7:00's Report

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

July 24, 2013

Pre 7:00 Look

- Futures marginally higher as decent earnings and a surprisingly strong EU flash manufacturing PMI are offsetting a "miss" on flash manufacturing PMI from China.
- EU Flash manufacturing PMI was much stronger than expected, rising to 50.1, a two year high, and further implies the EU economy is stabilizing.
- Chinese Flash manufacturing PMI missed estimates and fell to an 11 month low, dropping to 47.7 vs. estimates of 48.5.
- Econ Today: PMI Manufacturing Flash (E: 52.8), New Home Sales (E: 481K).

Market	Level	Change	% Change
S&P 500 Futures	1691.75	3.50	.21%
U.S. Dollar (DXY)	82.15	.11	.13%
Gold	1340.60	5.80	.43%
WTI	107.27	.05	.05%
10 Year	2.516	.028	1.13%

Equities

Market Recap

Stocks closed marginally lower Tuesday during another earnings-dominated but overall slow session. The S&P 500 declined 0.19% in quiet trading.

Yesterday started with markets virtually flat, and outside of earnings-specific trading, the biggest events that moved markets were the disappointing Richmond Fed manufacturing index (which didn't really move markets that much) and some comments by House Speaker John Boehner about the debt ceiling (which weren't constructive, and did cause a temporary dip in the market mid-morning). But, neither event was really that important, and markets largely shrugged off both by the afternoon.

SXPP: The European Basic Resources Index is a great proxy for global economic growth, and it looks as though it may be breaking a near-6-month downtrend.

Stocks sold off into the close ahead of some tech earnings after the closing bell (tech has been the big disappointment this earnings season) and ahead of the economic data this morning. Overall, though, it was a pretty quiet session, especially considering we're in the heart of earnings season.

Trading Color

Earnings results continue to dominate sector trading, and the broad takeaways from this earnings season were again represented yesterday. Basic materials stocks have been the clear "winners" as large, multinational miners have consistently beaten estimates. That continued yesterday as AK Steel (AKS), Alpha Natural Resources (ANR), Freeport-McMoRan (FCX) and Peabody Energy (BTU) all posted good results, and rose between 3% and 5% each.

Industrials have also been a positive surprise this quar-

Market	Level	Change	% Change
Dow	15567.74	22.19	.14%
TSX	12745.38	-13.00	-.10%
Brazil	48819.52	245.43	.51%
FTSE	6638.89	41.45	.63%
Nikkei	14731.28	-47.23	-.32%
Hang Seng	21968.93	53.51	.24%
ASX	5035.07	17.96	.36%

Prices taken at previous day market close.

ter, and Lockheed Martin (LMT) and United Technologies (UTX) continued that trend yesterday, both rallying off earnings results.

Finally, on the flipside, tech has been the undisputed loser this earnings season, although Apple (AAPL) beat after the close. That should help soften the blow and close the performance gap between the Nasdaq and other indices that's evolved since earnings started.

Market	Level	Change	% Change
Gold	1335.10	-2.20	-.16%
Silver	20.27	-.24	-1.19%
Copper	3.19	.01	.39%
WTI	107.31	.37	.35%
Brent	108.59	.44	.41%
Nat Gas	3.75	.07	1.85%
Corn	4.85	-.12	-2.56%
Wheat	6.52	-.07	-1.10%
Soybean	12.62	-.26	-2.06%
Prices taken at previous day market close.			

Elsewhere yesterday, financials were flat as their earnings are mostly over at this point, while homebuilders rallied after the FHFA House Price Index was in line with expectations.

Volumes, outside of earnings-specific situations, were below recent averages. Given that the broader indices didn't move, nothing much changed on the charts.

Bottom Line

"Apathetic" is probably the best way to describe this market right now. Normally, an earnings day as busy as yesterday would have been simply crazy, but yesterday seemed more like a day in the week before Labor Day than it did a day during the busiest week of earnings season.

Earnings haven't been universally good but, more importantly, they haven't been universally bad either, and hence aren't a reason to de-risk given the macro environment.

It seems that, at the moment, the market is stuck in a bit of purgatory. The larger trends (Fed "tapering," higher interest rates, stabilization of European Union growth and potential further European Central Bank action) that will dictate whether this market can continue its rally in the months/quarters ahead are simply not evolving right now. (That's because the market has accepted Fed "tapering," rates have stopped their steep climb higher, emerging markets have stabilized and the ECB isn't really in play right now, either).

So, we appear to be in one big "wait and see" mode that will likely have economic data be the driving factor in the near-term market direction.

Bottom line, though, is that while the markets are a bit stretched in the short term and they feel a touch tired, one of the first rules I learned on the floor was "You don't short a dull market."

So, for now I'd hold positions, and continue to use this pause/counter-trend rally to get positive exposure to higher rates/lower bond prices.

As far as what to watch, the most-interesting opportunities right now seem to be overseas—specifically, whether or not we are seeing a stabilization in global economic growth. While the situation in the U.S. may remain stationary until later this summer, that's not the case in Europe and Asia. There, we may be getting a positive turn in growth, and although the flash manufacturing PMIs this morning were mixed, on balance they are positive for global growth, as a return to growth in the EU economy is incrementally much more positive for the global economy than the deceleration of Chinese economic growth (from 8.0% to 7.5%) is negative.

Just In Time To Ruin Another Recovery

One of the reasons markets turned lower yesterday morning was because of Boehner's comments that there will be no debt ceiling increase this fall without spending cuts. In doing so, he fired an early warning shot about what could become another Washington fiasco this fall.

It's still a ways in the distance, and the comments didn't really affect trading yesterday all that much. But it's a good reminder that, when we sit and think about what could de-rail the recovery and the rally, Washington remains at the top of the list.

Four times since the recovery began, policies, fumbling and fighting in Washington have impeded the economy. *First*, it was with the battle and passage of the healthcare law. (Regardless of your opinion of the law, it created so much uncertainty for businesses that it sapped economic momentum from the economy back in '11.) *Second*, the debt ceiling debacle of summer of '11 negatively affected the recovery. *Third*, the fiscal cliff drama last winter was a headwind. *Fourth* and finally, the sequester—while not the catastrophe the pundits said it would be—certainly isn't helping things currently.

So, we should all enjoy the summer, but Washington has been on quite a roll lately when it comes to pushing back on a recovering economy. However, as they say, "hope springs eternal"—so maybe we'll finally get a tailwind from our fearless leaders this fall. Seriously, though, Washington remains a macro risk on the horizon, one that needs to be watched as October approaches. (That's when we'll likely hit the debt ceiling as of now.)

Economics

No reports yesterday.

Commodities

Commodities were almost universally lower early on Tuesday, but slowly and methodically they rallied throughout the day to finish flat—continuing the recent trend of resilient and strong price action.

Industrial commodities outperformed as the major influence in the commodity markets was bullish Tuesday, namely positive sentiment surrounding Chinese economic growth and a weaker U.S. dollar. Comments by Chinese Premier Li Keqiang saying sub-7% GDP growth in China is "unacceptable" is helping to calm fears of an unaddressed slowdown in growth. Plus, expectations of more Chinese rail expansion (officials said the rail department had only used 1/3 of its annual budget in the first half of '13) relieving supply gluts in cement and steel helped industrial commodities to largely outperform.

Dip-buying was the theme of trading Tuesday in the energy complex. WTI crude finished the day marginally higher, but that result was pretty good considering WTI crude was down by more than 1% early on Tuesday. Most of the weakness was due to profit-taking, and clearly there are a lot of buyers on dips—especially ahead of the weekly inventory numbers released this morning.

Market	Level	Change	% Change
Dollar Index	82.028	-.191	-.23%
Euro	1.3216	.0030	.23%
Pound	1.5374	.0015	.09%
Yen	99.57	-.10	-.10%
CAD $	.9710	.0033	.34%
AUD $	.9281	.0032	.35%
Brazilian Real	.4511	.0033	.74%
10 Year Yield	2.508	.023	.92%
30 Year Yield	3.58	.028	.78%
Prices taken at previous day market close.			

Energy outside of WTI crude was also strong, as Brent, RBOB gasoline and heating oil all rallied off their lows to finish marginally positive. Natural gas was actually the best-performing commodity yesterday, rising 1.7%, as some long-range weather models implied some hotter temperatures are returning. The truth is, Monday saw a good decline and a combination of short-covering and dip-buying helped nat-gas to rally.

Looking at precious metals, yesterday was a very impressive day, and gold and silver are trading as well as they have in months. Gold started the day down about 0.5%, but rose steadily throughout the day and actually was trading at a new, multi-week high after the close (over $1,540/oz.).

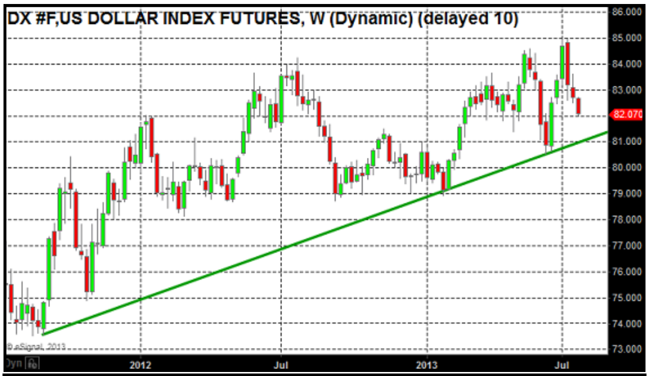
The rebound yesterday was even more impressive given that the Reserve Bank of India again took steps to curb gold imports—this time by requiring importers to sell gold only to jewelers and bullion dealers, who will then sell to jewelers. What's more, the bank is now requiring that 20% of imports must be used for export. So, given that last piece of news, you would expect gold to have traded lower yesterday, and it did not—and that's a positive sign.

In particular, watch how gold trades today after the flash manufacturing Purchasing Managers' Indexes. If the numbers are better-than-expected, and you see the dollar rally and gold rally (which isn't as mutually exclusive as most analysts make you think it is), then that tells you gold is rallying because it's discounting expected inflation. This will likely be a key signal that it's time to get long. However, IF the dollar rallies and gold declines sharply, then I don't think the downtrend will have ended, as inflation is the key to a sustained gold rally now.

Commodities continue to trade "better" than they have in months. While the economic data today and looming next week will certainly affect trading, it sure feels like the tide has turned in the natural resource/basic materials/commodities markets, and that allocating some capital to that sector finally offers some decent risk/reward.

Currencies & Bonds

The dollar was universally weak against all major currencies again on Tuesday. The Dollar Index fell 0.35%, going out at basically one-month lows. “Reasons” cited for the dollar weakness were the worse-than-expected Richmond Fed manufacturing reading and the Boehner comments about the debt ceiling. But, in truth, momentum selling continues to be more-responsible for the dollar slide than anything else, as no one pays attention to the Richmond Fed and the debt ceiling fight is still well in the distance.



Dollar Index: It’s not a perfect support line, but it illustrates the point—the longer term trend in the dollar index is still higher, despite this recent correction.

The Aussie dollar was again the biggest gainer vs. the greenback, thanks to the positive China comments and sentiment. The euro followed, rallying 0.3% vs. the dollar. This was mostly due to dollar weakness, but there were also some “whispers” of economic stabilization in Europe yesterday.

Although not official releases, there two internal looks at Spanish and Italian second-quarter GDP by each respective country, and the results are encouraging.

We’ve been saying here for a few weeks that European economic data appears to be stabilizing (and turning positive in the UK, hence the call earlier in July to get long that market). Well, yesterday the internal “looks” at Spanish and Italian GDP implied stabilization in those economies (two of the weakest in the EU). The estimates showed Spanish GDP contracting just 0.1% in Q2 (much-improved from the 0.5% contraction in Q1), while Italian GDP contraction also appears to be slowing.

From an investment standpoint, if these numbers hold true and there is stabilization in Europe, then that bodes well for my UK long. (I still think that is the better way to play a recovery on the Continent, as the UK doesn’t face the governmental integration headwinds that will continue to pop up in the EU for years to come.) If growth is stabilizing, then Europe is a big value, and a buy … but that’s still a big “if.” For now, at least, it appears as though growth there is stabilizing.

I’ve made it clear that I think the Dollar Index is undergoing a correction, not a trend change, given that the fundamentals behind the dollar rally from mid-June remain very much intact. So, if I think that, then, it’s logical that I have an area that I think the dollar correction will stop.

81.00-ish is an area of an uptrend in the Dollar Index dating back to May 2011. If the dollar remains in an uptrend, as I believe it does, then this decline will stop there, and I’d look to be a buyer of “dollars” via the PowerShares DB U.S. Dollar Index Bullish (UUP) or via shorting the yen (with the ProShares UltraShort Yen, or YCS), euro (with the ProShares UltraShort Euro ETF, or EUO) or Aussie (by shorting the iShares China Large-Cap ETF, or FXI) as the Dollar Index approaches that level. (If you’re already long the dollar, that’s your stop—about 1.5% from here.)

Treasuries finished marginally lower, although they rallied off their worst levels of the morning to close down 0.2%. (The reason cited for the bounce was again the Richmond Fed. Just like with the Dollar Index, that’s more of an excuse than anything.) Treasuries continue to consolidate ahead of the economic data today and the string of macro-economic events coming next week (the Federal Open Market Committee meeting, the jobs report) that likely will be the next major catalysts in this trend.

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	Neutral	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.**