7:00's Report

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

December 24th, 2014

Pre 7:00 Look

- Futures are flat after a very quiet night as focus turns to the holiday.
- Asia was stronger overnight, riding the momentum from the US record highs Tuesday. The Nikkei was the standout, rallying 1.24%, although part of that was catchup as Japan was closed yesterday.
- Economically there was no real news to speak of, and most global markets ex-Asia are flat.
- Econ Today: Jobless Claims (E: 290k).
- Today is an early close: Markets close at 1 PM EST.

Market	Level	Change	% Change
S&P 500 Futures	2079.75	0.75	0.04%
U.S. Dollar (DXY)	90.205	-.121	-0.13%
Gold	1176.60	-1.40	-0.12%
WTI	56.13	-.99	-1.73%
10 Year	2.257	.095	4.39%

Equities

The rally continued as stocks drifted modestly higher following a rebound in oil prices and better than expected economic data Tuesday. The S&P 500 closed up 0.17% and the Dow Industrials broke 18,000 for the first time.

There were multiple headlines to consider yesterday, including the failed Greek presidential election, Ukraine moving closer to Europe and a slew of domestic economic data. The GDP beat was the big, positive headline yesterday and it helped futures rally immediately after the open. Stocks hit what would be their highs of the day within the first 30 minutes of trading, and then settled in for a sideways chop once Personal Income and Outlays and New Home Sales mostly met expectations.

There were even some midday headlines as Standard & Poor's put Russia on credit watch negative and famed hedge fund manager David Tepper forecast that 2015 would be like 1999. Stocks dipped slightly on both reports but remained comfortably positive. After lunchtime, trading slowed materially and stocks drifted mostly sideways into the close to finish slightly positive on the day.

Trading Color

Healthcare was in focus yesterday as that sector materially underperformed the market as XLV dropped more than 2%, making it by far the worst performing S&P 500 sub-index.

The reason for the weakness was continued general pricing concerns following the Express Scripts deal for AbbVie's Hepatitis C drug (the lower than expected pricing for such a unique drug is sending reverberations throughout bio tech, and those stocks lead healthcare to the downside yesterday).

Elsewhere the move higher in interest rates generally helped the banks and financials outperform, although the moves weren't as big as you'd expect and there was not a definitive "higher rate" rotation going on in sector trading yesterday.

Merry Christmas

We want to wish you all a Merry Christmas and Happy Holidays. If you are traveling, travel safe, and we hope you enjoy this time with friends and family.

Finally, after starting the day on somewhat shaky ground, energy shares moved materially higher, as XLE rallied more than 3% to notch a new, multi-week high,

Market	Level	Change	% Change
Dow	18,024.17	64.73	0.36%
TSX	14,594.03	161.65	1.12%
Brazil	50.889.81	768.95	1.53%
FTSE	6,604.40	6.22	0.09%
Nikkei	17,854.23	219.09	1.24%
Hang Seng	23,349.34	15.65	0.07%
ASX	5,394.50	13.58	0.25%

Prices taken at previous day market close.

and imply further stabilization in the energy space (this helped stocks hold onto gains yesterday).

Overall activity was slow and outside of healthcare and energy most moves in the market mostly were due to general positioning, and there simply isn't too much to read into from an internals standpoint.

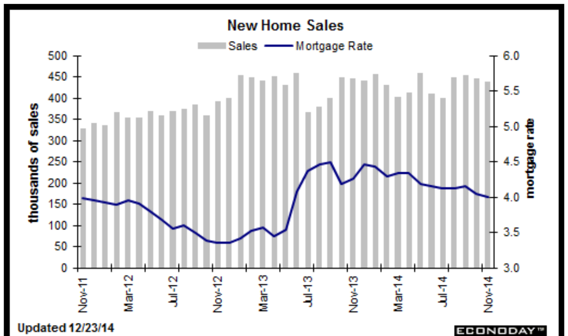
Market	Level	Change	% Change
DBC	19.07	.20	1.06%
Gold	1172.90	-6.90	-0.58%
Silver	15.67	-.018	-0.11%
Copper	2.8635	-.009	-0.31%
WTI	57.17	1.91	3.46%
Brent	61.71	1.60	2.66%
Nat Gas	3.174	.03	0.95%
RBOB	1.5716	.0366	2.38%
DBA (Grains)	25.36	.06	0.24%
Prices taken at previous day market close.			

Bottom Line

Energy stocks, junk debt and the ruble remain stable in the very short term, and with a mostly clear calendar into year end, the market is continuing to drift higher mostly on momentum.

The Greek election (Dec. 29th) is the last major potential hiccup to a quiet end to the year, and generally people are getting a bit more optimistic Samaras can get to the 180 votes needed for his candidate (although it'll be close).

XLE and JNK remain the tickers to watch as a leading indicator for the market, but don't sleep on bonds, either. Yesterday's drop in Treasuries was material, and while it's too early to say we've got a trend change on our hands, the price action in bonds was not positive yesterday, so that is something to watch into year end and early 2015.



New Home Sales were 438K vs. (E) 460K in November. The report was the second piece of disappointing housing data released this week, which has caused a slight uptick in angst about the U.S. real estate market.

Economics

There was a slew of economic data yesterday, but the bottom line is this: The U.S. economy saw a significant uptick in activity starting in spring 2014, it continued into the fourth quarter, and it's being driven by the consumer. The recent data consistently shows that the US economy remains the best-positioned in the global market.

Durable Goods Orders

- New Orders fell -0.7% vs. (E) +3.1%

Takeaway

This was a disappointing report as not only did the headline miss, but new orders for non-defense capital goods ex-aircraft (NDCGXA) were unchanged and the rolling three-month average—which is looked at as a proxy for business spending—fell 1.01% last month, marking the third decline in a row.

The durable goods report had a limited effect on morning trade yesterday, though as it was overshadowed by the very strong revised Q3 GDP report.

The decline in durables was somewhat expected, though, mainly because manufacturing activity was at an unsustainably high pace and due for some moderation coming out of Q3, and because of the stronger dollar suppressing exports.

Bottom line, manufacturing indicators can moderate given the stronger dollar, but that's ok as long as consumer spending metrics continue to rise.

Personal Incomes and Outlays

- Personal Income rose 0.4% vs. (E) 0.5%.

Takeaway

The income and spending data was in-line with expectations, but the focus in this report is always on the core PCE Price Index, which is the Fed's preferred measure of inflation. November Core PCE dropped 0.2% to 1.4% year-over-year, although October was revised higher to 1.6% from 1.5%.

Like the CPI report from last week, this core reading is being negatively pressured by the stronger dollar. But the bottom line is that the 0.1% decline isn't enough to make the Fed get incrementally more "dovish," as more structural indicators of inflation (like wages and capacity utilization) continue to firm.

Final Revision to 3rd Quarter GDP

- Final Q3 GDP was 5.0% saar vs. (E) 4.3%

Takeaway

Simply put, this was the strongest GDP report we've seen in years. Obviously the headline was very strong, but the details and revisions were also very impressive. While the naysayers on the economy will point out federal spending rose 9.9% in Q3 (led by a 16% jump in defense spending as we ramped up the fight against ISIS), the real story in this report is the strength of the U.S. consumer.

All the metrics of consumer spending were significantly revised higher, from the second look at Q3 GDP to the final PCE. Broad consumer spending rose from 3.2% to 2.2%, and Gross Domestic Purchases (the amount of "stuff" purchased in the U.S. regardless of where it was made) increased to 4.1% from 3.0%.

Additionally, inventories did not overly inflate the GDP print as final sales of domestic product, which is GDP less inventories, rose to 5% from 4.1%.

With regard to the uptick in consumer spending, a lot of the revised gains came from increased healthcare spending. While that's not typically what you want to see leading an economy, don't take the naysayers too seriously when they use it to discount the uptick in consumer spending. Healthcare spending is still a positive for the economy (as insurance companies, hospitals and doctors all benefit from increased healthcare spending).

Bottom line, this was a very strong report, and it clearly signals that starting in late Q3 2014, U.S. consumer spending finally broke out of the 6+ year doldrums.

Commodities

Commodity markets remain volatile amid lighter volumes and thin attendance at trading desks during the shortened holiday week. WTI and natural gas futures each rallied as much as 3% during yesterday's session while the metals generally traded lower. The DB commodity ETF, DBC, added 0.53% thanks to the outperformance in the energy sector.

Market	Level	Change	% Change
Dollar Index	90.315	.366	0.41%
EUR/USD	1.2174	-.0055	-0.45%
GBP/USD	1.5512	-.0076	-0.49%
USD/JPY	120.78	0.73	0.61%
USD/CAD	1.1619	-.0006	-0.05%
AUD/USD	.8088	-.0044	-0.54%
USD/BRL	2.6937	.0297	1.11%
10 Year Yield	2.257	.095	4.39%
30 Year Yield	2.852	.102	3.71%
Prices taken at previous day market close.			

The price action of crude oil remained volatile yesterday as futures knee-jerked down at the open, temporarily turning negative near support at $55 before reversing back toward overnight highs near $57. WTI futures finished the session up 3.55%.

News-wise, the blowout GDP report was cited as the primary driver of the gains; however the fundamentals of the market remain largely unchanged, with investors continuing to watch very healthy global supply levels. It is worth noting that "Oil Investing Great" T. Boone Pickens mentioned that he believed the recent sell-off has had more to do with softening demand than oversupply.

But, as production continues to rise (along with 2015 production forecasts) and demand is ho-hum, the economics of oil are collectively bearish currently. On the charts, WTI futures are continuing to consolidate the sharp declines of recent. Futures are trading between support at $55 and resistance at $58; however, the path of least resistance remains lower still for now.

Gold futures spent most of yesterday's session consolidating Monday's sharp sell off, but futures did roll over in the afternoon and end down 0.30%, marking the 7th drop in 8 sessions. Like oil, gold traded off the economic data, but with an opposite reaction—the stronger than expected GDP number spurred a risk-on move in the markets, which reduced demand for safe-haven assets like precious metals. The sold GDP report pushed the dollar higher by 0.45%, which also weighed on gold. For the near term we remain bearish on gold with resistance above at $1,185 while the next target to the downside is near $1,155.

Elsewhere in the space, trading was mostly quiet as natural gas oscillated around the unchanged mark, finishing up 0.89%. Meanwhile copper prices were heavy, falling 0.3% despite the strong U.S. economic data. Both natural gas and copper futures are in well-defined downtrends and although there is a risk for a bounce in nat gas (if weather forecasts take a turn colder), the near-term path of least resistance remains lower for both .

Currencies & Bonds

The bond market was in focus yesterday as the long bond fell 1.3%, which is the worst single-day performance since November 2013, as the 30-year went out basically on the lows of the day. And weakness was evident across the curve as the 10-year yield jumped back above 2.25%. The reason for the declines were the much stronger than expected U.S. data (particularly the GDP report) as well as another soft Treasury auction.

Bonds declined early following the stronger than expected economic data, but it was a weak 5-year auction that resulted in a significant acceleration in the declines.

For the second-straight day, we saw a weak Treasury auction, as the $35 billion 5-year note auction got a "D+" grade from Rick Santelli. And, the grade was justified.

The bid to cover (a measure of demand) was 2.39, which was the second lowest of the year, slightly above the 2.36 in October. This soft demand came despite the yield being the highest of the year at 1.739%.

The decline in Treasuries accelerated following the soft results, as the 30 year hit the low of the day following the soft auction.

The Dollar Index punched through the 90 mark for the first time in 8 1/2 years following the release of the very upbeat Q3 GDP report. DXY finished the session up 0.45%

The GDP report, while slightly dated, just further reinforces the point that the U.S. economy (and expected monetary policy) is diverging materially from other major, developed economies, and that remains the core force behind this massive dollar rally.

Japanese markets were closed for a holiday yesterday but that didn't stop the yen from being one of the worst performers against the dollar, as it fell 0.51%. There was no fundamentally bearish news out, though. The losses in the yen were a result of dollar strength paired with the general risk-on trade across asset classes that curbed demand for safe-haven currencies like the yen.

In Europe, the British pound fell 0.47% as a report out of the Office for National Statistics said the U.K. deficit widened in Q3 to £27B from £24.3B in Q2. The report also showed a revision to economic growth metrics, down to 2.6% from 3.0% a year ago, which was obviously discouraging and also weighed on the currency.

Elsewhere in Europe, the euro slipped down to a fresh 2 and 1/2 year low primarily on dollar strength and despite continued investor concern about the Greek elections and the possible repercussions for the January QE plans (which has been supporting the euro of late).

Fundamentals vs. Flows in the Treasury Market

I said in yesterday's Report that I would be interested to see how Treasuries would react to strong U.S. data yesterday, particularly if the strong data would weigh on Treasuries. It turns out that the strong data did result in a Treasury sell-off.

The reason I was focused on that is because 2014 for Treasuries has been characterized by foreign money inflows into Treasuries trumping bond-negative fundamentals.

Put simply, Treasuries are so relatively attractive compared to similar-term Japanese government bonds or German government bonds that, regardless of U.S. economic or policy fundamentals, foreign investors have been buying Treasuries simply because they are so relatively attractive.

At this point, a 30-year yield of 2.82% and a 10-year yield of 2.27% simply does not accurately reflect a U.S. economy that is breaking out, and an FOMC that has all but written down that they intend to start to raise rates in mid-2015 (likely June).

So, one of the big trends we are already watching for, and will be focused on in 2015, is whether U.S. economic fundamentals begin to trump foreign money flows.

And, if that happens, will we see a "taper tantrum" repeat sometime in Q1 2015? We obviously don't know the answer now, but it's something we are definitely watching. A year ago, everyone (including me) was "sure" yields were going higher. Now, everyone (except me it seems) is "sure" rates will stay low for a long, long time. Something to think about.

Happy Holidays and best to you and your family,

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*
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.

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Asset Class Dashboard

(Updated 12.22.14)

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**	*After suffering its worst decline in 3+ year two weeks ago, the S&P 500 enjoyed a huge "snap back" rally last week as stabilization in energy stocks, junk debt and the Russian ruble led to a massive short covering rally. Fundamentally, though, nothing material changed, so the 90+ point, 3 day rally in the SPX last week seems a bit artificial. We remain cautious on stocks at these levels.*

Best Idea: **Buy Retail (RTH).**

Best Contrarian Idea: **Buy Energy (XLE)**

Commodities	**Bearish**	**Bullish**	*Commodities stabilized last week as oil finally tried to put in some sort of bottom. But, it's important to differentiate the stabilization of oil as mostly just an oversold bounce, not the result of some positive change in supply/demand fundamentals. With the Dollar Index hitting new highs, though, we expect commodities to at best be range bound.*

Best Idea: **Buy Natural Gas (UNG)**

Best Contrarian Idea: **Buy Grains (DBA)**

U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index hit new multi-year highs last week, resuming its months long uptrend as the FOMC focused on rate hikes in mid 2015, highlighting the growing divergence between US monetary policy (tighter) and everyone else (more accommodative). Because of that, we expect the dollar rally to continue.*

Best Idea: **Sell the Yen (YCS)**

Best Contrarian Idea: **Long British Pound (FXB)**

Treasuries	**Neutral**	**Bearish**	*Treasuries declined modestly last week following the "hawkish" FOMC meeting, as domestic economic and policy fundamentals (better economy, forthcoming interest rate increases) continue to be ignored by bond investors. Until Europe shows signs of economic progress, Treasuries will remain well supported, even as fundamentals deteriorate.*

Best Idea: **Short "long" bonds (TBT)**

Best Contrarian Idea: **Short High Yield Bonds (SJB)**