# 7:00's Report

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

***January 14th, 2015***


***Copper: The collapse in "Dr. Copper," which hit 5 year lows yesterday, has been somewhat lost in the oil declines—but clearly this is not a good sign for global growth.***

## Pre 7:00 Look

- Futures are slightly lower this morning and most markets declined o/n on general global growth concerns.
- The World Bank cut their global growth outlook for 2015 & 2016, and while not surprising, the cut is weighing on global industrial stocks (it's why the FTSE is down 1%).
- ECB QE cleared a legal hurdle as the European Court of Justice theoretically "ok'd" QE, as was expected. The euro initially dropped on the news but is now flat.
- Earnings Today: JPM (E: $1.30), WFC (E: $1.02).
- Econ Today: Retail Sales (E: -0.1%).

| Market | Level | Change | % Change |
|---|---|---|---|
| S&P 500 Futures | 2011.75 | -4.50 | -0.22% |
| U.S. Dollar (DXY) | 92.50 | -.002 | 0.00% |
| Gold | 1228.70 | -5.80 | -.047% |
| WTI | 45.72 | -0.17 | -.041% |
| 10 Year | 1.890 | -.022 | -1.15% |

## Equities

*Market Recap*

Stocks declined during a volatile session Tuesday as early and substantial gains were all given back as oil resumed its declines. The S&P 500 fell –.26%.

The volatility continued and accelerated yesterday, as the peak to trough move in the S&P 500 was 44 points. Stock leapt higher at 8:30 for, in truth, no apparent reason (more on that later), although some of the "reasons" cited were "Dovish" comments by a normally "Hawkish" Plosser, strong small business wage data, and decent earnings (AA beat as did some European companies).

But, really none of those events, nor the better than expected JOLTS data, was really responsible for the 1% plus rally in stocks.

But, the gains proved fleeting as stocks hit their highs within 30 minutes of trading, and then by 11 were drifting lower and by the early afternoon were in full retreat. The reason "Why" is first because there was never any strength ot the early rally, and second because oil and energy stocks rolled over. In fact, if you take a look at XLE, it reversed right at 11 AM and stocks declined lock step with it from there.

Oil and energy stocks somewhat stabilized after 2:30 and stocks were able to close off the lows, but yesterday was a prime example of the point we're trying to make about the market being unable to sustain material gains until we get some macro clarity with oil, energy stocks and Europe.

*Bottom Line*

| Market | Level | Change | % Change |
|---|---|---|---|
| Dow | 17,613.68 | -27.16 | -0.15% |
| TSX | 14,187.16 | -77.85 | -0.55% |
| Brazil | 48,041.67 | -98.07 | -0.20% |
| FTSE | 6,453.13 | -89.07 | -1.36% |
| Nikkei | 16,795.96 | -291.75 | -1.71% |
| Hang Seng | 24,112.60 | -103.37 | -0.43% |
| ASX | 5,353.60 | -51.09 | -0.95% |
| Prices taken at previous day market close. | | | |

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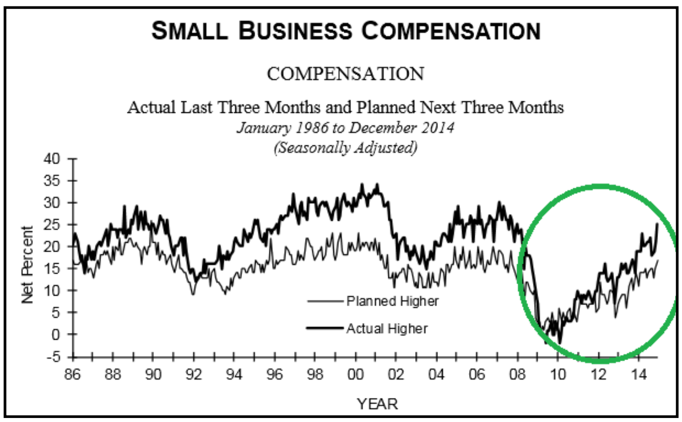
Trading color would be a bit of a waster this morning as at the moment this market is running in place. The major macro headwinds are preventing any real buying, but at the same time there isn't enough actual "bad" news to push stocks materially lower (although the S&P 500 did break through the 50 day moving average again).

We can expect continued volatility, likely with a slight downward bias for the next week or two until we get more clarity on ECB QE, Greece and oil (which at this point is absurdly oversold and due for a bounce).

*Did Someone Big Put a Massive "Long Europe" Trade on at 8:30 yesterday?*

At 8:30 yesterday stock futures leapt higher, while the euro and Treasuries fell sharply. Despite spending all day digging for the "reason," nothing was apparent. There were rumblings that Fed President Plosser made "Dovish" comments, but the currency and bond markets didn't agree (they reacted hawkishly). Also, the NFIIB wage data was out at 8:15, and wouldn't have made such an impact.

The only thing I can surmise from the price action was that someone large put on a "Long Europe" trade. The reason I say that is because: 1) European stocks significantly outperformed US stocks in the morning yesterday, 2) the euro came for sale hard, hitting a new low and 3) Treasuries sold off for no real reason. If you were a large macro fund trying to put on a longer term position across asset classes, those three steps are exactly what you would do to gain maximum exposure, beause if one if right, they likely will all be right. I obviously don't have any proof of this trade, but someone big was moving at 8:30. Food for thought.




***Boring but Important: Wages being paid by small business leapt higher in yesterday's National Federation of Independent Business survey, contradicting the sluggish statistical wage growth in Friday's jobs report.***

| Market | Level | Change | % Change |
|---|---|---|---|
| DBC | 17.20 | -.14 | -0.81% |
| Gold | 1231.00 | -1.80 | -0.15% |
| Silver | 17.02 | .456 | 2.75% |
| Copper | 2.596 | -.1295 | -4.75% |
| WTI | 45.83 | -.24 | -0.52% |
| Brent | 46.53 | -.90 | -1.90% |
| Nat Gas | 2.969 | .174 | 6.23% |
| RBOB | 1.2665 | -.008 | -0.63% |
| DBA (Grains) | 24.40 | -.26 | -1.05% |
| Prices taken at previous day market close. | | | |

# Economics

There were no economic reports yesterday.

# Commodities

Commodities were mostly lower yesterday as energy traded down to another set of new lows overnight while gold gave back early gains ahead of the JOLTS report. The standout exception in the space was natural gas which rose in sympathy with the European contract which gained on bullish supply data. The widely followed commodity ETF, DBC, fell 0.76%.

There were a multitude of oil headlines yesterday including more bearish comments out of the UAE oil minister regarding their shared intention with Saudi Arabia to maintain current productions levels. That headline was most responsible for pushing oil futures to fresh 5-1/2-year lows overnight, however, futures reversed direction upon the US market open and began a zig-zag march higher over the course of the day.

Much of the price action yesterday could be attributed to shorts booking profits, technical trading, and positioning ahead of options expiration today. On the charts we are eying two key resistance areas above at $47.50 and $48.75. As far as catalysts go today, the EIA reports inventories at 10:30 a.m. and analysts expect a build of 500K barrels in oil supplies, a 2.6M barrel build in gasoline stocks, and a 1M increase in distillate (heating oil) inventories. And as usual, any surprises combined with options expiration could result in a rather volatile session.

Natural gas was the best-performing commodity yesterday with Nymex futures adding 6.15%, rising in lockstep with their European counterparts. Nymex nat gas however did not materially break out through any notable

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levels and trend resistance remains intact in the upper $2.90s for now.

European nat gas stockpiles fell to their lowest level since 2011 yesterday, according to *Gas Infrastructure Europe*, a Belgian lobby group (similar to the API in the US). The drop in supply spurred speculation that inventories could possibly be completely depleted by April (which happened in 2013). The news was bullish for our domestic nat gas contracts because there are multiple LNG export facilities poised to start shipping more natural gas to both Europe and Asia this year, and with inventories in Europe expected to fall to almost nothing, Nymex contracts are showing heightened sensitivity to their market. Bottom line though, this is not an all out game changer *yet,* but looking ahead, the situation could have a substantial effect on our domestic nat gas market later this year.

Moving to the metals market, copper legged down 4.57% to a fresh 5-1/2-year low as speculation of lower production costs (thanks to the precipitous oil selloff) trumped unexpectedly strong Chinese import data. Copper is continuing to plummet with the rest of the industrial and energy commodity products, down another 4.99% this morning and the outlook remains very bearish as the declines have accelerated this week. The next downside target lies at $2.40 while near term resistance is now $2.58.

As for the precious metals market, gold traded up to an 11-week high yesterday as investors continued to weigh the effects of increased global liquidity and a potentially later rate hike out of the Fed (according to Fed futures) which has dovish implications, against the surging dollar which is obviously bearish for metals and the commodity space in general. But, futures rolled over mid-morning yesterday and actually closed down 0.15%. The recent rally seems to have run out of steam hear in the mid $1200s at least for the very near term however we will remain on the sidelines until a more defined trend develops. On the charts we are looking to resistance towards yesterday's highs in the mid $1240's while support is below towards $1220.

## Currencies & Bonds

The Dollar Index rallied modestly yesterday but on a combination of general dollar strength following the NFIB wages data and JOLTS report. But, euro weakness also played into the dollar rally as the euro hit a fractional new low at 1.1759 before bouncing a bit as stocks sold off during the afternoon.

News wise, except for the economic data, there wasn't a lot to trade off of in the currency markets, although a steep drop in the euro around 8:30 AM again suggests someone was putting on a massive "Long Europe" position.

The British Pound was in focus yesterday as Great Britain CPI joined the global dis-inflation party and missed estimates, dropping ot a 15 year low at just .5% year over year increase (emerging from the Tech Bubble was the last time UK CPI was so low). But, again, while CPI globally continues to decline, it remains largely a oil and commodity based phenomenon, and we saw that reflected in how the pound traded (it dropped sharply on the news but spent almost the entire day rallying to close slightly lower, down .16%).

The yen was the only currency to rally against meaningfully against the dollar yesterday, as it rose .46% on general risk aversion. Dollar/yen fell below 118 for the first time in a month and I maintain that we will see some needed consolidation/correction in Dollar yen, with a test of the December lows (116ish) not out of the question in the near term. I don't think the yen decline is over long term, but for now we've got to consolidate the last 5 months move.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dollar Index | 92.49 | .306 | 0.33% |
| EUR/USD | 1.1764 | -.0069 | -0.58% |
| GBP/USD | 1.5151 | -.0019 | -0.13% |
| USD/JPY | 117.81 | -.51 | -0.43% |
| USD/CAD | 1.1957 | -.0015 | -0.13% |
| AUD/USD | .8158 | .0002 | 0.02% |
| USD/BRL | 2.6418 | -.0315 | -1.18% |
| 10 Year Yield | 1.890 | -.022 | -1.15% |
| 30 Year Yield | 2.482 | -.010 | -0.40% |
| Prices taken at previous day market close. | | | |

It was a volatile day in the Treasury space yesterday as initially we saw Treasury weakness as part of the broad risk asset rally starting at 8:30 yesterday. And, the Treasury rally came in the face of the Plosser comments, which some tried to

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spin as “dovish” (but they obviously weren’t as bonds were down). Instead, it looked like Treasuries sold off as European stocks took off, which again furthers my idea that we may have seen some big money putting on a “Long Europe” trade yesterday (Long European stocks/ short Treasuries).

But, as stocks came in, bonds rallied and they basically were flat by lunch time, and turned higher following the ten year auction.

Speaking of which, the ten year auction yesterday which was surprisingly soft. The bid to cover was a touch light at 2.61 (down from the 2.71 2014 average) while the actual yield of 1.93 was a full basis point above the “When Issued” yield. That’s a bit interesting because it contradicts demand for the 3 year debt yesterday, and perhaps implies that bond buyers are not enamored with 10 year Treasuries with a “1” handle on them. Time will tell, but this auction should have been stronger given what we’ve seen in the bond market lately.

In an ode to how domestic fundamentals don’t really matter in the Treasury market, Treasuries actually rallied following the disappointing auction as the oil declines accelerated and stocks rolled over.

Bottom line, Treasuries remain in a defined uptrend but yesterday did offer a glimpse of what could happen to Treasuries if Europe actually starts to see economic growth and inflation. In that instance, foreign money will flow out of Treasuries, and if some large macro fund wanted to get “Long Europe” correcting and in a big way, you would also short Treasuries, because if one works then so will the other. It’s not happening any time soon, but that is something to keep in mind if/when we see QE start to drive European stocks higher.

*The Ruble Is in Trouble, Again*

The ruble dropped 4% yesterday on a combination of: plunging Brent Crude prices, the calling off of more peace talks regarding Eastern Ukraine, and reports of an uptick in fighting between Ukrainian forces and Russian seperatists. As we’ve been saying for weeks now, the ruble can only stabilize if we see both 1) oil stabilize or 2) Further de-escalation in Eastern Ukraine which will lead to a roll back of Western sanctions. Neither of those things are happening right now, so the ruble remains under pressure.

Remember the drop in the ruble unnerved markets last December, and we’re moving towards those lows now. This will become a headwind if the ruble continues to drop—so we need to be watching this, as it might come out of left field one morning and hit futures. EUM (inverse emerging markets ETF) remains one of the better “Pure play” hedges on this risk (EUM is one of the 4 positions in our “Systemic Oil Risk Hedge).

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<br>EUFN<br>EWI<br>EWP | 59.35<br>24.67<br>16.44<br>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<br>XOP | 18.97<br>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 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).<br>**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)<br>**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)<br>**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)<br>**Best Contrarian Idea:** Short High Yield Bonds (SJB) | | | |

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