7:00's Report

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

December 2nd, 2014

Pre 7:00 Look

- Futures are very slightly higher following a quiet night of market digestion.
- Asia outperformed, as China rallied more than 1% on more general "stimulus" speculation following Sunday's disappointing manufacturing PMIs.
- Economically the only report of note was UK construction PMI which slightly missed estimates.
- Econ Today: There are no economic reports today.
- Fed Speak: Fischer (8:15 AM), Brainard (12:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	2055.00	4.25	0.21%
U.S. Dollar (DXY)	88.305	.323	0.37%
Gold	1195.20	-22.90	-1.86%
WTI	68.21	-.79	-1.14%
10 Year	2.218	.024	1.09%

Equities

Market Recap

Stocks fell yesterday as a combination of disappointing retail sales data from Black Friday and weaker than expected global manufacturing data trumped rebounding oil prices. The S&P 500 fell 0.68%.

Futures were down early yesterday morning on continued concerns over the potential effects of the recent plunge in crude oil prices, the "miss" in both Chinese manufacturing reports, and the aforementioned concerns over weak retail sales figures from Black Friday.

JNK: The significant divergence between corporate credit (new lows) and stocks (new highs) is now extreme, and this discrepancy needs to reconcile itself one way or the other.

The combination saw stocks open in the hole and quickly sell off about 15 points.

Also influencing stocks to the downside yesterday was the continued sell-off in corporate debt (more on that later) also contributed to heavy price action.

By late morning, the S&P had traded down to support at 2,050 (the lows of the day), but that level held as sellers became a bit exhausted and the news of the day wasn't bad enough to push stocks through that support.

After lunch, markets got very quiet and stocks drifted sideways for the rest of the session, closing only slightly off the lows of the day.

There were two Fed speakers yesterday, and both were influential. William Dudley spoke on CNBC and while he had some interesting comments, he didn't move the stock market. But, Vice-Chair Stanley Fischer made comments that, surprisingly, downplayed the potential drop in inflation due to declining oil prices. If anything, Fischer was somewhat "hawkish" when he said he thought there was a significant change of an uptick in wage inflation in the near future.

Market	Level	Change	% Change
Dow	17,776.80	-51.44	-0.29%
TSX	14,625.32	-119.38	-0.81%
Brazil	52,276.58	-2,447.42	-4.47%
FTSE	6,729.23	72.86	1.09%
Nikkei	17,663.22	73.12	0.42%
Hang Seng	23,654.30	286.85	1.23%
ASX	5,281.26	73.54	1.41%
Prices taken at previous day market close.			

While interesting from a Fed standpoint, the comments didn't see much of a reaction from stocks.

Trading Color

Market	Level	Change	% Change
DBC	20.81	.39	1.91%
Gold	1210.60	35.10	2.99%
Silver	16.51	.954	6.13%
Copper	2.8995	.0535	1.88%
WTI	69.23	3.08	4.66%
Brent	72.83	2.68	3.82%
Nat Gas	4.02	-.068	-1.66%
RBOB	1.8852	.0576	3.15%
DBA (Grains)	25.85	.31	1.21%
Prices taken at previous day market close.			

There was clear cyclical underperformance Monday as the Dow was down only marginally and the S&P 500 down 0.68%, but the Russell 2000 and Nasdaq declined 1.6% and 1.3% respectively.

Cyclical underperformance was evident in sector trading too. Tech led to the downside, dropping more than 1% mainly on AAPL weakness, although semiconductors were also soft as were Internet stocks (QNET finished down 2.2%).

Retail got hit (RTH down 1%) on various reports of lackluster holiday spending on Black Friday and conflicting reports of sales on Cyber Monday. Regardless of instant reactions, it's very unlikely holiday shopping will be down this year, and any "weakness" in results on specific days is likely more a result of a spread-out shopping season (I got dozens of "pre Black Friday" marketing e-mails from various customers starting early last week).

The only S&P 500 sub-sectors higher on the day were energy, which enjoyed a very small dead-cat bounce despite the jump in oil prices, and utilities, which caught a small defensive bid with the broader market lower.

Of note, "Europe" again outperformed the S&P 500 yesterday, as HEDJ fell marginally, down 0.19%, and that ETF continues to trade very well going into the ECB decision Thursday. Also, DXJ hit a new all-time high after Japanese economic data were better than expected and it became clear that the horrid Japanese GDP figure released last month will be revised higher. We remain bullish on both ETFs on a relative and absolute basis.

Activity yesterday was subdued despite the declines, and the drop in stocks was due more to the "dip-buyers" who have been there on every pullback for the last 2 months moving to the sidelines. Selling was not aggressive; it's just buyers are more cautious here than they have been in the last several weeks.

A Growing Disparity Between Junk Debt and Stocks.

The disconnect between the corporate credit markets and the stock market is now extremely wide, as junk bonds and investment-grade bonds continued declined.

The ETFs JNK and HYG have totally broken from the stock market, and importantly both made a new closing lows (surpassing the October lows).

Obviously a lot of this fallout is from shale-related junk debt concerns, and the optimists will dismiss this drop in corporate credit as such. But, I'll again point out that energy makes up a small portion of JNK. So, people are obviously selling more than just the shale junk bonds.

JNK has been the predictor of the last two sell-offs in stocks (late July/early August and late September/early October). We all know past performance isn't indicative of future results, but this discrepancy between corporate credit and stocks has to be rectified. Of note, yesterday we also saw weakness in LQD, the investment grade ETF, and while it's just one day, if investment grade debt starts to trade heavy, that will be a further sign stresses in the junk market are starting to spread.

Economics

Global November Manufacturing PMIs

- U.S. Nov. PMI 58.7 vs. (E) 57.8.
- Germany Nov. PMI 49.5 vs. (E) 50.0.
- EU Nov. PMI 50.1 vs. (E) 50.4.
- China Nov. PMI 50.3 vs. (E) 50.6.

Takeaway

It remains a tale of two recoveries, as the November manufacturing PMIs further showed that while the U.S. recovery remains solid, the global economic recovery continues to teeter on the brink of failing.

Starting with the U.S. data, the official ISM manufacturing PMI declined from the October 59.0 reading, but the drop was less than expected. New Orders, the leading indicator of the report, rose slightly to 66, up from 65.8.

This report contradicts several other indicators we've gotten lately that imply we were seeing a moderation of activity in manufacturing, and this number may be slightly too good to be true. Case in point, the export index rose 3.5 points to 55, which makes little to no sense given the stronger U.S. dollar and weak global growth. Regardless, the U.S. manufacturing sector remains in fine shape, even if we are seeing a slight moderation in activity.

Looking at the international data, it was universally weak and the biggest negative surprise was the drop in German manufacturing PMI to 49.5, slightly into contraction territory.

China and the broader EU numbers were also soft, staying just above 50.0.

On the surface, these are numbers that imply the global recovery is teetering on the brink of failure, but the bad data are being countered by the idea of future stimulus from the ECB, PBOC and others. So, current bad data are being taken with a grain of salt, given there is a central bank "put" in the markets right now.

I am not at all convinced that is the right view, but it is the view the market is currently taking.

Bottom line, these were not good numbers for global growth, and they will 1) keep alive concerns about the global recovery and 2) increase the pressure on various central banks to do "more" to support their economies, and the pressure on those banks is already very, very high.

Commodities

Trading in commodities was wild yesterday with volatility remaining very high as traders returned to their desks from the holiday weekend to see the sharp declines in energy and metals.

Market	Level	Change	% Change
Dollar Index	88.00	-.413	-0.47%
EUR/USD	1.2475	.0025	0.20%
GBP/USD	1.5739	.0093	0.59%
USD/JPY	118.30	-.31	-0.26%
USD/CAD	1.1324	-.0089	-0.78%
AUD/USD	.8503	-.0006	-0.07%
USD/BRL	2.5595	-.0056	-0.22%
10 Year Yield	2.218	.024	1.09%
30 Year Yield	2.946	.036	1.24%
Prices taken at previous day market close.			

Energy, the metals and grains all surged yesterday as the dollar declined. Natural gas was the sole underperformer, falling on mild extended weather forecasts. The broad-based commodity ETF, DBC, jumped 1.91% from a fresh 5.5-year low.

Crude oil prices also bounced back yesterday, climbing 4.78% after selling off to fresh 5-year lows overnight on further OPEC selling. Yesterday's move was largely seen as a "dead-cat bounce" due to short-covering as opposed to a real "floor" forming in the market. On the charts, the rally in WTI has room to continue toward the $70-$73 level before selling is expected to resume, barring any unforeseen event such as an "emergency meeting" called by OPEC.

Energy remains in the spotlight of the financial markets as investors weigh the impacts of the sharp, nearly 6-month downtrend that has seen upward of 40% of prices disappear thanks to global production levels that are oversupplying the market by about 1M-2M barrels/day, according to most estimates. And, it still appears none of the world's producers are willing to forfeit any of their market share in order to support prices. So, bottom line, volatility is set to remain high as producers are forced to adjust to the basic laws of economics.

Natural gas was the only major commodity to trade lower yesterday, falling back 1.52% in sympathy with the recent plunge in crude oil prices as well as a result of warming weather forecasts for the month of December. Despite the move lower, volatility is beginning to ease in natural gas and a level of support is in focus near $3.90.

Industrial metals bounced back but precious metals surged yesterday. Copper rallied 1.86% while gold and silver gained 3.03% and 5.78%, respectively.

Copper bounced back from fresh 4.5-year lows yesterday on short-covering and dollar weakness. Early yesterday morning copper spiked down to $2.7775 following a weaker than expected Chinese manufacturing PMI report. China continues to represent 40% of copper demand globally, so the weak economic data put pressure on futures early. But, when the dust settled after the report, futures started accelerating higher as shorts rushed to lock in gains. Bottom line, copper may continue to be squeezed higher in the short term. However, the overall trend does remain lower with initial resistance above at $2.95 while yesterday's low ($2.7775) will be looked at as a "line in the sand" by the remaining bulls.

Gold futures were also very volatile to start the week as there were multiple catalysts in the market. Futures initially fell as Swiss voters rejected a proposal to increase the central bank's gold holdings. But then news broke that India, one of the world's largest gold consumers, lifted trade restrictions on gold imports, causing futures to reverse morning losses. Then, the rally extended as investors bought up the precious metal as a "safety asset" after the downgrade of Japanese debt by Moody's overnight.

A massive short squeeze then ensued that pushed gold through $1200, but as with most short squeezes, there was little conviction and this morning gold is back down through $1200/oz., down more than 2% on the day already. Gold remains a very volatile at these levels, and we maintain a general downward bias short term.

Currencies & Bonds

The dollar saw a decent sell-off Monday to start the week, as the Dollar Index dropped 0.6% and was lower again every major currency. The dollar ignored the strong U.S. PMI and weak foreign PMIs, and the most-cited reason for the drop was the Reuters article out Sunday which implied the plunge in oil could result in a pushing out of rate hikes by the Fed (because it'll keep statistical inflation below their target for an inordinate amount of time).

Beyond the Reuters article, remember last Friday saw a strong rally in the dollar/drop in everything else, and markets simply unwound a bit of that short-term trade. Nothing yesterday is about to derail the dollar rally.

The Loonie was the best performer vs. the dollar yesterday, rallying 1%. But, keep in mind that was following a greater than 1% drop on Friday so yesterday's move can be chalked up to a "dead-cat bounce."

The pound also had a strong showing, up 0.9% after UK manufacturing PMIs actually beat expectations (the only major European country to do so). Fundamentally the pound remains the best bet vs. the dollar, and on the charts it looks like the pound is trying to hold that 1.56 level. If you think the dollar rally may pause here going forward, the pound remains one of the best fundamental choices.

The euro also bounced 0.4% following Friday's drubbing, and again the fact that we saw the euro bounce in the face of soft German and EU PMIs implies we were seeing just a very short-term unwind of Friday's steep declines.

Bottom line, yesterday's price action much more implies a short-term reversal from Thursday/Friday's moves than anything material that will derail the dollar rally. The Reuters article, while certainly worth considering, isn't about to derail dollar strength.

Treasuries sold off to start the week yesterday, declining for the first session in seven on better than expected economic data and "Fed-speak" that was interpreted as hawkish. The 30-year bond fell 0.57% while the 10-year note declined 0.20% to finish the day with a yield of 2.218%

And, New York Fed President William Dudley reiterated that in a speech yesterday morning when he said the recent slide in oil prices is a positive as it should boost consumer spending and that investor expectations for a rate hike in mid-2015 are reasonable. Both comments were interpreted by the market as hawkish.

Bottom line, despite yesterday's weakness, the Treasury market continues to be controlled by foreign investment as U.S. yields remain too attractive on a comparative basis, notably with European equivalents. And, the multi-month intermediate rally in bonds remains intact for now.

Have a good day,

Tom

7:00's REPORT

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

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.

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 (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

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

Asset Class Dashboard

(Updated 12.1.14)

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 hit new all time highs last week but declined marginally by weeks end thanks to a Friday dip that was due mainly to the collapse in oil prices. The general macro back drop remains positive for stocks, but we continue to be cautious about adding additional capital at current levels, as we think most of the good news out there is already priced in.*

Best Idea: Buy Regional Banks (KRE).

Best Contrarian Idea: Buy Energy (XLE)

Commodities	**Bearish**	**Bullish**	*Commodities collapsed, again, late last week as oil went into free fall following a "do nothing" OPEC meeting. There was massive general selling in the commodity space and a surging dollar weighed on precious and industrial metals. The near term outlook for commodities remains very negative.*

Best Idea: Buy Natural Gas (UNG)

Best Contrarian Idea: Buy Grains (DBA)

U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index closed flat last week thanks to a big Friday rally. The euro sold off Friday (but finished the week positive) following lack luster HICP data, while the yen weakened Friday after economic data missed estimates. Finally commodity currencies got crushed last week on lower oil and at or near multi-year lows.*

Best Idea: Sell the Yen (YCS)

Best Contrarian Idea: Long British Pound (FXB)

Treasuries	**Neutral**	**Bearish**	*Treasuries rallied last week thanks to a good 5 year Treasury auction and continued strength in German Bunds. Despite some indications EU economic data is starting to get better, Bunds remain well bid, and as long as they do, Treasuries will stay buoyant.*

Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)