7:00's Report

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

December 9th, 2014

Pre 7:00 Look

- Futures are extending their losses this morning after lower oil prices weighed on Asia and more Greek political drama weighed on Europe.
- Shanghai is the laggard this morning, dropping 5% following general weakness in the US (there was no specific negative event but that market was very overbought).
- In Europe the Athens stock market is down 10% and Greek yields are higher on political concerns following the announcement of a Presidential election next week.
- Econ Today: Jolts (E: 4.79M).

Market	Level	Change	% Change
S&P 500 Futures	2053.00	-6.50	-0.32%
U.S. Dollar (DXY)	89.14	-.127	-0.14%
Gold	1205.3	10.40	0.87%
WTI	63.79	.74	1.14%
10 Year	2.257	-.050	-2.17%

Equities

Market Recap

Stocks saw decent declines for a second straight Monday as oil fell to new lows and a negative headline regarding TLTRO demand at this week's offering weighed on stocks. The S&P 500 declined 0.73%.

Stocks were lower from the outset yesterday as poor Chinese trade data and a surprise cut to Italy's debt rating weighed on European markets, which in turn weighed on futures.

JNK made new lows yesterday, and while the rest of the market seems assured this is just energy related, we do not share the same level of complacency.

As has been the case for 2 months, though, the early weakness was met with buying as the dip at the open drew out buyers. Within an hour of trading, stocks were flat on the day. But, the market acted a bit heavy and, when oil started to break down around 10:30 and move to new lows, it dragged the oil stocks down with it. This dragged the market down.

Adding to the negativity were two reports on Europe: First, Greek Prime Minister Samaras surprisingly called for a Presidential election next week, and it's not certain whether he has the votes in the Greek Parliament to get his candidate elected. This matters because Greece still needs to EU bailout to avoid default, and the concern is that if Samaras's candidate doesn't win, it could lead to larger elections where "anti-bailout" parties could gain seats or a majority. Sadly, we still have to monitor Greek politics. Second, there was a Reuters poll that forecast demand at this Thursday's TLTRO to be under the estimated 150 billion euros. Shortly after lunchtime stocks were at the lows of the day, down close to 1%.

Market	Level	Change	% Change
Dow	17,852.48	-106.31	-0.59%
TSX	14,144.17	-329.53	-2.28%
Brazil	50,247.07	-1,718.82	-3.31%
FTSE	6,602.92	-69.23	-1.04%
Nikkei	17,813.38	-122.26	-0.68%
Hang Seng	23,485.83	-561.84	-2.34%
ASX	5,282.67	-90.04	-1.68%
Prices taken at previous day market close.			

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Dip-buyers re-emerged mid-afternoon and stocks tried to lift. But there was no conviction to it and the best the buyers could do was cut the declines in half. But by the final hour of trading, they largely gave up. Stocks sold off into the close to finish not far from the worst levels of the day.

Market	Level	Change	% Change
DBC	19.81	-.36	-1.78%
Gold	1204.40	14.00	1.18%
Silver	16.365	.107	0.66%
Copper	2.883	-.0195	-0.67%
WTI	63.04	-2.80	-4.25%
Brent	66.19	-2.88	-4.17%
Nat Gas	3.626	-.176	-4.63%
RBOB	1.705	-.0684	-3.86%
DBA (Grains)	25.28	-.09	-0.35%
Prices taken at previous day market close.			

Trading Color

Cyclicals lagged yesterday but it wasn't a terribly negative day internally despite the Russell dropping 1.4%. But, that index has been very volatile lately and the Nasdaq basically traded in line with the S&P 500 (down 0.8% vs. 0.7% for the S&P 500).

Further to my point, sector trading was mixed. Obviously energy got killed again, as XLE dropped 4% and is now through the October lows, while materials also lagged.

Interestingly, despite the Nasdaq trading "ok," recent market-leading large-cap tech stocks continued to lag, and as a result the tech SPDR dropped 1%. AAPL was the main culprit, down another 2% yesterday, but MSFT, INTC and CSCO all were down around 1% also. I'm not sure if this is much, but those large-cap tech names led the S&P 500 higher over the past two weeks, so it's notable that those leaders are starting to break down a bit.

On the plus side utilities bounced back (up 0.8%) from Friday's underperformance as rates declined, but financials also rallied yesterday (up 0.4%) on continued momentum from Friday. So, clearly there were no interest rate related moves in the markets yesterday (although banks did decline marginally and it was insurance companies that had XLF positive). The other sub-sector to finish the day slightly positive was healthcare, which got a boost from continued M&A in the space (MRK buying CBST).

Finally, European ETFs lagged following the TLTRO poll (more on that later). HEDJ dropped 0.95%, but it closed well off the lows of the day and the story in Europe is now about QE. The ETF is overbought so we may see some profit-taking into the TLTRO auction, but any material dip would be a buying opportunity in our view.

Bottom Line

This market remains about energy stocks and credit in the short term, and both were sharply lower yesterday and so was the stock market.

Looking at credit, JNK broke below $39 yesterday and is headed lower, and I just don't share the same level of complacency regarding this junk/emerging market sell-off as other analysts. I have a hard time reconciling that it's just energy causing these declines. So, as a result, we remain cautious in the near term. Although the market made a new high last week, the price action of the past 10 days further validates our caution, as we continue to think the market is acting fatigued.

A Word of Caution on China

I'm not sure how many of you have China stocks exposure via something like FXI, but I want to point out a growing dichotomy in the market. The Shanghai Exchange has been soaring over the past two weeks while economic data there have been deteriorating. Part of the reason for soaring stock prices is anticipation of more stimulus from Chinese authorities, but it's also because of liquidity, as new access to the domestic Shanghai market from non-mainland China via a link in Hong Kong was established during the last month.

Well, that exuberance is reversing this morning as Shanghai closed down more than 5%, it's largest drop in several years. And, we believe the declines may not be over.

Yes, Chinese authorities will likely ease further, but economic data points in China aren't great, and I think the market may be getting a little ahead of itself of just how much stimulus the PBOC will unleash (people are hoping for a reserve ratio cut). Bottom line, if you've enjoyed a China run or have decent China exposure, consider booking some profits even in the face of the declines this morning, as the fundamentals and price action are starting to diverge in a pretty big way.

Economics

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There were no economic reports yesterday.

Commodities

Commodities were mostly lower again yesterday as oil sold off sharply, reaching fresh 5-year lows. The underperformance in energy weighed on U.S. equities but brought a bid into gold futures. The benchmark commodity ETF, DBC, like oil, traded down to a new 5-year low.

The slide in crude oil prices continued yesterday as WTI futures finished the day down 3.96%, the biggest drop since the knee-jerk sell-off the day after the Thanksgiving OPEC meeting. Futures quietly violated near-term support at $66/barrel last Friday, and the selling accelerated as soon as markets opened on Sunday night.

There were not any material developments regarding the fundamentals; the futures market simply remains very volatile as traders, analysts and producers alike continue to speculate when and where a bottom will be established in prices. Bottom line, oil futures remain in a sharp downtrend, and that is poised to continue over the near term with the next level of support lying below between $58 and $60. So, selling any strength toward $65 or $66 should make for a solid entry point if you are looking to "ride the slide" in futures prices.

It is worth mentioning that "net longs" in crude oil, according to the CFTC, increased by 14% last week. This was largely a result of short-covering, but there was also some speculative buying by the hedge fund community. We point these things out because, although money managers are often very early when calling a top or bottom in a market with so much momentum, it is an obvious precursor to the "real" bottom.

Market	Level	Change	% Change
Dollar Index	89.10	-.26	-0.29%
EUR/USD	1.2318	.0033	0.27%
GBP/USD	1.5655	.0074	0.47%
USD/JPY	120.59	-.82	-0.68%
USD/CAD	1.1474	.0036	0.31%
AUD/USD	.8295	-.0028	-0.34%
USD/BRL	2.5996	.0104	0.40%
10 Year Yield	2.257	-.050	-2.17%
30 Year Yield	2.901	-.063	-2.13%

Prices taken at previous day market close.

So, we will continue to monitor net longs over the coming weeks (or months if it takes that long) to help keep you informed of when the sell-off is more likely to actually end.

Natural gas futures fell for the 7th session in the past 8 yesterday (futures rallied on short-covering last Friday), dropping 5.02%. Natural gas futures started to sell off in late November in sympathy with crude oil prices, but then the selling accelerated as meteorologists began revising December weather forecasts, suggesting temperatures would not be as cold as initially thought.

Bottom line, futures remain in a sharp downtrend with the bears eyeing the 2014 low at $3.541, and if that level is violated, we anticipate momentum can carry futures down toward an initial target of $3.40 and a secondary target of $3.20.

Turning to gold, the rally last week was predictably almost entirely short-covering as the CFTC reported Net Long positions held by money managers increased 14K, more than 10K of which was a result of short-covering.

So, the takeaway here is that the recent jump in gold prices has not been a result of organic buying (no one is getting more "long" gold, they are just covering as it continues to act better). We remain medium term bearish on gold based on the stronger dollar argument but gold is now right against 4+ month resistance this morning so we will continue to watch the technicals closely here.

Currencies & Bonds

Like last Monday, we saw a pause in recent dollar strength again this past Monday, as a midday survey of anticipated underwhelming TLTRO demand exacerbated the reversal in currency markets yesterday.

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Even before the TLTRO poll, which we will cover in a minute, we were seeing some typical digestion of Friday's dollar strength/foreign currency weakness. The euro and yen, which saw the biggest declines last Friday, were bouncing consistently throughout the morning session, until the Reuters poll broke around midday and exacerbated the euro/yen strength and dollar weakness.

The euro closed up 0.28% vs. the dollar after giving back some gains late in the afternoon, while dollar/yen declined 0.75% (so the yen strengthened).

The dollar weakness wasn't universal, though, as the underwhelming Chinese import data weighed on Aussie, which declined 0.31% vs. the dollar, and the collapse (again) in oil weighed on the Loonie (-0.37%). In particular, the bad Chinese import data implies less commodity demand (specifically iron ore) from Australia, which could weigh on their economy, while obviously the Loonie is very correlated to the price of oil, and as oil continues to fall, so will the Loonie. I do not think we have seen the lows for either of the commodity currencies at this point.

Overall we can chalk yesterday up to the currency market taking a "breather" as the dollar rally is extended, even with supporting fundamentals. If the pro-dollar news will take a break, we may see a larger bounce in other currencies vs. the dollar. But overall the trend of dollar strength remains very much in place going forward.

Bonds bounced hard yesterday thanks to the bad TLTRO poll that hit midday, which accelerated the modest gains in Treasuries and German Bunds. The 30-year ended up 0.71%, recouping all of last Friday's losses.

Focus in the bond market early yesterday was on Italy, as S&P cut its bond rating. But, despite worrisome headlines, this was mostly a non-event. Although the Italian 10-year yield spiked over 2% initially on the news, they actually ended the day decidedly **lower** at 1.94%. So, despite S&P's concerns, the bond market viewed the news yesterday as a buying opportunity.

Treasuries continue to be supported by Europe, and as we said yesterday, as long ass Europe remains on the brink of deflation, ever-worsening bond fundamentals here in the U.S. will continue to be largely ignored by the markets).

TLTRO Primer

This Thursday brings the second offering of "Targeted Long Term Repurchase Operations" by the ECB. As a refresher, these are basically very cheap loans the ECB is making to banks to help them monetize existing performing loans, free up more capital and help spur the EU economy.

What sent the euro higher midday yesterday, and stocks and the dollar lower, was the release of a Reuters poll of EU money market traders that predicted demand at Thursday's offering of just 130 billion euros. That's up from the previous 84 billion in September, but under the 150 billion expectation.

Prior to last week, this offering was seen as a critical test of how successful the ECB would be at expanding its balance sheet. But, since QE in the EU has become a broad market expectation, this TLRTO auction has lost some importance. Even if it is bad, it's now seen as only increasing the chances of QE (and in fact the anticipation of the ECB buying corporate bonds or doing QE may delay banks from taking advantage of the TLTRO for hopes of a better deal later in the year).

But, it's not fair to be dismissive of this offering, nor the negative commentary on the EU economy if it is under expectations. Bottom line, this reflects the demand for money in the EU, and a bad auction will reflect, at least partially, a dour outlook on the EU economy by banks.

To keep things simple, one of the few reasons banks refuse cheap (or free) money is because there's no demand for good loans out there—when the economy is good, there is demand for money. When it is bad, there is not.

With QE looming in the distance, a bad TLTRO can be rationalized, but it is a bad sign for the EU economy. It won't make me abandon my "Europe outperforms" thesis, but it will take away some of the enthusiasm.

Have a good day,

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.			
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 12.8.14)

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 a new all time high last week thanks to strong US data and rising hopes of QE in the EU. But, markets also acted a bit fatigued as Friday's blow out jobs report failed to spur much of a rally, as data that good is seen as potentially creating a slightly more hawkish Fed. Bottom line, it'll be tough for stocks to sell off materially given current sentiment, but we see limited upside over the coming weeks.*
Best Idea: Buy Regional Banks (KRE). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Bearish**	**Bullish**	*Commodities declined again last week as oil tried to stabilize (but largely failed) and gold got hit on Friday following the strong jobs report. With concerns about the global economy and a relentlessly stronger dollar, the near term outlook for commodities remains poor.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index shot to new multi-year highs last week following the blow out jobs report. The yen was the weakest performer vs. the dollar, dropping more than 2%, but every major currency declined as the difference between US growth/monetary policy and the rest of the world continues to widen.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries declined last week on slightly "hawkish" comments by Fed officials Dudley and Fischer, and the strong jobs report. Importantly, last week the rising prospect of a more "hawkish" Fed weighed on bonds, and there are cracks appearing in the rally.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			

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