SEVENS REPORT

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

September 21, 2017

Pre 7:00 Look

- Futures are basically unchanged as there was no market moving news overnight.
- There were multiple central bank decisions yesterday beyond the Fed (including the BOJ), but like the Fed, they all met expectations and as such aren't moving markets.
- Economically, the only notable report was Japan's All Industry Index, which slightly missed estimate (-0.1% vs. (E) 0.2%.
- Econ Today: Jobless Claims (E: 303K), Philly Fed (E: 18.0), FHFA House Price Index (E: 0.4%).

Market	Level	Change	% Change
S&P 500 Futures	2,504.00	-1.25	-0.05%
U.S. Dollar (DXY)	92.225	-0.07	-0.08%
Gold	1,297.70	-18.70	-1.42%
WTI	50.50	-0.19	-0.37%
10 Year	2.277	.034	1.52%

Equities

Market Recap

Stocks rallied to all-time highs yesterday despite a hawkishly interpreted Fed announcement that initially weighed on the indices. The S&P 500 closed up 0.06%.

Stocks opened flat yesterday as sideways trade continued with a sense of "Fed paralysis" hanging over the market ahead of the FOMC statement and Yellen's presser. There was a mild selloff midmorning after some soft housing data (Existing Home Sales missed but the release was largely written off due to Harvey), but the selling eased as quickly as it started and the S&P settled into a 5-point trading range where it remained until the FOMC release at 2:00 p.m.

Gold futures did selloff as part of the hawkish reaction to the FOMC yesterday, but futures held key support at $1300 and the broader trend remains higher for now.

Initial reaction to the Fed decision was hawkish, and while that helped the components of the reflation trade (notably banks), profit taking in the 2017 outperformers was more pronounced and that weighed on the major averages (more on that below).

But, while the reaction to the Fed was hawkish, the actual meeting itself almost perfectly met expectations, so after dipping to a new low for the week on the whipsaw reaction to the Fed, stocks stabilized broadly and the S&P 500 rebounded back towards the unchanged mark. The benchmark index ended with a very slight gain, but that was all that was needed for another all-time high.

Trading Color and Bottom Line: Is It Time To Allocate to Our "Reflation Basket"?

There's a simple question that we need to address following the Fed's hawkishly interpreted announcement: *"Is it now time to rotate out of defensives (super-cap internet, healthcare, utilities, staples) and into cyclicals/*

Market	Level	Change	% Change
Dow	22,412.59	41.79	0.19%
TSX	15,389.60	96.63	0.03%
Stoxx 50	3,542.69	17.14	0.49%
FTSE	7,276.18	4.23	0.06%
Nikkei	20,347.48	37.02	0.18%
Hang Seng	28,110.33	-17.47	-0.06%
ASX	5,655.42	-53.67	-0.94%

Prices taken at previous day market close.

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reflationary sectors?"

I bring this up for two reasons.

First, getting this rotation right was the key to outperforming in 2016, and I don't think it will be different this year. Second, there are growing signs that it may be time to make this tactical rotation.

Looking at the sector trading yesterday, it was a classic "reflation rotation." Tech, utilities and consumer staples (sectors that have outperformed YTD) all lagged the market while cyclical sectors (which have badly underperformed) rose. Meanwhile, banks surged 1.1%, energy rose 0.35% and industrials gained 0.73%, while consumer discretionary rallied 0.34%. Additionally, small caps (which have been laggards YTD but are playing catch up in a hurry), rose 0.35% and the Russell 2000 was again the best-performing major index.

Market	Level	Change	% Change
DBC	15.40	.11	0.71%
Gold	1302.1	-8.50	-0.65%
Silver	17.075	-.204	-1.18%
Copper	2.9570	-.0125	-0.42%
WTI	50.59	.69	1.38%
Brent	55.81	.91	1.66%
Nat Gas	3.089	-.033	-1.06%
RBOB	1.6496	-.0054	-0.33%
DBA (Grains)	19.11	.23	1.22%

Prices taken at previous day market close.

So, to answer the question of whether we need to begin to rotate into these cyclical sectors, I believe the answer depends on your time frame.

For medium- and longer-term investors, I continue to believe the answer is "no," or at least "not yet."

However, for short term oriented, tactical traders/investors, legging into some reflation/cyclical sectors at these levels could make sense.

For medium and longer term investors/advisors, I'm looking for two key indicators to tell me when to rotate into cyclicals.

First, I want to see the bank index ($BKX) hit a new high for the year. That means trading above $99.77, and closing above $99.33 (so call it 100 to make it easy).

Second, I want to see 10-year yields close above 2.40% (currently 2.28%).

If those two signals are elected, then for medium- and longer-term advisors/investors, I would advocate booking (large) profits in healthcare (XLV/IHF/IBB), super-cap internet (FDN), consumer staples (XLP) and utilities (XLU).

And, I would advocate allocating those dollars to our **"Reflation Basket"** we introduced earlier this summer: KRE/KBE (bank exposure), XLI (global industrials), IWM (small caps), TBT/TBF (short bonds). Additionally, I view yesterday's price action as position for European financials and EUFN specifically.

Again, for those investors who are nimble and can stand some pain, establishing positions now does make some sense. But, for the remainder (again medium – and longer-term investors) I'd wait until those two indicators (BKX and 10-year yield) have been elected.

Regardless, we are witnessing a potential sea change in the outlook for central bank policy, and that's going to require more vigilance on the part of advisors and investors.

If the global rate-hike cycle is now underway, then the proverbial hour glass just got flipped and the sand is now running out on the eight-year bull market (more on that in tomorrow's issue).

Economics

FOMC Meeting

- The Fed left rates unchanged, as expected.
- The Fed announced the commencement of balance sheet reduction in October, as expected.

Takeaway

The Fed meeting largely met our "As Expected" scenario, as there were minimal changes to the statement (just a few lines about the transitory economic effects of the Hurricanes and the October data for balance sheet reduction).

Additionally, the "dots" were basically unchanged. The median dots for 2017 showed one additional rate hike (in December) and three hikes in 2018—both unchanged from June. There was one mild change, however, as one Fed governor saw two hikes in 2017, so a hike in November and December. But that was just one Fed official,

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and certainly not anyone in Fed leadership (Yellen/Fischer/Dudley).

Finally, Yellen offered no real surprises in her press conference.

From a market standpoint, as I cautioned, there was a hawkish reaction to the decision, not because the Fed was hawkish, but instead because the market had convinced itself (incorrectly) that the Fed was becoming more dovish.

Frankly, the odds of a Fed rate hike in December should never have fallen to 30%, so we saw a natural correction of that state yesterday despite the Fed almost perfectly meeting expectations. I expect this hawkish correction in market expectations will continue a bit longer, especially if we get good PMIs on Friday.

But, from a Fed outlook, the major takeaway is that nothing has changed. The Fed wants to hike rates in December, and as long as inflation or growth doesn't roll over materially, they will do so. And, if inflation picks up momentum, look for the prospect of four rate hikes in 2018, which could become a headwind on stocks into late-2017 or early 2018—but it's not a worry yet.

Bottom line, nothing the Fed did yesterday will, by itself, derail this 2017 rally.

Commodities

The two big catalysts for the commodity markets yesterday were the EIA report for energy futures in the morning and the Fed events for metals in the afternoon. The former resulted in oil and refined product gains and the latter weighed on the metals complex. The commodity tracking index ETF, DBC, rose 0.78% thanks to oil's gains.

Market	Level	Change	% Change
Dollar Index	92.458	.665	0.72%
EUR/USD	1.1871	-.0123	-1.03%
GBP/USD	1.3460	-.0043	-0.32%
USD/JPY	112.50	.91	0.82%
USD/CAD	1.2360	.0068	0.55%
AUD/USD	.8001	-.0009	-0.11%
USD/BRL	3.1385	.0030	0.10%
10 Year Yield	2.277	.034	1.52%
30 Year Yield	2.821	.008	0.28%
Prices taken at previous day market close.			

Beginning with gold, trade was choppy and range bound yesterday as the consolidation of the recent pullback was digested ahead of the Fed. Once the FOMC statement printed, the rebound bid fell out from under the precious metals and gold futures fell $20 from the highs, briefly dipping below the psychological $1300 mark. Futures stabilized, however, and gold ended the day down 0.37% near $1305.

Bottom line, the market's slightly hawkish interpretation of the Fed was bearish for gold, but futures did hold key support at $1300, which was previously a stubborn resistance level (which usually means it will now become a stubborn support zone). For now, the profit-taking pullback is still underway, but the recent run into the mid $1300s leaves the risk higher for gold. If, however, the hawkish reflation money flows accelerate (i.e. rates breakout), gold bulls will have trouble keeping prices above $1300 for long.

Copper futures pulled back slightly yesterday largely thanks to the post-Fed rally in the dollar. Copper, however, traded with more resilience than gold, only declining 0.30% on the day, and futures are showing signs of stabilizing as they test support between $2.90-$2.95. The late-summer rally was substantial and the market was due for a pullback, but the dominant trend remains higher for now, and that is an encouraging sign for the health of the global economy.

EIA Analysis and Oil Update

Oil futures have been range bound so far this week, with WTI largely stuck between $49.75 and $50.75. And while the US benchmark did make a new high above $51 yesterday, futures failed to close above the upper end of that range at least partially thanks to the details of the EIA report (and partially thanks to the dollar). WTI finished the day up 1.44%.

Beginning with the headlines, oil stockpiles rose 3.0M bbls, which was more than analysts expectations (+2.6M) and more than the API Report showed (+1.4M). In the products, gasoline remains the main focus in the wake of Harvey. The print showed an in line -2.1M bbl decline in inventories, yet that was much smaller than the API's -6.1M bbl draw. On balance, the headlines were slightly bearish as oil rose more than expected and gasoline fell less than esti-

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mated.

In the all-important details of the report, domestic oil production continued to rebound following the adverse effects of Hurricane Harvey. Lower 48 production rose 179K b/d, which brings the two-week total increase to 761K; almost all of the 783K b/d knocked offline due to Harvey. At first glance, this seems bearish. Yet in reality the market views it as slightly bullish. That's because, as far as markets are concerned, it is as though US production has been edging lower since late-August. Over the last month, the average weekly output increase fell from 25.5K b/d to 21.8K b/d. It doesn't seem like much, but annualized, that is over 190,000 barrels per day less than the trend suggested as recently as mid-August.

Looking ahead, it will continue to be important to see whether the rebound continues and if the weekly average increase edges back towards recent levels and total production makes new 2017 highs, or if things continue to level off in the US oil production complex. The former scenario would obviously have bearish implications while the latter would be supportive of a retest of the 2017 highs in the mid-$50s.

Broadly speaking, market focus is on more than just US production trends as the OPEC/Non-OPEC meeting tomorrow could potentially spark a rally if export controls are mentioned. Additionally, the IEA's recent upward revision to demand estimates for 2017 and 2018 also are adding to the bullish sentiment. Bottom line, the market remains range bound right now as fundamentals become less bearish and the technical outlook continues to improve. But that could change in a hurry if OPEC disappoints (again) or if the US oil production machine roars back to new multi-year highs in the coming weeks.

Currencies & Bonds

Currency markets were flat until the FOMC meeting, at which point we saw a decidedly hawkish response that was again more a function of unreasonably dovish expectations rather than an actual hawkish meeting. The Dollar Index rose 0.8%.

The Fed was the major influence on the currency markets Tuesday, as both the dollar, euro and yen were all flat heading into the meeting at 2:00 p.m. Following the release, we saw an immediate hawkish move as the euro and yen both came for sale, and that selling lasted the entire afternoon.

Both the euro and yen dropped 0.8% on a further unwind of the "short dollar/long everything else" trade that worked so well throughout 2017. And, since the euro and yen have been some of the biggest beneficiaries of that trade in 2017, they suffered some of the steepest declines Wednesday.

Stepping back, while in the short term it seems as though the dollar downtrend may be ending, it's important to realize that the Dollar Index needs to trade into the mid-94 region (currently 92.40) to really "break" the 2017 downtrend. Now, the Fed meeting (and expected rate hike) does imply we might have seen the lows in the dollar for 2017, but again, we'll need better inflation data and stronger economic growth to cause a decisive break of that 2017 downtrend. Point being, UUP is looking better, but it's not in a medium-term uptrend, yet.

Looking internationally, the only notable mover was the pound, which initially was up more than 0.5% vs. the dollar on Wednesday following stronger-than-expected British retail sales (1% vs. (E) 0.1%). The pound gave back those gains and actually closed modestly lower on the day (down 0.19%) following the dollar strength. I point this out only to highlight just how ubiquitous the dollar weakness has been in 2017, and if that trend is changing, then we should see universal strength in the dollar going forward (and that includes the pound, despite the potential for rate hikes by the BOE).

Turning to bonds, 10-year Treasury yields were flat ahead of the meeting; however, given the hawkish reaction, the 10-year yield rose four basis points to 2.28%, above a short-term downtrend at 2.27% but still below the ultimate resistance at 2.40%. Near term, given the number of head fakes in yields over the past year, I'd like to see a few closes above 2.28% before betting more positive on inverse bond ETFs (TBT/TBF). Yet for the first time since early July, there's hope for us bond bears. Now we need inflation and economic data to turn better and help push yields higher.

Have a good day—Tom.

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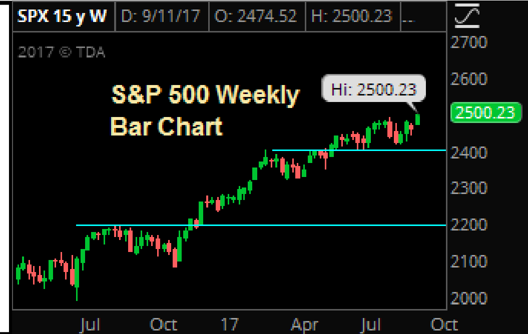
Technical Perspectives

(Updated 9/17/17)

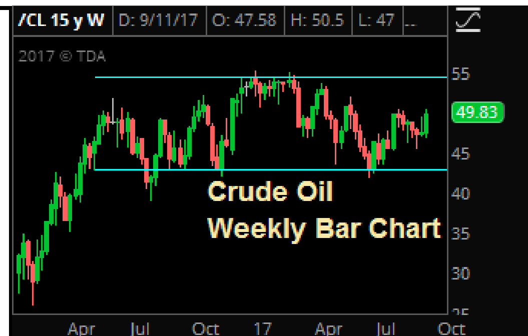
S&P 500

- Technical View: The S&P 500 hit a new all-time high last week and the dominant trend remains decidedly bullish.
- Dow Theory: **Bullish (Since the week of November 7, 2016)**
- Key Resistance Levels: 2408, 2525, 2536
- Key Support Levels: 2492, 2475, 2445



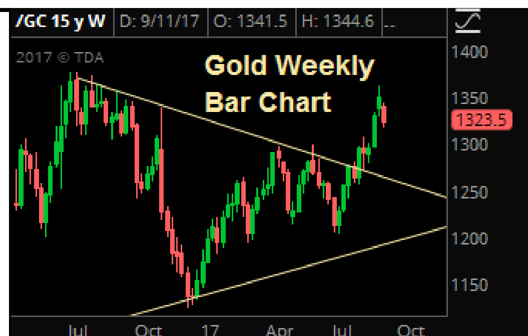
WTI Crude Oil

- Technical View: WTI futures have been stuck in a sideways range for over a year now, but the price action continues to favor the bears.
- Proprietary Model: **Neutral (Since the week of July 24, 2017)**
- Key Resistance Levels: $51.30, $52.91, $54.02
- Key Support Levels: $49.11, $48.10, $46.31



Gold

- Technical View: Gold broke through resistance at $1300 in late August, and the dominant trend is now bullish.
- Proprietary Model: **Bullish (Since the week of August 28, 2017)**
- Key Resistance Levels: $1351, $1370, $1388,
- Key Support Levels: $1313, $1296, $1266

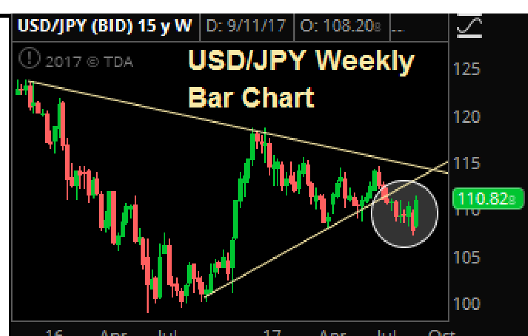


10 Year T-Note Yield

- Technical View: The 10-year yield had been in a sideways range since the election, but just recently began to break down, and the trend is now bearish.
- Proprietary Model: **Bearish (Since the week of September 4, 2017)**
- Key Resistance Levels: 2.226, 2.328, 2.371
- Key Support Levels: 2.157, 2.061, 1.957

Dollar/Yen

- Technical View: The dollar/yen broke through uptrend support recently and the currency pair is now trending lower.
- Proprietary Model: **Bearish (Since the week of July 24, 2017)**
- Key Resistance Levels: 111.16, 112.45, 113.93
- Key Support Levels: 109.21, 108.44, 107.77



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Fundamental Market View
(Updated 9/17/17)

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%	*Stocks rallied to fresh highs last week thanks to hints of an economic "reflation" and rekindled hopes for tax cuts. The medium-term trend in stocks is still higher, but we remain cautious simply because the market is trading at high valuations while a lot of positives (not-hawkish Fed, tax cuts in early 2018) are already priced into stocks. Meanwhile, low VIX continues to imply complacency ahead of the reduction of the Fed balance sheet.*

Tactical Allocation Ideas:

- **What's Outperforming: Healthcare (our #1 domestic contrarian idea: IHF, XLV, IBB), Europe (HEDJ, EZU), super-cap internet/ social media stocks (AMZN, FB, GOOGL, FDN is a good internet ETF), Short Duration TIPS ETF (VTIP).**
- **What's Underperforming: Small caps, financials/banks, retailers.**

Long Term Fundamental Outlook for Other Asset Classes

	Fundamental Outlook	Market Intelligence
Commodities	**Neutral**	*Oil surged 5% last week thanks to bullish supply data and supply-related rhetoric from OPEC. Meanwhile, gold dropped 2% on a general risk-on move in markets. For 2017, we view commodities' performance as likely more differentiated than in recent years, as commodities now trade off individual supply/demand outlooks as opposed to a macroeconomic proxy.*
US Dollar	**Bullish**	*The Dollar Index bounced modestly last week as lackluster growth data (retail sales/IP) offset stronger-than-expected CPI. Longer term, we remain generally positive on the dollar, especially in light of recent extreme weakness. In an absolute sense, barring an economic slowdown, the Fed will remove accommodation more quickly than Europe or Japan, which is long-term dollar bullish.*
Treasuries	**Bearish**	*Ten-year Treasury yields staged a big rebound as the 10 year rose 15 basis points following better-than-expected global CPI reports. And despite the overall near-term weakness, big picture, we continue to look for longer-term bond declines, and that's because the US outlook for monetary and fiscal policy is much more hawkish than the rest of the world. The broader trend of higher bond yields is here to stay barring any big economic slowdown.*

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.

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