

7:00's Report

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

July 12, 2013

Pre 7:00 Look

- Futures flat as markets digest yesterday's big gains.
- China remains a macro concern as o/n the Chinese finance minister said the government would be ok with 6.5% - 7% GDP growth in '13, which is lower than the current 7.5% expectation.
- Today should be relatively quiet as the focus of the market turns to earnings, which begin in earnest next week.
- Econ Today: Producer Price Index (E: 0.5%).
- Earnings Today: JPM (E: \$1.38), WFC (E: \$0.92).

Market	Level	Change	% Change
S&P 500 Futures	1671.50	1.50	.09%
U.S. Dollar (DXY)	83.165	.25	.30%
Gold	1274.80	-5.10	-.40%
WTI	104.74	-.17	-.14%
10 Year	2.574	-.106	-3.96%

Equities

Market Recap

Markets surged to new highs (either closing highs or yearly highs) yesterday after Ben Bernanke's comments reiterating that "tapering is not tightening" caused a big short-covering rally across multiple asset classes. The S&P 500 rallied 1.36% and made a new closing high.

Thursday was largely devoid of any influential news after jobless claims at 8:30 a.m. Most of the day's trading was driven by investors and traders repositioning their portfolios rather than responding to any headlines.



When EM bonds didn't sell off last Friday, that was the "tell" that the market dynamic has changed and markets were headed higher. As long as they remain stable, stocks can rally.

Stocks opened higher, and the broad consensus was that markets would come in during the afternoon. But when that didn't happen, it caused another round of short-covering during the last two hours of trading that sent stocks out basically at their highs.

Yesterday was driven by money flows and positioning, and a lot of people in the equity market were caught flat-footed (i.e., not long enough).

Trading Color

From an index standpoint, it was a "risk-on" day. Small caps and tech outperformed while the Dow lagged (although all major indices were up more than 1%). Looking at the sector trading, there was clearly some serious short-covering going on

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Market	Level	Change	% Change
Dow	15460.92	169.25	1.11%
TSX	12493.26	186.33	1.51%
Brazil	46626.26	1142.83	2.51%
FTSE	6578.03	34.62	.53%
Nikkei	14506.25	33.67	.23%
Hang Seng	21277.28	-160.21	-.75%
ASX	4973.89	8.19	.16%

Prices taken at previous day market close.

as Treasuries sold off hard. In fact, some of the most-hated sectors of the market (both recently and throughout the year) outperformed.

First, the “bond-proxy” sectors, which have been the recent market dogs, traded well. Utilities, REITs, homebuilders, telecom and healthcare all outperformed cyclical sectors. Second, basic materials—a big laggard all year—became the best-performing S&P 500 sub-sector. And finally, gold miners—probably the worst-performing sector in the market this year—rallied 8%.

But, while there was a lot of short-covering, there was also evidence of new money being put to work in cyclical, because consumer discretionary, tech and industrials all traded well (just not as well as some of the heavily shorted sectors). Financials were the only big laggard, as they rose only modestly as rates declined.

Volumes were in line with three-month averages, and there was definitely “real money” buying the market in the afternoon. While short-covering was the dominant force in yesterday’s rally, it doesn’t invalidate the move.

On the charts, the next resistance level is the old intraday high of 1,687, as the S&P 500 made a new all-time closing high yesterday. Meanwhile, the Russell 2000 made a new all-time high and Nasdaq made new highs for the year.

Bottom Line

It’s a valid point for the bears and shorts to say yesterday’s move higher wasn’t “valid” if Bernanke was the reasoning behind it. (More on “why” below). But, yesterday wasn’t really about Bernanke as much as the press made it out to be.

It was more about traders and investors being improperly positioned and not anticipating this move higher because they were still focused on the negativity surrounding the upcoming Fed “tapering.”

But, when stocks and yields rose together last Friday (thanks to the strong economic data), it showed us that

as long as emerging markets behaved and the economic data is good, the removal of QE is not a rally-killer.

Market	Level	Change	% Change
Gold	1280.90	33.50	2.69%
Silver	20.02	.86	4.46%
Copper	3.17	.08	2.81%
WTI	104.76	-1.76	-1.65%
Brent	107.66	-.85	-.78%
Nat Gas	3.60	-.08	-2.20%
Corn	5.27	.05	1.05%
Wheat	6.83	.04	.59%
Soybean	12.90	.06	.47%
Prices taken at previous day market close.			

Those reading this Report (and others—it’s not like I’m the only one who saw this) knew that on Monday. It appears the rest of the market realized it yesterday and scrambled to cover shorts and get “more long.”

Where we go from here depends on the data and earnings, which

begin in earnest next week. But, the market is making new highs, and while I’m certainly not a professional chartist, I did learn rule No. 1 of technical analysis: “You buy what’s making new highs.”

What Did Bernanke Say?

Generally speaking, I’m a “markets” guy and very, very seldom do I say that the market got something “wrong,” because I think that almost never happens. However, I think the consensus that Bernanke was “dovish” on Wednesday is “wrong.”

I’m very happy stocks rallied yesterday, given that I’ve been saying since Monday that I thought the path of least resistance in stocks is higher for now. But, citing Bernanke being “dovish” as the “reason” for the equity and Treasury rally, along with the dollar decline, simply doesn’t add up.

Bernanke wasn’t “dovish.” He was repetitive, and he merely was the loudest voice yet in the Fed publicity campaign that started immediately after June’s Federal Open Market Committee meeting to remind the market that “tapering QE” is not “tightening policy.”

Yesterday, Bernanke simply reiterated that message, and I expect he’ll do the same thing at “Humphrey-Hawkins” (i.e., his twice-yearly monetary policy report to Congress, named for the law that requires it) next week.

So, if you’re reading analysis that said Bernanke was “dovish,” that analysis is incorrect. Explicitly telling the market that LSAPs (Large-Scale Asset Purchases, or the nerdy name for QE) and ZIRP (Zero-Interest-Rate Policy) are two totally independent things is something the Fed

has been doing since news of “tapering” broke in mid-May. The Fed will become “hawkish” or “dovish” when the expectation for QE tapering to start moves from September, and that didn’t happen yesterday.

While I think the equities simply want an excuse to rally and the market is heading higher, I also think yesterday’s rally in Treasuries and the sell-off in the dollar were more a function of two trades (long dollar/short bonds) that had simply become too crowded with fast money, and some positions needed to be cleaned out.

That “cleaning out” might last a few more days, but keep in mind that nothing fundamentally has changed to alter the direction of the trends: higher for the USD, lower for Treasuries.

Nothing goes straight up or down, so I would look at this as a chance to lighten up on some bonds if you haven’t already; initiate or add to some short exposure via TBF, SJB, TBT, etc.; and potentially get short some major currencies or long the dollar (UUP). That’s because the fundamentals behind those trades remain the same as they were Wednesday at noon.

No one can tell the future, and perhaps data will change and the Fed will become more “dovish” or “hawkish” before September, but that didn’t happen yesterday.

Economics

Jobless Claims

- Weekly Claims were 360K vs. (E) 337K.
- Four Week Moving Average rose to 351K.

Takeaway

Claims jumped to almost a two-month high on the headline, but it wasn’t as bad as it looks.

First off, last week was a holiday week. Whenever July Fourth is in the middle of the week, it skews the weekly claims data for the following several weeks due to people not reporting, offices being closed and not getting data to the Fed on time, etc.

Second, July is always a volatile month for weekly unemployment data thanks mainly to auto-plant closures from the country’s carmakers for maintenance.

So, while the headline was a bit scary, you can pretty much disregard this number because it’s almost sure to be revised lower next week.

Commodities

Commodity markets were mixed yesterday despite the huge single-day decline in the U.S. Dollar Index. “Short-covering” was the dominant theme here, too, yesterday. Gold and silver both rallied strongly on simply massive short-covering, triggered by the dollar slide. Meanwhile energy sold off, as the sector simply became too short-term overbought.

There wasn’t much fundamental news in the commodity space yesterday with the exception of the grain markets, and the falling dollar was pretty much the only catalyst in the commodity markets yesterday.

The size of the Dollar Index decline undoubtedly caught a lot of metals shorts off-guard, and as a result we saw big short-covering in gold and silver, which rallied 2.9% and 4.5% respectively. Copper also rallied nearly 3%, although the positive sentiment surrounding China (hopes of some new monetary easing by the People’s Bank of China) helped push copper higher yesterday as well.

Gold, silver and copper all traded to close to three-week highs yesterday. Yet all three remain in a downtrend, as none have broken through important resistance levels. So, while yesterday’s short-covering rally was nice to see

for those long the metals, the trend remains lower for now.

Energy also traded lower yesterday for the first time this week, with WTI crude selling off 1.8% thanks primarily to some froth coming out of a very crowded “long

oil” trade. But, there were some peripheral fundamental factors as well: The Muslim Brotherhood has pledged

Market	Level	Change	% Change
Dollar Index	82.933	-1.108	-1.32%
Euro	1.3064	.0085	.66%
Pound	1.5153	.0138	.92%
Yen	99.07	-.61	-.61%
CAD \$.9626	.0070	.73%
AUD \$.9168	-.0004	-.04%
Brazilian Real	.4419	.0003	.07%
10 Year Yield	2.585	-.047	-1.81%
30 Year Yield	3.639	-.017	-.47%

Prices taken at previous day market close.

to “passively” protest the removal of President Mohamed Morsi. And while that is encouraging, I’d imagine their newfound desire for non-violence stems from 1) realizing they were no match for the military, or 2) they are waiting for more arms from various supporters in the Middle East.

Bottom line with Egypt is it will likely leave the headlines over the next few days, but the risk premium that’s been put into crude will hang around longer, so it probably elevates the new trading range in crude a few dollars.

Finally, the International Energy Agency released an estimate that oil supply would outpace demand in ‘14, thanks to 20-year highs in production from non-OPEC countries (meaning the United States). This isn’t exactly new news, but it did help put a bit of pressure on WTI crude.

Some froth needs to be taken out of energy, and it appears we’re seeing that happen now. But given the geopolitical situation and rising domestic demand, I’d expect the lower bound of this new range to be \$100/bbl at the lowest, and probably a dollar or two higher than that.

Commodities are now once again on the cusp of breaking the downtrend, and if DBC can close a few more times above \$26/share, that will be a bullish signal, finally. But, two or three more closes are needed.

Currencies & Bonds

Yesterday the bond and currency markets saw the reversal of some very crowded trades. Ostensibly, the Bernanke “dovish” comments were to blame, but the fact is many trades in the currency and bond markets have simply become too crowded. Just like the “short metals” and “long energy” trades in commodities, some cleansing was needed.

The Bernanke comments simply gave the snowball a push down the mountain, and the late longs and shorts in these trades did the rest throughout Thursday.

The Dollar Index plunged 1.6% yesterday, erasing the last two weeks of gains, while every other currency enjoyed strong gains as a result of the “dollar long” unwind yesterday. The euro traded 1.7% higher, the pound 1.8%, Loonie 1.1% and Aussie 0.7%.

The one currency that actually had some news attached to it was the yen, which rallied 1.3% and fell below 100/dollar. The rally was due to the sinking dollar, though, not the Bank of Japan’s announcement yesterday, as that largely met expectations.

The BOJ made it clear that it is maintaining policy until after the July 21 elections—and after that, it is likely to ease further rather than tighten policy.

The yen isn’t going to stay below 100/dollar unless 1) economic data in the U.S. turns horrid, and 2) the BOJ changes policy. Neither appears likely at the moment.

Turning to Treasuries, the weak-handed Treasury shorts all got tossed out yesterday, as the 30-year note rallied 1% and the yield on the 10-year note fell below 2.6%. Again, this was simply a “cleansing” of what had become a very crowded trade.

Most importantly for equities, though, was the fact that emerging-market bonds had a big day, with both EMB and PCY rallying nearly 2%. So, the late-day swoon in both ETFs on Wednesday appears not to signal a new decline, which is equity-market-positive.

This reversal across the currency and bond markets could last for several more days, seeing as nothing changed with the direction of Fed policy (or any other central bank). So, I’d use this move to either get short or more short of bonds and short foreign currencies or long the dollar.

I don’t say this because I’m stubborn in my own opinions about bond weakness and Treasury strength. When things change, I change, but nothing changed Wednesday despite the market reaction—so the bigger trends remain in place. Instead, the market is simply “letting us in.”

Have a good weekend,

Tom

The 7:00's Report Asset Class Dashboard

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

	<u>Fundamental Outlook</u>	<u>Technical Outlook</u>	<u>Overall</u>	<u>Comments</u>
Stocks	Neutral	Bullish	Neutral	<p>Stocks continue to act better than they have in two months as the market appears to be much more comfortable with Fed "tapering." As long as "cross assets" like emerging market debt can remain orderly, the path of least resistance for stocks appears higher.</p> <p>The S&P 500 broke through it's 50 day moving average for the first time in weeks, and made a new closing high Thursday. The last bit of resistance now lies at the intra-day high of 1687.</p>

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 lesser extent).

Commodities	Bearish	Bearish	Bearish	<p>Commodities continue to try and put in a bottom, but are facing stiff headwinds from a "hawkish" FOMC and a slowing growth in China. The recent rally in oil has helped push commodity indices into month's long resistance, although once again commodities are "knocking on the door" of breaking it's downtrend.</p>
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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 (like DBC) 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	<p>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, regardless of short term volatility.</p>
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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	<p>Treasuries 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.</p>
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Trade Ideas

Buy: TBF (unleveraged short 20+ year Treasuries) 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.

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