7:00's Report

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

September 28, 2016

Pre 7:00 Look

- Futures are little changed this morning as EU indices rebounded with Deutsche Bank shares while global investors are eyeing a slew of central bank speak scheduled for today as well as the conclusion of the oil producers meeting in Algiers.
- The International Energy Forum is expected to end without a "freeze deal," however oil futures are trading higher after the API reported a surprise supply draw late yesterday.
- Econ Today: Durable Goods Orders (E: -1.9%), EIA Petroleum Status Report (10:30 a.m. ET). Fed Speak: Kashkari (8:45 a.m. ET), Yellen (10:00 a.m. ET), Bullard (10:15 a.m. ET), Evans (1:30 p.m. ET), Mester (4:35 p.m. ET), George (7:15 p.m. ET)

Market	Level	Change	% Change
S&P 500 Futures	2150.50	-2.25	-0.10%
U.S. Dollar (DXY)	95.455	.143	0.15%
Gold	1328.50	-1.90	-0.14%
WTI	44.89	.22	0.49%
10 Year	1.556	-.033	-2.08%

Equities

Market Recap

Stocks bounced back Tuesday, not so much because Clinton "won" the debate but instead because Deutsche Bank fears receded a bit. The S&P 500 rose 0.64%.

It was a bit of a rollercoaster early on Tuesday, as futures were initially higher (the assigned "reason" for the rally was Clinton's performance in the debate, but futures were already higher ahead of that event).

While the media focus was on US politics, Deutsche Bank was the real driver of markets yesterday, and when that stock hit new lows Tuesday pre-open it dragged down stocks and the S&P 500 actually was negative early. But things turned around mid-morning when a Justice Department official made comments that implied the $14 billion fine for DB was negotiable, and as a result DB stock rallied—and so did the markets.

Stocks hit their highs of the day by 12:30 p.m. following digestion of those comments, and then basically traded sideways for the remainder of the session to close near the highs.

Trading Color

It was a pretty vanilla, bounce-back rally yesterday as all the major indices finished with similar gains (up about 0.6%), and there was little fundamentally driven differentiation among stocks.

Utilities were weak yesterday, as XLU dropped 1.3% and was by far the worst performer in the SPDRs we track, but that weakness was a bit overstated. First, several companies in that ETF went ex-dividend yesterday, and that contributed to some mild short-term profit taking as markets bounced back from the risk-off move.

Energy was the only other sector we track to finish in the red, as XLE dropped 0.67% thanks to the near-3% decline in oil. All things considered, that decline was pretty mild as the 3% move in oil was just speculators ahead of the summit later today, and not the start of some material downtrend (that's why the stocks didn't react all that much). Validating my point that yesterday's rally was more bank driven then politics driven, KRE (regional banks) rose 1%.

On the plus side, tech and consumer discretionary both rose 1% while most other sectors were modestly higher. From a single-stock standpoint there wasn't much news to speak of.

Market	Level	Change	% Change
Dow	18,228.30	133.47	0.74%
TSX	14,558.04	-61.42	-0.42%
Stoxx 50	2,990.99	20.15	0.68%
FTSE	6,850.63	42.96	0.63%
Nikkei	16,465.40	-218.53	-1.31%
Hang Seng	23,619.65	47.75	0.20%
ASX	5,412.35	6.46	0.12%
Prices taken at previous day market close.			

Bottom Line

Yesterday should be viewed as a simple bounce back from Monday's drop (Monday's declines were Deutsche Bank inspired, and yesterday's rally was Deutsche Bank relief inspired).

Market	Level	Change	% Change
DBC	14.53	-.14	-0.95%
Gold	2.1715	-.027	-1.23%
Silver	19.220	-.376	-1.92%
Copper	2.172	-.0265	-1.21%
WTI	44.57	-1.36	-2.96%
Brent	45.86	-1.49	-3.15%
Nat Gas	2.993	-.004	-0.13%
RBOB	1.3971	-.0053	-0.38%
DBA (Grains)	20.35	-.06	-0.29%
Prices taken at previous day market close.			

The election is obviously important, but near term the issue for stocks remains the lack of a positive catalyst. While bond yields are declining, the chances of them hitting pre-Brexit levels are low, so as a result the S&P 500 remains broadly "stuck" at 2200 on a valuation basis.

Assuming no surprises out of the oil production summit later today, the calendar is quiet for the next week (till the September Jobs report next Friday) so we could see a drift higher in stocks. But until we get 1) Further declines in the 10-year Treasury yield, 2) An uptick in economic activity, or 3) Earnings revisions, stocks will struggle to break out.

Economics

What the Election Means for Markets

The first presidential debate is now behind us and we're about six weeks from Election Day (November 8), so now is a good time to address what the election may mean for markets.

To that point, I want to make sure everyone knows: 1) What market expectations are 2) What the wildcards are to watch for that might hint at an upset, and 3) What assets and sectors will be winners or losers depending on who wins in November. Because I want everyone to have a clear, confident answer if a client or prospect asks: "Who wins and who loses from the election?" or "What does the election mean for the markets?"

What's Expected: A Clinton Victory

Polls have tightened, but most of the prediction/betting sites still have Clinton as a pretty comfortable front runner for two main reasons:

First, the electoral college map favors her (remember the presidential election is actually 50 individual elections, not a national poll). Second, most of the polls where Trump and Clinton are tied factor in third party candidates (Libertarian Gary Johnson and the Green Party's Jill Stein).

That favors Clinton, because while in polling those votes take away from Clinton, historically speaking on Election Day third party voters don't usually show up, so the polls tend to overstate their impact.

An Indicator to Watch: I'm not a political analyst, but the ones I've read have pointed to Pennsylvania as a key indicator of the election. If Pennsylvania starts to turn decidedly for Trump, that could signal a potential upset, as it will imply enthusiasm for Trump among historically Democrat blue-collar workers is rising, and that's the demographic Trump needs if he wants to pull an upset.

General Market Outlook Depending On the Outcome (between Election Day and Year End):

Market Winners (Regardless of Who Wins)

Infrastructure Stocks: Both candidates will likely expand infrastructure spending. Some names to watch (there isn't a pure play infrastructure ETF): Vulcan Materials (VMC), Martin Marietta Materials (MLM) and Summit Materials (SUM). IGF is a global infrastructure ETF, but the US makes up less than 1/3 of the ETF, so it's not a pure play (although still not a bad idea as increased government spending is likely across the globe).

Defense Stocks: Both candidates will likely increase defense spending, at least initially as the push to eradicate ISIS increases. Obviously given their stated policies it's more positive for defense names if Trump gets elected, but either way this is a sector that should have a tailwind regardless of the outcome. The most liquid ETF in this space is ITA (iShares US Aerospace and Defense ETF).

Gold: Regardless of who wins the outlook from a political and macro standpoint isn't exactly rosy, so gold will likely catch a mild bid in either case even if it's nothing more than as a protest vote by investors (neither candidate is exactly wanted by the markets).

Clinton Victory

Macro View: The market "prefers" a Clinton win solely because it's more of the same. So, a Clinton victory should be viewed more as "not bad" for stocks rather than "good" (in the short term) compared to the uncertainty of a Trump victory.

Market Reaction: Stocks: A mild relief rally (relief there were no surprises) but nothing particularly bullish. Bonds: Also a mild relief rally. Oil/Gold: Oil little changed, gold likely modestly higher. US dollar: Little changed.

Winners: Hospitals (Thesis: No Obamacare repeal or replacement, ETF: XLV), gun manufacturers (Thesis: Potential restriction on certain firearm sales. No ETF, best stock, SWHC). Alternative energy (Thesis: Continuation of investment in alternative energy programs. ETFs: ICLN, TAN, PBW, PBD, although all of these clean energy ETFs are low volume).

Losers: Biotech/Pharma (fears of regulation/price ceilings), energy & coal (Thesis: Increased environmental regulation reducing coal and fossil fuel production, ETFs: XLE & KOL. Private prison stocks (Thesis: Clinton said she wants them basically out of business at the debate. Stocks: CXW, GEO). Notable: Natural gas may be the exception here and worth a look on a dip as natural gas is the favorite fossil fuel of the alternative energy crowd.

Trump Victory

Macro View: The level of uncertainty regarding his policies will be very high, and that will elicit a "sell first, ask questions later" immediate reaction from stocks. But given the period between Election Day and Inauguration is usually a quiet one for the President-Elect, I don't think a Trump victory will, by itself, cause a material selloff into year end.

Market Reaction: Stocks: Likely a mild-to-modest selloff, but not a bearish game changer. Bonds: Treasuries lower near term but not a bearish game changer. Dollar: Lower as markets price in potentially contentious trade deals. Gold/Oil: Both up (potentially materially) on uncertainty (the former rather than the latter).

Winners: Coal (reduced regulation on coal production and sales. ETF: KOL), energy (Thesis: Relaxed regulatory environment. ETF: XLE), pharma/biotech (Thesis: No risk of price controls or ceilings. ETF: IBB), banks (Thesis: Potentially higher rates, rollback of certain Dodd-Frank regulations. ETF: KRE).

Losers: Hospitals (Thesis: Potential healthcare law changes. ETF: XLV). Alternative energy (Thesis: less funding for programs).

Commodities

The volatility in oil continued yesterday as traders await the outcome of the global energy forum, as well as weekly economic data today. Meanwhile, a pop in the dollar weighed on the metals market. The commodity ETF, DBC, fell 0.75% yesterday.

Gold declined yesterday as the dollar bounced and demand for the safe-haven assets diminished as investors saw Clinton come out of the first presidential debate ahead of Trump. Clinton is seen by the market as status quo while Trump represents a lot of unknowns. So as you might expect, there was some repositioning after the debate, and gold finished down 0.99%.

Near term, gold prices still are trading in a relatively tight range between $1310 and $1340, and we expect that to continue in the near term as the dollar also is trading sideways. Potential catalysts to watch this week with regard to gold are the slew of Fed speakers (notably Yellen today and tomorrow) as well as a few key economic releases (specifically Durable Goods today and Personal Incomes and Outlays Friday). If data remains weak and Fed speak keeps a dovish tone, gold could begin to rally again.

Market	Level	Change	% Change
Dollar Index	95.355	.145	0.15%
EUR/USD	1.1219	-.0035	-0.31%
GBP/USD	1.3013	.0038	0.29%
USD/JPY	100.38	.05	0.05%
USD/CAD	1.3207	-.0020	-0.15%
AUD/USD	.7666	.0030	0.39%
USD/BRL	3.2318	-.0106	-0.33%
10 Year Yield	1.556	-.033	-2.08%
30 Year Yield	2.279	-.047	-2.02%

Prices taken at previous day market close.

Global Energy Forum Review

On the eve of the Algiers meeting the news wasn't especially bullish for oil, as Saudi Arabia said that they would cut their production if Iran limited or froze their output. Iran, however, declined the offer which poured cold water on speculation that some sort of deal would be met. As a result, WTI crude oil futures fell 2.74% on the day.

It is lining up to be a busy morning for the energy market today as the official announcement from the energy summit is due at 10:00 a.m., just a half hour before the EIA releases weekly inventory figures. Obviously, if there is any sort of shock agreement out of Algiers, oil and refined product futures will soar (WTI likely towards if not through $50) as expectations of a deal are nominal.

But if the informal gathering turns out to be a non-event as most expect, attention will quickly turn back to the aforementioned weekly EIA release. The reason is crude oil supply draws have unexpectedly increased sharply in the last three weeks, which has caught some fundamental short sellers off-guard. If the drawdowns continue at the current rate, that will be reason for reevaluation of near-term supply and demand dynamics in favor of the bulls.

On the other hand, the underlying trend on the production side of things has been less supportive of prices recently, as US output in the lower 48 has seemed to stabilize just above 8M barrels/day. That number also is being reinforced by a rebound in active US oil rigs according to Baker Hughes. This is notable because many analysts had expected the substantial pullback in prices over the last two years to cause a much further decline in US production (longer-term bullish) but, the US shale industry has proved to be resilient, and as a result the global production surplus is now expected to last longer than most anticipated.

Bottom line, the meeting announcement at 10 a.m. will be important, but the chances of any collective action being taken remain very slim, so it will be important to watch two things in the EIA release: 1) The headline oil number. If it is another big draw, futures will likely rally. 2) The lower-48 production number as further stabilization above 8M b/d will remain the largest underlying headwind for the energy market medium term.

Currencies & Bonds

Currency markets took a breather Tuesday as the Dollar Index bounced slightly following several days of declines in quiet trading. The Dollar Index rose 0.14%.

There was economic data out yesterday (Case-Shiller Home Price Index and the September Flash Manufacturing PMI) but neither one of those reports can change the outlook for the Fed, and as a result the dollar largely ignored them and instead enjoyed a mild bounce in part because the yen stopped strengthening.

In Europe, the euro continues to largely trade inverse to the dollar as it dipped 0.3%, but the euro remains very comfortably in the middle of a month's long range between 1.12 and 1.13 vs. the dollar. The next major catalyst for the euro will be the ECB minutes out next week (and specifically if they show the ECB was more open to extending QE than Draghi let on at his presser). Looking elsewhere, the pound, Aussie and loonie were all modestly higher vs. the dollar, but in generally quiet trade.

Turning to Treasuries, the 30 year surged yesterday, rallying 0.72%. Some people said that the perceived Clinton victory in the debate sparked a move into Treasuries, although frankly that's a bit of a stretch. If it is true, it's not sustainable, as bond markets aren't reflecting election prospects (at least not at this early juncture).

That said, the 10-year yield did decline further to 1.55%, and if it closes here for another day or two that will signal a definitive break of the post-Brexit uptrend. While there's still nothing to imply that yields will keep dropping (unless economic data gets materially worse) the bottom line is that the uptrend in yields appears to have been halted, and that does remove a potential headwind from stocks (although again it's not bullish). The 10-year yield needs to get back above 1.60ish in the next day or so for the wider uptrend to remain intact.

Have a good day,

Tom

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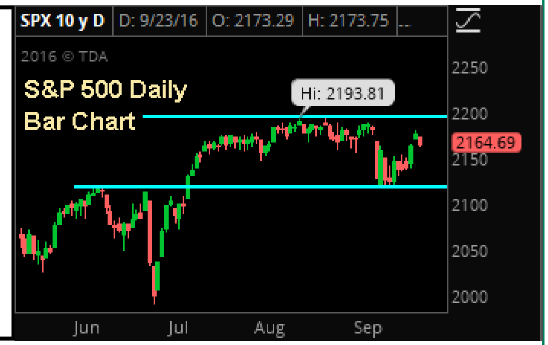
Technical Perspectives

(Updated 9/25/16)

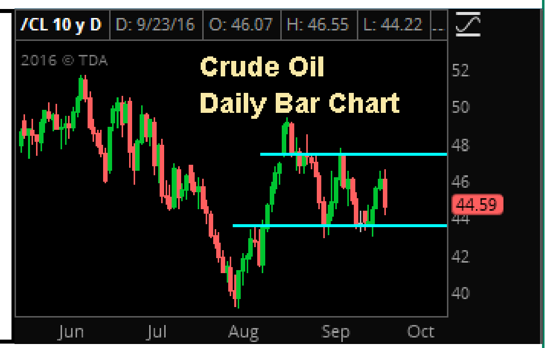
S&P 500

- Fundamental Outlook: Remains cautious based on valuations and a generally unfavorable risk-reward scenario.
- Dow Theory: **Remains bearish (since week of August 17, 2015)**
- Key Resistance Levels: 2170, 2186, 2200
- Key Support Levels: 2147, 2127, 2095



WTI Crude Oil

- Fundamental Outlook: Mixed as prospects of an oil production deal are keeping short sellers at bay while stabilizing US production is an underlying bearish influence.
- Proprietary Model: **Bearish (since week of August 29, 2016)**
- Key Resistance Levels: $46.12, $47.29, $49.12
- Key Support Levels: $43.77, $42.75, $41.50



Gold

- Fundamental Outlook: Bullish as the Fed has telegraphed a "dovish hike" in December while the "real interest rate" environment favors being long.
- Proprietary Model: **Bullish (since week of April 4, 2016)**
- Key Resistance Levels: $1349, $1364, $1372
- Key Support Levels: $1326, $1316, $1301

30-Year T-Bond Futures

- Fundamental Outlook: Neutral as prospects of a 2016 rate hike are bearish but the relative attractiveness of US Treasuries to overseas government bonds is supportive.
- Proprietary Model: **Bearish (since week of August 15, 2016)**
- Key Resistance Levels: 168'29, 170'07, 172'05
- Key Support Levels: 166'27, 165'14, 162'28

Dollar Index Futures

- Fundamental Outlook: Bullish as the Fed is technically in a rate hiking cycle while the rest of the world's central banks are expected to ease further.
- Proprietary Model: **Neutral (range-bound)**
- Key Resistance Levels: 96.01, 96.755, 97.255
- Key Support Levels: 95.10, 94.82, 94.49

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Fundamental Market View

(Updated 9/25/16)

Near-Term General US Stock Market Outlook

This is designed to provide a snapshot of our near-term (1 month) outlook for stocks. For general equity market exposure, we use a mix of SPHB (S&P 500 High Beta) and SPLV (S&P 500 Low Volatility) to create an aggressive, neutral or defensive stance on general equity market exposure.

Near Term Stock Market Outlook: **Defensive** **SPHB: 25% SPLV: 75%**	*"Not hawkish" BOJ and Fed decisions last week caused global bond yields to decline, and stocks were able to rally as a result—although its important not to confuse last week's relief rally with the start of a strong, new uptrend. Unless bond yields drop further (much further), economic growth accelerates, or 2017 earnings expectations start moving up, we view the S&P 500 as largely capped at 2200.*

Tactical Allocation Ideas:

- **What's Outperforming: Defensive Sectors (XLU/XLP, FXG), Short Duration TIPS ETF (VTIP), Super Cap Internet/Social Media Stocks (AMZN, FB, GOOGL, LNKD, FDN is a good internet ETF). Top Contrarian Idea (if you are a bull: Banks KRE).**
- **What's Underperforming: Europe (HEDJ/VGK), Retail (XRT), Tech (AAPL related supply chain), Healthcare (especially specialty pharma and biotech stocks), Small Caps.**

Long Term Fundamental Outlook for Other Asset Classes

	Fundamental Outlook	Market Intelligence
Commodities	**Neutral**	*Commodities surged last week despite a sharp drop in oil Friday, thanks almost entirely to a weaker US dollar. But while that bounce was nice for commodity investors, the Dollar Index likely isn't embarking on a material new downtrend, so it's going to take demand increases to power commodity prices materially higher from here, and there's scant evidence of that right now. This week, the oil producer summit will be the major influence over the oil and commodities markets.*
US Dollar	**Neutral**	*The Dollar Index dropped nearly 1% last week as markets chose to focus on the fact that the number of rate hikes in 2017 dropped from four to two. But the Dollar Index held support at 95, and because of the wide gap between Fed policy and the rest of the world (Fed hiking rates, everyone else neutral to easing) the Dollar Index should hold the current range.*
Treasuries	**Bearish**	*Treasury yields declined modestly as, like the currency markets, the bond market focused on the reduction of expected rate hikes in 2017 (and not the clear signal a rate hike is coming in December). The 10-year yield is testing support at the 1.60% - 1.63% range, and if that fails a decline to the lower 1.50% is possible, but last week's central bank decisions aren't enough to start a new rally in bonds/ decline in yields, so a sideways chop in Treasury yields is to be expected near term.*

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.