7:00's Report

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

December 4th, 2014

Pre 7:00 Look

- Futures are flat this morning while international markets traded higher o/n, rising in sympathy with the US and ahead of the ECB decision.
- Pretty much all markets are higher this morning but China's Shanghai Composite was the notable outperformer, surging 4.31% on further stimulus hopes (although nothing was actually announced).
- Econ Today: BOE Rate Decision (7:00 AM), ECB Press Conference (8:30 AM), Jobless Claims (E: 295K). Fed Speak: Mester (8:30 AM), Brainard (12:30)

Market	Level	Change	% Change
S&P 500 Futures	2074.00	1.50	0.07%
U.S. Dollar (DXY)	89.035	.042	0.05%
Gold	1202.20	-6.50	-0.54%
WTI	67.35	-.03	-0.04%
10 Year	2.287	.002	0.09%

Equities

Market Recap

Stocks kept rallying Wednesday as credit and energy were higher and economic data were good. The S&P 500 made a new all-time high and closed up 0.38%.

Much like Tuesday, stocks enjoyed a steady grind higher throughout a mostly quiet trading day. Unlike Tuesday, the gains accelerated into the close, as opposed to dipping slightly.

First, we said stocks were generally taking their cues

XLE: Energy stocks have enjoyed a nice bounce so far this week, but taken in context of the carnage of late last week, it's clearly just a bounce at this point.

from energy stocks and credit markets, and both were higher yesterday. Additionally, the ADP jobs report was mostly in-line with expectations while ISM Non-Manufacturing beat expectations and continued what has been a good week for U.S. economic data.

After the morning data, markets got very quiet and drifted sideways. The Fed speakers of the day revealed nothing new, and the Obama Q&A with Business Roundtable CEOs yielded little substance.

The gains accelerated during the last 90 minutes of trading despite Brent crude breaking $70/bbl (remember, this is more about oil stocks now than oil). The afternoon jump higher in the averages was mostly due to fast-money shorts covering and some buyers chasing, once stocks hit new highs. Markets closed just off their highs.

Trading Color

As mentioned, the two leading indicators for stocks right now, energy and credit, both traded well yesterday. JNK and LQD were up small, while XLE continued to bounce, rallying 1.3%.

Market	Level	Change	% Change
Dow	17,912.62	33.07	0.18%
TSX	14,774.47	18.66	0.39%
Brazil	52,320.48	708.01	1.37%
FTSE	6,719.16	2.53	0.04%
Nikkei	17,887.21	166.78	0.94%
Hang Seng	23,832.56	403.94	1.72%
ASX	5,368.80	46.98	0.88%
Prices taken at previous day market close.			

Beyond those two sectors, it was a "healthy" day internally as cyclicals led defensives. The Russell 2000 was up nearly 1%, and the only two S&P 500 sub-sectors that declined yesterday were utilities and consumer staples. Gains were led by basic materials, industrials and financials (so pretty textbook cyclical outperformance).

Market	Level	Change	% Change
DBC	20.26	-.14	-0.68%
Gold	1209.50	10.10	0.84%
Silver	16.375	-.081	-0.49%
Copper	2.8695	-.022	-0.76%
WTI	67.29	.41	0.61%
Brent	69.93	-.61	-0.86%
Nat Gas	3.803	-.071	-1.83%
RBOB	1.8068	-.0048	-0.26%
DBA (Grains)	25.27	-.22	-0.86%
Prices taken at previous day market close.			

Bottom Line

The new highs yesterday weren't met with the degree of joy you would expect, and I get the feeling most investors expected stocks to trade lower throughout the week.

We are cautious on stocks at these levels, but as we said yesterday, as energy and credit go, so will the stock market. Energy and credit have risen the last two days, and so have equities. If they break down further, that's when we need to go from cautious to concerned.

Bottom line is the backdrop for stocks is getting more challenging given valuations, but economic data have been good so far this week and credit/energy stocks stable. As long as that lasts, stocks will have a hard time declining in the near term (my concern emanates from the belief it may not last that much longer, but that's my opinion).

Economics

Economic events occurring today and tomorrow (ECB and Jobs Report) are more important than the data we got yesterday, so we are leading with those previews.

ECB Meeting Preview

- No changes are expected to interest rates or current monetary policies.

First off, despite expectations rising for the ECB to do QE (UBS was on the tape yesterday saying they now expect European QE in Q1 '15), **there is virtually zero chance QE will be announced later this morning.**

The policy announcement comes at 7:45 AM, but the real time to pay attention to this starts at 8:30, when Mario Draghi's press conference starts.

That's because the key regarding this ECB meeting will be the hints ECB President Draghi provides the market during his press conference regarding the potential of QE at the January or March meeting.

Specifically, the market will be looking for color on two topics:

1) **How negative is the ECB commentary on EU economic growth and inflation?** If the commentary regarding growth and inflation are decidedly more negative, then that will up the possibility of QE in the coming months (and validate the rising expectations).

2) **Is more work being done to prep for eventual QE, or is the ECB focused on trying to enhance other measures first?** Specifically this pertains to what work the staff is doing on sovereign-bond purchases (if Draghi discloses the council directed them to do more research), or instead if the focus is on making the current measures, including the TLTRO and ABS/covered bond purchases, more attractive.

Keep in mind the market has now significantly increased the expectation for QE in the EU. As a result, any ECB policies announced that 1) make TLTROs more attractive via cutting the rate charged to banks, or 2) increase the pool of securities for ABS or covered-bond purchases won't be well-received by the markets, even though they are economically positive. The market *wants* QE; anything less will be a disappointment.

Bottom line, we could see a bit of a "sell the news" reaction out of this meeting in HEDJ, but unless there are some clear signs the ECB is backtracking on QE, any post-ECB dip in HEDJ will be a buying opportunity.

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. As a result, wage increases and the unemployment rate are now just as important as the headline jobs number.

Wage Increases: 2.0% yoy - 2.2% yoy. If wage increases decline to below 2.0% (or stay at 2.0%) this will be slightly dovish. Conversely, if they spike to over 2.2% (which is very unlikely given other data), that will be hawkish, as it'll imply the labor market is tightening significantly.

Unemployment Rate: < 5.8%. The unemployment rate is already low enough to justify a more "hawkish" stance on the surface, so a further decline in the headline UE rate or the U-6 (which measures underemployment) will be mildly "hawkish" as it'll further imply the labor market is structurally healing further.

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, and 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 November, the chances of this number being a big miss are very remote. 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.

ISM Non-Manufacturing PMI

- The ISM Composite Index rose to 59.3 vs. (E) 57.3 in Nov.

Takeaway

The largest component of the U.S. economy remained quite strong in November as the ISM "Service" PMI hit a 9-year high, coming in ahead of estimates at 59.3—a gain of 2 full points from the October reading. The components of the report were solid as well, with new orders rising 2.3 points to 61.4 and business activity gaining 4.4 points. Meanwhile employment did slow slightly, down 2.9 points (but from October's near-record reading of 59.6). It is also worth noting that, when comparing industries, the retail sector remains at the top.

Bottom line, the service sector of the economy remains quite strong, which is a big positive for the overall economy as we enter the busiest time of year with the holidays approaching quickly.

Market	Level	Change	% Change
Dollar Index	88.995	.292	0.33%
EUR/USD	1.2309	-.0072	-0.58%
GBP/USD	1.5685	.005	0.32%
USD/JPY	119.81	0.62	0.52%
USD/CAD	1.1363	-.0042	-0.37%
AUD/USD	.8400	-.0039	-0.46%
USD/BRL	2.5521	-.0148	-0.58%
10 Year Yield	2.287	.002	0.09%
30 Year Yield	2.993	-.011	-0.37%
Prices taken at previous day market close.			

Commodities

Most commodities took a breather from the recent volatility and went through some consolidation yesterday. Natural gas was a notable exception, as the slide in futures continued with another 2% drop yesterday. The commodity ETF, DBC, fell to yet another 5-year low, though, finishing the day down 0.54%.

Energy markets were quiet yesterday as the Thanksgiving sell-off continues to be consolidated and inventory data was digested by traders. WTI finished the day up 0.60%. The EIA reported a -3.7M barrel draw vs. (E) of +600K in oil supplies, a build of +2.1M barrels vs. (E) +800K in RBOB inventories, and a +3.0M barrel build vs. (E) -300K draw in distillate supplies. The report turned out to be pretty much a wash, as the bearish product supply gains offset the bullish draw in crude stocks and futures did not materially move off the weekly report.

Bottom line in crude: The market is still in consolidation mode right now, and although there is a risk of a modest short-covering rally into the low-$70s, the near-term trend remains decidedly lower for the medium term.

Natural gas continued to slide yesterday as futures fell -1.94%. The market is all about the current demand situation and right now expected demand is limited due to the mild weather conditions across much of the Midwest and Northeast. And until the forecasts begin to show some colder temperatures, prices will remain under pressure. The EIA will release weekly supply figures this morning and analysts are expecting a draw of -41 Bcf, and you know the drill: Any surprises could spur a knee-jerk reaction in futures. On the charts, yesterday's lows of $3.75 is in focus.

Moving to the metals, gold surprisingly managed to rally yesterday despite the Dollar Index rising above 89.00 for the first time since Q1 2009. Gold futures closed up 0.91% at $1,210. There were a couple reasons cited for the rise in gold prices including the miss in the ADP headline and a sympathetic rally with the bounce in crude oil prices, but we believe the real reason is trader positioning ahead of today's ECB announcement and tomorrow's jobs report.

Gold has acted "better" the last few days and that is surprising, but with the Dollar making new highs, we think the upside in gold remains very limited, with risk to the downside.

Currencies & Bonds

The dollar rally continued yesterday. Although the strength wasn't universal, we did see new multi-year highs and lows in the Dollar Index, euro and yen respectively. The Dollar Index rallied 0.33% and broke through 89 for the first time in nearly 6 years thanks to good ISM service sector PMI and selling in the euro ahead of the ECB this morning.

The euro hit a new, multi-year low yesterday on selling ahead of the ECB, barely holding support at the 1.23 level (the low was 1.2302). A lot of the selling was in anticipation of some sort of "dovish" ECB outcome. While I think the ECB is getting more "dovish," I also think that unless they surprise markets, we could see a bit of a "buy the news" reaction later following this morning's meeting.

The yen nearly hit our 120 target yesterday, as the yen fell almost exclusively on dollar strength (there wasn't any bad news from Japan).

Bottom line, the economic data in the U.S. this week have been good (Manufacturing and Non-Manufacturing PMIs, Auto Sales, Construction Spending) while the data internationally have been at best "ho-hum." That's leading to a widening gap between the U.S. economy and everyone else. Combine that with an ECB and BOJ who are going to ease further and a Fed who seems more resolute this week to stay on track for policy normalization, and that will send the dollar higher. This is a trend that's going to continue.

The only exception out there at the moment is the British pound, which is trying to bottom. Manufacturing and service sector PMIs were good and the "Autumn" Statement (a report on the economy) was positive on growth. The British pound remains the best house on a bad foreign currency block.

Technical Update on the 30-Year—Trying to Turn Bearish

The technical situation in 30-year bond futures appears to potentially be shifting to bearish.

- First, the most recent rally failed before making a new high last week, suggesting exhaustion.
- Second, that aforementioned rally ended with a bearish, one-day (or outside) reversal, also consistent with rally exhaustion.
- And lastly, the uptrend line dating back to mid-September was violated yesterday, which is near-term bearish.

But, because of how "tricky" the bond market has been this year (there have been multiple "head fakes"), we would like to see futures break below the November lows as confirmation before initiating or adding to bond shorts. That "line in the sand" lies down at 140'00.

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.			
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.			

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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)