7:00's Report

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

January 13, 2015

XLE: This chart continues to get worse, and a test of the recent low of $72.51 (perhaps today) isn't out of the question.

Pre 7:00 Look

- Futures are bouncing as markets initially ignore another plunge in oil prices while Europe outperforms on QE hopes.
- WTI and Brent Crude are down 3% each and hitting new lows. The negative catalyst o/n was comments by the UAE Oil Minister which supported OPECs lack of production cuts.
- Economically, UK CPI dropped to a 15 year low (.5% yoy) although again most of the declines are due to falling oil and food prices and UK stocks are higher this morning.
- Econ Today: JOLTS (E: 4.875M). Fed Speak: Plosser (8:00 AM), Kocherlakota (5:00 PM)

Market	Level	Change	% Change
S&P 500 Futures	2035.25	12.75	0.63%
U.S. Dollar (DXY)	92.455	.271	0.29%
Gold	1239.20	6.20	0.50%
WTI	44.81	-1.26	-2.73%
10 Year	1.912	-.059	-2.99%

Equities

Market Recap

Stocks began the week by extending last week's losses as oil prices traded down to new multi-year lows, and that offset improved sentiment regarding ECB QE. The S&P 500 ended the day down 0.80%

Stock futures were higher early yesterday morning but the gains were short lived as crude oil futures rolled over and sold off to fresh 5-1/2-year lows, which once again weighed on energy stocks and the broader equity markets. One of the key catalysts for the crude oil and energy sector selloff was the price target cut by Goldman Sachs who dropped estimates by more than 40%.

Also weighing on stocks early was some "micro-economic" news as we saw some profit warnings from tech and retail companies.

Stocks dropped as the decline in WTI accelerated and basically traded with that commodity the entire day. WTI somewhat stabilized after the morning drop and the S&P 500 did as well (albeit down about 0.5%), but the afternoon drop in WTI after hours saw the S&P 500 take another leg down and stocks finished off the lows of the day—but towards the bottom of the range.

Trading Color

Despite the broad market declines, stocks were more mixed than the S&P 500 would imply, which also was the case last week. First, the Russell 2000 and Dow Industrials were down just half of the S&P 500's 0.84%, and while the Nasdaq was down as much as the S&P, it was mostly due to negative earnings guidance in semiconductor stocks. Point being, we didn't see the typical underperformance from the small caps and tech.

Market	Level	Change	% Change
Dow	17,640.84	-96.53	-0.54%
TSX	14,265.01	-119.91	-0.83%
Brazil	48,1329.74	-700.51	-1.43%
FTSE	6,545.44	44.02	0.68%
Nikkei	17,087.71	-110.02	-0.64%
Hang Seng	24,215.97	189.51	0.79%
ASX	5,404.69	-18.01	-0.33%
Prices taken at previous day market close.			

Looking at individual sectors, selling was once again broad but the sectors with the biggest declines were all news driven.

Market	Level	Change	% Change
DBC	17.36	-.37	-2.09%
Gold	1234.80	18.70	1.54%
Silver	16.615	.196	1.19%
Copper	2.7235	-.031	-1.13%
WTI	45.91	-2.45	-5.07%
Brent	47.37	-2.74	-5.47%
Nat Gas	2.799	-.147	-4.99%
RBOB	1.2771	-.0461	-3.48%
DBA (Grains)	24.66	-.18	-0.73%
Prices taken at previous day market close.			

Energy, predictably, was the worst performer for obvious reasons, as XLE fell 2.9% and continues to inch towards that $72.51 low.

Tech (XLK) was the other laggard, as it fell more than 1% this time on soft earnings guidance. SNDK was the main culprit as the stock traded down 14% on a profit warning, and that weighed on the entire tech sector and specifically the semiconductors (the SOX was down 2%).

Retail also was in focus as TIF dropped 14% on a lackluster guidance update, although broader retail impressively held up as RTH was down 0.3% and XLY (the broader consumer discretionary ETF) was down just 0.54%.

Finally, healthcare was again the outperformer, as XLV was the only sector to trade in the green yesterday, rallying small. M&A and continued focus on specialty drug pricing were the positive catalysts (and the 60 Minutes story Sunday night that showed how the healthcare industry was minting money off the Healthcare Act didn't hurt, either).

Bottom Line

I know this is getting repetitive, but until oil and XLE stabilize this market will have a hard time generating any meaningful upside. And though Europe is becoming a greater influence on stocks, energy showed again that it's still in charge, short term.

There remain too many macro headwinds to see material upside in US equities near term, but at the same time the market still acts "ok." People seem to be getting a bit more uncomfortable and there is a lot of "weak longs" in the market, so we could see a temporary spike lower, but any material dip below 2000 (say towards 1970ish) would be a buying opportunity in our view.

ECB QE Primer

I know this is a bit early for a ECB QE preview because an announcement likely won't come until next Thursday, but as we have seen over the last two trading days, articles about expected QE are now moving markets (and will continue to do so).

Instead of reviewing the multiple confusing possibilities that are being listed out there for ECB QE, I think it's much more useful to point out what will be required for the market to "like" the QE plan in the short term (and make it a positive catalyst for EU and global stocks). I suggest printing this section so you can reference back to it when the announcement occurs next Thursday (that's what I'm doing).

3 Key Points That Make ECB QE a Positive for Stocks

Key point #1: **Size: 500 Billion.** There have been leaks from the ECB that they are planning on announcing a plan of around 500 billion euros (so nearly 600 billion dollars). If the plan is equal to or greater than 500 billion, that will be considered a positive because it will make the ECB's goal of expanding its balance sheet by 1 trillion much more likely.

Key Point #2: **Debt Seniority: "Pari-Passu."** Pari-passu, with regards to the ECB QE program, will mean that any government bonds purchased by the ECB will be on the same seniority level as any outstanding government bonds owned by private investors (pension funds, etc.). That's important because it means the ECB will be willing to share risk with the private investor should an EU country default or restructure its debt. This should make the program more effective, because if the ECB deems their purchases senior to all other debt, it may result in sales of sovereign bonds by private investors, which will offset the benefit of the ECB purchases.

Key Point #3: ECB Makes the Purchases, Not Individual Central Banks. There has been some talk that to execute QE, the ECB may just mandate that each country's central bank buy their own bonds, keeping the risk of loss from a default on that country's balance sheet.

But, that will largely undermine the program and move the EU closer to splintering than tighter integration, which is the opposite of what's positive for the EU economy. In simple terms, the ECB needs to "step up" and take the risk of these purchases to gain the reward of increased credibility of its policies in the EU, and the rest of the world.

Right now, the positive scenario will involve the ECB buying bonds of investment grade countries, while making non-investment grade countries' central banks (Greece, Cyprus and maybe Portugal) buy their own bonds and take on the credit risk should they default.

That will achieve two goals: First, it will ensure the vast majority of QE purchases will be made by the ECB, not individual countries' central banks. Second, it will make non-investment grade countries' central banks more vested in 1) staying in the euro and 2) not defaulting (if the Greek Central Bank is buying its own debt, it's clearly dis-incentivized to default because it will suffer massive losses).

Bottom Line

But, even if all we get is the 500 billion euros, as I said on CNBC yesterday (link here for those interested) I still think European QE will be a major net positive for the EU stocks beyond the very short term, so unless a plan with no specifics and details is announced, I will still be a buyer of Europe on any dip.

Market	Level	Change	% Change
Dollar Index	92.18	.033	0.04%
EUR/USD	1.184	.0001	0.01%
GBP/USD	1.5175	.0017	0.11%
USD/JPY	118.24	-.26	-0.22%
USD/CAD	1.1954	.0088	0.74%
AUD/USD	.8159	-.0041	-0.50%
USD/BRL	2.6733	.0434	1.65%
10 Year Yield	1.912	-.059	-2.99%
30 Year Yield	2.492	-.064	-2.50%
Prices taken at previous day market close.			

Economics

There were no economic reports yesterday.

Commodities

Commodity markets began the week with a "risk off" attitude as energy and industrials sank to new multi-year lows while precious metals rallied on further "flight to safety" money flows. The benchmark commodity ETF, **DBC, declined –1.86% to hit a fresh all-time low.**

Crude oil began to decline as soon as futures markets started trading on Sunday evening, and the selling pressure remained constant all day as WTI closed down 4.88%, just ticks off the lows. The downward momentum is continuing this morning as WTI and Brent are off 3% each.

General negative commentary was responsible for the drop in oil over the last 48 hours. First, was the huge price cuts by Goldman Sachs yesterday morning. Then the resident investing Saudi Prince Alwaleed bin Talal, said "oil will never go back to $100." He also re-emphasized the Saudi view that any production cuts by Saudi Arabia would only result in a loss in market share by the kingdom and would not materially help stabilize prices. Then, this morning, UAE oil minister Suhail Mohamed Faraj al-Mazrouei defended OPECs lack of action, citing surging US shale production as the nexus of the supply problem.

On the topic of production, we mentioned the falling rig count in the US in yesterday's Report, pointing out some analyst are falsely assuming that a declining number of rigs is inherently bullish. But, according to the research company Wood Mackenzie, only 1.6% of the world's oil production is "at risk" with **Brent** oil prices at $40/barrel (so WTI even lower), most of which involve Canadian oil sand projects. So, the key takeaway is there is still room for futures to move lower before "shut ins" begin to materially affect production and ultimately price.

Bottom line, the trend remains lower in crude oil as both WTI and Brent dropped to new lows yesterday. On the charts, resistance has come down to $47-$47.50 while $40 has become an increasingly popular downside target (we have met out initial $45 target on WTI).

Natural gas futures also broke down to multi-year lows, falling 4.96% on the day to below $2.80 for the first time since fall 2012. Nat gas futures have been in a sharp downtrend since the last week in November, and it looks like that move lower will continue until support around $2.50.

ThCopper crashed through last week's lows in the mid-$2.70s and finished the day down 1.13%. Like the aforementioned products, copper is in a clear-cut technical downtrend supported by the fundamentalists' concern over the global economy, most specifically China. We anticipate some consolidation after yesterday's move with the potential for a "pop" into former support. Such a move would line up a favorable, risk-reward, short opportunity as you would be selling towards $2.76 with a clear stop above $2.78.

Moving to the precious metals, gold and silver both saw solid rallies with the former adding 1.51% and the latter gaining 1.10% (note the copper losses weighed on silver because of its industrial characteristics).

Focusing specifically on gold, futures jumped to the highest level in over a month yesterday, participating in the broader risk-off trade that was the function of further losses in oil prices and uncertainty in Europe. The dollar index also sold off as the day went on, allowing gold to extend gains into the afternoon.

Bottom line, gold futures are being driven higher as fear bids force out weak handed, fundamental shorts betting against gold because of the surging dollar. And, that "pain trade" of higher gold prices can continue for as long as risk assets remain under pressure, which ultimately leads back to the decline in oil prices. So, when oil stabilizes and stocks recover, gold should reverse direction. On the charts, $1220 has become support while gold is through resistance at $1239 and is now targeting $1250.

Currencies & Bonds

Currency markets were relatively calm Monday despite the drop in stocks, although like stocks plunging oil was the main catalyst.

Starting first with the majors, the Dollar Index, euro and pound were flat while the yen rallied modestly, up 0.3%. News flow was pretty slow, as the euro isn't reacting to the various ECB QE articles or central bank comments with the same volatility as stocks. At this point, the euro has priced-in ECB QE, and as I said last week I'd expect some consolidation here until next Thursday, when the details of the plan are revealed.

The volatility yesterday came again courtesy of oil markets, as the Lonnie was the worst performer, down .78% on the new lows in oil. The Loonie dropped to a new multi-year low versus the dollar, and even if oil stabilizes around this level, the damage wrought to the Canadian economy and balance sheet will continue on for some time. I would not be surprised to see the Loonie break .80 sometime in Q1 '15.

As the chart on pg. 2 shows, the ruble is through 65/dollar on plunging oil prices this morning, and while it's not being covered at the moment, we are approaching the "danger area" of 70 that will re-ignite currency crisis concerns and EM contagion risks. This will become a headwind if the decline in the ruble continues.

Not surprisingly given more ECB QE chatter and weaker stock prices, Treasuries continued to move higher yesterday, as the 30-year bond rose 0.6% to a new closing high while the 10-year yield is threatening to break below 1.91%.

Also helping bonds today was a strong 3-year auction, which saw the actual yield 1 full basis point below the "when issued" yield (indicating aggressive bidding) while the bid to cover was a also strong at 3.33. The fact that demand was strong for this short-term issue is interesting, as the 2-year Treasury has underperformed lately given rising expectations for a rate hike in mid-2015. This strong 3-year auction implies the bond market may be starting to doubt the Fed will hike in mid-2015 following last week's soft wage report. Up next today is a 10-year note offering, and given the macro backdrop, we can safely assume strong demand for that offering as well.

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 1.12.15)

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 declined .6% last week as dropping oil prices continued to weigh on global stock markets. Broadly, there are several macro headwinds facing stocks at the moment (European QE, Grexit, lower oil, potential rate hikes by the Fed) and as a result we view the upside as limited and would prefer to buy dips in the S&P 500 below 2000.*
Best Idea: Buy Retail (RTH). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Bearish**	**Bullish**	*Commodities were lower again last week as oil declines accelerated. The commodity complex remains under pressure broadly as a stronger US dollar, flagging global demand and continued exodus of investment dollars weighs on the complex.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index rallied to new highs last week despite declining last Friday following the disappointing wage data in the jobs report. Euro weakness remains the #1 driver of the currency markets at the moment, and while we may see some stabilization in the coming weeks, the trend remains firmly euro lower, Dollar higher.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries rallied to new highs last week as fears about European deflation sent German bunds and Treasuries higher, while Friday's disappointing wage data in the jobs report added fuel to the fire. Until there are legitimate signs of economic progress in Europe, Treasuries will continue to be extremely well bid, almost regardless of US economic fundamentals.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			