7:00's Report

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

March 16, 2012

Up, Up & Away: The Banking Index (BKX) has leapt higher since the announcement of the results of the "Stress Tests." The index is overbought, but historically we're still at good valuations in most banks.

Pre 7:00 Look

- U.S. equities flat on an extremely quiet night with no incremental news.
- Reports continue to contradict themselves over whether Obama will release oil from the Strategic Petroleum Reserve.
- Keep in mind today is quarterly options expiration (known as a quadruple witching) so indices could be volatile.
- Econ Today: CPI (E: .5%, Core .2%), Industrial Production (E: .5%).

Market	Level	Change	% Change
S&P 500 Futures	1396.25	.50	.04%
U.S. Dollar (DXY)	80.745	.24	.30%
Gold	1647.50	-12.0	-.47%
WTI	105.17	.04	.04%
10 Year	2.30	.02	.86%

Equities

Stocks rallied strongly again on Thursday and set new highs for the year (S&P up .58%). The S&P broke through 1400 for the first time in nearly 4 years.

There wasn't anything specific news wise on Thursday to push stocks higher, although all the small incremental stuff we got (jobless claims, Spanish auction, Empire/ Philly Fed) was all good.

From an internals perspective, the last 48 hours has helped resolve some of the divergences that I and others have been pointing out as late as yesterday. The "right' groups have outperformed this week, with the banking sector, semi conductors, industrials and transports all significantly outperforming on Thursday.

The Transports in particular, which had a lot of people concerned, rallied strongly (up 3.27%) on Thursday on the back of positive comments from CSX and NSC at a JP Morgan Transportation conference which alleviated worries about the coal market (which is a major source of revenue for rails).

The bottom line is the market continues to make new highs, and given the amount of underperformance out there, I expect we'll continue to see a lift at least into quarter end. I think performance chase will intensify as we end the month, so I would expect pull backs to be very shallow.

I know I keep being Debbie Downer by not throwing myself into this rally, but the market has become very complacent in my view, and virtually every piece of bad news is dismissed. That usually doesn't end well. For now though, the ride continues.

Market	Level	Change	% Change
Dow	13252.76	58.66	.44%
TSX	12455.82	77.92	.63%
Brazil	67749.49	-507.73	-.74%
FTSE	16993.31	142.99	.85%
Nikkei	10123.28	72.76	.72%
Hang Seng	21353.53	45.64	.21%
ASX	4277.77	-9.41	-.22%
Prices taken at previous day market close.			

Economics

It was a busy day for economic releases, and on balance I'd say the data was pretty good, in that it showed continued growth in manufacturing and employment, and no real uptick in cost inflation for businesses.

Market	Level	Change	% Change
Gold	1661.80	19.10	1.16%
Silver	32.67	.49	1.54%
Copper	3.89	.05	1.21%
WTI	105.12	-.31	.28%
Brent	122.77	-1.81	-1.45%
Nat Gas	2.28	0.00	0.00%
Corn	6.66	.07	1.14%
Wheat	6.64	.20	3.15%
Soybean	13.68	.17	1.31%
Prices taken at previous day market close.			

Weekly Jobless Claims

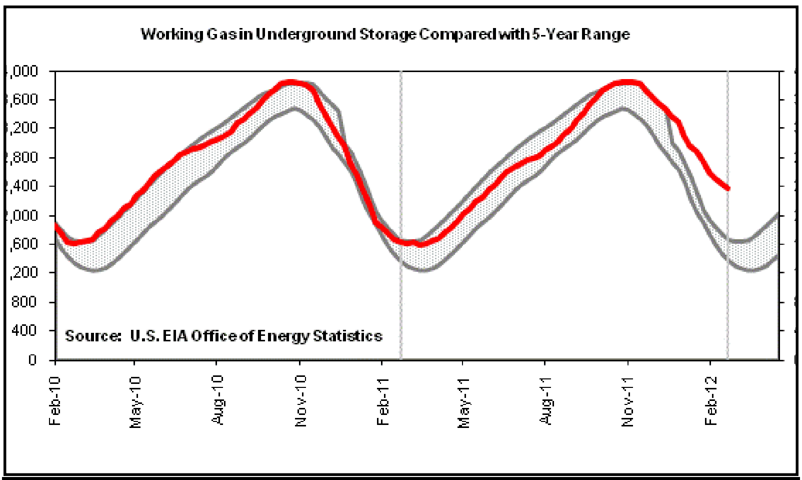
- Weekly Claims were 351,000 vs. (E) 355,000.
- Last weeks claims revised up 4,000 to 365,000.
- 4 week moving average unchanged.

Effect

No real effect on markets. Stocks were up marginally ahead of the release and stayed that way.

Takeaway

Steady as she goes in the jobs market. Things continuing to improve, albeit very slowly. The only thing that is a bit concerning is that the revisions to the data have all been higher for the past several weeks.



I'm long natural gas for a 20 or 30 cent short term trade. Longer term, there is a large supply glut that has to be worked out. Keep in mind, though, that over the long term that the best cure for low prices....is low prices.

I think that's why this number, while a beat, didn't really help push equities higher. The four week moving average stayed at the same level from last week. Bottom line is it shows the jobs market continuing to improve ever so slightly.

Empire Manufacturing

- March index 20.21 vs. (E) 17.50
- New Orders fell to 6.84 in March from 9.73 in February
- Prices paid index jumped higher to 50.62 from 25.88 in Feb.

Effect

There was little effect on equities off the release. While the headline number was a beat, the internals were a little disappointing, so the number was viewed as pretty neutral.

Takeaway

Empire and Philly Fed are important numbers for the market because they give us the first look at the current month's data (in this case March).

The bottom line on Empire is that manufacturing in the New York region continues to be strong, but the pace of growth is slowing.

We know that because the new order component of the index, which is a leading indicator, continues to slide lower, telling us that manufacturing is growing (because it's above zero, but the pace of growth is slowing).

The other important component of the release was the prices paid index. It jumped the most since the summer of 2011. This is important for 2 reasons:

First, if manufacturers are experiencing this amount of cost increase then that raises concerns about margin compression should they not be able to pass those increases on to their customers.

Second, it's another sign of accelerating inflation, and as these signs mount, pressure will be on the Fed to begin targeting inflation, which could mean tightening of monetary policy down the road.

Despite those longer term concerns, though, is this is a solid report.

Producer Price Index

- Month over month change .4% vs. (E) .5%
- Core PPI (less food & energy) .2% vs. (E) .2%

Effect

No real effect on markets as this number was basically in line with expectations.

Takeaway

Longer term readers know my dislike of monthly inflation numbers, and in particular any measure of inflation that removes food and energy.

But, the Fed watches these numbers so we have to also. The bottom line on today's release is there wasn't anything in it that shows inflation is accelerating, so from a Fed watching point of view it was pretty benign. Keep in mind, though, that this is a contradiction of what we saw out of the prices paid index in Empire Manufacturing.

Philadelphia Fed Manufacturing Index

- Business Conditions Index was 12.5 vs. (E) 11.5
- New Orders declined to 3.3 from 11.7 in February.
- Prices Paid index fell to 18.7 from last month's 38.7.

Takeaway

The Philly survey confirmed what we saw in Empire in as much as business activity continues to expand, although the pace of that growth is slowing.

Interestingly, the prices paid index fell sharply, refuting the rise in Empire. On balance, if we look at Empire, Philly and PPI, then the data shows that cost inflation, at this point, isn't too much of a concern, regardless of the Empire reading.

That is good for stock prices because again it'll keep any interest rate increase or hawkish Fed action off the table.

Market	Level	Change	% Change
Dollar Index	80.585	-.396	-.49%
Euro	1.3097	.0074	.57%
Pound	1.5722	.0048	.31%
Yen	1.1992	.0045	.38%
CAD $	1.0086	.002	.20%
AUD $	1.0542	.0105	1.01%
Brazilian Real	.54465	.0023	.42%
10 Year Yield	2.281	.007	.31%
30 Year Yield	3.412	.004	.12%
Prices taken at previous day market close.			

Commodities

GRAIN markets were much higher in trading yesterday (Corn, Wheat and Soybeans were up between 1% and 2% on the day).

Something very interesting happened in the corn market yesterday as May corn traded to a premium above July corn. That hasn't happened since 1996, and it reflects the relative dichotomy in the corn market, where demand for "old crop" (which is last years crop) is very high because of exports, while anticipated supply for "new crop" which is the crop to be planted this summer, is expected to be very large as more acreage will be planted. So, the dichotomy is bullish "Old crop" because of high demand, and bearish "new crop" because of a lot of anticipated supply.

I'll talk more about that dichotomy in the future and how we can try and make some money off of it, but the bottom line is that is a very bullish indicator for corn (in particular the May contract) and for those technical traders, this is a breakout that should absolutely be bought.

GOLD and SILVER both acted well in trading Thursday, starting the day lower and basically going out at the highs of the day. For yesterday, at least, gold appears to have held that support at $1640 which I highlighted in the chart in yesterday.

There wasn't any real specific reason for gold's bounce other than a weaker U.S. dollar. But we also have to consider just how oversold gold had become in the shorter term. In that context, a bounce of some sort seems logical, whatever the reason.

For me, this remains a bit of a no-mans land in gold, and although I think taking a shot at $1640 yesterday made sense, for those who did I'd suggest stopping that position flat.

At these levels, I suggest we all watch gold until it tells us which way it wants to go.

NATURAL GAS saw a greater than expected inventory draw which helped it turn positive shortly after the release at 10:30 AM. The weekly draw was 64 Bcf vs. expected 59 Bcf. Natural Gas continues to consolidate in the 2.25-2.35 region, and I continue to feel comfortable with long exposure there.

WTI CRUDE had a volatile day. It started trading Thursday higher, but then a rumor flew around desks that Obama was about to open the SPR (he talked to UK PM Cameron about it while he was visiting the White House) and crude traded down a quick 2 dollars. But, as the rumor was proved false, crude traded back to flat.

The only other thing interesting regarding crude was the fact that a report surfaced that the U.S. had asked the Russians to tell the Iranians that this latest round of negotiations would be the last available. This also coincided with a late headline hitting the tape that the EU had cut Iran out of the SWIFT interbank system, effectively stopping anyone in Europe from sending money into Iran.

We've gotten a bit quiet out of the middle east over the past 3 weeks, and crude has sold off accordingly. But, perhaps that trend is coming to an end. Cutting Iran out of SWIFT is not a subtle move.

Currencies & Bonds

Treasury bonds were flat on Thursday, and given their run up it's not surprising that they took a bit of a breather. Nonetheless, it looks like the breakout has held—either that or this is the greatest head fake of all time.

Things weren't so quiet in currencies, as the U.S. dollar was decently lower in trading, falling .6%. The Euro bounced as I thought it might, and the reason was the better than expected Spanish debt auctions that we saw Thursday morning.

Given the recent slide we've seen in the Euro and the rally we've seen in the U.S. dollar, a bit of a pause in both was in order—and that is exactly what we got yesterday.

Finally, the Yen has finally bounced after going down multiple days in a row and the only question we need to worry about now is "Where do we re-short it." Given the magnitude of its decline, and taking a quick look at the charts, the answer to that question could very well be at the 1.2350 region (it's 1.2000 now). Bottom line is I'd wait for a bit more of a rally.

General Commentary

Getting Long Yields

So I've been making a big deal about rising Treasury yields this week, and to be sure it is a big deal, but I wanted to do a little research and see what ways there are to get "long" yields so we hopefully can all make some money (or save some money) on this move.

From an investment standpoint, there are multiple ways to get long yields.

First, and the easiest for professional investors, is to simply short the 10 or 30 year Treasury bond through the futures markets. This, however, requires you to be comfortable with trading futures and also requires a futures account, something most individual investors don't have.

Luckily, there are many ETF's that provide generally the same exposure, although there are some things to be aware of with inverse ETF's.

A lot of people try and short yields via TBT, which is the Pro Shares Ultrashort 20+ Year Treasury.

Just keep in mind that as with all leveraged ETF's, there is going to be a decent amount of slippage over the long term versus the underlying asset (in this case Treasury bonds).

Generally speaking, I don't think leveraged ETF's are good long term investments because of slippage, but at the same time if yields move much higher from here you're going to make money with TBT.

An option that will suffer a bit less from slippage and might be a better longer term holding is something like a TBF, which is the non-leveraged version of TBT.

I'll most likely choose to use that ETF given that I view this as a longer term position, one that I will most likely put in my IRA.

Finally, there is another way you can get "long" Treasury yields—and that is by taking out all the debt you think you'll need for the next couple of years.

Locking in rates now, at historic lows, is one way to effectively get long yields—because all your assets will begin earning more as yields rise, but you'll still by paying lower interest rates from before.

Either way, I believe the era of lower rates is coming to an end. It's not ending tomorrow or next week or next month, but I believe the tide has changed, and those who aren't paying attention will miss out on one hell of an opportunity.

Have a good weekend,

Tom

Positions

SHORT 1 LOT OF EURO at 1.3054

I shorted the Euro on Wednesday morning basically on the open. Although I think there is some chance of a brief rally given it's decline, the multi-month uptrend has clearly been broken. Stop at 1.3165ish.

LONG 1 LOT OF FXC (Canadian dollar ETF) AT 100.17 AND SHORT 1 LOT OF FXA (Australian Dollar ETF) at 105.16 FOR A SPREAD OF $4.99.

The Aussie leapt higher yesterday, so I'm basically back to flat in the position. I remain confident in this trade and am looking to add to it.

This trade is designed to provide us hedged exposure to commodity currencies, and take advantage of the different growth trajectories of the U.S. and Chinese economies.

For those of you who haven't traded spreads before, now that the trade is on I'll look for that spread to compress from $4.99. The smaller it gets, the more money I make.

LONG 1 LOT of NATURAL GAS at 2.3670

Natural Gas bounced a bit yesterday on the inventory data, and I remain comfortable with the trade. Stop remains at $2.20.

(A reminder for new subscriber: 1 LOT = approximately 10% of trading capital).