7:00's Report

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

July 22, 2013

Pre 7:00 Look

- Futures flattish after a weekend of some relatively important news, but little market reaction.
- In Japan, PM Abe's party had a big win Sunday, giving him more than the 70 seats needed for a majority in both Parliamentary houses, which should make it easier to implement "Abe-nomics."
- In Europe, the Portuguese govt. failed to reach a "national salvation" pact, but the President said despite that there will be no new elections, so it's actually a positive event in the near term.
- Econ Today: Existing Home Sales (E: 5.27M).
- Earnings Today: MCD (E: $1.41), TXN E: $0.41, NFLX (E: $0.40).

Market	Level	Change	% Change
S&P 500 Futures	1690.75	1.25	.07%
U.S. Dollar (DXY)	82.39	-.321	-.39%
Gold	1316.40	23.50	1.82%
WTI	108.62	.57	.53%
10 Year	2.491	-.043	-1.70%

Equities

Last Week

Stocks rallied to new highs (52-week and all-time) last week thanks to another dose of Ben "Dovish" Bernanke, decent earnings and good economic data. The S&P 500 is now up 18.64% year-to-date.

Trading last week was dominated by Bernanke and earnings and, while neither revealed anything new from a positive-catalyst standpoint, both confirmed the status quo (and, more importantly, weren't negative). In this market, given that sentiment remains skeptical and managers remain underinvested, the "tie" goes to the bulls.

Starting with Bernanke, he didn't really break any new ground in his "Humphrey-Hawkins" testimony (which will very likely be his last). He continued to pound home the message that "tapering is not tightening," which the market now seems comfortable with.

He was, on balance, "dovish" as he referenced lower inflation more than expected, and also directly cited the housing recovery's huge, positive effect on the economy. He also directly addressed rising interest rates and promised the Fed would monitor their effect on the housing recovery (implying the Fed will act if higher rates choke off the recovery). Yet, nothing much was new. All told, the market now appears comfortable with the Fed "tapering" in September.

Earnings so far have been "OK," but that's all they really need to be given the current environment.

Through Friday, 102 of the S&P 500 companies have reported, with 73% beating estimates (per Barron's). The earnings so far certainly haven't been great (only about 50% of companies reporting have beaten on revenues). But, again, there have been no surprise "blow-ups" either that make people nervous about the business climate.

From a trading-color perspective, small caps continue to lead major indices higher, which is a bullish sign. Sector

Market	Level	Change	% Change
Dow	15543.74	-4.80	-.03%
TSX	12685.13	56.28	.45%
Brazil	47400.23	-256.29	-.54%
FTSE	6615.42	-15.23	-.23%
Nikkei	14658.04	68.13	.47%
Hang Seng	21416.50	54.08	.25%
ASX	4972.09	-24.33	-.43%
Prices taken at previous day market close.			

trading last week was mostly driven by earnings results, so there aren't a ton of takeaways to glean from it. The one standout I will mention, however, has been the notable underperformance of tech due to weak earnings—Google (GOOG), Microsoft (MSFT), Taiwan Semi (TSM), Advanced Micro (AMD) and Intel (INTC) all missed or disappointed on guidance. A lot of this seems to stem from the fundamental change we're seeing in the computer industry, as demand for tablets grows and saps demand for traditional PCs. For now it's not being taken as any type of greater commentary on the economy—just a change in the computing space.

Market	Level	Change	% Change
Gold	1295.60	11.40	.89%
Silver	19.485	.09	.50%
Copper	3.15	.02	.46%
WTI	108.47	.43	.40%
Brent	108.52	-.18	-.17%
Nat Gas	3.77	-.04	-1.08%
Corn	5.00	0.0	0.00%
Wheat	6.64	.04	.61%
Soybean	14.91	.22	1.46%

Prices taken at previous day market close.

Other laggards last week were telecom (weak Verizon earnings) and homebuilders, which sold off on profit-taking and given the mixed housing data.

Basic materials, banks, industrials and airlines were some of the best-performing sectors (thanks to better-than-expected earnings from bellwethers in those sectors) So, to a point there was a bit of "cyclical" outperformance, but again it was earnings-related. The rotation out of "bond-proxy" stocks and into cyclicals has stopped for earnings season, but I think that's a trend that will resume in the coming weeks, as we exit earnings season.

Volumes were close to average last week, which probably overstates the level of activity, as individual earnings news always adds to volume. But, for the summertime, activity was decent. On the charts the S&P 500 is at new highs, and next resistance sits at 1,700.

This Week

We're in the height of earnings season now, and this week will bring a lot more reports from tech companies (which are especially important given the aforementioned weakness). Banks' earnings are mostly wrapped up but insurance companies will release results this week. Large industrials will also continue to post results. Expect earnings to be the main driver of domestic equities this week, with the possible exception of Wednesday when the flash manufacturing Purchasing Managers' Indexes are released.

Bottom Line

The most important development over the past two weeks has been the market's acceptance of and adjustment to Fed "tapering." Last week, the "dovish vs. hawkish" tea-leaf reading became obsolete, as Bernanke's "dovish" testimony failed to move markets because everyone knows, regardless of what he or others say, the Fed is looking to "taper" in September, and the market is "OK" with that.

So, the near-term direction of equities will be decided by earnings and the economic data. The latter, while not stellar, are adequate so far for Q2—although this is a big week for "systemically important" companies and that could change this analysis. Economically, the flash PMIs matter but really next week will be more important from a WWFD ("What Would the Fed Do?") standpoint.

With markets at new highs, sentiment remains far from enthusiastic (and potential macro headwinds remain in Europe, especially politically in Portugal and Spain). But, for now the path of least resistance remains higher in equities. The clearest trend in any market is that of higher rates in the future and, although the decline in bonds has stalled over the past two weeks thanks to a "dovish" Bernanke, I believe firmly this is just a good entry point to the ProShares Short and UltraShort 20+Year Treasury ETFs (TBF and TBT, respectively), the ProShares Short High Yield ETF (SJB) and other "short bonds" plays.

Economics

Last Week

Economic data wasn't the main market driver last week, as earnings have taken center stage. But, the data was mostly positive and the big takeaway from last week is that Fed "tapering" remains very much on schedule for September.

The first look at July manufacturing data was pretty encouraging, as the Empire State Manufacturing Survey, Philly Fed Manufacturing Index and industrial production all pointed to a continued recovery in the manufacturing sector—something that, if confirmed by this week's national manufacturing flash PMIs, would be an economic positive.

Housing was also in focus last week, but the results were more mixed than the manufacturing data. Positively, homebuilder sentiment hit a new high, reflecting the fact that homebuilders, so far, don't think higher interest rates will hurt the market. Housing starts, however, had a big headline drop, which spooked some investors. However, it's important to note that drop came from the multi-family segment. The more-important single-family segment was basically flat month-over-month, so the number wasn't as bad as expected. The takeaway is that the question of whether or not higher rates might slow the housing recovery remains very much unanswered.

The one definitive negative last week was the retail sales report, which missed expectations and implies, somewhat, that the consumer might be slowing spending. Whether consumer spending can continue through tax increases, sequestration, etc. has been a concern for some time. And, last week's numbers, while not definitively saying the consumer is slowing, will keep the debate, and concern, alive. Finally, jobless claims reversed their recent increase last week (the increase was mostly due to the July Fourth holiday skewing the data), so the jobs market continues to improve at about the same pace we saw last month (which is a positive).

Internationally, there was a lot of Chinese economic data last week. Given the concern about China's economy, it was closely watched. But, the result was relatively anticlimactic. The data largely met reduced expectations, and 7.5% growth remains a key number to watch. The Chinese government said they still expect '13 GDP growth to be 7.5%, but most believe there's downside risk to that number. If expected GDP growth drops below 7.5% and moves toward 7%, that'll be a headwind for commodities and global equities. So, the situation in China remains precarious.

Market	Level	Change	% Change
Dollar Index	82.715	-.24	-.29%
Euro	1.3139	.0034	.26%
Pound	1.5255	.0044	.29%
Yen	.9980	.0024	.24%
CAD $	.9631	.0014	.15%
AUD $	.9157	.0026	.28%
Brazilian Real	.4429	-.0025	-.56%
10 Year Yield	2.491	-.043	-1.70%
30 Year Yield	3.572	-.058	-1.60%
Prices taken at previous day market close.			

Again, the main takeaway from the data last week was that nothing was released that changed the current expectation of Fed "tapering" to begin in September.

This Week

The highlight of the week undoubtedly will be the global "flash" manufacturing PMIs released in China (Tuesday night) and Europe and the U.S. (Wednesday morning). The international data will be more market-moving than the U.S. data. In particular, markets will be looking for:

1) Stabilization of the Chinese manufacturing sector (so the PMI doesn't fall much further than last month's 48.3).

2) An uptick in growth in the EU manufacturing sector (so an uptick from last month's 48.7).

If the data reflect both those events, it'll be a tailwind for stocks and commodities, and vice-versa.

Looking domestically, housing and manufacturing continue to be the key areas of focus this week. Given the uncertain nature about the housing recovery, existing home sales (today) and new home sales (Wednesday) will be closely watched for more color on whether higher rates are slowing the housing market. In manufacturing, June durable goods are released, and are expected to give further insight as to whether we are seeing a growing recovery in manufacturing.

Finally, weekly unemployment claims will be monitored to make sure they "stick" at current low levels, and that the spike higher in early July was indeed a one-off July Fourth statistical aberration.

While the international PMIs this week are pretty important with regard to sentiment toward China and Europe, domestically the data is more anecdotal with regard to WWFD. Nothing on its own this week will likely alter the present course of Fed "tapering" unless there is a big negative surprise.

Commodities

Commodities rallied almost 1%, rising to a five-week high last week, as a weaker dollar and better-than-expected domestic manufacturing data helped to offset continued worries about Chinese economic growth.

Energy was once again the big outperformer, as WTI crude rallied nearly 3% on momentum buying after another much larger-than-expected weekly draw on inventories. In fact, the three-week draw on domestic inventories has been nearly 27 million barrels, the highest in 30 years!

One of the reasons for that draw was increased refinery runs, which are in part due to the closing of the very profitable spread between Brent and WTI crude prices. That spread stood at over $20 earlier this year (and produced huge margins for certain U.S. refiners), but as of this morning, WTI is trading at a premium to Brent for the first time in years.

Turning to metals, both gold and silver traded higher last week, mostly in reaction to the weaker dollar, although both metals once again failed to break through important resistance levels, until this morning.

While the headlines surrounding gold remain pretty negative, there are some positive undercurrents. First, the third quarter is a seasonally strong period for gold (thanks mostly to increased demand surrounding various Indian festivals). Second, inflation has ticked up just a bit recently (CPI and PPI). Finally, the Indian government has recently taken multiple steps to defend the rupee, which is peripherally gold positive.

$1300/oz. has been critical resistance in the gold market recently, but this morning gold is trading well through that level (around $1315/oz. as of this writing). Given the record number of shorts in gold, this isn't an insignificant event, although I will want to see gold notch two or three closes above that $1300 level before saying the multi-month downtrend is over.

Commodities in general appear to have finally broken the months long downtrend that's been in place for much of the year, although obviously risks remain (primarily Chinese growth). Those with high risk tolerance looking for a place to outperform should continue to look to commodities, as ETFs like DBC have badly lagged other asset classes, and could significantly outperform if the global economy improves. This week's flash PMI numbers will be very important towards confirming last week's commodities breakout.

Currencies & Bonds

The dollar traded lower again last week, as a "dovish" Bernanke overshadowed better than expected economic data. And, the weakness continues as this morning the dollar is trading at a new, multi-week low, which implies this correction isn't over.

But, I still consider this weakness in the dollar little more than the further "flushing" of the late dollar bulls, as the dollar index's recent performance is only becoming more detached from the economic reality, as Fed "tapering' of QE remains firmly on schedule, while the rest of the world's central banks are firmly in the mode of "doing more" accommodation. As a result, I think this remains a buying opportunity in the dollar.

Turning to other currencies, there were two events in Europe and Japan that were closely watched over the weekend, but neither result appears too market moving. In Japan, PM Shinzo Abe's party easily won the upper house election yesterday, and won more than the 70 seats needed to have a majority in both houses. This obviously makes it easier for him to perform "Abenomics," which is yen bearish. But, the result was expected, so we're not seeing much of a move this morning.

In Europe, unsurprisingly the Portuguese government failed to reach agreement by the Sunday deadline called the Day of National Salvation (politicos in Portugal are as bad as European soccer players with their histrionics). But, importantly, the Portuguese President, who can dissolve Parliament and call elections, said last night the current government will serve out its term until early 2015. That removes the prospect of new elections, and the euro is rallying as a result. Looking ahead to the week, the economic data Wednesday will be the main driver of currencies & bonds this week.

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 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 rally in the dollar index has paused over the past two weeks. But, 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 over the past two weeks on "dovish" comments for Bernanke. But, with the Fed moving to the sidelines until later August, the fundamentals of "tapering" and an improving economy should once again exert downward pressure on bonds.*

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.**