7:00's Report

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

July 19, 2013

S&P 500: That's a new all-time high, and the first rule of technical analysis says you buy what's making new highs, and sell what's making new lows.

Pre 7:00 Look

- Futures very slightly lower thanks to disappointing earnings after Thursday's close. There was little macroeconomic news o/n.
- MSFT and GOOG both missed earnings after the close, further weighing down tech, which underperformed yesterday.
- Econ Today: No Reports Today.
- Earnings Today: GE (E: $0.36), HON (E: $1.21), COL (E: $1.17), SLB (E: $1.11).

Market	Level	Change	% Change
S&P 500 Futures	1678.75	-1.75	-.10%
U.S. Dollar (DXY)	82.89	-.07	-.08%
Gold	1287.40	3.20	.25%
WTI	108.34	.30	.28%
10 Year	2.534	.043	1.73%

Equities

Market Recap & Trading Color

Stocks surged to new highs Thursday on a combination of decent earnings, good economic data and some economically supportive rules changes from the European Central Bank. The S&P 500 rose 0.50% to a new closing and all-time high.

Futures started Thursday slightly higher thanks to earnings, but accelerated higher after the ECB collateral changes were announced. (This was an underreported positive catalyst yesterday.) Additionally, the Philly Fed Manufacturing Index beat expectations. And finally, Ben Bernanke's testimony to the Senate—while claiming a lot of the headlines—was a non-event yesterday.

We are now in the height of earnings season and, so far, they haven't been particularly good or bad. (But in this market, a tie goes to the bulls.) Yesterday results were more mixed than good: Intel (INTC), eBay (EBAY) and American Express (AXP) disappointed, while Morgan Stanley (MS), Xilinx (XLNX) and UnitedHealth (UNH) beat. But, as usual, and while it's still early, the vast majority of companies are beating estimates. (75% of the 80 S&P 500 companies that have report are beating the consensus estimates.) And while officially earnings season will continue for several more weeks, the bulk of the "systemically important" companies (from which analysts extrapolate their results as commentary on the economy) will wrap up by the end of next week.

Sector-wise yesterday's trading continued to be dominated by earnings, although it's worth continuing to point out that small caps again led the major averages higher, a bullish sign.

Market	Level	Change	% Change
Dow	15548.54	78.02	.50%
TSX	12628.85	60.08	.48%
Brazil	47656.92	249.61	.53%
FTSE	6611.39	-23.01	-.35%
Nikkei	14589.91	-218.59	-1.48%
Hang Seng	21362.42	17.20	.08%
ASX	4972.09	-21.33	-.43%

Prices taken at previous day market close.

Looking at the sectors, tech was the notable laggard, weighed down by semiconductors (INTC, Taiwan Semiconductor (TSM) earnings). Telecom also underperformed (disappointing Verizon (VZ) results) as did homebuilders (higher bond yields).

Conversely, banks were best-performing sub-sector thanks to MS earnings, while energy (higher crude prices) and industrials also beat the market.

Market	Level	Change	% Change
Gold	1286.60	7.80	.61%
Silver	19.43	.01	.05%
Copper	3.13	.04	.14%
WTI	108.35	1.87	1.76%
Brent	108.70	.09	.08%
Nat Gas	3.82	.19	5.32%
Corn	5.00	-.01	-.25%
Wheat	6.60	-.04	-.68%
Soybean	12.65	-.17	-1.38%
Prices taken at previous day market close.			

Volumes were busier than the rest of the week, but that was thanks mostly to earnings-related situations (as opposed to large-scale buying of the "market"). On the charts the S&P 500 rose to new all-time highs, which is bullish, and resistance now sits at 1,700 (a round figure).

Bottom Line

Markets have made the adjustment to a reality where the Fed is going to start to "taper" and remove stimulus. But as long as economic data improves and earnings are "OK," that's a not a rally-killer and stocks can head higher. Macro risks still loom (Portuguese and Spanish political problems in particular), but they have been looming for 3+ years and contribute to this sanguine sentiment toward equities, which has led to widespread underinvestment and made the "pain trade" consistently higher in equities.

Bottom line is the market is not data-dependent, but the clearest trend in markets remains of higher rates (and I think the best risk/reward trades are centered on that theme). And, I'm not the only one, as BlackRock's Larry Fink said yesterday he could see 10-year yields hitting 3% by year-end. Perhaps he's been reading the 7:00's Report. (I wish!)

Boring But Important: ECB Relaxes Collateral Rules

This news hit wires pretty quietly Thursday, but the ECB took action to help solve a major issue that is impeding the recovery in Europe.

One of the problems I and others have been discussing for some time in Europe is the inability for very cheap money (low interest rates) to get into the hands of so-called "SMEs," or small to medium enterprises. The idea was supposed to work like this: The ECB lends money to banks at virtually 0%, and banks provide current loans (mortgages, inventory loans, etc.) as collateral for the funds. The banks are paying virtually 0% for the money, and they can then turn and lend it to the SMEs (or the real economy) at a higher rate, and everyone wins: The SMEs get fresh capital to invest and expand, the banks make a spread on the loans, and the ECB helps revive the EU economy.

Here's what's been happening instead: Cheap funds from the ECB have been staying on bank balance sheets. It's not because of the "evil bankers"; it's because a lot of the ECB's new rules require greater capital ratios, and the ECB won't accept certain types of loans as collateral for cash, which smaller commercial banks can then lend out to "SMEs," which will hopefully stimulate the economy. So, like most things fiscally speaking in Europe, it was a "one foot in, one foot out" approach, and that's why it hasn't worked.

Well, yesterday the ECB took two steps to help change that. First, they relaxed some of the ratings requirements on certain loans that could be pledged as collateral for cash loans to these central banks. Second, the ECB realized "haircuts" on asset-backed securities pledged as collateral for loans from the ECB to these commercial banks.

Previously, because asset-backed securities are deemed riskier, if I were a commercial bank and had a 100-million-euro loan from a car dealer secured by the inventory, I could pledge that to the ECB to get fresh capital to lend. But I wouldn't get 100 million; I'd only get 75 million or 80 million, because the ECB imposed a "haircut" in the loan to insulate it from losses. (I'm making up the numbers, but it illustrates the point.) Well, that "haircut" made it *not* worth it to me economically, so I didn't do it. Now, with haircuts on asset-backed securities reduced, this is a viable option, and it is one of the better ways to help get all this cheap money in the hands of SMEs (or the "real" economy) and break the capital logjam at the banks.

So, yesterday's news was positive for two reasons: First, it'll help the EU economy. Second, it implies the ECB is still working on ways to stimulate economic growth in the EU, and it will boost expectations that more plans may be announced at the ECB meeting in August.

Bottom line, though, this is a positive for, first, European banks and, second, the European economy. And, it's more of a tailwind on my "long" UK idea (ETF symbol EWU, the iShares MSCI United Kingdom Index). While it doesn't really affect the UK, it's peripherally positive.

Economics

Similar to Tuesday, economic data Thursday wasn't important on its own but instead further reinforced two bigger, positive trends we're seeing in the economy.

First, weekly jobless claims fell back down to a more-comfortable 334K (vs. (E) 344K), reversing much of last week's big July Fourth-related jump. So, weekly claims continue to reinforce that we're seeing improvement in the labor market consistent with the past few months. Weekly claims around the 330K/340K level have equated to about 200K jobs/month in the non-farm payroll report, so we're right on target.

Second, the Philly Fed Manufacturing Survey was 19.8 vs. (E) 9.0, and hit the highest level since March 2011. The report wasn't quite as strong as the headline, as New Orders dipped from 16.6 in June to 10.2 in July. But overall the point is that the Philly Fed further confirms that we are seeing a potential rebound in the manufacturing sector domestically, which is a positive for the domestic economy.

Market	Level	Change	% Change
Dollar Index	82.823	.115	.14%
Euro	1.3099	-.0025	-.20%
Pound	1.5209	-.0003	-.02%
Yen	100.58	.99	.99%
CAD $	.9629	.0018	.19%
AUD $	.9166	-.0071	-.77%
Brazilian Real	.4494	.0001	.02%
10 Year Yield	2.54	.046	1.81%
30 Year Yield	3.634	.054	1.49%
Prices taken at previous day market close.			

Commodities

Commodities were strong again Thursday, with energy and metals higher despite a stronger U.S. dollar. Commodities have now spent six days trading above resistance, shrugging off continued concern toward the Chinese economy. Commodities appear to finally, after five months of a downtrend, be breaking out.

Natural gas was the best-performing commodity on the screen yesterday, rallying more than 5% thanks to a smaller-than-expected weekly injection (58 Bcf vs. expectations of 64 Bcf). The heat wave that is sitting on the Northeast is raising concerns that cooling demand will cause another small injection into inventories next week. As a result, shorts are covering in earnest.

After months of failing to break above the 50-day EMA, the commodity ETF DBC looks as though it's finally breaking its downtrend.

Natural gas will remain a weather-dominated market in the near term. That's because, without sustained intense heat (and increased cooling demand), the market is well-supplied and prices toward $4.00/Mcf are a little rich. So, if you were long natural gas from about two weeks ago when I mentioned buying some (or the XOP, the SPDR Oil & Gas Exploration & Production ETF) now may be a good time to book at least some profits. If the weather turns cooler, natural gas will head to the $3.60 level in a hurry.

Positive economic data (Philly Fed and jobless claims) helped push energy higher, as WTI crude traded 1.4% higher and above $108/bbl, the highest level since February 2012. The buying momentum in WTI crude is obviously accelerating, and the trend remains firmly higher as momentum traders push into the contract. (The Philly Fed numbers weren't *that* good.)

At this point, although the trend is higher, I don't think getting long energy (or specifically WTI crude) at this point is a good risk/reward trade at these levels. I maintain that WTI is overbought here and likely due for some sort of a correction, as the fundamentals don't warrant *this* quick of a run to $109/bbl. And, I could continue to be wrong as momentum buyers push in, but proper trading and investing is about identifying positive risk/reward setups, and I don't think buying WTI up here is a good risk/reward setup. But, I remain bullish on energy in the medium term. With manufacturing apparently picking up and the economy improving, I'd look to buy any decent dips, as energy is heading higher over the medium term, as long as the economy continues to improve.

Finally, the WTI/Brent spread has moved below $1.00/bbl for the first time since late 2010. Again, part of the massive draws we've seen in domestic crude stocks is almost certainly because of refiners pushing crude through while margins (loosely based on the WTI/Brent spread) were healthy. But, those margins are now evaporating, so I'd expect some moderation in the inventory draws in crude over the next few weeks.

So, while I expect some sort of a short-term pullback (and have for the last week, so I've been wrong or early), the larger trend in energy remains bullish as long as the domestic economy is recovering.

Elsewhere in commodities, things were pretty quiet: Gold rebounded from Wednesday's sell-off, while silver and copper were flat. Finally, grains remain weak as expected higher supplies are weighing on prices.

Currencies & Bonds

Currency markets were relatively quiet Thursday with the exception of the yen and Aussie, both of which fell sharply vs. the dollar. The Dollar Index, though, was virtually unchanged, as were the euro and pound. The ECB collateral rules, while initially taken as euro-bearish, aren't really. The ECB isn't incrementally easing monetary policy; they are just helping the current accommodation be more-effective. So, yesterday's news *isn't* another reason to sell the euro.

30-Year Treasuries: The old Wall Street saying goes: "Even the deadest of cats will bounce if thrown out of a high enough window." So it appears to be with bonds, and the bounce looks like it may be ending.

The yen took a dive yesterday, as it once again traded above 100/dollar ahead of the Upper House elections in Japan this weekend. Most polls are predicting a pretty big win for Prime Minister Shinzo Abe, and the key number to watch for is 70. If Abe's Liberal Democratic Party can win 70 of the 121 seats up for election, then he will have an absolute majority in both houses of parliament—making it much easier to him to carry out "Abe-nomics," which is obviously yen-negative.

As I said before, if the election results hold, then I expect this will kick off the next leg down in the yen. From people I talk to, the ultimate target for the yen remains in the 115—120 range. If that comes true, the WisdomTree Japan Hedged Equity Fund (DXJ) has a ways more to go before the trend gets long in the tooth.

Treasuries declined for the first time in nearly a week yesterday, as the better-than-expected economic data reinforced the fact that, while Bernanke "talks" dovish, "tapering" will begin in September. And as long as the data improves, the marginal direction for monetary policy is "less accommodative." The market no longer cares about "dovish vs. hawkish" innuendo from Fed speakers, which only leaves the policy-direction reality, and this means that interest rates are headed higher in the future. Unless the economic data turns for the worse, I think this counter-trend rally in Treasuries is about over.

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)

	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 made a new intra-day and closing all time high Thursday, and now eyes resistance at 1700.*

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	Neutral	Neutral	*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.**