7:00's Report

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

January 6th, 2015

Pre 7:00 Look

- Futures are stable this morning as is Europe as markets try to recover from yesterdays drubbing. Asia lagged (Japan was down 3%) on follow through selling from Monday.
- Economically, the focus was on Composite PMIs and the results were mixed. A surprise drop in Italian Composite PMI to 49.4 is raising more concerns about EU growth, but that is being offset by a better than expected German PMI.
- Oil continues to drop as WTI crude broke temporarily through $49.00/bbl overnight.
- Econ Today: ISM Non-Manufacturing Index (E: 58.0).

Market	Level	Change	% Change
S&P 500 Futures	2021.75	5.75	0.29%
U.S. Dollar (DXY)	91.850	.228	0.25%
Gold	1209.10	5.10	0.42%
WTI	49.22	-.82	-1.64%
10 Year	2.039	-.084	-3.96%

Equities

Market Recap

Stocks fell sharply Monday, as the S&P 500 saw its biggest decline in three months as oil hit a new six-year low while the euro dropped to a nine-year low. The S&P 500 sank 1.85%.

Stocks were lower from the outset Monday as rising anxiety about a potential Greek exit from the EU, which eminated from comments by German Chancellor Merkel and French PM Hollande, weighed down the averages.

Yet despite Europe getting most of the press yesterday, the declines in US stocks were much more about oil prices than Old World politics.

Looking at a daily chart, S&P 500 futures were holding up fine until about 8:30 AM, when WTI crude took a decided turn lower, breaking below $51.00, and Brent crude broke down through $54.00.

That drop, combined with slightly disappointing auto sales results, weighed on stocks and the markets opened decidedly lower. From there, the day was totally driven by oil. As the oil declines intensified, stocks followed and selling really accelerated as WTI broke through $50.00 in the morning.

Oil bounced from those early lows and stocks were able to somewhat stabilize during the middle part of the day, but as WTI crude again retreated back through $50.00 late in the afternoon, stocks moved to their lows before catching a small bid into the closing bell.

Trading Color

Internals weren't quite as bad as you would expect yesterday, as both small caps and tech relatively outperformed (Russell was the best performing major average yesterday, falling 1.46%).

Internally, the selling was broad (all 10 S&P sectors were lower) led predictably by XLE (the energy ETF) which plunged more than 4%.

Stock-specific news was light yesterday with the exception of healthcare. XLV was the relative best performer, declining just 0.5%. Healthcare continues to be dominated by micro factors such as the Hepatitis C pill drama. Yesterday, CVS announced it would give preferred status to Gilead's Hep C drug , which is a blow to ABBV. This Hep C drama continues to have broader pricing implica-

Market	Level	Change	% Change
Dow	17,501.65	-331.34	-1.86%
TSX	14,392.70	-360.95	-2.45%
Brazil	47,516.62	-995.40	-2.05%
FTSE	6,334.29	-82.87	-1.29%
Nikkei	16,883.19	-52552	-3.02%
Hang Seng	23,485.41	-235.91	-0.99%
ASX	5,364.80	-85.53	-1.57%
Prices taken at previous day market close.			

tions on the entire drug industry. But, before we get too excited about the relative performance of XLV, remember that healthcare lagged all of December, so even with yesterday's modest declines, it still doesn't look great.

Market	Level	Change	% Change
DBC	18.00	-.23	-1.26%
Gold	1206.00	19.80	1.67%
Silver	16.215	.447	2.83%
Copper	2.7635	-.054	-192%
WTI	49.88	-2.81	-5.33%
Brent	52.93	-3.49	-6.19%
Nat Gas	2.928	-.075	-2.50%
RBOB	1.3801	-.0533	-3.72%
DBA (Grains)	24.95	.31	1.26%
Prices taken at previous day market close.			

On the charts the S&P 500 traded through the 50 day MA (2039) and the next major support lies at the 100 day MA (2003).

Bottom Line

Yesterday was much more about oil than it was Europe, and as we have been saying for the last few weeks, if XLE, JNK and the ruble roll over and start to push toward new lows, then the stock market will go down in sympathy.

I'm not convinced at this point we're looking at a negative game changer, and I still view any further dip towards or below 2000 as a potential buying opportunity. However, I don't see any real point to trying to add broad domestic exposure here, at least not until oil stabilizes and puts in a tradable bottom.

XLE remains the best leading indicator for the market on a daily basis. If XLE takes out the old lows ($72.51) my opinion for stocks near term will get decidedly more negative, but thankfully we are currently about 6% above that level.

Update on Europe

Comments from German Chancellor Angela Merkel (and to a lessor extent French PM François Hollande) sent European and US markets sharply lower yesterday, as they both openly discussed the idea of Greece leaving the EU.

But, while markets reacted negatively to these comments, it's important to view them as what they are: political strategy. Importantly, the chances of a "Grexit" (Greek Exit from the EU) remain very, very low.

The reason I say that is money. It's simply too expensive to see Greece leave the EU.

If Greece abandons the euro and re-introduces a devalued Drachma, then the ECB, which owns the majority of Greek debt, stands to loose massive amounts of money. And, seeing as Germany and France are the main contributors to the ECB given they are the regions two largest economies, those countries stand to lose massive amounts of money. So, neither Germany nor France, despite the comments of their respective leaders over the weekend, will do anything to encourage (or allow) a Greek exit from the EU.

Instead, Merkel was trying to frame the upcoming Greek election as a referendum on EU membership for Greece, and that should be expected.

If Merkel and Greek PM Samaras frame the election as a referendum on Greece's membership in the EU, the chances of a Syriza victory will decline. As we saw with the Scotland UK vote earlier this year, voters will say they want independence in polls, but when they actually have to cast a vote for the unknown (and for potential chaos), they often chicken out and vote status quo.

Additionally, the idea that "contagion" from a "Grexit" will be controlled because Ireland, Portugal and Spain are on better footing is tenuous as best. If Greece goes (which it almost certainly won't) then I imagine you'll see contagion re-appear very quickly.

The takeaway for us is that we need to (once again) watch Greek, Portuguese, Italian and Irish bond yields. They are the true barometer of the probability of a "Grexit" and right now they simply aren't moving very much. If we see those yields begin to rise materially, however, then that's a different story.

From a "Long Europe" standpoint, I continue to view this drama as a buying opportunity, and I actually bought small in HEDJ yesterday. We are also researching selling a February put spread in HEDJ, VGK or EWG to take advantage of the volatility, but haven't found anything attractive yet (mainly because of low liquidity in the options). If we do put on an option trade in one of the European ETFs, though, we will relay what do.

We could see several weeks of uncertainty out of this, so there's no need to stampede into Europe right now, but I think this situation is presenting an attractive entry point for 2015 given the macroeconomic fundamentals. As of now, I view this temporary political uncertainty as providing an excellent entry point for HEDJ.

Economics

There were no economic reports yesterday.

Commodities

Commodities were mixed yesterday as oil futures broke to fresh multi-year lows below $50/barrel. The slump in crude weighed on global equity markets, which in turn invited a slew of fear bids into the precious metals market that boosted gold and silver. The DB commodity ETF, DBC, fell 0.98%.

Yesterday, crude oil futures plummeted to fresh 5+ year lows again, starting the week with a 5.05% loss as the bears tested and broke the $50 mark. That selling is continuing this morning as WTI crude is below $49/bbl.

As we mentioned in yesterday's Report, there were a couple of bullish headlines last week that spurred some short-lived gains; however, the global supply glut and lackluster economic growth expectations trumped those headlines and saw futures trade to new lows.

In addition, there is a new bearish topic being discussed regarding the oil slump: the effects of oil companies hedging strategies and how long they can keep those companies afloat. And, it is apparently a lot longer than OPEC initially thought, which clearly has bearish implications for the near-medium term price target for crude oil prices.

According to various news outlets, many oil companies successfully hedged their 2015 production targets with a $90+ price expectation in mind, which means those hedges are now "in the money" in a big way. The "net short" positions held by producers (not *money managers* like we normally report to indicate speculative gold positions) further supports that theory as they have surged from 15MM contracts in August to 77MM contracts last week.

So, bottom line, Shale producers are not yet feeling the "full on" pain from the roughly 50% selloff seen in H2'14 thanks to their hedging strategies, so we can expect production to remain high and therefor the fundamentals remain very bearish. There are risks for short covering rallies towards a resistance band between $51.50 and $52.50, however our near-term target remains $45/barrel.

Elsewhere in energy, natural gas also traded lower to start the first full trading week of 2015 with futures falling 2.66%. The move lower came in spite of a very cold forecast for much of the country later this week. But, traders seem focused on the very healthy supply situation. But, the unseasonably mild December surely helped allow stockpiles to move back to roughly the five year average, a level that hasn't been seen since October 2013 (before the original polar vortex). Bottom line, both the fundamental and technical situations are bearish for natural gas with initial resistance above, between $3.00 and $3.10, while last week's low of $2.80 is in focus to the downside.

Shifting over to the metals market the stronger dollar weighed on industrials which were also pressured as part of the risk-off move seen across asset classes. Copper futures declined by 2.06% to fresh four-plus year lows. The trend remains decidedly lower for copper with key resistance still sitting between $2.825 and $2.85 while the 2010 low of $2.72 remains in focus to the downside.

Market	Level	Change	% Change
Dollar Index	91.590	.207	0.23%
EUR/USD	1.1944	-.0056	-0.47%
GBP/USD	1.5266	-.0059	-0.39%
USD/JPY	119.61	-.88	-0.73%
USD/CAD	1.1746	-.0037	-0.31%
AUD/USD	.8094	.0007	0.09%
USD/BRL	2.7059	.0128	0.48%
10 Year Yield	2.039	-.084	-3.96%
30 Year Yield	2.605	-.092	-3.41%
Prices taken at previous day market close.			

The aforementioned influences had an equal and opposite effect on the precious metals, as investors looked to hedge exposure to risk assets. Gold and silver rallied 1.64%, and 2.87%, respectively.

Looking at gold specifically, "fear bids" drove up futures yesterday likely triggering some weak short-stops, and it does appear the rally can continue up towards $1215-$1220 before it runs out of steam. For the near term, trading in gold really depends on the overall appetite for risk in the global markets, and if equities remain under pressure then short term expect gold to remain elevated. On the charts we are looking for resistance up between $1210 and $1220, while initial support is below at $1195. As a reminder, the medium-term argument for gold remains a bearish one, as the surging dollar will continue to prevent material gains in precious metals.

Currencies & Bonds

The euro and ruble were the drivers of the currency markets yesterday as both saw material declines due to rising political angst and falling oil.

Starting with the euro, it hit a new six-year low, dropping below 1.18 early Monday morning before stabilizing at the mid 1.19 level. The reason for the drop was obvious: the Der Speigel article over the weekend ignited more “Grexit” fears, and an already downward trending currency simply accelerated. Between Greek concerns and the looming prospect of QE, there is simply massive downward pressure on the euro at the moment, and while I’m not sure we’re going to see material downside in the near term (yesterday's move seemed a bit overdone), we can expect it to remain under pressure until we have more clarity on Greece and the ECB QE plans. There is little reason to buy the euro here other than trying to catch a falling knife.

Turning to the ruble, it dropped more than 4% yesterday and as of this writing is trading back above 61 to the dollar. The ruble is one of our three “Oil Contagion Indicators” and the fact that it, XLE and JNK all dropped sharply yesterday is disconcerting in the short term. And, the charts of all three look very similar (they all appear to be rolling over after bouncing the last three weeks of December). 62 is the next key level in the ruble (an excellent real time chart/quote from Marketwatch.com is here). If we see the ruble move above 62 to the dollar, we once again could see some spreading of emerging market stresses and that will exert more downward force on stocks in the near term.

The Dollar Index was mostly reactionary in trading yesterday as it rose .2% thanks to euro weakness, as there was no economic news. Comments by Fed President Williams largely reflected what we’ve been hearing from other Fed officials (namely that there is no rush to raise rates but that mid 2015 seems like a good time to start. His comments didn’t change the general expectation that the first hike will be in June 2015).

Turning to bonds, as expected given the European headlines, Treasuries surged, as the yield on the 30 year broke to a new two-year low as EU deflation concerns and worries about a “Grexit” made Treasuries even more attractive to European investors. As we have been saying, near term the prospect of deflation and QE in Europe has been supporting Treasuries, but that got an added boost along with the “Grexit” concerns.

Even in the context of the Williams comments yesterday (who said the Fed will be patient but rates should rise in mid 2015), to say that Treasuries are not reflecting domestic bond and interest rate fundamentals would be obvious, seeing as the 30 year yield is just 16 basis points above the lows of the last decade (which I believe are all time lows).

But, until we get some signs of real economic progress in Europe, the relative value of Treasuries is simply too attractive to foreign investors, and although we think the risk of the “Grexit” is overdone, it’s simply adding fuel to the Treasury buying fire.

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 unanimous 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 1.5.15)

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 over 1% last week mostly on year-end positioning. Most of the declines last week were due to year end positioning, but it is notable that oil made new lows. Very short term, this market is still being led by energy, and XLE and JNK appear to be rolling over. If they resume their decline, stocks will too.*
Best Idea: Buy Retail (RTH). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Bearish**	**Bullish**	*Commodities were lower again last week as oil resumed its declines making new, multi-year lows. With both Brent and WTI making new lows this morning, clearly the bottom in oil isn't "in" yet, and until oil stabilizes, commodities in general will have a hard time sustaining any real gains.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index exploded higher on Friday thanks almost entirely to a declining euro, which fell as ECB President Mario Draghi strongly implied coming QE. And, that drop in the euro to new multi-year lows is continuing this morning as concerns rise about Greece remaining in the EU.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries enjoyed a strong rally to start the year as growing EU deflation worries, more concern about Greece political stability, and the foreshadowing of QE in the EU send German bunds and US Treasuries soaring. Until there are signs of economic progress in the EU, Treasuries will remain well bid in spite of an improving US economy and looming rate hikes.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			