7:00's Report

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

December 30th, 2014

Pre 7:00 Look

- Futures are modestly lower and international markets declined o/n thanks to year end positioning and new lows in oil.
- Asia traded lower as the yen rallied 1%, although again that was mostly due to year end positioning as there were no real negative headlines o/n.
- Economically, EMU M3 (money supply) grew slightly faster than expected yoy (2.7% vs. (E) 2.5%).
- Econ Today: Case-Shiller HPI (E: 0.6%).

Market	Level	Change	% Change
S&P 500 Futures	2080.50	-5.25	-0.25%
U.S. Dollar (DXY)	90.36	-.136	-0.15%
Gold	1187.30	5.40	0.46%
WTI	53.60	-.01	-0.02%
10 Year	2.207	-.043	-1.91%

Equities

Market Recap

Stocks hit new intraday highs but finished basically unchanged yesterday during quiet, uneventful trading. The S&P 500 closed up 0.09%.

Initially futures were marginally lower on general Europe worries following the failed Greek election, but the fallout was contained from the outset and it didn't look like it was going to be much of a negative influence.

Case in point, within a few minutes of the lower open, stocks had turned back positive as buyers stepped in to the mild early weakness.

The calendar certainly had an effect on trading yesterday, as after the initial dose of volatility (and I use that term loosely) stocks drifted for much of the remainder of the day.

A mid-afternoon nosedive by WTI crude oil (which hit new lows yesterday) weighed on stocks a bit but that was countered by comments from David Tepper who said he expected the S&P 500 to return 8%-10% in 2015. Most importantly, though, energy stocks held up despite the declines in oil and that helped the averages generally ignore the lower oil prices. Stocks closed quietly, just off the highs of the day.

Trading Color and Bottom Line

Like last week trading was very slow and year-end positioning was the main driver of trading yesterday, so again we aren't reading too much into anything. But, utilities surged again to new highs (the best-performing S&P 500 sub-sector YTD is now utilities, which are up over 30%), while consumer discretionary and retail names also continued to trade well. Tech lagged thanks to some profit-taking in the tech mega-caps (AAPL, INTC, MSFT) as did consumer staples, but the declines were minimal. From a single-stock standpoint, it was a quiet day yesterday.

We can expect another quiet day today and then some year-end rebalancing on Wednesday. But other than the PMIs Friday morning, there isn't much else on the calendar this week.

That said, yesterday was a good representation that this market continues to be led by energy stocks, not oil, as XLE held up despite the new lows in crude (although we'll see if that lasts once the calendar hits 2015). I re-

Market	Level	Change	% Change
Dow	18,038.23	-15.48	-0.09%
TSX	14,663.92	54.67	0.37%
Brazil	50,593.82	449.19	0.90%
FTSE	6,578.21	-55.30	-0.83%
Nikkei	17,450.77	-279.07	-1.57%
Hang Seng	23,501.10	-272.08	-1.14%
ASX	5,416.63	-57.15	-1.04%
Prices taken at previous day market close.			

main unconvinced that the energy contagion scare is totally past us, but we'll have to wait till next week to see if I'm right, as positioning and rebalancing is driving trading for the next few days. Case in point, I do want to point out oil hit new lows and the ruble declined 9% yesterday, tried to rally overnight, but finished flat. It's obviously not definitive, but oil making new lows and renewed volatility in the ruble isn't what you want to see if the bottom in both assets is "in."

Market	Level	Change	% Change
DBC	18.60	-.19	-1.01%
Gold	1181.40	-13.90	-1.16%
Silver	15.79	-.357	-2.21%
Copper	2.8165	.0025	0.09%
WTI	53.63	-1.10	-2.01%
Brent	57.93	-1.52	-2.56%
Nat Gas	3.181	.148	4.88%
RBOB	1.4529	-.0558	-3.70%
DBA (Grains)	25.22	.01	0.04%
Prices taken at previous day market close.			

What You Need to Know About Greece

Greek PM Samaras' gamble to call presidential elections failed, and now Greece will hold general elections on January 25th.

There are several important takeaways from this with regard to general global equity market allocations and specifically European holdings. But first and foremost, it's important to realize that the fallout from this negative surprise was pretty contained yesterday (which is a positive).

Yes, the Greek stock market traded down 8%, but it finished off the lows, and more importantly pan-European markets were mostly flattish. Additionally, while Greek 10-year bonds declined and the yields rose, there was no panic in that market and again there were no signs of "contagion" in other PIIGS' debt. Finally, both the yen and euro declined (the opposite would have happened if the market was worried about contagion from Greece). **Point being, as we have been saying here for 3+ weeks, the market is simply not concerned about a Greek default or "Grexit" (Greek exit from the EU). That is a remote possibility and simply not one we should be worried about.**

What's Next If Syriza Wins. Most of the angst surrounding this issue is based on the idea that Syriza will gain control of the Greek government and threaten a Greek exit or default. Neither one of those events are likely.

First, Syriza has already said it will honor Greece's market liabilities and IMF loans. It is focused on restructuring other loans from the EU (about 200 billion euros). But, point being, the party isn't looking for a Greek exit from the EU or to default; it's looking for a better deal and a dial-back of austerity.

Second, it's not clear Syriza will win the election. In mid-November the party held about a 7-point lead in polls. Now, it's down to (about) 3.5%. It's almost impossible for Syriza to get an outright majority, so it will have to govern with a coalition, which may involve New Democracy (the current party in power). So, again, the idea that if Syriza wins they will demand a exit from the EU isn't reasonable. Tougher negotiations? Yes. Default? No.

But, there are risks associated with this event; they just aren't the ones that the financial media is pointing out.

Risk #1: Delayed QE by the ECB. This is what we really need to be watching specifically for European equity allocations. It is widely expected that the ECB will do some sort of QE at the January 22nd meeting, but the Greek election uncertainty may delay that action until there is more clarity in Greece. Although it may be a close call, we do not think the Greek uncertainty will prevent the ECB from doing QE in January.

The reason we have that opinion is because there are two easy options the ECB can choose if it wants to do QE and insulate itself from Greek risk (and since we know what they are, we are sure the minds at the ECB know what they are).

First, the ECB can simply refuse to buy bonds from any country that isn't in compliance with EU budget or bailout rules. This would simply exclude Greek debt from the available pool of securities that can be purchased.

Second, and more likely, the ECB may choose to force national central banks to share in the risk of QE. One of the Germans' objections to QE (other than it being potentially inflationary) is that the ECB can lose money buying PIIGS' debt. If that happens, then Germany is (mostly) on the hook for the losses (because it's the biggest economy in Europe). But, to mitigate that risk, the ECB can mandate individual countries to set aside reserves to account for losses in their bonds, or just make the central banks buy their own bonds directly and ensure they are senior to all other debt.

So, for instance, the ECB can lend money to Greece and the Greek National Bank buys the bonds, holds them, and those bonds have seniority over all other creditors. That way, the National Bank of Greece shares in the credit risk with the ECB.

Regardless of which strategy is chosen, the point is that if the ECB is intent on QE in January, there are several simple ways they can overcome Greek uncertainty. And again, because of that we do not see Greek political uncertainty delaying QE in January.

Risk #2: Greek Bank Runs. The other major risk that has come out of this Greek election is the (very remote) possibility of bank runs in Greece. Undoubtedly the ruling party in Greece (New Democracy) will frame the election as a referendum on EU membership (which it is not, but that's politics). If the perception grows among Greeks that Syriza winning the election means a potential "Grexit," they may pull money and cause a banking run that stresses EU banks and gives us a replay of the EU debt crisis. We think this is a very remote possibility, even if Syriza wins. Greece survived a banking run 3 years ago when things were much worse than they are now—it is unlikely that we will see a repeat.

Investment takeaway: Stay Long Europe. For the above reasons—no "Grexit," and likely no delay in ECB QE—we maintain at this point that this is not a bearish game-changer for Europe, and we continue to view this dip as a buying opportunity in HEDJ and, for those with higher risk tolerance and a multi-month time horizon, EIRL, EWP and EWI. The broader trend of ECB balance sheet expansion in the context of more-attractive valuations for European stocks continues to point to European outperformance in 2015. The ECB attempts to reflate the EU economy will likely result in higher stock prices (we maintain buying HEDJ is to a point similar to buying the S&P 500 at the start to QE2).

Market	Level	Change	% Change
Dollar Index	90.52	.21	0.23%
EUR/USD	1.2153	-.0022	-0.18%
GBP/USD	1.5513	-.0041	-0.26%
USD/JPY	120.69	.30	0.25%
USD/CAD	1.1631	.0006	0.05%
AUD/USD	.8132	.0017	0.21%
USD/BRL	2.703	.0355	1.33%
10 Year Yield	2.207	-.043	-1.91%
30 Year Yield	2.776	-.038	-1.35%
Prices taken at previous day market close.			

Economics

There were no material economic reports yesterday.

Commodities

Commodity markets were generally lower yesterday with the exception of natural gas, which rose on weather fueled short-covering. Oil futures legged down to another set of multi year lows as several technical support levels were broken while the metals were pressured thanks to the stronger dollar. The benchmark commodity tracking index ETF, DBC, fell 0.18%.

Crude oil began the final trading week of the year with a thud yesterday as futures punched through a series of support levels after overnight gains were reversed in morning trade. The selling pressure gained momentum as a series of sell-stop orders began to be triggered under recent lows. WTI futures finished the day down 2.32%.

There was no real fundamental reason for yesterday's sell-off. But after spending the better part of 2 weeks in consolidation, once the market started moving lower, the bears piled on and the market picked up some momentum to the downside. The Saudis' initial target of $60/barrel (Brent) gave way yesterday and futures have begun another leg lower.

It is worth mentioning that historically, the last week of the year is a generally a volatile one in the energy futures market. That's because book-squaring and tax-selling skew the natural market. However, the charts don't lie, and the technical situation currently remains very bearish for crude oil, confirmed by yesterday's new lows.

Natural gas prices bounced back from last week's two-year lows ($2.97) yesterday, rallying 5.08% thanks to some colder than average weather reports for the month of January.

This spurred some short-covering and speculative buying. As a reminder, nat gas futures were trading as high as $4.00 the 1st of this month, and with half of U.S. households heated by natural gas, a rally on news of cold weather like we saw yesterday was not a surprise.

Although the primary trend of natural gas prices remains lower, nat gas futures are known for big momentum swings. So, if futures can rally above last week's highs of $3.25, we could easily see the gains extended toward $3.50.

Looking to the metals, gold rolled over with the euro yesterday as the dollar rallied to fresh multi-year highs. Gold futures fell 1.16%. Europe was in focus as investors appeared to be less concerned with the situation in Greece materially affecting the ECB's plans for QE in January, which contributed to the weakness in gold.

Gold traders are also continuing to digest last week's blowout GDP number, which is weighing on demand for gold as a safe-haven asset. On the charts, we are looking to the $1,190-$1,195/oz. band for resistance while the next target to the downside is toward $1,165

Currencies & Bonds

The dollar was mostly stronger against other currencies yesterday with the exception of the Aussie dollar, which rallied in sympathy with China. The Dollar Index added 0.23% to start the shortened trading week yesterday.

European currencies traded lower yesterday as the failed Greek election was seen as a mostly isolated event and speculators resumed selling the euro amid expectations of QE in January. The euro fell 0.18% yesterday while the pound declined 0.26%.

In Asia, the Aussie rallied 0.21% on continued follow through from the Chinese announcement to expand bank's deposit bases (which is a form of mild economic stimulus).

This spurred moderate gains in the Aussie, one of China's largest raw materials providers. On the charts, the Aussie has been consolidating the most recent slide, holding support around $0.80. However, the general trend in the Aussie dollar remains a bearish one, so any material rally back toward $0.82 or $0.83 should be seen as a potential selling opportunity.

Elsewhere in Asia, the yen traded lower with the USD/JPY pair moving further through the 120 level toward last week's highs of 120.81. Fundamentally, there were some yen-bearish headlines by PM Abe, who said Japan should cut the tax rate on corporate income by 3.29% over the next two years to encourage companies to increase wages and business investment—essentially, another attempt at boosting economic activity. The yen, like most other global currencies, remains in a very well-defined downtrend against the dollar and the path of least resistance remains lower. The yen is bouncing this morning (up 1%) although that appears to be more year-end positioning than anything else as there was no real "yen positive" news out overnight.

Bond traders looked at the political situation in Greece as another excuse to buy (the opposite approach from precious metals and currency traders). The German bund continued to rally which, in turn, drew U.S. Treasuries higher with them. The 10-year note gained 0.27% while the 30-year bond added 0.41%. At least some of yesterday's price action also needs to be attributed to the calendar, as PMs continue to position ahead of the end of the year. But, bottom line, the bond market remains strong for now as international money flows—paired with a bit of a political fear bid thanks to Greece—are offering plenty of support to the market.

Have a good day—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.

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 12.29.14)

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 rallied just under 1% last week mostly on year-end positioning. The move higher extended the rally to over 100 points in less than 8 trading days, as a stabilization in oil prices and the Russian Ruble has led to massive short covering and buyers chasing into year end.*

Best Idea: Buy Retail (RTH).

Best Contrarian Idea: Buy Energy (XLE)

	Near Term Trend	Long Term Trend	Market Intelligence
Commodities	**Bearish**	**Bullish**	*Commodities were lower again last week as oil resumed its declines, although it did not make new lows. Oil continues to try and put in a bottom here, but it's unclear if a bottom is truly "in." Gold was the only commodity to finish higher last week higher, as it rallied in low volume trading Friday on general geo-political concerns.*

Best Idea: Buy Natural Gas (UNG)

Best Contrarian Idea: Buy Grains (DBA)

	Near Term Trend	Long Term Trend	Market Intelligence
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index again hit new multi-year highs last week following the very strong GDP report, which further highlighted the growing disparity between the US economy (getting stronger) and everyone else (stagnant). Because of that, we expect the dollar rally to continue.*

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 again last week following the strong GDP report, although there remains plenty of support for Treasuries and this failed Greek election will further support Treasuries in the near term. But, it does appear that markets are starting to consider negative domestic bond fundamentals, although again we need some progress in Europe before we will see any material downside in Treasuries.*

Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)