7:00's Report

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

July 23, 2013

Pre 7:00 Look

- Futures marginally higher ahead of a busy day of earnings, rising in sympathy with Asian markets.
- The news o/n emanated from Asia, and it was universally positive: Chinese Premier Keqiang made comments that sub 7% GDP growth "would not be tolerated" and a government report in Japan upgraded the economic outlook, saying deflation was receding. The Hang Seng and Nikkei rallied 2.3% and .8% respectively.
- Econ Today: No Reports Today.
- Earnings Today: APPL (E: $7.31), T (E: $0.71), DD (E: $1.35), LMT (E: $2.18), NSC (E $1.50), UTX (E: $1.59).

Market	Level	Change	% Change
S&P 500 Futures	1693.00	2.75	.16%
U.S. Dollar (DXY)	82.40	.083	.10%
Gold	1328.60	-7.40	-.55%
WTI	106.10	-.84	-.79%
10 Year	2.488	-.003	-.12%

Equities

Market Recap

Stocks continued their grind higher Monday during a very quiet trading session, where the royal birth seemed to generate as much buzz as anything market-related.

Other events from abroad over the weekend that captured traders' attention on a macro level included the removal of Portuguese election risk and Shinzo Abe's win in the Japanese Upper House, although neither affected trading much.

Gold: For the first time in 4 months gold is trading above the 23 & 30 exponential moving averages. If it can hold these levels for the next few days, the downtrend will have ended.

Domestically, although this is the busiest week of earnings, Monday was relatively subdued. And, Monday reflected earnings season to date: mixed results but nothing really that bad. McDonald's (MCD) and Halliburton (HAL) both dropped post-earnings, as did Netflix (NFLX) after the close. But trading remains "earnings-specific" and there's not much extrapolation occurring from individual company results. (The point being, weak individual earnings aren't dragging down entire sectors of the market.)

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The "miss" on existing home sales saw markets trade to their lows of the day (but down only marginally) before a gradual lift took stocks from slightly negative to slightly

Market	Level	Change	% Change
Dow	15545.55	1.81	.01%
TSX	12758.38	73.25	.58%
Brazil	48574.09	1173.86	2.48%
FTSE	6644.38	21.42	.32%
Nikkei	14778.51	120.47	.82%
Hang Seng	21915.42	498.92	2.33%
ASX	5017.11	15.25	.30%
Prices taken at previous day market close.			

positive by the close. Overall, Monday was a quiet day.

Trading Color

The Nasdaq and small caps were the outperformers Monday (although only marginally so), while the Dow finished virtually unchanged.

Market	Level	Change	% Change
Gold	1335.90	41.90	3.24%
Silver	20.46	1.00	5.11%
Copper	3.17	.04	1.24%
WTI	106.77	-1.28	-1.18%
Brent	108.14	.07	.06
Nat Gas	3.67	-.12	-3.06%
Corn	4.97	-.04	-.70%
Wheat	6.58	-.06	-.94%
Soybean	12.90	.16	1.30%

Prices taken at previous day market close.

The tech sector bounced back from its earnings-related declines ahead of Apple (AAPL) today, but the real market leaders yesterday were financials (which we saw via follow-through buying of the banks post-earnings) and basic-materials stocks (thank to the Chinese finance minster re-affirming 7.5% annual growth). And, of course, the big winner on the day was the gold mining sector, with the Market Vectors Gold Miners ETF (GDX) up 6% on gold's big surge.

Conversely, energy led the way lower on profit-taking, lower WTI crude and HAL's earnings-related decline. Meanwhile consumer staples also underperformed thanks to MCD.

Finally, I want to point out that the two big "winners" so far this earnings season appear to be the basic materials companies (Alcoa, Rio Tinto, BHP Billiton, etc. all beat) and Industrials (GE results on Friday and then Lennox and Emerson Electric's numbers yesterday). Generally speaking, those are two groups that tend to lead an uptick in global economic growth. It's certainly too early to tell, but for those who took a contrarian play on basic materials/commodities/industrials, this earnings season has got to make you a bit optimistic on the future.

Volumes were well-below recent averages, and that's not surprising given the deluge of earnings starting today and the economic data looming Wednesday. On the charts the S&P continues to grind to new highs, and resistance at 1,700 is well-within striking distance.

Bottom Line

Nothing really changed in the market yesterday. Stocks are exhibiting a bit of fatigue at these levels after the run, so a sideways consolidation wouldn't be surprising. But, with bonds in a downtrend and the macro horizon relatively clear, unless economic data turns south or earnings get much worse, it'll be tough to get this market to materially decline.

The path of least resistance remains higher in equities, and lower in bonds (with the latter being the easier way to make money over the coming months, I think). Things should get a bit busier today with earnings and the economic data looming Wednesday morning.

Economics

Existing Home Sales

- June 5.08M vs. (E) 5.27M

Takeaway

Monday's existing home sales report missed expectations, and while it wasn't really a "bad" report, it'll keep alive the concern that higher mortgage rates will dampen the housing recovery.

Existing home sales fell in June and May's data was revised lower, pointing to a slowdown in activity. But, to keep context, June was the second-strongest month of sales since the homebuyer tax credit was created several years ago, and prices remain firm. (Which, from a family balance sheet perspective, that's almost more important than the pace of sales.) Prices increased again in June and year-over-year are 13.5%. Supply remains tight at just 5.2 months' supply.

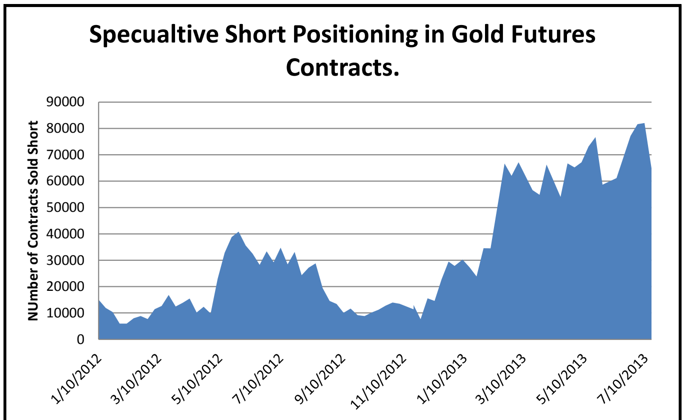
So, the takeaway is that this isn't a horrible number, but it does at least anecdotally imply higher rates are exerting some sort of an influence on the housing market. At this point, though, they certainly aren't a "recovery-killer" and this number won't alter any Fed intentions to "taper" QE.

Commodities

Commodities in aggregate were flat to start the week as the complex consolidates last week's big gains. But, Monday exhibited a bit of a leadership change in the commodity complex, as metals rallied strongly and offset some weakness in the energy complex, which has been the sector most responsible for the recent rise in commodity indices.

Gold and silver had their best day in a long time Monday, rallying 3% and 5% respectively, and importantly breaking through some critical resistance levels.

In looking at "why" gold and silver rallied, certainly the weak dollar had something to do with it—but so did the strong election results favoring "Abenomics" in Japan, which will almost certainly lead to further devaluation of the yen and higher inflation.



The number of "shorts" in the gold market remains near record levels. If gold can move higher from here, the rush to cover could produce a violent rally.

Finally, positive comments from China's finance minister implying the Chinese economy may be bottoming, combined with the aforementioned lending reforms, all helped to push gold through resistance in early Asian trading Monday morning,. The strength carried through here domestically yesterday.

Gold and silver have now broken through the 23- and 30-day exponential moving averages, which have capped any rally since March. But, given the volatility in that market, I will want to see another close or two above those levels, and ideally above the 50-day EMA at $1,335 in gold, before confidently saying the gold decline is "over."

It's important to remember, though, that short-covering is going to play in important part in whether gold continues to rally. Although there was covering last week (and certainly a lot of covering yesterday) the number of shorts in the gold market remains simply massive. If gold can hold these levels and move through $1,335, then the covering will intensify, and we could see a substantial and violent move higher, as shorts rush to cover their positions and book profits (or cut losses).

Market	Level	Change	% Change
Dollar Index	82.197	-.41	-.50%
Euro	1.3190	.0047	.36%
Pound	1.5356	.0089	.58%
Yen	99.55	-1.10	-1.09%
CAD $	.9674	.0029	.30%
AUD $	.9250	.0078	.85%
Brazilian Real	.4480	.0031	.70%
10 Year Yield	2.482	-.006	-.24%
30 Year Yield	3.553	-.011	-.31%
Prices taken at previous day market close.			

The benefit of the doubt still goes to the bears, but if gold can hold these levels through the economic data Wednesday, then I think we'll see a potentially violent move higher on short-covering.

From a "how to play it" standpoint, I've bought the lesson many times over that you buy breakouts in gold. (You don't watch the breakout and then hope for a pullback; it doesn't come.) So, since this move isn't really a true breakout yet, I wouldn't buy at these levels, as it's still possible this is one massive head fake.

Instead, I'd look to buy any decent breakout above that $1,335 level—and yes, I'd buy the miners (GDX) too if gold can break this downtrend. But, it pays to be patient here, especially with the economic data looming tomorrow.

Away from the precious metals, the commodities markets were relatively calm. As mentioned, energy finally took a breather, as WTI crude fell 1% while natural gas and RBOB gasoline, which were some of the biggest gainers last week, fell 3% and 2% respectively.

Excluding natural gas, WTI and Brent crude were lower on general profit-taking, although as I've been saying I think both are due for a correction, given the run-up we've seen. But, the trend in energy remains higher, and I'd buy any material dip in WTI (say, nibbling a bit below $103 and buying more as it gets closer to $100/bbl).

Looking at natural gas, it remains totally weather dominated, and cooler weather is expected across much of the mid-west/north-east over the next week, hence the dip yesterday.

While weather dominated in the short term, I do think it makes sense to continue to take advantage of natural gas on big dips, say down toward the $3.50 level, like we did in early July. That's because at those levels, unless the weather turns decidedly cool, the risk/reward on the trade is reasonable.

Given the increased demand, the price band for natural gas has shifted higher. At these inventory levels, $3.50 reflects some value. So, I'd be a buyer of nat-gas on any dips toward $3.50.

Wednesday will be a big day for the commodity markets (global flash manufacturing PMIs released) so until then I'd expect a relatively quiet (and somewhat meaningless) trade in the commodity space—with the exception of the precious metals.

Currencies & Bonds

Dollar weakness continued Monday, as the Dollar Index fell 0.5%, thanks to follow-through selling from last week and the weaker-than-expected existing home sales data. The correction in the dollar continues, but until the Dollar Index breaks the 81 level, this is little more than a correction in an upward-trending market.

While the dollar was universally lower vs. other major currencies, the big currency news of the weekend (no Portuguese elections and the further strengthening of power for Japanese PM Shinzo Abe) failed to produce much of a response, as both events were somewhat expected.

Looking to Japan, the elections over the weekend have resulted in what some are calling the strongest Japanese government in 10+ years. With the Abe's LDP Party (Liberal Democratic Party) in charge of the upper and lower house, it ends the "hung parliament" that has been in place since '06. And, almost as importantly, the LDP did not earn an outright majority in the upper house (their governing coalition has the majority) so that's being viewed as a positive, as it'll keep Abe focused solely on economic reforms. (He doesn't have a blank check in Parliament to do whatever he wants, just a strong majority coalition.)

As far as "what's next" and what does this mean for Japan, we should see the unveiling of what's being referred to as the "Third Arrow" of Abenomics. The third arrow is structural reforms in the economy that are designed to facilitate economic growth. This includes measures like reducing regulation, cutting corporate taxes (but increasing consumption taxes), and other policy0related measures.

With a strong majority in government, it's expected Abe will be able to implement the "third arrow" soon and we should begin to hear more details about this in the August/September time frame.

From an investment standpoint, the result is bullish the WisdomTree Japan Hedged Equity Fund (DXJ) and bearish the yen. Although the yen rallied yesterday on the result, that was more due to dollar weakness than yen strength. I expect it'll only be a matter of time till the yen is back below 100/dollar—this time likely for good.

Whether or not the full implementation of "Abenomics" works is very debatable, but it will devalue the yen, and it will raise share prices. From an investment standpoint, that's all we need to know. So, bottom line is I remain bullish on DXJ, and expect it to grind higher over the coming months as the full implementation of "Abenomics" occurs.

Turning to bonds, they were flat yesterday despite the Fed buying $1.5 billion worth of long bonds Monday morning. I continue to expect that this counter-trend rally in bonds is nearing its conclusion—as long as the economic data stay decent.

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 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).**

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 their 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 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.**

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.**