7:00's Report

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

January 20, 2015

Pre 7:00 Look

- Futures are higher as are most international markets after Chinese economic data beat estimates. Despite ominous headlines, Chinese GDP and retail sales beat estimates, although that positive news was tempered by an IMF growth cut.
- Focus remain on China following Monday's 8% drop in the Shanghai exchange, but that was due mostly to a change in margin rules, not some macro event.
- Earnings Today: BHI (E: $1.08), HAL (E: $1.11), JNJ (E: $1.25), MS ($0.47), AMD (E: $0.00), NFLX (E: $0.44).
- Econ Today: Housing Market Index (E: 58.0). Fed Speak: Powell (10:00 AM EST).

Market	Level	Change	% Change
S&P 500 Futures	2020.00	7.00	0.35%
U.S. Dollar (DXY)	92.98	-.09	-.10%
Gold	1289.20	12.30	.96%
WTI	48.12	-1.01	-2.02%
10 Year	1.815	.40	2.25%

Equities

What Happened Over the Long Weekend

Most of the focus over the long weekend was on Europe, and there were a few moving parts that we need to be aware of.

First, there were multiple articles out over the weekend that stated the ECB will do QE on Thursday (as expected) but that it will also direct each national central bank to buy its own bonds. If you remember from our ECB QE preview, this is an ostensible negative as it 1) reduces the credibility of the ECB, and 2) makes European countries less joined together, both on a monetary and psychological level.

But, European markets largely shrugged off the news yesterday as it seems that the only real thing people are focused on is the size of the program, and again that magic number seems to be 500 billion. If the ECB QE package is 500 billion or over, then it seems like the details of the package aren't all that important (as we said in our preview last week).

Second, we are seeing more news on the European currency front. Over the weekend the Danish Central Bank cut interest rates to –.20% to –.05%. The reason for the cut was because the Danish krone (their currency) hit a new 2-1/2 year high vs. the dollar last week, and like the Swiss, the Danes are trying to devalue their currency.

Also, there are rumblings that the Danish Central Bank will potentially break their peg vs. the euro just like the SNB did last week. They obviously refuted the speculation, but then again, remember the SNB declared the franc/euro peg the "cornerstone" of their monetary policy four days before the abandoned it.

Like the SNB decision last week, there has been a lot of extrapolating out of the Danish move as another negative for the euro zone, which simply isn't true, yet.

Yes, the SNB decision, Danish central bank decision, pending ECB QE and Greek elections Sunday are all going to increase volatility, but increased temporary volatility and "bearish game changers" are two different things. The situation in Europe is coming to a head this week, and it does need to be watched closely, but the facts on the ground right now are not reasons to reduce European exposure, despite somewhat ominous headlines.

We continue to believe Europe offers the best potential risk/reward set up of any major market in 2015—and all

Market	Level	Change	% Change
Dow	17,511.57	190.86	1.10%
TSX	14,293.67	-15.74	-0.11%
Brazil	47,758.01	-1,258.51	2.57%
FTSE	6,623.40	38.07	.58%
Nikkei	17,366.08	352.01	2.07%
Hang Seng	23,951.14	212.67	.90%
ASX	5,307.80	-1.07	-0.03%

Prices taken at previous day market close.

this added potential volatility could end up further validating that opinion (point being, these events are not definitive negatives right now, although they are risks that need to be watched closely, which is what we are doing).

Market Recap

The volatility continued in stocks last week as a continued drop in energy, growing worries about the health of the global economy and a volatility inducing shock by the Swiss National Bank weighed on stocks. The S&P 500 fell 1.28% last week, and is down 1.92% year to date.

Market	Level	Change	% Change
DBC	17.55	.33	1.82%
Gold	1277.20	0.30	0.02%
Silver	17.70	-.045	-0.25%
Copper	2.58	-.04	-1.51%
WTI	47.89	-1.24	-2.52%
Brent	47.60	-.07	-0.15%
Nat Gas	2.995	-.13	-4.22%
RBOB	1.3447	-.01	-1.04%
DBA (Grains)	24.16	-.08	-0.33%

Prices taken at previous day market close.

Stocks started last week by extending the prior week's losses as improved sentiment regarding ECB QE was offset by new lows in crude oil futures, spurred by a forecast cut by GS. Profit warnings by tech and retail stocks also weighed on markets.

Equities were sharply higher on Tuesday morning but new lows in oil once again pulled the indexes down to negative territory in another very volatile session.

Wednesday, stocks traded better as the indices finished the day well off the lows despite soft economic data in the morning. The midday rebound was largely thanks to a strong rally in oil prices and subsequent gains in energy stocks.

The trend of volatility and declining stock prices continued on Thursday as the Swiss National Bank rattled currency markets by unexpectedly removing the franc's peg against the euro overnight. Additionally, lackluster economic data (Philly Fed particularly) and soft bank earnings weighed on sentiment.

Friday stocks rebounded in part because of better-than-expected consumer sentiment and December Industrial Production, but the gains were relatively tepid and mostly it was short covering ahead of the long weekend.

Bottom Line

Despite the volatility last week, the general macro back drop remains the same, with too many macro "unknowns" for stocks to be able to advance. When will oil bottom? - Will the euro stabilize and stop the rising tide of central bank "freak outs"? - Will the ECB do something credible on QE (i.e. over 500 billion)? - Will the ruble stabilize?

So, for this decline in stocks to stop, we need: 1) Oil to stabilize, 2) the euro to stabilize, 3) clarity from the ECB, and Greek election clarity.

Number 1 fixes the oil bottom and ruble problem, while 2 and 3 fix European concerns.

And, despite high anxiety levels from investors as we start this important week, it is possible we get some or all of those things to occur.

Bottom line, I don't think the very near-term bottom is in yet because XLE made new lows and it's been a leading indicator, but I don't think we're witnessing "bearish game changers" and if the S&P 500 dips into the mid- to high-1900s I think you can buy cyclicals on that dip.

Economics

Last Week

Last week's economic data elevated concerns that 1) Global economic growth is slowing, and 2) Global deflation is becoming more of a risk.

Interestingly, it was mostly data from the US that re-enforced those fears.

Put simply, last week was not a good one for US economic data. December retail sales was the negative highlight as that report badly missed expectations, as the headline dropped -.9% vs. (E) -.1%. But, more importantly, the "control group" which excludes gasoline, cars and building materials, also declined –.1%, implying that actual consumer spending in December was soft. The weak retail sales report resulted in some negative revisions to Q4 GDP due to lower-than-expected PCE.

Turning to manufacturing, January Empire Manufacturing bounced back and beat estimates at 9.95 vs. (E) 5.0, but the Philly Fed Manufacturing Index badly missed estimates at 6.3 vs. (E) 20.0.

Those mixed reports were somewhat offset by Industrial Production (headline met estimates of –.1% but the manufacturing sub index slightly beat at .3% vs. (E) .2% and November was revised .2% higher), but broadly the idea that manufacturing is losing some growth momentum was reinforced last week.

Finally, US December CPI was slightly soft, as core CPI was unchanged month over month while year over year core fell .1% to 1.6%.

Bottom line, none of the data from the US last week was really "bad" in an absolute sense, but to a market that is already concerned about the global economy, the lackluster data only served to bolster those concerns—because the only economy that's actually doing well in the world is the US, and if that begins to moderate, then it's not good for global growth.

To be clear, last week's data does not imply we are seeing the US economy losing momentum, but the concern remains.

Internationally, the big news was obviously the Swiss National Bank decision to remove the peg between the franc and euro. But, that was more of a financial/solvency issue for the SNB than it was some macro related decision. The extrapolation is that the ECB will do a bigger QE program than everyone expects and that's why the Swiss abandoned the peg, but we obviously have to wait until Thursday to see.

Bottom line, last week we saw worries grow regarding the global economy and global deflation and that weighed on stock markets and sent bond markets soaring. Fundamentally things did not get materially worse, but the lackluster US economic data and lack of any real, positive news from Europe or China allowed those worries to grow.

This Week

This is the first really important macro-economic week of 2015, and while there aren't a lot of economic events this week, what we do get is very important.

Obviously the clear highlight is the ECB meeting Thursday. We'll be previewing it before, but given the SNB decision last week it seems that expectations of something big from the ECB are rising. At this point in the week, 500 billion euros remains a key level—anything under that will be considered underwhelming.

In addition to the ECB we also get the global January flash PMIs Wednesday night/Thursday morning. Given the concerns about global growth and deflation, they are obviously important, as the market needs a confidence boost about the pace of growth globally.

Specifically, China and Europe remain in focus, especially following the Chinese data Monday night and the ECB decision looming Thursday morning. And, for the first time in a few months, even the US data will be watched closely. On an absolute level it should be fine, but right now the key is just how much momentum the US manufacturing sector is losing, and if we see a sharp deceleration, it may weigh further on sentiment.

Staying in the US, we also get the latest round of housing data via Starts on Wednesday and Existing Home Sales on Friday. Remember, housing has quietly lost a bit of positive momentum over the past two months, and some stabilization in that data will help provide a boost to market confidence.

Bottom line, this week is key because it is an opportunity for the ECB and economic data to help partially vanquish the growing concerns about the pace of global growth and dis-inflation. If the PMIs are decent (meaning China and Europe stay above 50) and the ECB does something powerful (greater than 500 billion), the outlook for the global economy could be a lot better as we head into Greek elections Sunday.

Market	Level	Change	% Change
Dollar Index	92.835	-.055	-0.06%
EUR/USD	1.1617	.0027	0.23%
GBP/USD	1.5117	-.0043	-0.28%
USD/JPY	117.682	.164	0.14%
USD/CAD	.835	.0002	.02%
AUD/USD	.8175	-.00022	-0.27%
USD/BRL	2.644	-.0069	-0.24%
10 Year Yield	1.815	.40	2.25%
30 Year Yield	2.435	.24	1.00%

Prices taken at previous day market close.

Commodities

It was more of the same in the commodities space last week as the energy components and industrial metals traded down to another set of fresh multi-year lows while precious metals continued higher thanks to volatility-induced fear bids. The benchmark commodity ETF, DBC, edged up 0.11% last week largely thanks to the squeeze in gold futures.

Gold was the big winner in the commodity space last week as it rallied 4.65% on short covering as stock market volatility and the surprise SNB decision sent shorts rushing for cover.

Looking ahead, the near-term path of least resistance remains higher for now as the bulls have momentum on their side and weak-handed shorts are continuing to get squeezed out of the market. However, looking to the medium term, we continue to find it hard to believe that gold can materially rally while the dollar is in such a sharp uptrend, which leaves us with a cautiously bearish view on gold. Technically, gold is forming a "flag" on the daily chart and if last week's highs are broken we expect a swift move to $1300.

The energy sector traded down to fresh lows to start the week last week, led down by WTI crude oil which dipped below $45 on Tuesday. But, WTI futures bounced back on short covering and finished the week up a modest 1.45%.

As far as trading catalysts go, the week contained much of the same: the big OPEC producers were still adamant about maintaining production levels to keep market share, less-important OPEC members continue to vow they will somehow get prices to rebound, there was further chatter about falling rig counts in the US, and yet another global growth forecast was reduced for 2015 and 2016 (The World Bank). And the latest comments from the weekend were still bearish, as Amos Hochstein of the State Department confirmed the U.S. will remain sidelined and let the market continue to determine the price (as opposed to stepping in to help curb the declines) while the Iranian oil minister said his country could withstand a drop to as low as $25/barrel.

Bottom line: the outlook for crude oil and the energy sector remains grim, and despite our first target of $45 being reached last week, the path of least resistance is further down from here, which will likely keep the throttle open on volatility for other asset classes.

Currencies & Bonds

Last week was simply a historic one in the currency and bond markets. Obviously the Swiss National Bank breaking the peg to the euro Thursday night was the major catalyst, as that move sent the euro to multi-year lows, while the Dollar Index surged above 93 almost entirely because of the euro decline (the data last week in the US wasn't great and actually the yen and Aussie rose vs. the dollar last week while the yen was flat, so the dollar strength wasn't universal).

The other major influence on the currency markets last week was oil. The new lows in oil sent the Loonie to new, multi-year lows vs. the dollar and is now just a few points above 80.

The other currency to get hit on the drop in oil was the ruble. The ruble finished the week above 65/dollar. The ruble fell thanks to the drop in oil but also on renewed violence in Eastern Ukraine, as fighting intensified and cease fire talks between Russian separatists and Ukraine were delayed. The falling ruble remains a background risk for markets—if we see the rubble continue to decline towards 70, this will become an additional headwind on risks assets.

Turning to Treasuries, the "Perfect Bullish Storm" continued last week as the 30-year yield dropped to new all-time lows while the 10-year yield fell below 1.80%. Worries about European deflation, the looming prospect of ECB QE, volatility from the SNB decision, and lackluster US economic data all combined to push Treasuries sharply higher, as the bullish momentum continues.

Obviously this week the huge event in currency and bond markets is the ECB QE meeting. Euro weakness and Treasury strength (which are all part of the same trade) are at extremes, so common sense tells me that unless the ECB does something massive, QE is already priced in. It is very possible that the ECB this week will signal the beginning of the end of the Treasury rally (if their policies lead to economic growth), but it'll take time to figure that out, so don't read too much into the initial reaction, regardless of the headlines.

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 fell more than 1% last week after new lows in oil, concerns about global growth and a surprise move by the Swiss National Bank weighed on markets. Near term there remain multiple macro headwinds preventing new highs in stocks, although medium term the outlook is constructive. We would be buyers on dips.*

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 continued. Currency volatility is helping to support gold (the dropping euro is gold positive), but beyond that the outlook for commodities remains challenging with slowing global growth and a stronger dollar.*

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 again surged to new highs last week thanks almost entirely to euro weakness in the wake of the Swiss National Bank decision. Focus this week is entirely on ECB QE, as that decision will cause near term volatility. Beyond the near term, though, the trend of Dollar strength should continue.*

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 again last week as lack luster US economic data, rising expectations of ECB QE and Swiss currency volatility all added fire to the bullish Treasury fire. The ECB decision looms large with regards to the continued Treasury rally but until we get real signs of EU economic growth and inflation, the Treasury rally will continue.*

Best Idea: **Short "long" bonds (TBT)**

Best Contrarian Idea: **Short High Yield Bonds (SJB)**