SEVENS REPORT

EVERYTHING YOU NEED TO KNOW ABOUT THE MARKETS BY 7AM EACH MORNING IN SEVEN MINUTES OR LESS

January 10, 2019

Pre 7:00 Look

- Futures are modestly lower as markets digest the recent rally following a quiet night of news.
- Economically, Chinese inflation underwhelmed as CPI rose 1.9% vs. (E) 2.0% and PPI gained just 0.9% vs. (E) 2.7%.
- On trade, there were no further comments from either side (a slight negative).
- Econ Today: Jobless Claims (E: 224k). Fed Speak: Barkin (8:35 AM), Bullard (12:40 PM), Powell (12:45 PM), Evans (1:00 PM), Kashkari (1:20 PM), EST.

Market	Level	Change	% Change
S&P 500 Futures	2,567.25	-15.25	-0.59%
U.S. Dollar (DXY)	95.2770	0.580	0.06%
Gold	1,294.60	2.60	0.20%
WTI	51.91	-0.45	-0.86%
10 Year	2.728	.012	0.44%

Equities

Market Recap

Stocks rallied on the back of dovishly interpreted Fed speak, but ended off the highs thanks to political drama in the U.S. The S&P 500 rose 0.41%.

U.S. equity futures were higher ahead of the open yesterday amid ongoing optimism about a U.S.-China trade deal after mid-level talks wrapped up in Beijing Wednesday. The major indexes opened higher and hit new multi-week highs before a bearish headline in the weekly EIA report caused oil prices to fall hard, dragging stocks into negative territory.

Oil stabilized, however, as the data was shrugged off as a function of the calendar. The rally then resumed with the S&P hitting new highs before lunch as trader focus turned to the minutes from the December Fed meeting.

There were several dovish comments made by Fed officials, most notably Rosengren, which helped stocks rally into the minutes. On balance, the minutes were seen as mildly dovish, but political drama between the White House and Congressional leadership over the government shutdown and border security debate served as an excuse for profit taking in the final hour. Stocks ended in the upper half of the day's trading range.

Trading Color

Cyclicals once again outperformed and led markets higher Wednesday, although there were some subtle signs of a loss of momentum. Nonetheless, given what we've been through over the past few months, the price action was still welcomed. On an index level, the Russell 2000 and Nasdaq both outperformed, rising about 0.8% each while the S&P 500 and Dow Industrials rose 0.4%.

On a sector level, six of the nine SPDRs we track were higher on the day, with energy (XLE) and tech (XLK) rising by more than 1% thanks to strength in chipmakers following the not-as-bad-as-feared SWKS negative guidance. Energy was driven higher by oil.

Defensive sectors were negative on Wednesday as utilities (XLU) fell 0.60% while consumer staples (XLP) fell 0.93% in a pretty standard rotation from defensives into cyclicals. But it wasn't all positive, as materials (XLB) was little changed on the day despite continued rising optimism on a U.S.-China trade deal. Part of that weakness was due to 2% decline in packaging company Sealed Air (SEE), and actually resource stocks traded pretty well (HAP, VanEck Natural Resource Stock ETF, rose 1%).

Market	Level	Change	% Change
Dow	23,879.12	91.67	0.39%
TSX	14,804.73	199.58	1.37%
Stoxx 50	3,061.84	-8.40	-0.27%
FTSE	6,900.19	-6.44	-0.09%
Nikkei	20,163.80	-263.26	-1.29%
Hang Seng	26,521.43	59.11	0.22%
ASX	5,795.27	16.98	0.29%

Prices taken at previous day market close.

U.S.-China Trade Update

Market	Level	Change	% Change
DBC	15.41	.30	1.99%
Gold	1294.00	8.10	0.63%
Silver	15.785	.072	0.46%
Copper	2.6610	.005	0.19%
WTI	52.24	2.46	4.94%
Brent	61.33	2.61	4.44%
Nat Gas	3.003	.036	1.21%
RBOB	1.4296	.0643	4.72%
DBA (Grains)	17.30	.02	0.12%

Prices taken at previous day market close.

As you've likely read by now, discussions between the U.S. and Chinese trade delegations went well, with the talks being extended for a third day (from the originally scheduled two days) and both sides emerged with positive commentary.

Ever since the Trump/XI G-20 summit in November, the markets have been gradually increasing expectations for a medium-term trade "truce," one that practically removes the "trade war" from the list of market headwinds, and that outcome is looking more and more likely. Bottom line, there are two main takeaways from the positive trade talks.

First, a deal is already at least partially priced into markets, and as such, don't expect any announcement in the next month and a half to be a material positive for stocks. However, emerging markets, which got hammered in 2018 on China growth fears/trade war, could benefit substantially from an actual deal, as that clarity, combined with Chinese economic stimulus and a likely top in the dollar is a very positive set up for emerging markets (EEM) and commodities (DBC).

Second, while optimism towards a deal is rising, nothing is certain. And if anything, risk now is for disappointment if a deal does not get done. From a "What's Next" standpoint, the sooner the next talks are announced, the better. I've seen reports implying the next round of talks could happen in a week or two, or later in January. For the market, the key here is continued progress, so any headlines that imply talks will resume quickly should be worth a short-term bounce, although again for U.S. stocks I think a "deal" is largely priced in at this point. And, given growth and earnings worries in the U.S., a trade deal won't be the positive market catalyst it would have been four or five months ago.

Technical Update: Bounce or Bottom?

We have received a lot of questions this week regarding the sizeable rebound in stocks since the Christmas Eve lows, and how the rally has affected our technical outlook. So, we wanted to provide a brief but thorough update on the technical backdrop of the broader stock market to offer subscribers perspective on the charts, and some key levels to watch that effectively answer the question: *Is this a bounce or a bottom?*

What is the short-term path of least resistance? *Higher*. The short term trend in stocks is decidedly higher right now, and it has been since the major indexes reversed sharply the day after Christmas, when market conditions had become deeply oversold thanks to a buyers strike into the holidays. The overdue rally across stock indexes since the late-December lows has been impressive, with the S&P notably rallying more than 10% trough-to-peak.

Is it sustainable? *Unfortunately, probably not, on a longer time frame.* The most discouraging part about this now three-week rally is that it has occurred on relatively thin volumes. For reference, during the two-week selloff before Christmas, 25.6M S&P futures contracts changed hands as the S&P plunged to new 52-weeks lows. Meanwhile, just 15.1M contracts were traded in the final two weeks of the year as the S&P rallied almost 200 points from the lows. Looking at the NYSE, total volumes were the highest of the year in the week ending 12/21 when the S&P fell 184 points. And even though it was options expiration, the high-volume selloff underscored the fact that sellers have had much more conviction than buyers over the last several weeks.

How far can stocks rally? *Somewhat encouragingly, pretty far.* To the upside, the major U.S. stock indexes are beginning to approach critical, respective, resistance levels. But to analyze the medium- to longer-term technical outlook we need to zoom out to weekly and monthly time frames. Sticking with the S&P 500, the benchmark is quickly approaching the bottom end of key resistance that spans from 2600, where support was first definitively broken in early December, all the way up to 2800, where the November rebound failed. A lot of volume traded hands in this area, and big volume often acts as a magnet for the market when conditions become overbought or oversold like they are now.

Is the bottom in? *For the next few weeks, maybe; for the longer term, not likely.* Putting fundamentals aside and looking solely at the technical backdrop and internals of the broader U.S. stock market, investors are likely to see a retest of the December lows before a run at new all-time highs. The main reason is the aforementioned resistance zone between 2600 and 2800 and the large amounts of volume that changed hands there. History may not repeat itself, but it does rhyme, and based on the technical set ups like this one that have occurred in the past there will be plenty of "supply" by investors who *bought the dip* in Q4 before support broke and are now patiently looking to break even on those long positions. Bottom line, beyond the short term, the broader technical backdrop for this market is remains bearish, even if we get a best case rally to 2800 in the S&P 500, as there remains a lot of technical damage done to this market from the Oct-Dec volatility.

Economics

There wasn't any notable economic data out yesterday, but there was a lot of dovish Fed speak from three Fed governors and the FOMC minutes. All of it combined to further reinforce Powell's comments last Friday that implied the Fed was going to "pause" its rate hike regimen. We go more in-depth on the comments in Currency & Bonds.

Market	Level	Change	% Change
Dollar Index	95.162	.741	-0.72%
EUR/USD	1.1552	.0111	0.97%
GBP/USD	1.2803	.0086	0.68%
USD/JPY	108.03	-.72	-0.66%
USD/CAD	1.3217	-.0057	-0.43%
AUD/USD	.7179	.0039	0.55%
USD/BRL	3.6809	-.0328	-0.88%
10 Year Yield	2.728	.012	0.44%
30 Year Yield	3.024	.031	1.04%
10's-2's	16 bp		
Prices taken at previous day market close.			

Commodities

Commodities rallied broadly yesterday as the dollar came for sale hard on dovish Fed commentary, offering broad support to the complex. The commodity ETF, DBC, jumped 1.99%.

Beginning with the metals, gold was an upside standout thanks to its very high inverse correlation with the dollar, which fell almost 1% yesterday. While the pace of the gold rally may have slowed at the turn of the year, the path of least resistance is still higher for now as the dollar is hitting multi-month lows and the Fed's tone has shifted considerably in favor of the doves.

Weekly EIA Analysis and Oil Update

The calendar is always a major influence on oil and refined product storage as physical traders square their books into year end and position into the new calendar year with taxes in mind. That appeared to be the case in yesterday's weekly EIA report as there was a modest 1.7M bbl draw in oil stocks but significant builds in both gasoline, +8.1M bbls, and distillate inventories, +10.6M bbls. On balance, the report was bearish. Despite the discouraging industry report, WTI rallied 5.02% on the day thanks optimism about OPEC cuts and rising odds of a U.S.-China trade deal.

The headline crude number was in line with expectations but well below the -6.1M bbls the API reported while the product builds were much larger than analysts expected as well as higher than even the sizeable API figures. That led to a sharp pullback in the energy space in the wake of the release.

U.S. production was unchanged on the week, remaining at the record high of 11.7M b/d. Meanwhile, the Strategic Petroleum Reserve was unchanged on the week further suggesting that the DOE has at the very least paused their attempts at keeping energy prices in check after the more-than-30% correction in Q4.

Bottom line, the EIA reports before and after the turn of the year tend to be volatile, and as a result, yesterday's bearish figures were largely shrugged off as WTI hit new session highs within an hour after the print. Right now, the fact that "OPEC and friends" appear to be taking the latest round of production/export cuts (that just went into effect this month) seriously is being well received by the market, as energy futures all rallied into their respective resistance zones yesterday. Additionally, from a demand standpoint more progress on a potential trade deal with China is a bullish development for energy. Looking ahead, the $53-$54/barrel area in WTI still appears to be formidable resistance, but a break above could see prices run back into the low $60/barrel range on momentum alone, especially if fundamental headlines and catalysts continue to favor the bulls.

Currencies & Bonds

Dovish Fed speak continued to weigh on the dollar Wednesday as the greenback dropped to three-month lows. The Dollar Index fell 0.72%.

There was some decent European data out on Wednesday, specifically EU unemployment, which dropped to 7.9% vs. (E) 8.1%, but that wasn't the reason the dollar fell sharply. We know that because at 8:00 a.m. the dollar was down only modestly vs. major currencies.

That dollar decline really accelerated into and through the early morning, and that revealed the negative catalyst was a series of dovish comments by numerous Fed speakers, including Atlanta Fed President Ralph Bostic, Chicago Fed President Charles Evans, and Boston Fed President Eric Rosengren. Bostic and Evans spoke at 8:20 and 9:00 a.m., respectively, and without boring you with the specifics, their message was clear: both think the Fed needs to pause the rate hike cycle until there's more clarity on the direction of economic growth in the U.S.

Rosengren echoed those comments later in the morning at 11:30, thereby creating a trifecta of dovish voices that largely reinforce Powell's dovish comments from last Friday.

The Dollar Index dropped throughout the morning before hitting a low just before noon (after Rosengren had spoke). And as you'd expect given the magnitude of the dollar decline, the gains by foreign currencies vs. the dollar were nearly universal.

The euro surged 0.92%, aided by the better-than-expected unemployment number, while the pound rose 0.6% as uncertainty is cresting ahead of the January 15 vote on Parliament on the Brexit deal. But, that uncertainty continues to be a headwind on the pound broadly.

Bottom line, it's clear that the Fed is rhetorically shifting to a more dovish policy stance. And, they are trying to communicate that to markets, not just via the Fed Chair but also via the regional governors. Looking forward, today both Vice Chair Clarida and Powell speak, and we'd expect them to continue this dovish verbal barrage that stresses a "pause" in the rate hike cycle. While that won't directly cause a material rally (dovish Fed rhetoric is now largely priced in), it is a general tailwind, and in a market that badly needs it, that's a least a mild positive.

Turning to bonds, the 10-year yield didn't react to the dovish rhetoric as it rose 1 basis point. And that makes sense because it's growth and inflation expectations that drive the long end of the Treasury yield curve, not Fed policy. And, nothing yesterday changed on the growth or inflation front (although that might change tomorrow with the CPI report).

The 2-year Treasury yield did decline on the dovish rhetoric, as the expectations for another Fed rate hike in 2019 fell. The 2-year yield dropped 2 basis points to 2.56% and the 10's-2's spread widened to 17 basis points.

There was a 10-year Treasury auction that saw decent demand despite the yield being at a one-year low, but singular auctions are impacted by a lot of different, idiosyncratic reasons, especially at the end and beginning of each calendar year. Point being, I don't think there are a lot of actionable takeaways from the auction.

Bottom line, the Fed is rhetorically turning dovish and that's weighing on the dollar, but we're still only at October levels. To get the dollar to decline more materially we need better foreign economic data like we saw Wednesday from the EU Unemployment Rate.

Until we get more data like that, I'd consider the dollar rangebound as opposed to outright declining—which is not a tailwind for stocks.

Have a good day,

Tom

1/10/2019

SEVENS REPORT

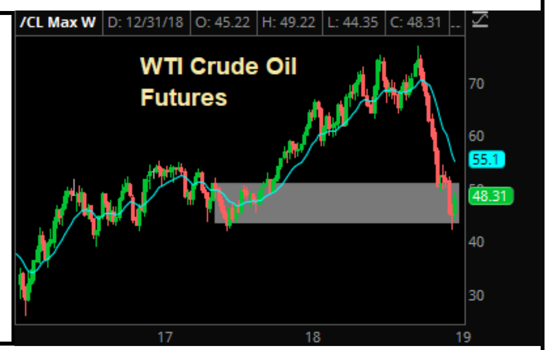
Technical Perspectives (Updated 1/6/18)

S&P 500

- Technical View: Volatility has persisted throughout 2018, and material cracks have recently emerged in the long-term uptrend in the equity markets.
- Dow Theory: **Bearish (Since the week of December 3, 2018)**
- Key Resistance Levels: 2560, 2599, 2651
- Key Support Levels: 2491, 2442, 2351

WTI Crude Oil

- Technical View: The long-term uptrend in oil broke in October, and while near-term momentum is still lower, the medium-term outlook now is neutral.
- Proprietary Model: **Neutral (Since the week of October 29, 2018)**
- Key Resistance Levels: $49.47, $50.31, $52,61
- Key Support Levels: $46.61, $45.12, $42.68



Gold

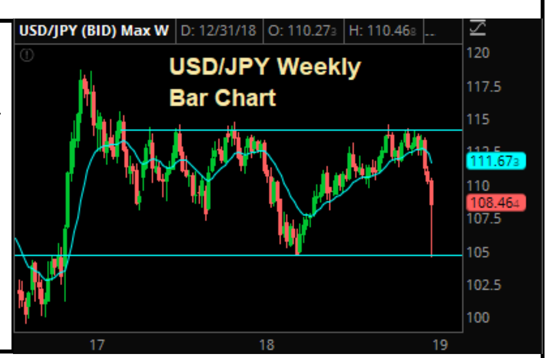
- Technical View: The sharp drop in gold from the summer paused in recent weeks and futures began trending higher, confirmed by last week's new multi-month highs.
- Proprietary Model: **Bullish (Since the week of December 2, 2018)**
- Key Resistance Levels: $1303, $1322, $1337
- Key Support Levels: $1270, $1246, $1223

10 Year T-Note Yield

- Technical View: The 10-year yield has fallen significantly in Q4 and ended at multi-month lows last week, suggesting the path of least resistance is now lower.
- Proprietary Model: **Bearish (Since the week of December 17, 2018)**
- Key Resistance Levels: 2.686, 2.792, 2.850
- Key Support Levels: 2.599, 2.554, 2.497

Dollar/Yen

- Technical View: The dollar/yen broke out through 2017 trend resistance in July, shifting the trend from bearish to neutral for the medium term.
- Proprietary Model: **Neutral (Since the week of July 9, 2018)**
- Key Resistance Levels: 108.86, 110.29, 112.43
- Key Support Levels: 107.65, 106.74, 105.88



SEVENS REPORT

Fundamental Market View
(Updated 1/6/2019)

Near-Term General U.S. 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: **Neutral** **SPHB: 50% SPLV: 50%**	*A huge Friday rally, which was powered by a blowout jobs report and dovish commentary from Fed Chair Powell, resulted in stocks logging a solid rally to start the year. There are clearly some troubling signs about global economic growth, but a global slowdown is not a foregone conclusion, and at the beginning of 2019 stabilization in global economic data will be the key to this market finding a bottom.*

Tactical Allocation Ideas:

- **What's Outperforming: Utilities (XLU), consumer staples (XLP), healthcare (XLV and IHF) and value sectors (IVE). Top domestic contrarian ideas continue to be banks, industrials and value more broadly. What I would allocate to right now (tactical long but not contrarian): High free cash flow producing companies.**
- **What's Underperforming: Tech (XLK), super-cap internet (FDN), commodities (DBC) and growth/higher-beta sectors.**

Long Term Fundamental Outlook for Other Asset Classes

	Fundamental Outlook	Market Intelligence
Commodities	**Neutral**	*Commodities surged last week thanks to a weaker dollar and a big bounce back rally in oil. Looking forward, the trade truce with China will be a positive for commodities broadly, likely driving gains in copper and stemming losses in energy, but the still-conflicting current trends leave the outlook neutral for now.*
US Dollar	**Neutral**	*The Dollar Index dropped modestly last week thanks to disappointing economic growth combined with dovish Fed rhetoric. Economic growth remains solid in the U.S., and unless we see overseas data catch up in a big way, the path of least resistance will be higher for the buck.*
Treasuries	**Bearish**	*The 10-year Treasury yield fell 5 basis points last week despite a 12-basis-point rally on Friday, as bad economic data fueled more U.S. growth concerns. Broadly, we still maintain the uptrend in yields remains in place, but for Treasury yields to begin to move higher and the yield curve to steepen, we'll need to see solid global and U.S. growth.*

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.