7:00's Report

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

July 15, 2013

Pre 7:00 Look

- Futures flat after a pretty quiet weekend of news outside of the Chinese economic data, which largely met expectations.
- The latest round of Chinese data released o/n was mixed, but while the main takeaway was that it wasn't as bad as feared, it doesn't alleviate concerns about a potential growth slowdown, either. GDP met expectations at 7.5%, industrial production slightly missed expectations while retail sales best estimates.
- Econ Today: Empire State Manufacturing Survey (E: 5.0), Retail Sales (E: 0.8%).
- Earnings Today: C (E: $1.16), JBHT (E: $0.75).

Market	Level	Change	% Change
S&P 500 Futures	1672.25	2.00	.12%
U.S. Dollar (DXY)	83.415	.252	.30%
Gold	1280.20	2.60	.20%
WTI	105.17	-.76	-.72%
10 Year	2.601	.027	1.05%

Equities

Last Week

Stocks rallied to new closing and all-time highs last week. Macro-economic calm, coupled with comments from Ben Bernanke that were perceived to be "dovish," pushed all markets higher. The S&P 500 rallied 2.6% last week and is now up 18.81% year-to-date.

Going into last week, we said the Fed-related events would be the biggest things to watch, and they didn't disappoint. Stocks saw modest gains to start last week, as follow-through buying from Friday's jobs report pushed markets higher.

The defining moments were the Federal Open Market Committee minutes and Bernanke's testimony, which were taken as mildly dovish (an interpretation I think is wrong, as I said last week). But, that "dovishness" led to a cleansing of some very over-crowded trades (long U.S. dollar, short Treasuries) and caused a bit of a squeeze (both for shorts and underinvested managers) in the equity market, which rallied to new highs.

From a sector perspective, it was a "risk-on" week. Macro indices led markets higher, as the Russell 2000 traded to a new all-time high. The Nasdaq rallied to a new high for the year (and the highest level since November 2000).

Sector-wise, virtually all sub-sectors participated in the rally, although some of the most heavily shorted "bond-proxy" plays outperformed on the week. Sector trading, however, wasn't quite as bullish as the larger indices (cyclical sectors didn't decidedly outperform).

Shorts were squeezed out by the plunge in yields Thursday and, as a result, homebuilders, REITs and utilities all outperformed, as did tech and consumer discretionary. Banks actually lagged the markets last week (but were still up about 1%), thanks in part to concern about leverage ratios, and despite decent earnings from Wells Fargo (WFC)

Market	Level	Change	% Change
Dow	15464.30	3.38	.02%
TSX	12462.18	-31.08	-.25%
Brazil	45533.24	-1093.02	-2.34%
FTSE	6562.06	17.09	.26%
Nikkei	14506.25	33.67	.23%
Hang Seng	21303.31	26.03	.12%
ASX	4981.11	7.22	.15%
Prices taken at previous day market close.			

and JPMorgan (JPM) Friday. But, banks have handily outperformed lately on a "rising-yield" play, so the reversal in yields last week undoubtedly led to some profit-taking in the sector.

Transports also rallied 2% last week, despite weakness in rails due to the Quebec train derailment and also the UPS profit warnings that hit Friday. (I think a lot of people were off the desk for this, but I don't like to see a company like UPS warning on profits if the global economy is expected to turn.)

Market	Level	Change	% Change
Gold	1283.10	3.20	.25%
Silver	19.86	-.09	-.48%
Copper	3.15	-.02	.76%
WTI	106.25	1.34	1.28%
Brent	109.05	1.32	1.23%
Nat Gas	3.64	.03	.80%
Corn	5.09	-.18	-3.37%
Wheat	6.81	-.02	-.29%
Soybean	14.29	-.43	-2.92%

Prices taken at previous day market close.

Volumes were about average last week (light early in the week, heavy late in the week). On the charts the S&P 500 got through resistance at 1,650 and only the intraday highs of 1,687 remain. The trend on the charts is bullish.

This Week

Earnings now become the focus of markets, as a lot of "systemically important" companies will report in the tech, industrial and banking sectors. So, expect these results to be the main driver of markets, at least until Wednesday when Bernanke gives his "Humphrey-Hawkins" testimony, named after the legislation that requires this twice-a-year monetary-policy report.

There shouldn't be any surprises in his comments, as I'm sure he'll stick with the "tapering is not tightening" mantra. But I didn't think last week would yield any surprises either and, while his comments weren't surprising, the market reaction sure was. So, obviously we'll be watching. With the data from China out already, there is little else on the "macro" front this week, so the focus should be on earnings when it's not on Bernanke.

Bottom Line

For all the varying headlines, this latest rally in the market, which began in late June, has been about investors becoming more and more comfortable with Fed "tapering" and higher rates—and them recognizing that both yields and stocks can rise together, as long as the former don't rise too fast and 1) cause an emerging-market debt crisis or 2) choke off the recovering domestic economy. So, far, they haven't and that, more than anything else, is why stocks have been able to hit new highs.

As long as that continues, stocks should remain resilient. With the "macro" environment relatively calm, earnings and economic data should decide whether or not this rally continues. If earnings and the data are good, we're going to new record highs in the S&P 500. If they aren't, then the rally will stall. Any "macro" risks that are being talked about right now, unless they change, simply aren't important enough to de-rail the rally.

But, from a "what am I watching" standpoint, emerging markets remain the biggest "macro" risk to the rally. China's growth needs to stabilize, and emerging-market bonds need to continue to behave—these remain the two "macro" risks that can derail the rally, although both would have to get worse from current levels.

So, the path of least resistance on stocks appears higher as long as earnings and economic data are "OK." But, I continue to think one of the easier places to make money is by adding exposure on this correction to the most-powerful market trend: higher rates. That remains the clearest, most-consistent trend in the markets.

Economics

Last Week

Looking at the actual economic data from last week, there really wasn't much to talk about domestically. Jobless claims spiked higher, but there's a lot of "noise" in the number given the July Fourth holiday and seasonal shutdowns of auto plants by the carmakers.

The Producer Price Index numbers on Friday came in hotter than expected on the headline, thanks to higher energy prices. However "core" PPI, which excludes food and energy, met expectations—rising 0.2% in June.

But, I'll point out that the year-over-year increase for June in the headline PPI shot up to 2.5%, from 1.8% in

May. So, while it's just one report and "core" PPI stayed subdued, for the first time in a while there is a subtle hint of inflation.

If inflation finally begins to creep into the system (which I think it will), then that will be bullish for commodities and yields. No one expects inflation right now and, as I've said, I think getting long "inflation" is the contrarian play right now. Seeing PPI pop gives me hope I may be right later this year.

The big economic data last week actually came from China, and it was not good. Consumer Price Index and PPI data basically implied that there's enough inflation to keep the People's Bank of China from being more-accommodative, while PPI showed there's lackluster demand for basic materials. (So the economy is slow but inflation is too high to warrant more accommodation.) Merchandise trade badly missed expectations, with exports and imports falling (exports fell for the first time in 17 months). Finally on Friday, the finance minster said that 6.5% - 7.0% growth in '13 would be "OK" from a government standpoint, leading everyone to think the current 7.5% expectation is too optimistic.

This Week

The economic calendar picks up compared to last week. But, once again, this week's most-important events are Fed-related. Bernanke gives his semi-annual testimony to Congress Wednesday and Thursday, and last week showed Bernanke's comments still have the power to move markets.

Away from the Fed, we get the first look at July economic data via the Empire Manufacturing Survey (today) and Philly Fed Survey (Thursday). These are worth watching because they both ticked up in July. Along with the other readings, this implied that we're seeing a slight uptick in the manufacturing sector, which has been one of the most-sluggish of the economy. So, it will be good to see if that positive momentum continues.

Market	Level	Change	% Change
Dollar Index	83.13	.21	.25%
Euro	1.31	-.0038	-.29%
Pound	1.5096	-.0088	-.58%
Yen	1.0065	-.0033	-.33%
CAD $	.9606	-.0016	-.17%
AUD $	.9016	-.0118	-1.29%
Brazilian Real	.4360	-.0015	-.35%
10 Year Yield	2.601	.027	1.05%
30 Year Yield	3.649	.024	.66%
Prices taken at previous day market close.			

The latest round of housing data kicks off this week, with the Housing Market Index (Tuesday) and Starts (Wednesday). Housing data this month is more-important than usual, because it's June data, which will reflect the higher interest and mortgage rates. It will also give some insight into whether or not higher rates are a new headwind for the housing recovery. (If the data implies that higher rates are a headwind, the market could react pretty negatively, because the recovery in housing is the best thing going in the economy right now.)

Finally, retail sales (Monday) and Industrial Production (Tuesday) will also be watched, although the truly important economic data starts next week with flash manufacturing PMIs.

Remember that "good is good" with regard to the data. The market doesn't want a weak economy so it can get more QE—good data will result in a rally, and vice-versa.

Commodities

There was a big rally across the commodity space last week, with the broad-based commodity ETF rallying more than 2%, led by precious metals and energy. Grains were the only commodity sector to finish last week lower.

The plunge Thursday in the dollar (in reaction to the "dovish" FOMC minutes and Bernanke comments) was the main influence on the commodity markets, and that is reflected by gold and silver being the best-performing commodities last week (up about 6% each).

But, in testament to just how beaten-up the precious metals are, both gold and silver are only now, after the big rally last week, hitting months-long resistance. So, until gold can trade consistently above both the 23- and 30-day exponential moving averages (which are $1,304 and $20.47, respectively), the trend remains lower.

Energy continued its rally, and although there was some settling in Egypt (relatively speaking, as the geo-political risk in oil isn't going away anytime soon), another large weekly draw in supply (20 million barrels in two weeks) helped WTI crude to rally. But, as I detailed in last week's issues, the huge weekly draws appear to be the result of refiners processing as much product as they can while the Brent/WTI spread remains positive. Unless the economic data improves substantially, I believe WTI crude is a bit ahead of itself, and think a correction of some sort—down to the $100/barrel area—is coming, short of the situation deteriorating in Egypt.

The other big piece of news in the commodity space last week was the weak Chinese economic data. Interestingly, that negative news only weighed on copper, not the entire commodity complex, which I take as an anecdotal positive. It's an old rule of trading that when a sector starts to "ignore" bad news, that's bullish. Commodities in aggregate "ignored" what was some pretty bad news on China. Whether that can continue remains to be seen, but for last week at least, it was a good sign for the commodity bulls.

Commodities remain the "contrarian" play in the market, as they have performed horribly this year and everyone is bearish. But, once again it looks as though the asset class is trying to bottom. The 23- and 30-day exponential moving averages have been resistance for the commodity ETF DBC since February. But a few more DBC closes above $26 and I think we can say the downtrend has finally ended. Last week's rally was because of the dive in the dollar, which I think was overdone. So, be patient and wait for sector to bottom—given the declines, there's plenty of money to be made on a rally, so missing the first bit to be sure is the smart play.

Currencies & Bonds

Last week was a week of "cleaning" in some very overcrowded currency and bond trades. The Bernanke comments were the key catalyst last week, and the perceived "dovishness" of his comments led to a huge decline (nearly 2%) in the Dollar Index Thursday, and a huge rally (over 1%) in Treasuries, as weak-handed and late longs and shorts got swung out.

With the dollar in freefall Thursday, every other currency rallied: The euro finished the week 1.8% higher and back above 1.30; the pound bounced hard off a three-year low vs. the dollar Tuesday, to close back above 1.50; and even the yen rallied vs. the dollar, closing the week below 100/dollar.

The only currency *not* to rally substantially vs. the dollar last week was the Aussie dollar, which plunged 1.3% Friday thanks to the weak Chinese economic data, comments about 6.5% - 7.0% growth being "OK" with the government, and more sluggish economic data.

Even at 90/dollar—given the exposure to China and the slowing economy, and the Reserve Bank of Australia's desire to push the currency lower—I don't think the decline in the "Aussie" is done. A short position in that currency continues to act as a great "China hedge" for those with a lot of Chinese exposure.

Looking at Treasuries, we saw a big rally in bonds Thursday, again thanks to Bernanke. But the trend remains lower, regardless of whether this bounce lasts through this week or not. More importantly, emerging-market bonds were stable last week. With regard to the equity market, as long as EMB and PCY can continue to stabilize (again, they don't have to rally; they just have to not implode) then rising yields won't de-rail rising equity prices, as long as economic data remains good.

Last Thursday's reversals in the dollar and Treasuries were violent and surprising, but the takeaway is only that those trades had become too crowded, not that the fundamentals behind those trends (bullish dollar/bearish Treasuries) have changed.

Bernanke and the FOMC minutes weren't "dovish" last week, regardless of what the market did Thursday. So, as I said last week, I view this as the market "letting us back in" to what have been two great trades: long U.S. dollar, short long-dated Treasuries. With Bernanke's "Humphrey-Hawkins" testimony looming this week, the "cleansing" of these crowded trades might not be done—but I believe any more violent declines in the dollar and rallies in Treasuries would be a fantastic opportunity to get more exposure to long dollar/short Treasury trades, via UUP (the long dollar ETF), and TBF, TBT and SJB as short Treasury plays.

Have a good week—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	Bullish	Neutral	*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.* *The S&P 500 broke through it's 50 day moving average on Friday 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.*

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).**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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. The recent rally in oil has helped push commodity indices into month's long resistance, and once again commodities are "knocking on the door" of breaking it's downtrend.*

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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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, regardless of short term volatility.*

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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	Bearish	Bearish	Bearish	*Treasurys saw a strong bounce last week on "dovish" comments for Bernanke. That could continue this week with Bernanke testimony Wed/Thurs, but the trend in bonds remains lower, and this bounce should be used to get short.*

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.**