7:00's Report

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

January 21, 2015

Pre 7:00 Look

- Futures are flat and most global markets are little changed ahead of the ECB decision tomorrow. China outperformed mostly on a bounce back from weakness Monday/Tuesday.
- UK stocks are higher after BOE meeting minutes were more dovish than expected as two governors dropped their calls for rate hikes amidst low inflation.
- The BOJ ended an policy meeting with no changes, as expected, but the yen rose 1% vs. the dollar as some had hoped for some surprise stimulus.
- Econ Today: Housing Starts (E: 1.041M).

Market	Level	Change	% Change
S&P 500 Futures	2016.00	-0.75	-.0.04%
U.S. Dollar (DXY)	93.055	-.294	-0.31%
Gold	1297.00	2.80	0.22%
WTI	47.01	0.54	1.16%
10 Year	1.807	-.008	-0.44%

Equities

Market Recap

Stocks were little changed yesterday as a rally in the technology sector offset mounting global growth concerns. The S&P 500 edged up 0.15%.

It was a volatile start to the shortened trading week yesterday as early optimism indicated by higher stock futures quickly gave way to selling pressure at the open thanks to another 5% plunge in oil prices, soft earnings reports, and a downward revision to global growth outlook by the IMF. Uncertainty surrounding the ECB announcement tomorrow, and the subsequent positioning, also contributed to the price action.

Stocks hit their lows just before lunch (not coincidentally at the European close) and began to steadily march higher from S&P support at 2005. But the rally fizzled out in a session void of any material intraday catalysts, leaving stocks to finish the day only slightly higher.

Trading Color

From a market internals standpoint, yesterday's rally put out mixed signals as small caps badly underperformed large caps with the Russell falling 0.54% while the Dow was up marginally (somewhat defensive), but high-beta stocks handily outperformed their low-volatility counterparts (somewhat encouraging).

Looking at the more specific sector trade it was kind of a wash as industrials, consumer staples, and tech all handily outperformed the S&P, with the latter gaining nearly 1% on the day, while financials traded lower as long dated Treasuries rallied, flattening the yield curve and in turn squeezing bank lending margins.

Consumer discretionary stocks were the only other subsector to finish in the red, falling 0.57%.

It is worth noting that XLE finished slightly higher yesterday despite a 5% drop in WTI oil prices. It was only one day, but we will be watching the sector closely today to see if an "XLE bottom" is forming.

Bottom line, there are so many forces pushing and pulling the market around right now between energy prices, positioning ahead of the ECB and further drops in Treasury yields that it would be hard to make sense of yesterday's session, leaving most investors in a wait-and-see mode for the most important event of the week: tomorrow's ECB announcement.

Market	Level	Change	% Change
Dow	17,515.23	3.66	0.02%
TSX	14,308.44	-4.06	-0.03%
Brazil	47,876.66	118.65	0.25%
FTSE	6,663.05	42.95	0.65%
Nikkei	17,280.48	-85.82	-0.49%
Hang Seng	24,352.598	401.42	1.68%
ASX	5,393.38	85.71	1.61%
Prices taken at previous day market close.			

ECB QE Primer

We previewed this last week and largely the key points remain the same, but we are including an updated ECB QE preview here so that everyone knows what's expected tomorrow.

Market	Level	Change	% Change
DBC	17.32	-.23	-1.31%
Gold	1294.70	17.80	1.39%
Silver	18.02	.27	1.52%
Copper	2.5945	-.0225	-0.86%
WTI	46.60	-2.53	-5.15%
Brent	47.60	-.09	-0.19%
Nat Gas	2.872	-.255	-8.15%
RBOB	1.3172	-.0416	-3.06%
DBA (Grains)	23.99	-.17	-0.70%
Prices taken at previous day market close.			

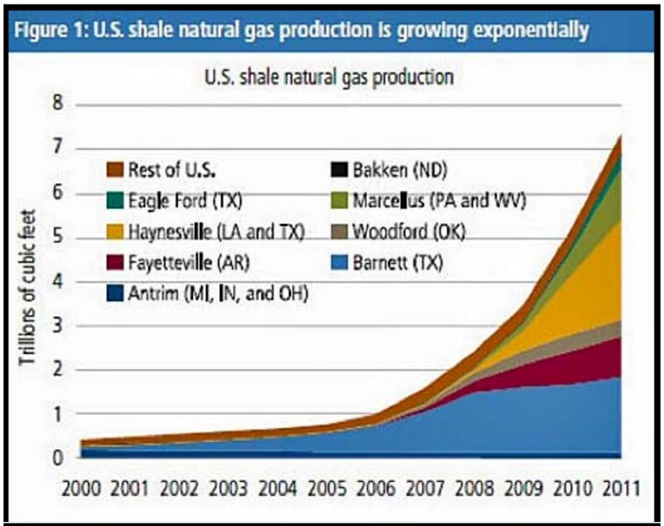
3 Key Points That Make ECB QE a Positive for Stocks

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.

Broadly speaking, this is a negative because that will largely undermine the program and move the EU closer to splintering rather 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.



Crude oil's production-to-price relationship is strongly resembling that of natural gas in the late 2000s (charts above). And, if the market dynamics are similar, which we believe they are, the crude oil selloff is not yet over.

If, as recent reports have implied, the ECB requires individual central banks to buy their own bonds, it won't undermine QE as long as the program is big enough and it won't cause EU stocks to decline as long as the program is 500 billion or larger.

Bottom Line

Even if all we get is the 500 billion euros, I still think European QE will be a major net positive for 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. (**Note:** there were rumblings late yesterday that the ECB's total QE package could be around 700-750 billion euros, which would take the ECB much closer to that 1 trillion goal. The bigger the QE the better for European equities, but **remember the key threshold level is 500 billion**.

What's Next for Oil: Natural Gas Offers Us a "Blueprint"

One of the most notable oil "bullish" topics has been about declining rig counts in the U.S. and how the falling number of drilling operations is a "game changer" for the oil markets which will foresee the bottom in energy prices. But that simply is not true and here is what you need to know:

First, rig counts have indeed dropped from a recent high of 1931 in September to 1675 as of last week. And though that may seem bullish on the surface it is not because total US production is still expected to **rise between 5% and 10%** next year. This is because the rigs that are being shut in are low production/exploratory type rigs that don't contribute to a lot of production.

Second, many analysts are focused on oil producers' published "break-even prices" as they try to pinpoint a fundamental price floor (many of which we have already crashed through). But, there is speculation that a lot of those "published numbers" are misleading and that as prices continue to fall **producers will only try to pump more in an effort to stay profitable. Put simply, the producers often lie about where their "break even" really is.**

Supporting this idea is the recent history of the natural gas market, which saw production boom in the last several years cause prices to plummet, much like we have seen in the global crude oil market over the past 6 months. Many energy analysts pointed to $5/MMCF as the "break even" price, and implied that as prices fell below the $5 threshold, we would see massive production shut ins. Instead, the opposite happened. As prices fell producers pumped more natural gas as they tried to have volume offset the margin declines. And, if it wasn't for last year's extremely cold winter drawing supply levels down so far, nat gas prices would probably be even lower than current levels.

Point being, low oil prices are not currently shutting in as much production as certain statistics imply. Bottom line, neither history nor numbers lie. And both suggest that we are poised to see lower oil prices in the near term which will continue to cause heightened market volatility in other asset classes.

Market	Level	Change	% Change
Dollar Index	93.33	.44	0.47%
EUR/USD	1.1546	-.0058	-0.50%
GBP/USD	1.5154	.0044	0.29%
USD/JPY	118.75	1.20	1.02%
USD/CAD	1.21	.0163	1.37%
AUD/USD	.8172	-.0039	-0.47%
USD/BRL	2.6126	-.0385	-1.45%
10 Year Yield	1.807	-.008	-0.44%
30 Year Yield	2.398	-.037	-1.52%
Prices taken at previous day market close.			

Economics

There were no economic reports yesterday.

Commodities

Commodities mostly extended recent trends yesterday as crude oil sold off over 5% and gold rallied up towards $1300. The benchmark commodity tracking index ETF, DBC, fell 1.4% in sympathy with the steep declines in oil prices.

The energy space remains the focus of the commodity markets as crude oil started the week with a flop. WTI futures opened the Nymex session deep in the red and closed down 4.99%. As far as headlines go, yesterday's bearish catalyst was two fold. First there was the 2015 global growth outlook cut by the IMF (down from 3.8% to 3.5%). And that paired with news from Iraq's Oil Minister who said Iraqi oil production has jumped to record levels (roughly 4 MMb/d).

Bottom line here is it appears the downtrend is poised to continue as production levels only seem to be increasing while demand metrics remain lackluster.

Natural gas was the worst performing commodity yesterday as futures fell 8.35% thanks to weather forecasts that were revised to reflect more milder temperatures ahead. And with supply levels back at the 5-year average, the soft weather-driven demand outlook leaves the path of least resistance lower from here.

Gold bulls continue to feed on broad market volatility while investor demand for the safe haven asset continues to rise ahead of the ECB QE decision tomorrow morning. Those two influences will continue to be the key drivers of the gold market in the very near term. Yesterday, futures rose 1.32%

Fundamentally, the most recent Commitment of Trader's report released by the CFTC suggested that net long positions held by money managers rose 7.7K to 102K last week, hitting the highest level since last July as most shorts have been squeezed out thanks to the recent volatility while speculators are buying with momentum investors hedging positions in risk assets (notably European bids ahead of the ECB announcement).

Shifting gears to the industrial metals, copper prices extended last week's declines as futures fell 0.86% yesterday. However, copper futures did manage to close off the worst levels of the day as Chinese economic data spurred some short covering. Chinese GDP rose 7.4% yoy in 2014, modestly beating analysts' estimates of 7.3%.

But, bottom line, the headline figure still suggested that Chinese growth in 2014 was at the slowest level since 1990. And, as the largest global consumer of copper at about 40% of annual consumption, the slowing growth metrics in China do not bode well for the demand side of copper's supply-demand equation. And speaking of supply, cheap energy costs are allowing copper miners to continue to extract the industrial metal at a very low cost. Bottom line, the outlook for copper remains rather bearish and the charts are in agreement as initial resistance is above $2.60 while support lies below at $2.56.

Currencies & Bonds

The dollar was stronger against most of its peers yesterday, most notably the yen and the Loonie and to a lesser extent, the euro while the Swiss franc extended last week's gains. The Dollar Index finished the day up 0.47% trading just below Friday's multi-year high.

The Canadian Loonie fell 1.21% to the lowest level in over five years yesterday on investor speculation the BOC may take a more dovish stance because of their growth outlook being revised lower, primarily due to falling oil prices (Canada's largest export). Yesterday's 5% drop in WTI prices to start the week certainly did not help support the Loonie, either.

The Loonie remains in a steady downtrend as investors fear the Canadian economy may face recession later this year as a result of the global slide in oil prices. Currency traders now are speculating on a potential cut to Canada's benchmark interest rate as early as the end of March, if economic readings continue to disappoint which would obviously be even more bearish for the Canadian currency.

The yen also traded very poorly against the dollar yesterday as Asian markets enjoyed a risk-on trading session yesterday, with stocks gaining the most in a month thanks to the better-than-expected Chinese economic data. The yen, however, is currently in a consolidation pattern as the cross remains well within a near 3-month trading range between 116 and 120. Looking ahead, appetite for risk and volatility levels will continue to have a heavy influence on the yen in addition to normal economic data and central bank policy announcements. But, we do not find it likely that the dollar/yen pair will fall materially below the 116 level and the longer-term trend remains in favor of a weaker yen.

Moving over to Europe, the euro traded off modestly, slipping 0.30% on the day as investors continue to position ahead of the ECB meeting tomorrow and positioning is likely going to be the primary driver of the market as the economic calendar is pretty clear until the announcement.

The bond market began the week with Treasuries trading higher, and the 30-year bond and 10-year note yields dipping towards record levels at 2.398%, and 1.807%, respectively.

Globally, government bonds remain very well bid as the ECB is poised to unleash a round of QE tomorrow. The speculation of such a program continues to influence investment in dollar-denominated assets. And, with U.S. Treasury yields being very attractive on a relative basis, they remain one of the most popular destinations for the aforementioned money flows.

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 1.20.15)

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)			
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)			
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)			
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)			