7:00's Report

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

November 7th, 2014

Bonds: The 30 year Treasury is set to decline for the third straight week, and closed below a key 2014 trend line yesterday.

Pre 7:00 Look

- Futures are flat ahead of the jobs report as German trade data was the only material number out o/n.
- September German trade data was better than expected, as imports rose 5.5% vs. (E) 2.7%. That data point is helping to calm some nerves about the German economy.
- Geo-politically, Ukraine/Russian tensions are again on the rise as Russian troops apparently entered Eastern Ukraine again temporarily last night.
- Econ Today: Employment Situation Report (E: 240k). Fed Speak: Yellen 10:15 AM EST, Tarullo 2:30 AM EST.

Market	Level	Change	% Change
S&P 500 Futures	2027.25	-.75	-0.04%
U.S. Dollar (DXY)	88.115	-.019	-0.02%
Gold	1143.20	.60	0.05%
WTI	78.10	.19	0.24%
10 Year	2.375	.025	1.06%

Equities

Market Recap

Stocks surged to new all-time highs again yesterday following a "dovish" ECB press conference and in-line economic data. The S&P 500 rose +0.38%.

Weekly jobless claims were better than expected Thursday morning, but the ECB was the main influence on stocks early in trading. As is usually the case, the market got the ECB "wrong" right off the bat. Futures and European stocks initially declined during the first hour of trading as the ECB meeting wasn't viewed as very "dovish." But, as usual, once there was some time for the press conference to set in, markets did realize that Draghi and the ECB were "dovish." Stocks began to rally straight into the European close at 11:30, making fresh all-time highs shortly before 11:30.

Stocks basically chopped sideways through lunchtime, before embarking on another grind higher throughout the afternoon. Equities were driven primarily by a weaker euro and by investors who were looking to buy a dip throwing in the towel and getting more "long." There were multiple headlines out of Washington ahead of the leaders' conference at the White House tomorrow, but none of them were effectual. From a political standpoint, all eyes remain on the president's next move with regard to immigration. Stocks finished the day basically at the highs in another strong showing.

Trading Color

Despite the rally, it was a very uneventful day Thursday in markets. Most major indices traded in-line with one another (up about +0.4%) while sector trading was

Market	Level	Change	% Change
Dow	17,554.47	69.94	0.40%
TSX	14,563.38	15.12	0.10%
Brazil	52,637.06	-1,061.36	-1.98%
FTSE	6,589.18	38.03	0.58%
Nikkei	16,880.38	87.90	0.52%
Hang Seng	23,550.24	-99.07	-0.42%
ASX	5,549.13	43.02	0.78%
Prices taken at previous day market close.			

mixed. Banks, industrials and energy all outperformed, while we saw some profit-taking in utilities (down -1.7%) and tech again lagged. Insurance companies also underperformed and weighed on financials; consumer staples also were barely positive. So, there was a hint of a "pro-cyclical" rotation but nothing major yesterday.

Of note, though, Europe handily outperformed. HEDJ, the best way to trade Europe, rallied +0.8% and is now approaching some critical resistance at the $57.40 level. If that resistance is broken, then we could see the rally in Europe accelerate.

Market	Level	Change	% Change
DBC	21.87	.01	0.05%
Gold	1144.60	-1.10	-0.10%
Silver	15.445	.006	0.04%
Copper	3.014	.0065	0.22%
WTI	78.02	-.66	-0.84%
Brent	82.80	-.15	-0.18%
Nat Gas	4.381	.187	4.46%
RBOB	2.1315	.0448	2.15%
DBA (Grains)	25.31	-.04	-0.16%
Prices taken at previous day market close.			

Is the U.S. Consumer About to Expand Its Balance Sheet? Consumer Finance Companies Should Benefit

One of the investment themes I've been focused on since August was the "return" of the U.S. consumer and an uptick in consumer spending. Declining commodity prices, upward-trending wages, steady home price values and still-low interest rates have combined to make the consumer balance sheet as strong as it's been in years. At the same time (presumably), this is providing more disposable income as wages slowly tick higher and commodities decline.

I don't have enough room to fully flesh out the idea in today's Report and will elaborate more on it next week once more research is completed, but one way to play a revival of the U.S. consumer is through consumer finance companies. Synchrony Financial (SYF)—the old GE consumer lending division—Springleaf Holdings (LEAF) and J.G. Wentworth (JGW) are all companies that could stand to benefit from an expansion of the U.S. consumers' balance sheet, now that there is more disposable income and stable asset prices.

We've only done preliminary research on those three names and need to do more before fully committing. But they (and others in the sector) could stand to benefit as the American consumer finally gets a tailwind in this economic recovery, and uses it to start taking on debt and increasing spending again. Food for thought.

Economics

ECB Meeting

- No change to interest rates (as expected) and no changes to any stimulus policies (some tweaking of TLTRO was a possibility).

Takeaway

The main takeaway from yesterday's meeting is that the ECB is continuing to slouch toward more QE.

Draghi and the ECB chose not to alter any of the aspects of the TLTRO offering prior to the December auction, which was initially disappointing to the market. But, Draghi did do about as good a job as possible in trying to "talk" dovish.

First, it's obvious Mario Draghi reads Reuters. Draghi, during his press conference, specifically addressed the growing concerns about a fractured ECB. First, he said the ECB is unanimously in favor of expanding the ECB balance sheet by 1 trillion euros (it wasn't clear if the Germans were on board with that). That is an important point, because if the ECB is united in that goal, it makes it more likely they will actually achieve it. This means increased probability of corporate bond purchases and QE.

Draghi also explicitly noted that the risks to economic growth in the euro-zone had shifted to the downside (previously risks to growth had been described as "balanced"). That's important because one of the preconditions for the ECB to act further is a downgrade in the outlook for the EU economy. And, while not there yet, risks are now skewed to the downside.

Finally, Draghi also noted that the ECB staff has been tasked with researching more unconventional measures of monetary stimulus. While this seems innocuous, it's a subtle but important shift.

Previously, when downplaying the prospects of sovereign QE or more stimulus, ECB hawks often cited the fact that the ECB staff hadn't even begun to research any additional stimulus measures. Now, that can't be said, and obviously the first step toward actually enacting more stimulus (whether it's buying corporate bonds or QE) is researching potential tactics.

Bottom line is the ECB is slouching its way toward more stimulus, and we believe this meeting makes eventual corporate bond purchases all the more likely in early 2015. As a result, the investment thesis behind Europe remains the same: There is significant opportunity for Europe to outperform as the ECB expands its balance sheet toward its $1 trillion goal, but the market remains skeptical. And, I continue to view that as a contrarian opportunity over the next several months and quarters. HEDJ remains our preferred way to play the "Long Europe" trade.

"We know the risks are to the downside. We know we need to be prepared. And both the ECB staff and the members of the committee know this. They know this very well."

ECB President Mario Draghi in yesterday's Q&A.

Jobs Report Preview

The importance of these jobs reports from a Fed policy standpoint is on the rise, and the risk to stocks is for the numbers to run too "hot" and pull forward Fed interest rate increases.

The "Too Hot" Scenario: >300K job gains. A jobs number this strong would likely result in a pulling forward of rate increase expectations, and the markets would react **hawkishly**: Stocks, bonds and commodities would all decline, the U.S. dollar would continue to rally.

The "Just Right" Scenario: 180K - 290K job gains. This is the "sweet spot" for this report, as it implies a still-healing labor market but not one that's so strong it would pull forward the date of the first rate hike. A number in this range shouldn't elicit too much of a market reaction as it's mostly priced in.

The "Too Cold" Scenario: <180k job gains. Given all the other employment metrics released in October, the chances of this number being a big miss are very remote.

If we get a number below 180K, expect a mildly "dovish" reaction—stocks and the dollar will decline, while bonds and commodities will rally. But, even if this is a big miss, don't expect markets to move too much as it'll probably be discounted as a statistical aberration.

Wage Increases and the Unemployment Rate: >2.2% and <5.9% will be taken as "hawkish."

Given the risk is skewed to the "hawkish" side of things for this meeting, changes in the year-over-year wage gains and unemployment rate are equally as important as the headline jobs number.

An annual wage increase over 2.2% would be considered "hawkish" and elicit a "hawkish" reaction from markets, while a drop in the unemployment rate below 5.9% would also be "hawkish."

Commodities

Commodities were all over the board yesterday. Refined products rallied but crude oil fell, while both industrial and precious metals closed essentially unchanged. And natural gas was the big mover, as futures continued to surge on cold weather prospects. The DB commodity ETF, DBC, closed marginally higher, up +0.05%.

Beginning with natural gas, it is clear we were early in calling the end of the short-squeeze yesterday. Futures did fall to session lows mid-morning on a larger than expected EIA inventory report (+91 Bcf vs E: +86 Bcf) but then quickly reversed and surged to fresh 5-month highs in another short-squeeze style rally into the end of the day, closing up around +6%.

Market	Level	Change	% Change
Dollar Index	88.135	.568	0.65%
EUR/USD	1.2387	-.0098	-0.78%
GBP/USD	1.5838	-.0136	-0.85%
USD/JPY	114.94	.31	0.27%
USD/CAD	1.142	.0035	0.31%
AUD/USD	.8566	-.0024	-0.28%
USD/BRL	2.5692	.0656	2.62%
10 Year Yield	2.375	.025	1.06%
30 Year Yield	3.093	.028	0.91%

Prices taken at previous day market close.

Traders are continuing to buy up supply here in anticipation of a colder than originally expected November, the month when the shift from the "build season" to the "draw season" generally occurs. It is worth noting that the supply deficit of current stockpiles to the 5-year average has narrowed to just over 8% from a record 55% earlier this year because of a record pace of supply injections this summer. Bottom line, with supply levels almost back to average, price action is being driven by demand expectations and the market remains very volatile (bulls do have the momentum on their side, though) so we will stay sidelined and let the day traders play the nat gas game for now.

Elsewhere in energy, crude oil fell back -1% for the 5th drop in 6 sessions yesterday as OPEC cut demand forecasts all the way through the year 2035. On top of that, Libya is set to resume pumping crude from its biggest oil field "soon," and the dollar traded up to another 4-year high. As we said yesterday, the trend remains decisively lower in crude oil, and until we begin to see some technical trend resistance levels broken, that will continue. The first such resistance level is hovering at $79.00.

Trading in the metals was very quiet yesterday as copper continued to oscillate around the psychological $3.00 mark as traders weigh the stronger dollar and continue to watch and speculate economic growth globally. Meanwhile precious metals were little-changed again as futures consolidated Wednesday's steep losses. Note: Futures are acting the exact same way they did Monday and Tuesday after Friday's big move, and the possibility of a violent move of say $20 to $40 on a surprise either way in the jobs number is a definite possibility.

Currencies & Bonds

We're not stopping yet and the Dollar was higher again, up .63% (now above 88 for first time since June 2010) but today the catalyst was euro/pound weakness as opposed to dollar strength. Once again every major currency was lower vs. the dollar. Good data (Jobless Claims) helped send the dollar higher but really the dollar index rose because of negative/bearish news in other currencies.

Before getting to the Euro, we have to first touch on the pound as it was the worst performer yesterday, dropping .82% following an uneventful Bank of England meeting. They made no changes as expected but there was a negative economic print yesterday as the Halifax Home Price Index fell -.4% vs. (E) 0.4% increase, and while it by itself isn't that big a negative, like Australia, there are concerns that the UK home price bubble is popping, which as we know can be a big negative on the economy.

That concern, along with good US economic data, pushed the Pound to new 52 week lows vs. the Dollar, and as expectations for when the BOE will raise rates continue to get pushed out, the Pound will continue to drift lower vs. the dollar.

Staying in Europe, the Euro was the second worst performer vs. the dollar on Dragi's dovish tone, falling .72% and trading through 1.24 for first time since 2012. To be clear, the ECB *wants* a weaker euro, and baring any shocking disappointment in US economic data, the declines in the euro are not over, and testing the 3 year lows of 1.2051 isn't out of the question over the coming 2-3 months.

Outside of European currencies most moves were muted, although every other major currency remains in a clear downtrend vs. the dollar. The Loonie made a new closing low after an uninspiring Ivey PMI (51.2 vs expectations of 57.0), while the Aussie bounced very slightly off better than expected employment data, although it hit new multi-year lows this week and clearly is headed lower.

Bonds declined yesterday, and the major negative influence was the dovish ECB and declining German bund prices, not the good jobless claims data. Bonds have been quietly trending lower for three weeks now, and on the charts there are some subtle breakdowns occurring. This morning, if the jobs number is "too hot" there's a good chance we could see bonds move sharply lower, although us bond bears need the European outlook to improve before we can declare the near term trend in bonds is lower. But, with the S&P 500 at 2031 (all time highs) and the ten year ten year yield still depressed at 2.37%, bonds are rich here and need to decline to "square the circle," assuming equities are correctly valued at these levels. Again as I look across asset classes, given the dollar and stock levels, bonds are the one asset that look very expensive up here.

Have a good weekend,

Tom

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.			

7:00's REPORT

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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*
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)			