7:00's Report

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

January 8, 2015

Pre 7:00 Look

- The rally continued overnight as global stocks and US futures traded higher following further stabilization oil and "OK" data from Europe. Futures and Europe are up 1%.
- Economically, focus was again on Europe and results were mixed but overall "OK." December German Manufacturers Orders badly missed estimates but November was revised higher, while EU retail sales beat (0.6% vs. expectation of 0.2%).
- Econ Today: BOE Announcement (No change to rates or policies). Jobless Claims (E: 290k). Fed Speak: Rosengren (12:00 PM), Kocherlakota (8:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	2038.25	18.75	0.93%
U.S. Dollar (DXY)	92.63	.51	0.55%
Gold	1205.60	-5.10	-0.42%
WTI	49.18	.55	1.17%
10 Year	1.954	-.009	-0.46%

Equities

Market Recap

Stocks rebounded Wednesday as stabilization in the price of oil and a positive Greek/EU Bloomberg article helped fuel the bounce. The S&P 500 rose 1.16%.

Stocks were higher from the outset yesterday as Europe and oil continue to lead the S&P 500 around by the nose. The two indicators were higher pre-open yesterday as European economic data was better than expected (and HICP was perfectly "Gold-i-locks) while oil was able to stabilize after more declines Tuesday night/ Wednesday morning.

There were many headlines in play Wednesday (bullish oil inventories, the aforementioned Bloomberg article on Greece & the EU, President Obama's Housing Policy) but the biggest event yesterday was a Bloomberg article (link here) that dialed back some of the Germany is ok with a 'Grexit' talk.

That article, which hit shortly after the European close and was accompanied by some comments by German PM Angela Merkel, dialed back the "Grexit" rhetoric and importantly resulted in a leap higher in the S&P 500.

I say it was important because prior to those events the S&P 500 had given up the majority of the morning's gains, and you got the feeling that if something good didn't happen the averages might give up the entire rally.

As volatile as the morning was, the afternoon was the exact opposite. The S&P 500 traded in a 2-3 point range from noon on as news flow dried up and stocks closed quietly.

Trading Color

Gains were broad yesterday as all four major indices traded in line with one another (up around 1.2% each) while all 10 S&P 500 sectors were higher.

But, it was still very much a defensive led rally as consumer staples (up 1.7%) and healthcare (up 2.35%) were the big outperformers, while tech, industrials, financials and banks broadly underperformed. More to the point, SPLV handily outperformed SPHB, rallying 1.33% vs. .98%.

Point being, this was not a very strong or convicted rally yesterday, as it was not led by aggressive buying of cyclicals.

Market	Level	Change	% Change
Dow	17,584.52	212.88	1.23%
TSX	14,285.00	38.23	0.27%
Brazil	49,462.91	1.461.99	3.05%
FTSE	6,503.85	84.02	1.31%
Nikkei	17,167.10	281.77	1.67%
Hang Seng	23,835.53	154.27	0.65%
ASX	5,381.45	27.84	0.52%
Prices taken at previous day market close.			

Looking at stock-specific news, retail traded higher on JCP earnings (JCP up 20% although that was more a single stock story than a broader "retail" positive). Homebuilders rallied hard on the Obama FHFA news, while tech lagged thanks to HP's negative update at a conference, and underwhelming MU earnings.

Market	Level	Change	% Change
DBC	17.71	-.09	-0.51%
Gold	1214.80	-4.60	-0.38%
Silver	16.58	-.057	-0.34%
Copper	2.762	-.005	-0.18%
WTI	48.70	.77	1.61%
Brent	50.99	-.11	-0.22%
Nat Gas	2.874	-.064	-2.18%
RBOB	1.3345	-.0198	-1.46%
DBA (Grains)	25.01	-.10	-0.40%
Prices taken at previous day market close.			

Bottom Line

Yesterday felt like a pretty low conviction bounce, so it'll be interesting to see if the gains this morning can hold. There remain several macro headwinds to watch (Europe deflation, ECB QE, "Grexit") but near term this market remains all about oil. I expect that the 2000 level in the S&P 500 to (generally) hold, but we've got to see some sort of a bottom in XLE confirmed before we can confidently add incremental US equity market exposure—.

In XLE, the two levels to set alerts at are $81.00 (the highs from last week) and $79.51 (the lows from December). Whichever level is violated first will give us a "tell" on whether energy stocks have bottomed, and that will give us a much better clue as to whether it's time to add incremental capital to domestic equity sectors.

Economics

Jobs Report Preview

As has been the case for the last few jobs reports, the wage and unemployment number will be just as important as the headline jobs figure.

The official estimate is 245k jobs added, down substantially from November's blistering 321k, but still a strong number.

As has been the case with the last few jobs report, the risk to stocks is of a "too hot" number that potentially begins to pull forward the date of the first Fed rate hike (resulting in a "hawkish" reaction). If we see a "too hot" number, expect stocks, bonds and commodities to drop (with bonds potentially dropping hard) and the Dollar surge.

The "Too Hot" Scenario

- **> 2.2% yoy wage increase**. Wages are probably the most important metric in this jobs report. I say that because for all the noise surrounding Greece, European deflation, slowing Chinese growth, etc. I think the biggest risk to this bull market is a "pull forward" of Fed rate hikes or the revelation that hikes will happen faster than expected. One of the things that can make that happen is an acceleration in wage growth, so this number is probably the most important one in the jobs report.
- **< 5.6% Unemployment Rate**. An unemployment rate of 5.5% is basically "normalized" for an economy. The expectation is for 5.7% (down .1% from November), but again if we see a 5.5% print then it becomes pretty difficult for the Fed to continue to justify 0% rates, especially if we also see U-6 drop below 11% (which probably won't happen tomorrow but the trend is headed that way).
- **> 300k Job Adds.** The November jobs report (321k) was about as "blowout" as it could get, and stocks didn't really care. There is the expectation we'll see a moderation in the number of jobs, but if we see a print of another 300k then that will be taken as "hawkish" by the market and we could see stocks sell off.

The "Just Right" Scenario

The highest probability is for this number to be a non-event. So, basically anything under the "too hot" scenario levels would be considered "just right" and the market should broadly yawn in response.

The "Too Cold" Scenario

- **< 2.0% yoy wage increase.** There really isn't much of a chance of a "too cold" scenario unless we see year-over-year wage increases drop below 2%, because even if there is a big miss on the headline jobs report it'll be ignored as a one off.

Bottom Line

Almost all the risk into this jobs number is to the downside for stocks, as any surprise will be a "hawkish" one. But, that's a low probability event and in all likelihood this jobs number will broadly confirm that we are seeing continued progress in the labor market, but nothing good enough to make the FOMC consider rate hikes earlier than June.

FOMC Minutes—A Hint of "Hawkishness"

There weren't many surprises in the Minutes so I'm not going to spend a lot of time recapping them. There is one theme that I do want to point out, though. Importantly, the committee noted that current low levels of core inflation wouldn't delay a rate hike later this year, as long as they were confident inflation was going to trend higher in the future. This is important because it further confirms my (and other's) belief that low statistical inflation readings aren't "Dovish," as the Fed is looking past them. Point being, low inflation readings caused by commodity prices will not delay rate hike "Lift off" in June (or maybe earlier).

Bottom line, the minutes weren't materially hawkish, but they further confirmed the FOMC is potentially more committed to raising rates than the market may think.

ADP Employment Report

- Private Payrolls rose 241K vs. (E) 235K in Dec.

Takeaway

The first look at December jobs data was a good one yesterday as the ADP reported that private payrolls grew to 241K vs. (E) 235K. Also, the November data was encouragingly revised higher from 208K to 227K (but that figure is still well below the blowout 321K of last month's government BLS Report). Markets were leaning towards a "risk on" morning with higher stock futures and lower gold and bond prices and those moves were extended upon release of the optimistic report. Bottom line though, yesterday's ADP Report did not materially affect the "whisper number" for tomorrow's official government jobs report which remains around 245K.

Market	Level	Change	% Change
Dollar Index	92.175	.437	0.48%
EUR/USD	1.1843	-.0045	-0.38%
GBP/USD	1.5115	-.0035	-0.23%
USD/JPY	119.11	.72	0.61%
USD/CAD	1.1822	-.0013	-0.11%
AUD/USD	.8068	-.0016	-0.20%
USD/BRL	2.6829	-.0167	-0.62%
10 Year Yield	1.954	-.009	-0.46%
30 Year Yield	2.515	-.008	-0.32%
Prices taken at previous day market close.			

Commodities

Crude oil futures rallied yesterday after the market became very oversold in recent weeks and short sellers began taking some profits. The rest of the space however was heavy with the refined products falling on news of sizeable supply builds, while the precious metals lagged along with other safe haven assets. DBC fell 0.53% on the day.

WTI crude oil futures caught an oversold bid yesterday (as we said the market was overdue for in yesterday's report) rallying back towards the $50 level. The energy space was largely influenced by yesterday's EIA report which showed a draw of -3.1M barrels vs. (E) of +300K in crude oil inventories, a +8.1M barrel build vs. (E) +3.2M in gasoline stocks, and a +11.2M barrel build vs. (E) +2.3M barrels in distillate fuels.

As you might have guessed, crude oil held onto morning gains, closing higher by 1.21% while RBOB gasoline and Heating Oil fell back 1.59%, and 1.67%, respectively. But the moves, primarily the gains in WTI, don't seem to be genuine, as some bearish comments by the UAE Energy Minister, Suhail Al Mazrouei, who said that the glut "may take months or years to be absorbed" reminded everyone about the crude reality in oil.

Bottom line, we saw some short covering in a very oversold WTI futures market yesterday and some further consolidation may be in store. But, all indications continue to point to further weakness and we expect new lows to come with the next WTI target between $45 and $46 per barrel.

Nat gas futures fell 1.80% yesterday in choppy trade as traders speculate on whether or not the recent cold temperatures across the nation have spurred enough demand to substantially draw down supplies. Analysts are expecting a draw of –125 Bcf, a material jump from last weeks meager draw of –26 Bcf. Bottom line, the mild December temperatures, and subsequent low demand for heating products, allowed supplies to move back to the five year average for the first time in 15 months last week. So, if we see that trend continue, then we can expect the selling pressure to remain on natural gas futures. Technically, we are looking at resistance at $3.00 while the "level to beat" to the downside is $2.80. Expect the nat gas market to remain volatile as we enter the heart of winter.

Metals were heavy yesterday as the dollar traded up to yet another multi-year high against its peers. Copper fell 0.18% in quiet trade, while gold and silver spent most of the day drifting slowly lower, falling an equal 0.49% a piece. The dollar remains a dominant force in the overall metal markets while more Chinese growth concerns weighed on industrials, and while soft inflation metrics paired with expectations of mid-'15 rate hikes (mildly hawkish) continue suppressing precious metals prices.

Currencies & Bonds

It was a mostly quiet day in the Treasury market as Treasuries traded basically close to flat the entire day , while European bonds also were calm. Economic data was largely ignored as were the FOMC Minutes (there weren't any great revelations in the minutes). In Europe there was a lot of data out (almost all of it positive) but we're so close to ECB QE now that it is the total focus of the European bond market short term.

There was a bit more action in the currency markets yesterday as the dollar again traded to a new, multi-year high, again benefitting from euro weakness (which is continuing this morning). The Dollar Index rose .55% and traded modestly higher against every currency but the Loonie (which was flat thanks to the bounce in oil).

Starting with the euro, it fell to new multi-year lows yesterday and this morning, and the euro has traded down through 1.18 this morning. The catalysts for the drop have been the economic data, starting with the "weak" December flash HICP and then followed by the mixed reports this morning (the EU reports this morning we actually better than the headlines suggest). But, the big number this week was the HICP and it is an important number to get "right" so I want to spend a bit of time covering it.

First, the euro dropped on surging expectations of QE on January 22, as the headlines –.2% y/y reading in HICP screams deflation and almost guarantees QE. But, the details of the report were much better and actually slightly imply the beginning of a stabilization of price trends in the EU. The y/y change in core HICP was flat from November at 0.7% (this is they key number to watch), and again the HICP for the service sector was up 1.2%. Point being, a lot of the negative price effects are energy and commodity based—and those are not the causes of true deflation.

As we said yesterday, the EU HICP headline will make QE almost a certainty, **but from an investment standpoint we are looking for signs that the EU economy is starting to stabilize, because if we can get that along with more ECB stimulus, then European stocks can move materially higher as a naturally bottoming economy gets a big central bank policy tailwind.** That is what we are looking for, and there are signs that it is happening (quietly Germany and EU retail sales and unemployment were better than expected this week while manufacturers orders were stronger than the headline suggests, and that's adding to a slowly growing list of better than feared EU economic reports). Again, I'm not ignoring the Greece situation, but we are trying to look a bit beyond it to the structural factors affecting the European markets.

Elsewhere in the currency space we saw broad strength in the dollar as the yen dropped .5%, the pound fell .4% (ahead of the Bank of England this morning which should be a non-event) and a .46% decline in the Aussie dollar. Trading was quiet and there weren't any real catalysts for the drops, other than the general trend of dollar strength. Right now, the euro is really the key to the currency markets and everything else (including the dollar) is just reacting to it.

The euro is now absurdly oversold in the short term and a bounce back above 1.19ish over the coming weeks can be expected, unless we get more Greece-related negative headlines, and as long as the jobs report Friday isn't blow out.

Have a good day,

Tom

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.			

Asset Class Dashboard

(Updated 1.5.15)

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