7:00's Report

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

January 16, 2015

Swiss Franc: This chart is one for the history books, as the Franc rose nearly 14% vs. the dollar yesterday, reversing over 18 months of gains and inflicting big losses on many leveraged macro hedge funds.

Pre 7:00 Look

- Futures and foreign markets are drifting marginally lower on momentum from yesterday's declines. It was a quiet news night.
- Economically focus is on inflation this morning. Final German CPI and EU HICP readings were unchanged from the flash estimates, while all eyes are on US CPI at 8:30.
- Earnings Today: GS (E: $4.29), PNC (E: $1.74).
- Econ Today: CPI (E:-0.4%), Industrial Production (E: -0.1%). Fed Speak: Kocherlakota (8:50 AM).

Market	Level	Change	% Change
S&P 500 Futures	1985.50	-3.00	-.015%
U.S. Dollar (DXY)	92.76	.152	0.16%
Gold	1259.60	-5.30	-.042%
WTI	47.99	1.26	2.70%
10 Year	1.775	-.062	-3.38%

Equities

Market Recap

The declines continued yesterday as the surprise removal of the Swiss franc/euro peg, weaker oil prices, and some lackluster manufacturing data weighed on stocks. The S&P 500 closed down 0.92%.

Much like Wednesday, there were multiple reasons stocks were weaker Thursday morning. Obviously the Swiss Franc news weighed on sentiment, but also C and BAC earnings disappointed, manufacturing indices were uninspiring, and IMF Chief Christine Lagarde made cautious comments on the global economy (which added to the "global growth is slowing" sentiment).

But, this market remains driven by oil. Futures made a turn for the worse at 9 a.m. when oil opened and went into a nose dive, and as oil declined throughout the day, so did stocks. Selling was steady and consistent throughout the morning and afternoon, and the only saving grace for the bulls is that volumes and activity are both very light. Again, it is not a coincidence that both XLE and the S&P 500 both basically closed on the lows of the session.

Trading Color

It was another very ugly day for cyclicals, as the Russell 2000 and Nasdaq both significantly underperformed (the Russell 2000 was down 2% yesterday and is down 4.15% year to date).

Sector wise, it was more of the same as there was a clear and definitive defensive rotation. Utilities (XLE), consumer staples (XLP) and REITS (VNQ) all traded higher, while energy, financials, tech, consumer discretionary

Market	Level	Change	% Change
Dow	17,320.71	-106.38	-0.61%
TSX	14,041.82	-42.61	-0.30%
Brazil	48,026.31	380.44	0.80%
FTSE	6,467.11	-31.67	-0.49%
Nikkei	16,864.16	-244.54	-1.43%
Hang Seng	24,103.52	-247.39	-1.02%
ASX	5,299.24	-32.13	-0.60%
Prices taken at previous day market close.			

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and healthcare all traded down 1%.

Looking at the stock-specific news of the day, both consumer discretionary and banks were in focus because of earnings. BBY dropped hard on disappointing results (retail has been under fire this week from both the macro retail sales data and anecdotal company reports).

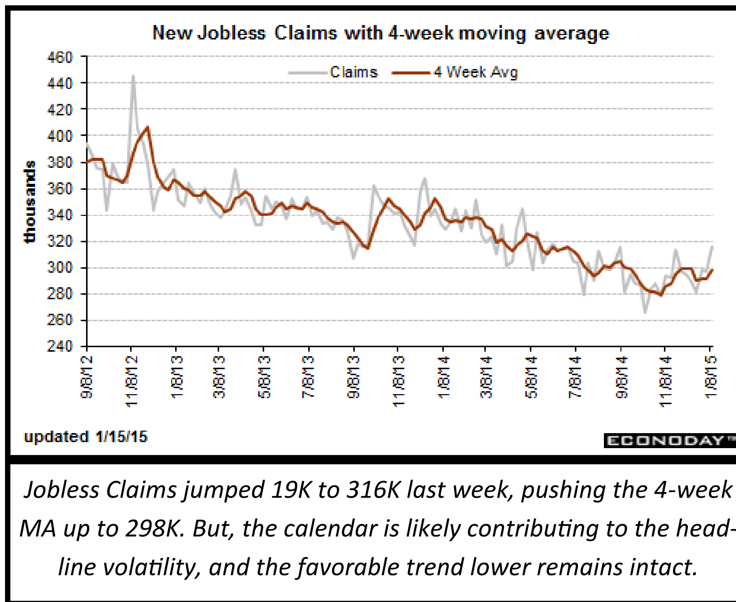
Market	Level	Change	% Change
DBC	17.22	-.24	-1.37%
Gold	1258.60	24.10	1.95%
Silver	16.885	-.103	-0.61%
Copper	2.5705	.065	2.59%
WTI	46.73	-2.23	-4.55%
Brent	47.60	-1.09	-2.24%
Nat Gas	3.205	-.028	-0.87%
RBOB	1.3014	-.0493	-3.65%
DBA (Grains)	24.24	-.12	-0.49%
Prices taken at previous day market close.			

KBE also badly underperformed, dropping more than 1% following the BAC and C earnings results. With banks, though, it's really the crashing interest rates that are weighing on the space, so I again will reiterate that if you think rates will bounce back, then banks offer value on this dip.

On the charts, the S&P 500 now is through the 100-day moving average and is sitting on last week's and this week's lows of 1992. If 1992 is broken, look for support at 1980ish.

<u>SNB Surprise Decision—Two Key Takeaways:</u>

There was a lot of coverage and noise on this yesterday, as the Swiss National Bank, or SNB, unexpectedly scrapped its capping of the franc to the euro. Bottom line, however, is we don't think the event itself is really that influential for markets in and of itself. There are, however, two derivative takeaways we want to point out, as they have potential implications for European stocks (potentially positive) and general market volatility (potentially negative).



Jobless Claims jumped 19K to 316K last week, pushing the 4-week MA up to 298K. But, the calendar is likely contributing to the headline volatility, and the favorable trend lower remains intact.

Takeaway #1: ECB QE May Be Bigger Than Estimates. The move by the SNB implies (but does not guarantee) that we may be seeing bigger-than-expected QE in Europe, because clearly this move by the SNB implies they are worried about further declines in the euro near term. Importantly, this is not a bearish game changer for our "Long Europe" thesis (and to a point bolsters it).

Takeaway #2: Beware "Knock-On" Effects from this Decision. For over a month now stock markets have been watching extreme volatility in currency and bond markets, and extrapolating out that volatility will hit stocks sooner or later. This adds to that sentiment, and this, more than anything, is why stocks traded lower following the news.

Overnight currency brokerage firm FXCM took massive losses that, reportedly, wiped out all the firm's equity. FXCM is not a small shop and if they took a hit, I'm sure others also have been hit hard.

Also, I heard from several friends that shorting Swiss francs was a very popular trade amongst macro hedge funds, because from a US dollar investor standpoint, due to the peg, the franc basically followed the direction of the euro (so down over the past 8 months).

But, obviously yesterday that trade blew up in a fantastic way, as the Swiss franc rose by 14% vs. the dollar!

Now, give that currency leverage can easily be 10:1 on futures contracts (and even more in spot forex) that's a BIG problem for funds that were heavy in that market. Point being, we will be on the look out for "knock on" effects from this decision and any collateral damage across assets.

Economics

<u>Empire State Mfg and Philly Fed Surveys</u>

- Empire State General Business Conditions Index was 9.95 vs. (E) 5.0 in January
- Philly Fed General Business Conditions Index was 6.3

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vs. (E) 20.0

Takeaway

Both the Empire State Manufacturing Survey and the Philly Fed Survey for January were released yesterday morning, offering the first look at the health of the manufacturing sector in 2015—and the results were mixed.

On an absolute level both of yesterday's headline reports remain in positive territory, and new orders, the leading indicator in each report, also remain positive.

Bottom line, neither of these numbers were "bad" yesterday in an absolute sense and they don't imply the economy is losing momentum. But, taken in the context of the soft retail sales report from earlier this week, the underwhelming data is raising anxiety levels. Remember, we know manufacturing growth is slowing thanks to the stronger dollar, which is "ok" as long as it's replaced by increased consumer spending. This week saw disappointment in both sectors from a data standpoint, so that's why Empire and Philly weighed on stocks yesterday more than they probably should have.

Commodities

Commodities were mostly lower yesterday, led down by energy which gave back substantial morning gains. The key exceptions on the day were gold and copper which rallied on the Swiss bank news, and extremely oversold conditions, respectively. DBC finished the day down 1.03%.

Beginning with the big story, gold futures rallied 1.89% yesterday with most of the move coming overnight Wednesday after the Swiss National Bank removed the "peg" against the euro. The price action the prior two days was beginning to suggest that the recent volatility fueled gold rally had become exhausted and futures were actually down prior to the SNB announcement hitting the newswires.

Market	Level	Change	% Change
Dollar Index	92.605	.26	0.28%
EUR/USD	1.1611	-.0178	-1.51%
GBP/USD	1.5167	-.0065	-0.43%
USD/JPY	116.39	-.93	-0.79%
USD/CAD	1.1969	.0018	0.15%
AUD/USD	.8220	.0074	0.91%
USD/BRL	2.641	.0251	0.96%
10 Year Yield	1.775	-.062	-3.38%
30 Year Yield	2.411	-.040	-1.63%
Prices taken at previous day market close.			

Aside from basic safe haven demand for gold following the announcement there were a few other reasons that gold rallied yesterday. First, we were not the only ones that saw the chart patterns consistent with exhaustion, so there were undoubtedly stops above the Wednesday lows that were tripped overnight, pushing futures higher. Second, as stated, many investors speculated that the reason the Swiss acted was because they are anticipating very large QE program out of the ECB, which would be viewed as inflationary on balance (so good for gold). Lastly, money managers who were short the Swiss franc were also short gold as part of their macro view allocation. When the peg as removed and the franc soared, margin calls undoubtedly forced some to cover their gold shorts.

Bottom line, the gold market was completely caught off guard by the SNB news yesterday morning and as a result futures were sent up to multi-month highs. But, outside the very near term we remain cautiously bearish (cautiously because of all of the recent volatility and potential for further geopolitical fear bids) on gold as it would be difficult to see a material rally in gold at the same time as the dollar is trading up to multi-year highs. On the charts the countertrend rally remains intact for now with the next level of resistance at $1280, while support is below at $1240.

Copper took a breather yesterday from the recent plunge as futures bounced back by 2.63%. The copper market remains very volatile right now and yesterday's move higher was largely the result of shorts booking profits. That said, the trend in copper remains lower as global demand is largely in question with investor concerns surrounding global economic growth forecasts (remember the World Bank lowered 2015 and 2016 forecasts on Wednesday). The volatility has left gaps in the chart with the initial downside target being $2.54 while the upside (short squeeze) target is just above $2.63.

Moving to the energy space, Wednesday's options induced short squeeze continued into early trade Thursday before the bids ran out and the selling accelerated. WTI

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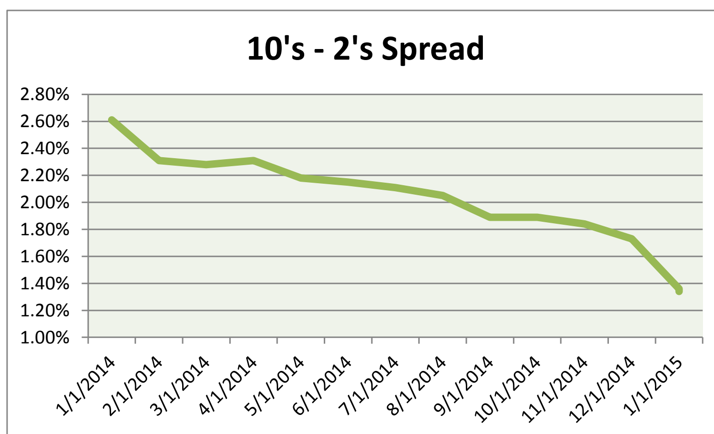
futures gave back morning gains of over 5% to finish the day down 4.58%, marking one of the widest percent change trading days in months. After the settlement yesterday, WTI futures finished back well below the trend line that prices tested on Wednesday, confirming that the most recent "downtrend leg" of the 6-month price slide is intact. Bottom line, the path of least resistance remains lower for oil, with yesterday's high tick of $51.73 becoming a bit of a "line in the sand," while there is some initial support between $45.75 and$46.15.

Currencies & Bonds

Given the news yesterday, it was obvious that European currencies were in focus, with the euro being the biggest mover on the day, dropping 1.32% on franc-related volatility as well as the extrapolation that the ECB is going to massively ease next Thursday. The euro hit new multi-year lows, dropping below 1.17 on the news and that is continuing this morning as the euro is again sharply lower, dropping below 1.16 overnight on growing expectations of QE.

Despite the drop in the euro, the Dollar Index was little changed yesterday (up 0.24%) and that's because the yen was stronger vs. the dollar, which offset most of the lower euro benefit. Dollar/yen declined below 117 but support at 116 seems to be holding for now. The reason for yen strength was disappointing economic data (machine orders and PPI both missed estimates).



Despite the new lows in the euro, I still am sticking to what I said yesterday, that I think this dollar rally is entering a consolidation phase, which is longer-term healthy and needed. The dollar bull run isn't over longer term, but with economic data flagging a bit domestically and (apparently) ECB QE now (mostly) priced into the euro, there appears to be a dearth of positive catalysts developing for the dollar near term.

The other big mover in the currency space yesterday was the Aussie, which rallied 0.88% on a much stronger-than -anticipated jobs report. Aussie unemployment dropped to 6.1% vs (E) 6.3%, while monthly employment rose 37,400 vs. (E) 2,500 (I did not leave a zero off that number). The number was so much better than expectations it'll likely be revised, but the broader point was that this was a good number, and as such created a nice little short squeeze.

Bigger picture, does this economic data make me less bearish on the Aussie? No, not really. Any material rally into the mid 0.80's, which is entirely possible if we get a commodity rebound and dip in the dollar, would be a good shorting opportunity via CROC. In many ways, "Aussie" is a proxy for global growth, and while I am an optimist on the global economy, there simply isn't much reason right now to be aggressively buying anything pegged to global growth.

Turning to Treasuries, they predictably surged on the volatility caused by the de-pegging of the franc, as the 30-year yield hit new all-time lows and the 10 year yield dropped below 1.80% for the first time in several years.

As a point of reference from just how extreme this recent bond rally has gotten, less than a month ago the 10-year yield was 2.30%, nearly 50 basis points higher than today's close. I understand the influence of European buying, and have cited it here many times, but regardless of the fundamental reasons yields this low are becoming a bit absurd from an "eye-test" standpoint.

Six years into a recovery, with GDP hitting multi-year highs, unemployment sub 6%, U-6 unemployment about to break below 11% and several months of 200k + jobs adds, regardless of what's happening in Europe, yields should not be crashing to new lows like they are (and keep in mind the CNB decision was just the latest log on the fire). But, for now, liquidity continues to trump fundamentals.

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)**

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