +0.67% respectively. Meanwhile, healthcare lagged (XLV down -0.10%) and was the only S&P 500 sub-sector to finish lower yesterday.



The October ADP jobs report met expectations of a 230k increase, firming up expectations for a good government report tomorrow.

One interesting beneficiary from the elections was the utility sector, as XLU surged +2.25% to new 52-week highs. (Republicans are stereotypically pro-coal and pro-nuclear and not as environmentally sensitive. So, in a knee-jerk, that is positive for the utility sector.)

But, I will stress that most of these moves are temporary and driven more by day traders than anything else. I'd be more inclined to buy healthcare and sell energy off these moves than anything else.

Volumes and activity were subdued compared to the last month and once again we seem to have a market with little conviction. The old all-time highs of 2,024 remain resistance while support sits lower at 2,000.

Bottom Line

The general backdrop remains unchanged this week but the wide consensus is now for stocks to grind higher into the end of the year with the BOJ/Republican elections as positive catalysts. And, the sense of inevitability of a move higher is once again palpable (this is a total 180-degree turn from just 3 weeks ago).

Europe (and specifically the ECB and its policies) remain the key to markets right now. While the consensus is for calm and a move higher into year-end, I remain cautious about stocks and continue to have a hard time identifying the next, major positive catalyst for stocks that isn't ECB-related.

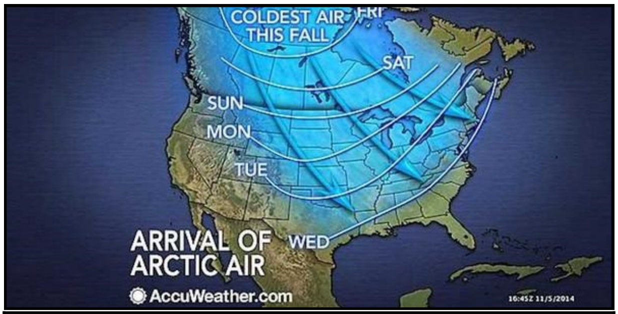
Finally, very quietly JNK continues to sell off and is once again sitting at $40.00. JNK predicted both the late-July/early-August sell-off and the late-September/early-August sell-off. While JNK isn't breaking down, I do think it's noteworthy that it is declining. I know it's again consensus, but I would not be surprised to see a "19" handle on the S&P 500 before the year is up.

Midterm Election Takeaways

Ignoring the politics (I'll leave that to others far more intelligent than I), there are a few potential market takeaways to monitor now that the Republicans will control the 114th Congress (undoubtedly some clients will call asking what the mid-terms mean for the market, and I want to provide some talking points).

First, all the major players meet tomorrow at the White House (Obama, McConnell, Reid, Boehner, Pelosi), but nothing is expected to come out of the meeting other than lip service. AS far as evidence the government may start actually functioning again now that the elections are over, the first major hurdle to watch is immigration. If President Obama uses an executive order to provide amnesty to illegal immigrants and go around Congress, then it's likely the next two years will be as contentious and useless as the previous two from Washington.

And, while that won't necessarily cause a market decline, the market would like to see some positive action on corporate tax reform, the Keystone Pipeline and a rollback of some parts of the "Affordable Care Act." If Obama unilaterally moves on immigration, the chances of any of the above going forward will be materially reduced. Again, it won't be a market headwind per se. But fixing the corporate tax, approving Keystone, removing the ban on oil exports and changing the ACA would be a positive for the market.



It's Back: The first "Polar Vortex" of the season is expected to arrive later this week.

Outside of those policy issues, we also need to consider the impact of a Republican Congress on the Fed. Rand Paul already has legislation to audit the Fed in Congress, and there have been specific requests made by Republicans for a detailed plan on how the Fed plans to normalize interest rates. Bottom line, scrutiny of the Fed could increase materially under a Republican Congress, which could make the process of normalizing policy more difficult.

Bottom line, Washington remains on the back burner from a market standpoint and will remain so until the beginning of next year when the new Congress is seated, barring an executive order from Obama on immigration. But, I think it's safe to say that this relative quiet we've seen from Washington throughout 2014 won't be repeated in 2015. If the anticipated levels of foolishness from Washington were a chart, it just bottomed.

Economics

ISM Non-Manufacturing

- October ISM Non-Manufacturing PMI was 57.1 vs. (E) 58.0.

Takeaway

The non-manufacturing (or service sector) October PMI was a slight disappointment as it declined from a 58.6 reading in September, and the details were also a bit underwhelming. New orders (the leading indicator of the report) fell 1.9 points to 59.1, the lowest reading since April. And, this weakness was confirmed by the private firm Markit's service sector PMI, which also fell to 57.1. The one bright spot was the employment component, which rose to 59.6 from 58.5 in September, a multi-month high (which bodes well for the jobs number Friday).

But, while a slight moderation, the bottom line here is the absolute level of activity of the service sector (which is by far the larger portion of the economy compared to manufacturing) remains strong and comfortably above 50. There is some slight evidence that, on the margin, the pace of activity in the U.S. economy is moderating slightly, but the recovery remains very much intact, and the economy remains generally supportive of stock prices.

Market	Level	Change	% Change
Dollar Index	87.545	.453	0.52%
EUR/USD	1.2482	-.0062	-0.49%
GBP/USD	1.5976	-.0026	-0.16%
USD/JPY	114.72	1.14	1.00%
USD/CAD	1.1392	-.0016	-0.14%
AUD/USD	.8589	-.0149	-1.71%
USD/BRL	2.5036	.0077	0.31%
10 Year Yield	2.350	.008	0.34%
30 Year Yield	3.065	.012	0.39%

Prices taken at previous day market close.

Commodities

Crude oil and the energy sector rallied yesterday amid bullish supply data and news of a pipeline fire in Saudi Arabia. Meanwhile the metals badly underperformed thanks to a stronger dollar and more dovish commentary out of the BOJ. The broad-based commodity tracking index ETF, DBC, added +0.28% on the day.

Yesterday, crude oil futures rallied +2.16%, retracing much of the week's earlier losses to close at $78.85. The reason behind the rally was twofold. First, there was news that a pipeline belonging to Saudi Aramco (the state-owned Saudi Arabian Oil Company) caught fire, which spurred fear bids and introduced a lot of volatility to the market as weak-handed shorts were squeezed out of positions during the $3 rally from the morning lows.

Sources (supposedly) familiar with the situation told the WSJ that the fire was short-lived and quickly contained. Futures quickly pulled back nearly $2 before finding support and methodically marching higher into the close thanks to a bullish EIA report.

The weekly inventory numbers for crude oil and the refined products from the EIA were bullish yesterday and spurred rallies in the energy complex. Crude oil stockpiles grew by 500K barrels vs. (E) +2.2M barrels (bullish), RBOB gasoline supplies fell -1.4M barrels vs. (E) -300K barrels (bullish), and distillate inventories declined -700K barrels vs. (E) -1.8M barrels (modestly bearish). Refining capacity utilization rose to +1.8% vs. (E) +0.3%, the first increase in 6 weeks, suggesting a solid uptick in demand.

Bottom line, although WTI futures saw decent gains yesterday, crude remains in a sharp downtrend. Until we start to see some trend resistance broken, the trend is downward. Notable resistance levels (on a closing basis) are above at $79.50 and $81.25.

Natural gas futures continued to get squeezed higher yesterday, gaining +1.67% as weather forecasts continued to be adjusted to reflect colder temperatures ahead. But, the surge in futures ran out of steam at former trend-channel resistance (click here for chart) and closed well off the best levels of the day.

Today the weekly EIA inventory report will be in focus with analysts expecting a build of +86 Bcf in stockpiles. Remember though that this figure is pretty close to the size of last week's build, and temperatures dropped late in the week, so there is a risk that the number "misses" estimates and futures continue higher. Bottom line, watch for the data print at 10:30 AM (ET).

Moving over to the metals, as we mentioned in yesterday's Report, gold got crushed in the pre-market yesterday as BOJ Governor Kuroda spoke words similar to "we will do whatever it takes" when discussing the central bank's goal of reaching 2% inflation. The comments pushed the yen to new lows and the dollar to new highs; they also pushed the perception of the divergence between developed economies' monetary policy to new extremes, spurring a "hawkish" reaction from the markets. Going forward the trend remains decidedly lower; however the short trade is getting a little crowded. So, it is worth noting that the risk of a brief but sharp short-covering rally exists. Such a move, however, would be an opportunity to open, or add to, existing short positions.

Currencies & Bonds

The Dollar Index surged again to new multi-year highs on the Republican win, euro and yen weakness and decent domestic economic data. The strength was universal and the dollar climbed to it's highest level against the Yen since 2007. With the strong ADP Payrolls number and a solid ISM, the rally in the greenback continues.

Continuing a volatile week, Aussie was by far worst performer, plummeting 1.8% again to a 4 year low, as it smashed though the old low .8598, closing below .86.

Soft Chinese composite PMIs and plunging Iron Ore prices were the main negative catalysts, but it was also technical trading as Tuesday's dead cat bounce elicited more selling and once support at 86 was broken, the waterfall declines began. Aussie is now deeply oversold and but should see some sort of a short term bounce, but the trend remains decidedly lower and low .80's seems like a reasonable target over the coming weeks.

The Yen also collapsed further (own 1%) on more "dovish" comments from BOJ Governor Kuroda. He was very dovish in his first comments since surprising the markets last Friday, and basically re-iterated that he will do whatever it takes to break deflation. And, after last week's massive stimulus, the market believes him. Bottom line – Kuroda remains committed to stimulus, and if he thinks more is needed to truly vanquish inflation, he won't hesitate to do it. And, clearly he's not afraid to back up that rhetoric.

Treasuries were flat ahead of the ECB this morning, and although economic data continues to be generally Treasury negative, showing a solid US economy, foreign money and ECB/BOJ policies continue to support bonds. Treasuries will trade off the ECB this morning, declining if the ECB is "dovish" and rallying if they are not. Europe remains a dominant force in this trade.

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.			
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)