7:00's Report

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

January 15, 2015

Pre 7:00 Look

- Futures are decidedly lower again this morning after the surprise decision by the Swiss National Bank to scrap the peg vs. the euro.
- Fundamentally, the SNB decision isn't a negative game changer for stocks, but it does contribute to the general sense of uncertainty in the market, and that's why futures are lower.
- Gold was up big o/n following the decision while oil continues to drift lower (down just under 1%).
- Earnings Today: BAC (E: $0.31), BLK (E: $4.68), C (E: $0.09).
- Econ Today: Jobless Claims (E: 295K), PPI (E: -0.4%), Empire State Mfg Survey (E: 5.0), Philadelphia Fed Survey (E: 20.0).

Market	Level	Change	% Change
S&P 500 Futures	1997.25	-10.50	-0.54%
U.S. Dollar (DXY)	92.12	-.225	-0.24%
Gold	1256.10	21.80	1.73%
WTI	48.61	-0.29	-0.59%
10 Year	1.837	-.053	-2.80%

Equities

Market Recap

Stocks dropped again yesterday, but finished well off the lows of the downbeat session as myriad negative news early was partially offset by a big rebound in oil and energy stocks. The S&P 500 declined 0.58%.

Stocks started in the hole Wednesday morning thanks to multiple negative factors; World Bank growth forecast cuts, JPM earnings miss, retail sales miss, copper implosion, more political uncertainty in Europe (the Italian President resigned) as well as a continued plunge in the ruble.

XLE traded to new intra-day lows yesterday and rebounded along with oil in the afternoon. But, it still implies we haven't seen the short term lows in stocks yet.

Stocks gapped lower on the open, bounced slightly as early shorts covered, and then began a bleed lower that lasted well into the afternoon session.

News wise it got quiet after the open, but the macro uncertainty weighed on stocks, and despite oil actually spending most of the day higher, XLE made a new low and dragged the markets down with it.

But, trading slowed materially during the afternoon and oil began to rally as it neared its close at 2:30 p.m. EST. We'll cover this further in the commodities section, but while there were numerous reasons cited for the oil rally, the real cause was options expiration. Yesterday was expiration of February oil options (WTI and Brent) and a lot of the massive rally we saw in oil had more to do with positioning into that expiration than anything fundamental.

Still, the acceleration higher in oil lifted energy stocks (XLE) off the lows, and the broad market was able to rise along with energy stocks to rally during the final two hours of trading. Like Tuesday, yesterday was a text-

Market	Level	Change	% Change
Dow	17,427.09	-186.59	-1.06%
TSX	14,084.49	-102.73	-0.72%
Brazil	47,645.87	-395.80	-0.82%
FTSE	6,363.20	-25.26	-0.40%
Nikkei	17,108.70	312.74	1.86%
Hang Seng	24,350.91	238.31	0.99%
ASX	5,331.37	-22.23	-0.42%
Prices taken at previous day market close.			

book example of how XLE, not oil, is leading the S&P 500 (oil was up all day yesterday but XLE was down, which weighed on stocks).

Market	Level	Change	% Change
DBC	17.41	.14	0.81%
Gold	1233.10	-1.30	-0.11%
Silver	16.97	-.186	-1.08%
Copper	2.512	-.132	-4.99%
WTI	48.14	2.25	4.90%
Brent	48.50	1.91	4.10%
Nat Gas	3.24	.297	10.13%
RBOB	1.3399	.0714	5.63%
DBA (Grains)	24.34	-.08	-0.33%

Prices taken at previous day market close.

Tanker Stocks: One of the Winners from Lower Oil

While most of us have been focused on the absolute price of oil, there has been equally interesting developments occurring in the physical oil market that may present some intriguing stock opportunities over the coming weeks/months. Specifically, the widening of the WTI and Brent Oil "contango" has created an attractive set up for tanker stock companies.

Without boring you by including the vagaries of the physical oil market, the bottom line is that the spread, or difference, between front oil (February contract) and "back" month oil (say July) has widened significantly as front month oil has seen tremendous selling by macro funds and commodity traders. Back month commodity contracts are used mostly as hedging vehicles for commodity trading firms so there isn't as much volatility.

The important thing here is that physical oil companies can now make a lot of money storing physical oil because that spread has widened so much. Currently, the spread between February Brent oil ($46.12) and July Brent oil ($51.96) is nearly $5.70, which is significantly larger than normal.

That is obviously a good deal, and what's happened is physical oil companies have been bidding for storage of oil. And, when oil tanks get full, they book oil tankers to hold the crude. This has resulted in spot day rates for Very Large Crude Carriers (VLCC) spiking to $70k/day, as of this week.

Predictably, oil tanker stocks have reacted and are all at 52-week highs. But, they are starting to get pulled down along with the broad market. Beyond the wide contango, though, it's also important to realize that oil market fundamentals are looking up for tankers. Generally speaking, global oil demand is steady (it's not falling precipitously) so tanker day rates remain buoyant. Also, as gas prices drop it costs less to operate the tankers as they move from point to point (so in a way their margins are increasing).

Finally, it's longer term, but the bottom line is that the US is moving towards being able to export crude, and is already exporting condensate. While it won't add a lot to tanker demand near term, it is a general macro tailwind.

There is no tanker ETF, but some of the better names to watch are: **DHT, NAT, TNP and STNG**. All except STNG have seen big runs over the last week and need to come back in, but any general market weakness could provide an opportunity on the long side for these stocks as the shifting fundamentals of the oil market should be positive for tankers going forward.

Bottom Line

The volatility will continue until there is some more macro clarity. There is no more proof needed than the last two days to show this market still is being run by oil and energy stocks, and until they stabilize, the market will remain under pressure.

That said, we are getting closer to achieving some clarity in several areas, namely ECB QE and Greek elections. With regards to oil, we now have hit our $45 target, and while the better trade is on the short side, from a macro standpoint, we have to be getting close to oil stabilizing (meaning it stops going down $2-$3 per day).

XLE made fractional new lows yesterday which, if past is prologue, means we may see the S&P 500 break through the 1990 low yesterday before this sell off is "over." Yet unless something fundamentally changes, I think we're closer to the end than the beginning, and any "whoosh" down to the mid 1900s (call it 1975ish) would be a buying opportunity in cyclicals in our opinion (SPHB, KRE, KBE, RTH, XLK).

Economics

December Retail Sales

- Retail Sales fell -0.9% in December vs. Expectations of –0.1%.

Takeaway

Yesterday's Retail Sales report for December disappointed investors with the headline falling 0.9% vs. (E) -0.1%. And the details of the report matched the "control group" which is comprised of retail sales ex-autos, minus gasoline stations and building materials, as that metric fell 0.1% marking the first decline since last February. Of the 13 components the report is comprised from, nine declined. Revisions to the prior two reports were also disappointing, as both were corrected lower (November notably fell from +0.7% to just +0.4%).

Bottom line, yesterday's Retail Sales report was surprisingly soft. But the data follows several strong reports from the end of 2014 as the job market remained healthy and gas prices receded. Additionally, the report is historically volatile, especially around holidays when seasonal adjustments prove more difficult. So, although yesterday's report was disappointing it was not bad enough to completely dismiss recent strength in the retail sector, and we continue to believe the US consumer remains healthy.

Commodities

Global growth concerns weighed on commodities early yesterday, most notably copper which traded down over 5%, but options expiration in the oil markets spurred sharp rallies in the afternoon. The benchmark commodity tracking index ETF, DBC, gained 0.84% thanks to the strength in energy.

Copper futures tumbled 4.78% yesterday thanks to the aforementioned World Bank revisions to global growth outlooks. Copper has been in a bearish downtrend now really since the spring 2011 highs, but most recently lower energy costs and weak demand specifically out of China, the world's largest consumer of the industrial metal, have pushed prices down to near 6-year lows.

Market	Level	Change	% Change
Dollar Index	92.355	-.147	-0.16%
EUR/USD	1.1777	.0005	0.04%
GBP/USD	1.5218	.006	0.40%
USD/JPY	117.32	-.60	-0.51%
USD/CAD	1.1956	.0001	0.01%
AUD/USD	.8147	-.0018	-0.22%
USD/BRL	2.6167	-.0258	-0.98%
10 Year Yield	1.837	-.053	-2.80%
30 Year Yield	2.451	-.031	-1.25%
Prices taken at previous day market close.			

Chinese demand is expected to fall from 5.5% last year to 4% this year. The bottom line is clear, copper is falling victim to a combination of low production costs (oversupply) and soft demand expectations, which is resulting in a sharp slide to the downside that has room to continue lower. Technically speaking, the next two notable support levels are $2.40 and $2.20, and although copper futures have a lot of momentum to the downside, they also are quickly becoming very oversold. So, some consolidation or near-term short covering should not come as a surprise, but the path of least resistance is lower.

Gold made a nominal new high yesterday morning, but much like Tuesday's session, futures drifted lower over the course of the day, closing down 0.34%. After yesterday's session the recent rally appeared to have become exhausted from a technical standpoint, leaving the path of least resistance back down towards the $1200 level. But, the Swiss National Bank decision obviously changed that, as gold surged more than 1% on the news (because of more uncertainty) and rallied above resistance at $1250. With so much volatility in the market, the chances for a greater short squeeze in gold are rising, although fundamentally the outlook remains cautious. We would not be buyers here.

Energy markets were skewed by options expiration yesterday which saw both the WTI and Brent contracts rally sharply. WTI finished the day up 5.21% while Brent closed up 3.56%. Yesterday's trading session was largely driven by options expiration and trader positioning as opposed to market fundamentals.

Confirming that was the market's failure to selloff upon release of the unanimously bearish EIA inventory report. Inventories for crude oil grew 5.38M barrels vs. (E) +500K, RBOB gasoline stocks increased by 3.17M barrels vs. (E) 2.6M, and distillate supplies rose 2.9M barrels vs. (E) 1M. Upon release, algorithms sold the active February contract but the dip was quickly bought up by big-money (human) traders with options plays in focus.

For those looking to trade oil, today will present a low-risk shorting opportunity based on the technical situation as futures finished yesterday up against one month trend resistance at $48.65. That level should be your stop though as a break of that level likely means a run to $50 or $52.50.

Currencies & Bonds

As you know, the Swiss National Bank surprisingly abandoned its peg of the Swiss Franc to the euro last night. As a reminder, the SNB established that peg in 2011 as money poured into the Franc as a safe haven thanks to the Euro sovereign debt crisis. The surging Swiss currency threatened deflation and recession, so that is why the SNB pegged it to the euro (taking away any chance of appreciation).

The stated reason for the removal of the peg last night was that the euro had come down so much that the Franc wouldn't be overvalued any more. In reality, the SNB likely did this because the volatility in the euro was causing stress on them maintain the peg as money flowed back into Francs for safety. And, they chose to remove it instead of having the peg broken by the market.

From an investment standpoint this will introduce more volatility into the markets, which will weigh on sentiment short term, but it should not have a major effect on US or EU stocks much beyond this morning. It does not change our opinions about European or US stocks.

Volatility continued in both the currency and bond markets yesterday and we saw a "dovish" reaction in both yesterday as the US Retail Sales report was the key catalyst. At one point Wednesday morning the retail sales miss had the Dollar Index down 0.7% as we saw a mini-unwind of the month's long "Long Dollar" trade.

The yen was the biggest beneficiary of this unwind as it was also helped by an unimpressive Japanese federal budget. At the highs the yen was up more than 1.4% vs. the dollar, the biggest one day gain in months. The euro also benefitted from the dollar unwind as the euro was up 0.6% Wednesday morning. Additionally, the "dovish" reaction swept through the bond markets as Treasuries surged and both the 10-year and 30-year yields hit new all-time lows.

And, although yesterday may have marked a temporary pause on this massive multi-month dollar rally (the longer term move isn't over), it is notable that by the close Wednesday the Dollar Index rallied all the way back to (nearly) flat, finishing down just 0.16%, while the euro, yen and pound all saw their gains vs. the dollar cut in half. Even Treasuries gave back ground throughout the day as the 30-year finished up 0.46% (well off the highs).

There are two takeaways from Wednesday's price action. First, the "Long Dollar/Short Everything Else" trade is extremely crowded. The risk of a bigger correction is high, and we need some sort of consolidation for some health to be restored to the currency markets.

Longer term, the dollar still has a big tailwind (not only does the Fed want to raise rates but perhaps more importantly, remember that on balance the rest of the world's monetary policy is going to get easier in 2015 thanks mainly to the ECB and BOJ). Near term, unless the ECB is fantastically dovish next week or prospects of a "Grexit" become real, we may have seen the short-term top in the Dollar Index (which again longer term is healthy).

Turning to bonds, for the second straight day we saw a weak auction. This time it was $13 billion of 30-year bonds, which like Tuesday's 10-year auction saw lackluster demand. The bid to cover was 2.32 (well below the 2014 average of 2.47) while the actual yield was 2.43%, more than 1 basis point over the "When Issued." So, not only was the number of bids disappointing, but so too was the activity of those bidders.

It's too early to generate any concrete takeaways from two January auctions, but the results this week imply that bond buyers aren't as convinced we're entering deflation as everyone else. To put it into perspective, yesterday's yield in the 30-year was almost 100 basis points under the 2014 high yield of 3.37%, and it would appear those low yields are starting to dampen demand, at least this early in 2015. Anecdotally that provides some solace for us fundamental bond bears, although the key to this market remains Europe—signs of inflation and real economic growth is what is needed to break the Treasury fever.

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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)

	Near Term Trend	Long Term Trend	Market Intelligence
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)