7:00's Report

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

January 26, 2015

Pre 7:00 Look

- Futures are modestly lower but global markets are little changed following a muted reacted to the Greek elections.
- Syriza won the Greek elections by a greater margin than expected, although importantly failed to get a majority.
- Economically data was "ok" o/n. Japanese exports beat expectations (12.9% yoy) while the German IFO Business Expectation survey slightly missed (102 vs. (E) 102.5).
- Earnings Today: STX (E: 1.36), MSFT (E: 0.72), TXN (E: 0.69).
- Econ Today: January Services PMI Flash (E: 53.8).

Market	Level	Change	% Change
S&P 500 Futures	2036.75	-7.25	-0.35%
U.S. Dollar (DXY)	95.32	0.267	0.28%
Gold	1280.00	-12.60	-0.97%
WTI	45.12	-.48	-1.07%
10 Year	1.817	-.079	-4.17%

Equities

Market Recap

After a volatile, holiday-shortened trading week, stocks finished decidedly higher as the ECB unveiled a larger-than-expected QE program amidst a relatively stable week for oil prices. The S&P 500 rose 1.6% and is basically flat year to date.

Stocks began the week on Tuesday by selling-off right at the open thanks to a 5% drop in oil prices, soft earnings reports, and a downwardly revised global growth forecast by the IMF. Positioning ahead of the ECB became noticeable as the sell-off in stocks reversed right at the European close, and US tocks finished essentially flat.

Wednesday, stocks rallied amid ECB QE optimism but again, trading was largely dictated by positioning ahead of the Thursday announcement, so the move was mostly interpreted as noise.

The big news (and rally) of the week came on Thursday with the ECB pleasantly surprising markets with a much-larger-than-expected QE program. US stocks had their best session of the year rallying more than 1.5%.

Friday, stocks declined on general profit taking following the Thursday rally, as a profit warning from UPS weighed on industrials. Stocks still, however, managed to close solidly positive.

From a performance standpoint, cyclical sectors ex-banks outperformed last week thanks to the Thursday rally, and the S&P 500 very quietly rallied nearly 70 points in just five trading sessions before coming back in Friday.

Greek Election Takeaways

Syriza scored a larger than expected victory in the Greek elections Sunday but importantly fell short of an absolute majority (Syriza ended was 149 members of Parliament, 2 short of the 151 needed!).

This is not the negative event the headlines implied, yet, as global markets are higher this morning. There will be a lot of rhetoric, but for now the market views Syriza's bark as worse than it's bite with regards to international creditors.

The first hurdle will be an extension (likely 6 months) of the current bailout program by the end of February. That is widely expected, but if we get a lot of drama surrounding that event, the views towards Greece could

Market	Level	Change	% Change
Dow	17,672.60	-141.38	-0.79%
TSX	14,779.35	15.37	0.10%
Brazil	48,775.30	-667.32	-1.35%
FTSE	6,807.85	-24.88	-0.36%
Nikkei	17,468.52	-43.23	-0.25%
Hang Seng	24,909.90	-59.45	-0.24%
ASX	5,501.82	81.88	1.51%
Prices taken at previous day market close.			

turn more negative. **For now, though, this is not a bearish game changer to our "Long Europe" thesis and we will be buyer on any material weakness sin HEDJ today.**

Market	Level	Change	% Change
DBC	17.29	-.11	-0.63%
Gold	1294.10	-6.60	-0.51%
Silver	18.325	-.035	-0.19%
Copper	2.495	-.0835	-3.24%
WTI	45.29	-1.02	-2.20%
Brent	47.60	-.09	-0.19%
Nat Gas	2.967	.132	4.66%
RBOB	1.346	.0152	1.14%
DBA (Grains)	23.48	-.25	-1.05%
Prices taken at previous day market close.			

Earnings Season Update

About 20% of the S&P 500 has reported earnings, and the results have been broadly mixed. About 75% of those firms have beat estimates, which is a pretty good percentage, but the results haven't been as good on revenues, where the results have been much more in-line with estimates. So, at least so far, we are not seeing the strong revenue numbers like we saw in Q3 earnings late last year.

The single biggest takeaway so far from this earnings season is that between the strong US dollar and reduction in expected energy company earnings, the expected S&P 500 earnings number has come in somewhat materially from $130/share six months ago to under $125/share now, which does have an effect on valuations. Using $122/share, at 2070 the market is 17X current year earnings—not prohibitively expensive given 0% interest rates, but given the macro environment it's definitely on the high side. Point being, valuations is something we need to keep an eye on if results for the remainder of earnings season continue to disappoint, because valuation could become a mild headwind on the S&P 500 towards 2100 (it's one of the reasons I'm cautious about buying up here).

Bottom Line

We are starting to get resolution in several of the macro overhangs that have weighed on stocks early in 2015, but at 2070 a lot of "non-negative" resolution is already priced in, and I continue to have a hard time seeing a material positive near-term catalyst that will push stocks to 2100 and beyond.

The ECB decision was a positive as the program will be powerful, and global central bank easing is a general tailwind on stocks. And, while likely a problem for another day, the Greek elections at least give some certainty.

Up this week is the Fed, and whether they are getting more "dovish" given the global slowdown and central bank easing. "When/How the Fed will raise rates" is a macro headwind on stocks, so this week will be a market mover. But, keep in mind, even if the Fed is dovish Wednesday, the market would much prefer a surging economy, rising inflation and higher rates, not continued low rates.

Finally, the Russia/Ukraine situation is heating back up as outright fighting between Russian backed rebels and Ukrainian government forces started again over the weekend, and the West is already threatening more sanctions. Remember, a ruble above 70 will be a macro headwind on emerging markets and risk assets broadly.

Bottom line, there remain too many headwinds for a material move higher in our estimation.

The news last week was bullish for Europe and HEDJ hit a new 52 week high, and is solidly outperforming the S&P 500 YTD, and we would continue to be buyers on any dip (especially Greek election related). But, from a broad US standpoint, I would not buy at these levels and would wait to add to select sectors more towards 2000 in the S&P 500.

Economics

Last Week

The major economic takeaway from last week was that the world's central banks are getting aggressively more accommodative (the ECB was just the most-followed example). Economic data, while important, took a decided back seat.

Everyone rightly focused on the ECB, but two other major central banks acted to ease policy last week, while the BOE minutes revealed a more dovish Monetary Policy Committee. All told, four major central banks got "easier" last week from a policy/market expectation standpoint.

Looking at the various moves, the ECB decision, regardless of the skeptical commentary, was "more" than what

the market was expecting, as the ECB ostensibly increased its balance sheet target to 1.2 trillion euro from the previous 1.0 trillion. That, in and of itself, constitutes more accommodation and is incrementally bullish for European stocks. For a complete review of the move and why we think it's bullish for EU stocks, click here to read last week's analysis.

The most active central bank last week was the Danish Central Bank, which actually cut rates twice last week as the Danish krone rose to a 2 -1/2 year high. The initial cut last Monday was from –.05% to –.20% on the deposit rate, but that was followed by another cut post ECB from –.20% to –.35%.

The Bank of Canada also announced a surprise cut on Wednesday following a continued drop in oil prices, while the minutes from the recent Bank of England Monetary Policy Committee saw two BOE Governors abandon their votes for immediate interest rate hikes, citing inflation that was too low.

Turning to the data, last week's numbers weren't that bad when taken in the context of growing concerns about the health of the global economy.

Flash January global PMIs were better than feared in China (49.8 vs. (E) 49.6) and Europe (52.6 vs. (E) 52.2), while the flash January manufacturing PMI was a slight miss here in the US, but still remains in healthy absolute levels (53.8 vs. (E) 54.0).

Additionally, the latest round of Chinese economic data, despite headlines decrying the "worst growth in 24 years" were also better than expected (GDP 7.3% vs. (E) 7.2%). Remember, the "Maginot Line" with China is 7.0%. As long as the authorities can maintain greater-than 7% GDP growth, it's not a specific, material negative for general US stocks or other risk assets.

Market	Level	Change	% Change
Dollar Index	95.33	.968	1.03%
EUR/USD	1.1204	-.0162	-1.43%
GBP/USD	1.4989	-.0021	-0.14%
USD/JPY	117.77	-.72	-0.61%
USD/CAD	1.2420	.0040	0.32%
AUD/USD	.7912	-.0114	-1.42%
USD/BRL	2.5802	.0056	0.22%
10 Year Yield	1.817	-.079	-4.17%
30 Year Yield	2.394	-.075	-3.04%
Prices taken at previous day market close.			

Bottom line with the global data last week is it was better than feared. The concern regarding a global slowdown has reached a fevered pitch, which prompted action from central banks last week. But, the data was "ok" and at least, for a week, implied the global economy may be trying to stabilize.

This Week

The Fed meeting Wednesday is the highlight of the week, and while no one expects any changes to policy, the statement will be watched closely to see if all this international easing is making the Fed more "dovish."

As we discussed last week, all of this global easing is causing estimates of when the Fed will raise rate to be "pushed out" to September from June. Right now, it seems the consensus is split between the two, so markets will be watching to see if the Fed implies the increasing divergence between US policy (flat to tighter) and "everyone" else (easier policy), will delay rate hikes here in the US.

With regards to the actual data, this week has some releases but nothing should materially shift the outlook for the global economy (so concerns about growth will remain almost regardless of the data this week).

While US GDP (Friday) is the data highlight of the week, I believe the most important number will be the Employment Cost Index, also out Friday. Remember, low wages remains the key factor that is allowing the Fed to ignore rate increases until June. If wages begin to tick higher (which we should all hope for), that will be a "hawkish" surprise and could complicate the consensus of a June or September hike.

Also on Friday we get the last EU flash HICP (their CPI). Given the move by the ECB this loses some of its typical significance because even if it's weak, it won't reflect any benefit from QE. However, it's still an important number to watch given our "Long Europe" strategy.

Domestically, the other releases we will be watching this week include New Home Sales (tomorrow) and weekly jobless claims Thursday. Internationally, watch EMU M3 Money Supply Thursday (goes to inflation in the EU) and German retail sales (Friday).

Bottom line, last week we got a lot of insight into the direction of monetary policy across the globe (easier), this week we get incremental insight into the Fed's policy outlook via the meeting and Employment Cost Index.

Commodities

The recent trend in commodity markets continued last week as oil fell back towards multi-year lows, copper extended recent declines to new closing lows, while gold continued its recent counter-trend rally. The benchmark commodity tracking index ETF, DBC, fell 1.48%.

Beginning with the energy space, it was more of the same last week as WTI futures fell 7.48% to finish the week back towards the recently established, nearly six-year lows.

The narrative also remains largely the same as traders continue to listen closely to any OPEC chatter and eye falling rig counts, while at the same time monitor rising inventories. Looking first to OPEC, the death of Saudi Arabia's King was a non-event for global oil fundamentals as the new King, King Salman, chose to keep Oil Minister Ali Al-Naimi at the post he has held for 20 years, meaning that Saudi production policies will remain the same for the foreseeable future.

Bottom line for oil, both fundamentals and technicals continue to favor the bears, however, we are approaching a "tipping point" on the charts this week as trend resistance edges down to $46.75 while the recent low of $44.20 is in focus to the downside.

Moving to the metals market, gold continued to rally last week with futures rising 1.08% thanks to continued volatility in US equities, and more so on the ECB announcement of a larger-than-expected stimulus plan. But, despite futures continuing to rise we remain longer-term bears on gold as inflation expectations remain soft and the dollar continues to surge.

And encouragingly, Goldman Sachs released a research note last week that agreed with our stance on precious metals. On the charts, the near-term path of least resistance remains higher but there is a solid level of trend resistance between $1320-$1330 and we do not expect that to be materially violated. And, as a result, we believe that adding to or initiating new shorts once futures approach that area is a sound trade based on current market dynamics.

Currencies & Bonds

Last week was one for the history books as the Dollar Index surged above 95.00 thanks to an acceleration of the declines in the euro following the announcement of ECB QE. The Dollar Index rose 2.69% while the euro collapsed Thursday and Friday, finishing the week down 3.51% at more than a decade low.

The euro wasn't the only currency to fall hard vs. the dollar as the Loonie dropped to new, multi-year lows on the surprise BOC rate cut, the Aussie dollar broke below .80 for the first time in years on general macro weakness, and the pound hit new lows following dovish MPC minutes. The yen was about the only major currency to trade decently vs. the dollar last week thanks to a stubbornly low expected inflation, as it fell very slightly vs. the greenback.

To say this trend of dollar strength is overextended would be a massive understatement, but the Fed this week could see either an acceleration (if the Fed reiterates its mid-2015 rate hike guidance) or a reversal (if the Fed get "dovish" and implies delaying expected hikes due to global uncertainty.)

Regardless, like oil, we need to watch the pace of euro-related currency declines. It is not heathy to have the euro in freefall, as it's causing peripheral stress (see Swiss and Danish central banks). Point being, for the stability of risk assets the drop in the euro needs to slow its pace, otherwise we could start to see more serious signs of contagion.

Turning to bonds, with German bunds surging higher you would have expected Treasuries to do the same, but they did not. Bonds did not catch a big bid following European QE, and as I wrote last week, as a bond bear I'm inclined to see QE as a negative for Treasuries as it will become inflationary. I think we simply have to be patient and wait for a bigger decline to consider short positions in bonds. Fed outlook this week will be the next major catalyst.

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**	*Stocks rebounded last week as the S&P 500 rallied 1% following the ECB's larger than expected QE program. The S&P 500 has quietly rallied more than 50 points in just over a week, but with several macro headwinds still looming, we would prefer to be broad equity buyers in the S&P 500 more towards 2000.*
Best Idea: Buy Retail (RTH). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Bearish**	**Bullish**	*Commodities declined, again, as oil and copper both dragged down the commodities complex. With global growth teetering and the positive effects of easier global monetary policy still in the future, the outlook for commodities remains challenging.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index again surged to new multi-year highs as the euro collapsed (down 3%) following the ECB bigger than expected QE program. In addition to the ECB, there were two other central banks who eased policy last week, and one other whose minutes were "dovish." Bottom line, while over extended, the trend of dollar strength is here to stay.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries finished last week higher but only marginally so, as the ECB QE announcement actually weighed on Treasuries late in the week. And, while theoretically ECB QE might mark the beginning of the end of the Treasury rally, we need to see more actual positive effects of ECB QE before we can expect a material move lower in Treasuries.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			