7:00's Report

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

July 18, 2013

Gold: I'm not a predominantly technical trader, but days like yesterday show why watching the technicals are important, especially in commodities. $1300 remains resistance.

Pre 7:00 Look

- Futures flat again this morning after another relatively quiet night.
- Earnings will be the main focus of the market today. Yesterday's results were "ok" but EBAY and INTC were both sharply lower after the close.
- European shares are mixed as UK Retail sales were very slightly better than expectations, while Ericsson missed earnings.
- Econ Today: Jobless Claims (E: 344K), Ben Bernanke testifies before Senate (10AM).
- Earnings Today: COF (E: $1.66), GOOG (E: $10.80), MSFT (E: $0.75), MS (E: $0.48), VZ (E : $0.73).

Market	Level	Change	% Change
S&P 500 Futures	1676.75	1.25	.07%
U.S. Dollar (DXY)	82.88	.04	.05%
Gold	1279.60	2.10	.16%
WTI	106.24	-.23	-.22%
10 Year	2.491	-.04	-1.62%

Equities

Market Recap & Trading Color

Stocks recouped most of Tuesday's losses as Wednesday's Ben Bernanke monetary-policy testimony was a relative non-event. Plus, some decent earnings helped push the averages marginally higher. The S&P 500 rose 0.28%.

Futures were virtually flat prior to the release of the Bernanke minutes, but rallied as the initial take was "dovish." Also helping stocks to rally were earnings beats by Bank of America (BAC) , BHP Billiton (BHP) and Yahoo! (YHOO). The earnings weren't really a beat. but traders focused on the Asian metrics.

Like most days this week, all of the trading action occurred in the first few hours of the day. And because Bernanke's Q-and-A ended up being a non-event, markets basically again treaded water during a very quiet afternoon.

Earnings continue to largely dominate the sector trading, but it's worth noting that small caps again outperformed, continuing a bullish trend.

Looking at the various sectors, homebuilders outperformed thanks to Bernanke's housing-supportive comments and a housing starts number that wasn't as bad as initially thought. One thing people *aren't* talking about enough is the fact that basic materials also continue a great run this week, as the BHP earnings beat is just the latest to help the sector. (Alcoa kicked things off on the right foot, and Rio Tinto's production numbers earlier this week also helped). Basic materials, the "dog" sector of '13, continues to offer "value" in the market if you

Market	Level	Change	% Change
Dow	15470.52	18.67	.12%
TSX	12568.77	51.88	.41%
Brazil	47407.31	538.02	1.15%
FTSE	6593.51	21.58	.33%
Nikkei	14808.50	193.46	1.32%
Hang Seng	21345022	-26.65	-.12%
ASX	4993.42	11.74	.24%

Prices taken at previous day market close.

think global growth is stabilizing. Tech was also strong, thanks to YHOO and ASML Holding (ASML), while consumer discretionary continues to lag on earnings and a hangover from retail sales data.

Volumes remain below recent three-month averages (although not horribly so) while on the charts the market has gone nowhere this week, so the technical picture remains the same.

Market	Level	Change	% Change
Gold	1276.00	-14.40	-1.12%
Silver	19.38	-.56	-2.78
Copper	3.12	-.06	-1.84%
WTI	105.99	-.01	-.01%
Brent	109.40	.31	.28%
Nat Gas	3.63	-.04	-1.20%
Corn	5.02	-.09	-1.71%
Wheat	6.67	-.02	-.34%
Soybean	12.84	-.02	-.17%
Prices taken at previous day market close.			

Bottom Line

The Fed appears to be moving to the back burner for now with regard to deciding the near-term direction of equities. Earnings and economic data are now in charge, although earnings season hasn't been "good" or "bad" enough to cause the market to move one way or the other. So, absent any catalysts, I'd imagine the path of least resistance remains higher. I'd also expect the old intraday highs to be tested sooner than later, and would hold current equity allocations.

Economics

Bernanke Humphrey-Hawkins Testimony

Fed Chairman Bernanke's testimony before the House Financial Services Committee didn't contain any major surprises, and it largely met expectations of being slightly "dovish."

There were two takeaways from Bernanke's prepared comments (the Q-and-A was a non-event): First, the Fed understands just how important housing is to the economic recovery. Bernanke's first sentence at his testimony was: *"Housing has contributed significantly to recent gains in economic activity."* He's absolutely right, and he followed those comments almost immediately by addressing the rise in yields we've seen lately: *"Housing activity and prices seem likely to continue to recover, notwithstanding the recent increases in mortgage rates, but it will be important to monitor developments in this sector carefully."*

That, I believe, is "Fed-speak" for "We don't like how quickly mortgage rates have risen, and while we are still going to taper QE, we're going to do everything we can to slow the rise in interest rates, because if the housing recovery stalls, the economy stalls."

The second takeaway was that, up until yesterday, Bernanke had been quasi-dismissive of low inflation. But, yesterday he surprisingly focused a bit more on low inflation than he had previously.

However, the Federal Open Market Committee is certainly aware that very low inflation poses risks to economic performance—for example, by raising the real cost of capital investment—and increases the risk of outright deflation. Consequently, we will monitor this situation closely as well, as the Fed acts as needed to ensure that inflation moves back toward its 2% objective over time.

So, those two points (focus on housing and low inflation) led the market to interpret Bernanke's remarks as marginally "dovish," just as we expected he would be.

Takeaway

While it's true to say Bernanke's remarks were a touch dovish, the market didn't really react in a "dovish" manner. Gold sold off hard, the dollar was steady and Treasuries rallied initially but then drifted lower throughout the day.

I believe there are two main reasons the market didn't react yesterday: 1) Nothing Bernanke said yesterday has altered the expectation for "tapering" of QE to begin in September, and 2) This whole discussion of "dovish" vs. "hawkish" is becoming pretty stale from a market standpoint. The Fed is going to start tapering in September. Bernanke and others can talk "dovish" every day between now and then, but unless the economic data deteriorates significantly, it won't change their action plan. So, expect "dovish" vs. "hawkish" tea-leaf-reading of Fed speeches to have a smaller and smaller effect on market (like it did yesterday).

The focus will now shift to 1) How much tapering can we expect in September and when does QE end (meaning what's the pace of "tapering"?) and 2) Who is Bernanke's replacement? (The favorite remains Janet Yellen, but I've been reading that Larry Summers is a fast-rising contender.)

Housing Starts

- June Starts 836K vs. (E) 951K.

Takeaway

On the headline this was a bad number and actually caused a dip in the dollar rally in Treasuries Wednesday morning. But, as with most economic releases, the "guts" of the number tell a different story than the headline.

Most of the headline drop in the June housing starts number was due to a huge decline in the "multi-family" segment, and that's not really an important part of the release.

The more important part is the "single-family" housing starts, as they give a much-better picture of the health of the residential real estate market. In June, the single-family segment was basically unchanged (technically it declined 0.8%), so this report doesn't imply that higher mortgage rates led to a significant drop in the residential real estate market, despite the headline.

Building permits, which are the leading indicator in the housing starts report as permits lead starts by about 3-6 months, also saw a big headline decline (from 985K to 911K). But it was the same thing as starts: The decline came from multi-family permits, while permits for single family homes actually rose slightly.

So, while the headline was a disappointment, the details in the report don't imply that we're seeing a drop-off In housing demand because of higher rates—at least not yet.

Commodities

Commodities were flat again Wednesday, and away from the metals, most commodities didn't really trade off the Bernanke testimony. Commodities continue to consolidate right at resistance, but haven't broken that resistance convincingly, yet.

Starting with energy, WTI crude again staged a big reversal. Crude traded down nearly 1%, to $105/bbl, early in the morning before reversing and closing basically at the highs of the day. This was thanks to another bullish weekly inventory reading.

This week, oil inventories declined 6.9 million barrels compared to expectations of 2 million barrels. Over the last three weeks, we have seen simply massive draws on domestic oil inventories of 27 million barrels, which is the largest three-week decline in over 30 years.

During this three-week period, we've seen oil inventories flip from being at a healthy surplus compared to last year, to now a 2.7% deficit to last year's inventory levels.

This pace of inventory draws won't continue. (I believe a lot of it has to do with refiners pushing through product while margins remain decent.) While we have seen significant supply growth over the past year, we are also seeing demand growth—and that will make the lower band of the new WTI trading range higher than most people think.

WTI has been consolidating around the $106 level for over a week now, and while I continue to think the contract is a little rich in the short term, don't expect any pullback to be material. (I imagine you'll see a lot of buying in the low-$100s/bbl.) Oil remains in a well-defined uptrend.

Conversely, the metals traded awfully yesterday—breaking down badly, once again right at critical resistance levels. *Yesterday was the type of day that breeds conspiracy theorists in gold.* Shortly after the release of Bernanke's comments, gold traded to a high of $1,299.70, up about 1%. Then, right around 10 a.m., for no discernible reason, the entire metals complex went into freefall. Gold dropped $25 to close down 1%, while silver fell 3% on the day, and copper fell 2%.

Market	Level	Change	% Change
Dollar Index	82.569	.071	.09%
Euro	1.3133	-.0029	-.22%
Pound	1.5225	.0065	.43%
Yen	99.45	.35	.35%
CAD $	.9610	-.0034	-.35%
AUD $	.9239	-.0013	.15%
Brazilian Real	.4481	.0044	.99%
10 Year Yield	2.499	-.038	-1.52%
30 Year Yield	3.576	-.014	-.39

Prices taken at previous day market close.

Much to the conspiracy theorists' disappointment, there is no conspiracy. Very large traders remain in the gold market, and one (or all) of them simply broke support with a well-timed wave of selling. It's called a "bear raid" and it happens all the time in the futures markets. (It just happens a lot more frequently in gold and silver.)

So, while I'm not a predominantly technical trader, we do see the value of technical levels in the commodities. As resistance at $1,300/oz. once again held, the trend in metals remains firmly lower.

Currencies & Bonds

As already mentioned, the Dollar Index didn't really trade off the Bernanke comments, as the market is quasi-exhausted with the whole "dovish vs. hawkish" interpretation game. Nothing changed in the direction or timing of Fed policy yesterday, and I think that unless the economic data turns materially worse, the sharp decline we've seen in the dollar since last Wednesday may be at an end.

The big mover in the currency markets yesterday was the British pound, rallying 0.5% vs. the dollar, as the Bank of England minutes from the July meeting revealed a 9-0 vote against more quantitative easing. (Previously two BOE governors had voted for more QE). Also, the latest labor market report was better than expected, implying further improvement in the employment situation in the UK.

Outside of the pound it was a quiet day in currency markets, as the euro drifted lower (not surprising given the big rally over the last week) as did the yen (which is inching back toward 100/dollar).

Looking at Treasuries, they were the most-reactive to the Bernanke testimony (his focus on higher mortgage rates put a bit of a bid under Treasuries). But, after an initial sprint higher, Treasuries drifted lower throughout the day and finished marginally higher. I would expect, that unless economic data changes, that this bounce in Treasuries is closer to the end than the beginning. It's true the Fed will use rhetoric to slow the rise in rates—but it can only really affect the pace at this point, not the direction (unless they backtrack on "tapering," which appears extremely unlikely).

Was the Bank of England Really Hawkish?

Last week I spent some time discussing how, given the Bank of England's new focus on "forward guidance" as a means to further help the economy, I was turning bullish on UK shares. After all, the economy appears to be finally gaining some traction after years of QE and other measures. But, while the economy appears to be improving, the BOE remains committed to extraordinarily accommodative policy.

Yesterday when I woke up and saw the headline that the BOE minutes were "hawkish," I had a mini-heart attack—given that it appeared I'd misread the situation.

But, after calming down and looking into it, I don't think I have. (The fact that EWU, the UK ETF, was up 0.5% yesterday also helped calm my nerves.)

The fact that the Monetary Policy Committee voted 9-0 for no additional QE is not, in my opinion, hawkish. Last meeting, the BOE announced it would be using a new monetary tool to help keep rates low and policy accommodative: forward guidance. So, in a way, the BOE eased policy at the July meeting. Since it eased policy, it's not surprising that the MPC members voted against more QE. (Why advocate for more QE if, at the meeting, you agreed to use forward guidance to ease policy?)

Quantitative easing is a powerful, and potential dangerous, monetary policy tool. It should be used in case of emergency. Like the U.S., but to a lesser extent, the UK economy is rebounding ... so there is no need for more QE. But, the Bank of England does want to make sure interest rates stay extraordinarily low to help the recovery, so forward guidance will help achieve that goal.

I think the improvement in the labor market yesterday was more important than the 9-0 vote against more QE. The vote *should* have been 9-0; they introduced another tool to make policy more-accommodative!

While it's not clear where the pound is going, I think UK shares will continue higher on a combination of very accommodative policy and improving economic conditions—no more QE is *not* a rally-killer in the UK.

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	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).**

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.**

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.**

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.**