7:00's Report

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

July 10, 2013

Pre 7:00 Look

- Futures flat after economic data from China disappointed and the S&P downgraded Italy to BBB on economic concerns.
- Chinese trade balance for June missed expectations. Exports fell 3.1%, the first monthly decline in 17 months, and imports fell 0.7%. Chinese shares rallied, however, as the weak data has sparked hopes of a reserve ratio cut by the PBOC.
- European shares slightly lower after the Italy d/g, and on disappointment over the proposal for a pan-European agency that will close troubled banks. As usual, EU officials only went half way.
- Econ Today: FOMC Minutes (2:00 PM), Bernanke Speech(4:10 PM).

Market	Level	Change	% Change
S&P 500 Futures	1643.75	-1.75	-.12%
U.S. Dollar (DXY)	84.55	-.24	-.28%
Gold	1252.50	6.60	.53%
WTI	104.84	1.31	1.27%
10 Year	2.63	-.015	-.57%

Equities

Market Recap

Stocks extended their recent rally Tuesday, as the S&P 500 rose 0.72% thanks to positive sentiment surrounding Alcoa's (AA) earnings and the continued stability in "cross-assets" like emerging-market bonds.

Like Monday, yesterday was a pretty quiet day in the markets after the open. Once again, for the most part stocks spent the afternoon largely treading water.

There were, however, a few news items cited as "reasons" for the rally: First, as mentioned, AA earnings were taken as a positive—not so much because of the financial results, but more because of the macro outlook: AA kept aluminum demand growth estimates for '13 at 7%, and the CEO gave some upbeat commentary on China. (He couldn't say the bottom was "in" but he's currently "not concerned about China.")

Second, although the International Monetary Fund cut its global growth forecast, this was largely expected. The report didn't reveal any "new" reasons why the outlook was cut. The sequester and weakness in the emerging markets were cited as the causes for the cuts in growth forecasts, which are two issues the market already knows about and has priced in.

As an aside—while I'm sure the IMF does a lot of good in the world—if you're a subscriber to this Report, and you see a macro-economic report from the IMF that tells you about any major trend or theme in the global economy that you don't already know, then you can fire me. That's because the IMF is very good at producing beautiful reports that point out the barn door is wide open, long after the animals have already run away.

Third, the resiliency of the banking sector was taken as a positive yesterday, after the KBW Bank Index (BKX) recovered from negative territory after the recommendation of a 6% leverage ratio for the country's eight largest banks. (This followed yesterday's 5% leverage ratio for the eight largest bank-holding companies, as it was expected the leverage ratio for the banks would also be 5%). The BKX turned negative immediately following the news yesterday morning, but quickly recovered as dip-buyers moved to get exposure to the sector.

Trading Color

Unlike Monday, where the rally was accompanied by

Market	Level	Change	% Change
Dow	15300.34	75.65	.50%
TSX	12297.09	88.22	.72%
Brazil	45075.50	-134.99	-.30%
FTSE	6491.23	-21.85	-.34%
Nikkei	14416.60	-56.30	-.39%
Hang Seng	20904.56	221.55	1.07%
ASX	4901.36	19.70	.40%

Prices taken at previous day market close.

trendless sector trading, yesterday was a much more typical "risk-on" day, and it feels like this rally is starting to gain some momentum.

Market	Level	Change	% Change
Gold	1246.00	11.10	.90%
Silver	19.16	.12	.61%
Copper	3.06	-.04	-1.23%
WTI	103.23	.09	.09%
Brent	107.40	-.03	-.03%
Nat Gas	3.64	-.10	-2.78%
Corn	5.18	.17	3.50%
Wheat	6.77	.14	2.19%
Soybean	12.72	.20	1.62%
Prices taken at previous day market close.			

Basic materials were one of the leaders of the rally, despite the negative headline Chinese inflation data, as AA earnings and commentary helped commodity producers to outperform.

Industrials, thanks to positive Danaher (DHR) guidance, along with energy and homebuilders also rallied hard. Meanwhile safety sectors like healthcare and telecom lagged (although all 10 S&P 500 sub-sectors finished the day higher).

The best performing sub-sector on the day was actually transports, which is surprising given the weakness in rails due to the Quebec oil train derailment. The reason for the strong performance was FedEx (FDX), which was up more than 4% yesterday on rumors that activist shareholder Bill Ackman may be targeting the company.

Volumes again were lower than recent averages, but again that's not terribly surprising given the holiday weekend and the anticipation of the Federal Open Market Committee minutes/Ben Bernanke speech today (which are the biggest events of the week).

On the charts, the S&P 500 closed right at resistance at 1,652. That seems to be a closely watched level with expected stiff resistance, so I think it'll take a few closes above this level to pull momentum longs off the sidelines. If resistance at 1,650 is broken, however, it's a straight shot to the old intraday highs.

FOMC Minutes/Bernanke Preview

The Fed remains critical to the market, so today's Fed events today will be front-and-center like they always are. But, whatever the immediate "reaction" to the FOMC minutes and Bernanke, keep in mind that the very broad consensus is that the Fed will begin "tapering" at the September meeting. That is the baseline expectation.

With regard to the minutes, they have the potential to be a touch hawkish, as there will probably be a Fed official or two who says tapering should start in July. But, unless there are "many" Fed officials who espouse that view, it won't change September as the consensus date.

Bernanke's speech, if he touches on monetary policy at all, will likely be dovish. No doubt he will reiterate the "tapering is not tightening" refrain.

He's right, of course, but saying that doesn't change the fact that tapering will likely start in September. Unless he says that tapering might not start until '14, the comments won't really alter the baseline expectations.

Bottom Line

For all the incremental headlines over the past few days (and this morning) the rally this week is bout investors becoming more comfortable with the "tapering" narrative and the reality of higher interest rates in the future.

The fact that higher stock prices and higher rates no longer appear to be mutually exclusive is bullish for the market, and as long as that continues, expect the path of least resistance to be higher in equities.

Economics

No reports yesterday.

Commodities

Commodities continued their rally Tuesday despite the stronger dollar, as every major commodity traded higher with the exception of copper and natural gas.

Yesterday's Chinese Consumer Price Index and Producer Price Index data, while cited as an influence in the commodity markets, was really more of a wash than anything else. The 2.7% year-over-year inflation number was driven by temporary food price increases and the fact that inflation dipped in June 2012. (This makes the year-over-year number jump artificially higher.)

So, bottom line is that the inflation data wasn't a major positive or negative influence in commodity markets yesterday (outside of copper). The takeaway is that Chinese inflation remains elevated enough that the People's Bank of China won't offer more stimulus, but it's not high enough to cause any tightening, either. As a result, we can expect the PBOC to remain on the sidelines for the foreseeable future.

The one commodity that did trade off the China news was copper, which fell 1) because the data implies no further accommodation from the PBOC, and 2) the PPI declined 2.7% year-over-year, and that's worth noting because it shows continued weak demand for raw materials and industrial inputs, which implies a soft economy. The inflation report was a double-whammy for copper, and that's why it traded down 1% on the day. So, while the AA report was anecdotally positive for China, the data yesterday wasn't.

Turning to the precious metals, gold and silver both rallied 1% Tuesday, thanks to short-covering and some potentially positive developments in India.

Yesterday, the Indian government took two steps to help stabilize the plunging rupee. First, they banned banks from "prop trading" (i.e., trading with the banks' own money and not the customers') domestic currencies and currency futures. Second, they doubled the margin requirement on Dollar/Rupee forward contracts.

Again, both these efforts are aimed at helping to arrest the rupee decline. That's peripherally bullish for gold, too, because the falling rupee makes gold more expensive for Indian buyers, and they are the major source of physical demand in the market.

If gold is going to finally put in a bottom, it has to see the return of Indian physical demand.

So, over the coming months, keep in mind that a stronger rupee is bullish for gold. Whether or not the Indian government's measures will stop the rupee's fall is not yet clear, but at least they are trying. And yesterday, that helped gold recover most of the decline from late last week. Despite the recovery, however, the trend for all metals remains lower.

Energy was broadly higher, with the exception of natural gas, which gave back most of Monday's rally as temperatures look to moderate from their currently scorching levels across most of the country.

WTI crude finished the day higher and traded above $104/barrel late Tuesday on reports that the Muslim Brotherhood has rejected the proposed timetable for elections in Egypt. Also, reportedly there were more clashes and deaths between the various political factions in the country. As I've said, until Egypt calms down, WTI crude will have a hard time materially declining, but fundamentally, at $104/bbl, it's a bit ahead of itself. So, I would not be adding more exposure at these levels.

Commodities in aggregate continue to grind higher, and were up 4 out of the last 5 days. The PowerShares DB Commodity Index Tracking Fund (DBC) is through its 23- and 30-day moving averages, so now $26.00, the 50-day EMA, is in focus. Two or three closes above that level, and perhaps we've finally gotten a bottom in commodities.

Currencies & Bonds

The Dollar Index resumed its rally Tuesday, but more because of falling foreign currencies than anything particularly "dollar bullish."

The euro fell below 1.28 vs. the dollar after European Central Bank member Jorg Asmussen made several dovish comments in an interview (continuing the global "dovish" rhetoric campaign by the world's central bankers, aimed at slowing the rise in interest rates across the world). 1.2751 is the low for the year in the euro—so a break of that level opens the door to 1.2675. If that's broken, look out below, as there's little support between 1.26 and 1.20!

Market	Level	Change	% Change
Dollar Index	85.654	.461	.55%
Euro	1.2773	-.0097	-.75%
Pound	1.4860	-.0090	-.60%
Yen	101.00	.02	.03%
CAD $	.9493	.0021	.22%
AUD $	.9185	.0050	.56%
Brazilian Real	.4423	.0005	.11%
10 Year Yield	2.627	-.012	-.45%
30 Year Yield	3.647	.011	.30%
Prices taken at previous day market close.			

The pound was equally weak vs. the dollar yesterday, falling 0.52% to a three-year low vs. the dollar after UK industrial production missed expectations. The headline was certainly a disappointment, but a lot of the "miss" came from reduced pharmaceutical output, so it's not exactly a bellwether of the economy, although the manufacturing component did decline slightly in May.

But, one month does not a trend make, and as I pointed out yesterday, the UK economy appears to be finally turning toward recovery (at least for now, although the plunging pound certainty isn't going to hurt).

In Asia, the Aussie dollar continued its "dead-cat bounce," rallying 0.5% despite soft economic data, while the yen was slightly lower ahead of the start of the Bank of Japan meeting today.

Treasuries were basically unchanged yesterday , despite the Fed buying 3.15 billion of 7-10 year notes at 11 a.m. yesterday. Treasuries continue to consolidate the drop from last Friday, but the trend remains lower. At the risk of becoming a broken record, I'd use any further bounce to short the bond market or re-arrange any bond-heavy allocations.

Finally, and importantly, emerging-market debt and currencies continue to behave themselves, which is allowing stocks to continue to rally. Both EMB and PCY rallied again yesterday, and they look like they are trying to stabilize. As long as emerging bonds don't resume their implosion, stocks can continue to rally.

Have a good day,

Tom

The 7:00's Report Asset Class Dashboard

(Outlook on the primary trend for major asset classes over the next month)

	Fundamental Outlook	Technical Outlook	Overall	Comments
Stocks	**Neutral**	**Neutral**	**Neutral**	*Domestic equities rallied last week thanks to strong economic data, and it appears that the markets are becoming more comfortable with the rise in interest rates and the decline in emerging market debt and currencies.* *The S&P 500 broke through it's 50 day moving average on Friday for the first time in weeks, and now the S&P is sitting on resistance at 1652.*

Trade Ideas

Long/Overweight: **The biggest trend in the equity markets currently is the rotation out of "bond proxy" sectors and into sectors positively correlated to higher rates and more economic growth. So, banks are the most favored sector in that environment, followed by other typical cyclicals like tech, consumer discretionary, and energy. For those looking for a contrarian play, basic materials remains on of the biggest underperformers in the market, but offers value if the economic recovery turns global in the coming months. Also, after a correction, the "Long Japan" DXJ trade appears to be back "on" and I'd use any decent dip to initiate or add to positions.**

Short/Underweight: **Anything that is a "bond proxy" - Utilities & REITS especially, Telecom, healthcare & consumer staples (to a lessor extent).**

Commodities	**Bearish**	**Bearish**	**Bearish**	*Commodities continue to try and put in a bottom, but are facing stiff headwinds from a "hawkish" FOMC and a slowing growth in China. While commodities reflect a sector with some value in the market, at this point its too early to declare a bottom is "in."*

Trade Ideas

Long: **I have no great conviction as the environment is simply too unpredictable. For those looking to take some risk, and who think the global economy will see an acceleration of growth over the coming quarters, then industrial commodities offer some value, and a ETF like DBB will offer substantial upside. More broad based commodity ETF's are also a potential value at these levels, if growth stabilizes. Commodities and raw materials are the ultimate "contrarian" investment in the current market environment.**

U.S. Dollar	**Bullish**	**Bullish**	**Bullish**	*The dollar is in full rally mode, and should be given the marginal direction of change for short term interest rates in the U.S. is higher, and everywhere else in the world it is lower.*

Trade Ideas

***Short*:** **Japanese Yen on any decent bounce (YCS being the ETF to use). Short the Aussie Dollar, given a weakening economy and dovish central bank (short FXA). Short the euro on any further bounce due to the fact the ECB is squarely focused on economic growth, and won't let the currency appreciate too much as that would cause a stagnation in exports.**

Treasuries	**Bearish**	**Bearish**	**Bearish**	*Treasurys traded to new lows for the year last week on good economic data. The decline in bonds is accelerating, and every oversold bounce should be used to initiate or add to short or inverse positions.*

Trade Ideas

Buy: **TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury). SJB (inverse junk bond ETF) is also rallying during this period of global uncertainty, and basically has acted as a hedge against falling equity prices. It doesn't trade with a lot of volume, however, so buyer beware.**