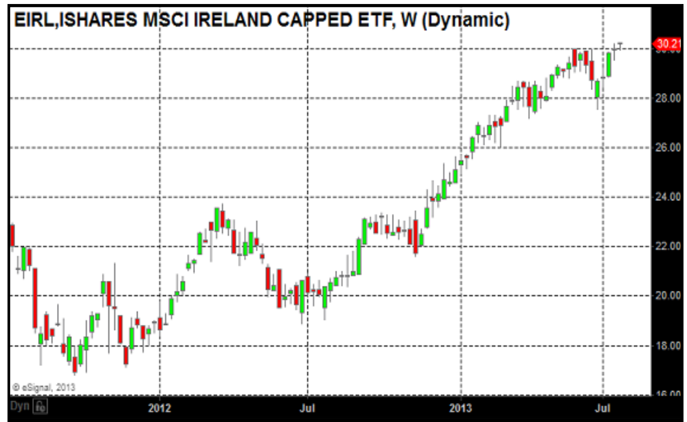
7:00's Report

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

July 25, 2013



Ireland ETF: Of all the bailout countries, Ireland is in the best position fiscally and economically, and may offer the most upside on a continued rebound in Europe.

Pre 7:00 Look

- Futures sharply lower as higher rates in the U.S. once again spook investors and caused weakness in emerging markets.
- European markets down by 1% despite good economic data: UK Q2 GDP met expectations, and German IFO Sentiment survey beat estimates.
- China outperformed in Asia (but still finished lower) after the government announced a mini stimulus program comprised mainly of tax cuts for small business.
- Econ Today: Jobless Claims (E: 341K), Durable Goods Orders (E: 1.5%).

Market	Level	Change	% Change
S&P 500 Futures	1672.50	-11.25	-.67%
U.S. Dollar (DXY)	82.375	-.025	-.03%
Gold	1311.60	-7.90	-.62%
WTI	104.59	-.80	-.76%
10 Year	2.588	.072	2.86%

Equities

Market Recap

Stocks drifted lower Wednesday, as a spike higher in interest rates offset generally positive earnings and good economic data. The S&P 500 fell 0.38%.

Stocks started Wednesday stronger, rallying off good earnings out overnight (AAPL in particular) and also thanks to the surprisingly strong flash Purchasing Managers' Indexes form Europe and the U.S.

But, what drove stocks yesterday wasn't earnings or economic data—it was Treasury yields, which had their biggest one-day jump in weeks from several articles stating Larry Summers is the new frontrunner to replace Ben Bernanke. The sell-off in Treasuries was then exacerbated by the better economic data.

Although stocks opened higher, as yields rose this acted as a drag on stocks. The averages spent virtually the entire day lower before catching a small bid during the last hour of trading to halve their declines.

Trading Color

While earnings still figured prominently into sectors' and indices' performance yesterday, we also saw a return of the effect of higher interest rates on sector trading (something that has been absent for a few weeks). "Bond-proxy" and yield-sensitive sectors underperformed yesterday as utilities, REITs and homebuilders were the worst-performing S&P 500 sub-sectors. Basic materials and energy also lagged, trading off the weak Chinese economic data and the drop in oil prices (the reduced CAT guidance didn't help things, either).

Market	Level	Change	% Change
Dow	15542.24	-25.50	-.16%
TSX	12672.30	-73.08	-.57%
Brazil	48374.23	445.29	.91%
FTSE	6550.61	-69.82	-1.05%
Nikkei	14562.93	-168.35	-1.14%
Hang Seng	21900.96	-67.97	-.31%
ASX	5035.61	0.54	.01%
Prices taken at previous day market close.			

Tech was the big outperformer, as earnings in the sector yesterday were much-better than they had been so far this season (not just AAPL, but EMC and ARW were also better).

Yesterday, trading volumes were heavier than they have been, but that's not saying a lot considering how quiet things have been. On the charts there's some support at 1,680-ish, while resistance lies at 1,700 (that round number has proven formidable resistance this week).

Market	Level	Change	% Change
Gold	1318.60	-16.60	-1.24%
Silver	20.07	-.19	-.93%
Copper	3.18	-.01	-.52%
WTI	105.04	-2.19	-2.04
Brent	107.02	-1.40	-1.29%
Nat Gas	3.70	-.04	-1.15%
Corn	4.80	-.05	-1.08%
Wheat	6.53	-.01	-.08%
Soybean	12.56	-.03	-.28%

Prices taken at previous day market close.

Bottom Line

Yesterday was a good reminder that, while the stock market may be comfortable with Fed "tapering" in September, the expected rise in interest rates needs to be "orderly," otherwise we'll see a repeat of the turmoil in June.

That said, this market (domestically and internationally) feels a bit "tired" and, like most things that are tired, the market is probably overreacting a bit to the uptick in yields yesterday and this morning. But, the key will be the emerging markets. If PCY and EMB start declining sharply again, that's a sign this could be another bout of money flows out of emerging market like we saw in June, and that would be a negative for equities.

But, yesterday was another reminder that, while the market will continue to adjust to the idea of higher yields, the way to play that is to get exposure to higher yields (they are the constant here, not the market rallying). So, I'd continue to look to do that methodically.

The Prized PIIG

Yesterday was a good day for Europe, as the flash manufacturing PMIs rose to their best levels in months, confirming other data we've seen lately that Europe's economy might finally be stabilizing. If that is the case, then Europe offers some substantial value over the medium and longer term, although obviously risks remain.

As I said a few weeks ago, I think one of the better ways to play a recovery in Europe is by buying the UK, as it insulates you from the political battles that have yet to be waged on the continent. It also gives you "pure" exposure to a rebounding economy in that region. The iShares MSCI United Kingdom Index (EWU) is the easiest way to affect that trade.

But, there's an argument to be made that the most beaten-down European markets will rebound the most (and that's probably true, but it's also risky). EWP (Spain ETF) and EWI (Italy ETF) are there for those looking to just throw money at the most beaten-up, troubled countries. (Not really a strategy I like, but to each their own.)

But, for those looking to get a higher risk/return profile but who don't just want to throw money into Spain or Europe, take a look at the Ireland ETF (EIRL). Ireland has very quietly become the prized PIIG. As the economy has rebounded, Ireland appears close to getting full access to the capital markets, which in turn would make it eligible to access the ECB's Outright Monetary Transactions program (and very cheap funding, which should further help the economy).

So, while it remains to be seen whether fellow PIIGS Italy and Spain can get their houses in order, Ireland has plodded along quietly and appears close to exiting the liquidity hospital it's been in since the bailout three years ago. So, it's still high risk/reward, and I'd certainly wait for a bit of a correction (which may be starting today) before getting long EIRL, but at least you've got some positive fundamental economic/fiscal momentum on your side (one more thing—volumes on this ETF is pretty low, so you'll want to be careful with any big allocations).

Economics

Economic data yesterday was good. The big number of the week, flash manufacturing PMIs, beat expectations, as did new home sales. Data yesterday helped contribute to the bond market sell-off, as it further solidified the expectation that the Fed will "taper" QE in September.

PMI Manufacturing Index Flash

- July Flash Manufacturing PMI 53.2 vs. (E) 52.8.
- New Orders rose to 55.1 vs. 53.4 in June.

Takeaway

The rebound in manufacturing appears to be gaining steam after a sluggish Q2, as the "flash" PMI confirmed multiple other measures in manufacturing activity by accelerating in July. The headline beat expectations and is at a four-month high, while the details of the report were also strong. New orders, the leading indicator of the report, rose to 55.1, implying business activity is accelerating. Importantly, the employment index rose back above 50, increasing to 52.6 from June's 49.9, implying the pace of hiring in the manufacturing sector is accelerating. So, this was a pretty good report and is positive 1) for the economy generally and 2) for industrial stocks. Treasuries fell on the news as this further solidifies the economy is gathering steam, which makes "tapering" in September that much more likely (and it's widely expected at this point).

New Home Sales

- June New Home Sales were 497K vs. (E) 481K, seasonally adjusted annual rate.

Takeaway

New home sales had a pretty strong headline number, with the pace of sales hitting their highest level since May 2008. But, the details weren't quite as good as the headline report. First, there were revisions of -38K for the three months preceding June. Second, sales could have spiked higher because of buyers trying to lock in financing in the face of higher rates, so to a point this number may reflect a "pull forward" in demand.

The new home sales report pretty much wraps up housing data for June, and the takeaway is this: The housing recovery remains very much in gear, but there were hints in the June data that higher rates may be starting to be a bit of a drag. Housing is very, very important to the economic recovery (prices more so than sales), so this will remain an area of interest next month. From a What Will the Fed Do (WWFD) standpoint, though, nothing in the housing data this month would cause them to change their current course (so tapering in September is still on).

Market	Level	Change	% Change
Dollar Index	82.289	.344	.42%
Euro	1.3197	-.0026	-.20%
Pound	1.5312	-.0056	-.36%
Yen	100.17	.74	.74%
CAD $	.9692	-.0028	-.29%
AUD $	.9159	-.0136	-1.47%
Brazilian Real	.4451	-.0062	-1.37%
10 Year Yield	2.598	.088	3.38%
30 Year Yield	3.655	.075	2.05%
Prices taken at previous day market close.			

Commodities

Commodities were sharply lower Wednesday, as virtually every commodity on the screen declined (wheat being the notable exception). Despite a lot of headlines regarding the weak Chinese PMI report, it was actually the stronger dollar that was responsible for the commodity weakness. Most commodities started trading Wednesday flat to slightly higher, but turned sharply negative around lunchtime as the dollar moved to the highs of the day.

WTI crude was the worst-performing commodity yesterday, declining 2% despite seeing a larger than expected draw in the weekly inventory numbers (-2.8 million barrels vs. (E) -2.1 million barrels). But, WTI had gotten very stretched, and a correction of some sort was warranted—the soft Chinese data and higher dollar were merely the catalysts.

Energy was broadly lower (Brent, natural gas and heating oil were all down around 1%), but RBOB gasoline, much to consumers' dismay, only declined marginally. The reason for the outperformance was a surprise decline in weekly inventories of 1.4 million barrels, compared to an expectation of a 900K increase. So, the supply/demand situation in gasoline remains relatively tight.

Turning to metals, gold fell 1.2% yesterday, as around 12:30-ish a wave of selling hit gold—sending it to the lows of the day. (Gold had spent most of the day relatively flat, and was trading pretty resiliently until the close.) Silver fell by 1%, generally following gold lower, while copper was down only marginally (which confirms that the Chinese data wasn't the main driver of commodity weakness yesterday).

I said yesterday it'd be interesting to see if gold was able to rise with the dollar, should the PMI number be good. That would be a clue that gold—and the commodities markets. to a lesser extent—were starting to trade off expected inflation and economic growth, not simply as contra-dollar assets, as they've been lately. Well, that didn't happen, and as the dollar rallied commodities got hit en masse.

The key now is whether the complex can hold. A correction like this isn't necessarily surprising given the big move higher in commodities. The key now is if the breakouts that have occurred can hold support. These levels are important: $26.00 in DBC, $1,300 in gold and $3.16 in copper. If those levels hold, then the downtrend is over; if they don't, this has been one enormous head fake. This is why you always want to wait for a few closes to confirm a breakout in commodities, because they are notoriously prone to head fakes (as I've learned the hard way over the years).

Currencies & Bonds

The Dollar Index and Treasuries both rallied for the first time this week on Wednesday, but the main catalyst wasn't the better economic data (although that obviously helped). Instead, the reports in the Washington Post (link here) and Huffington Post (link here) that Larry Summers appears to be the favorite to become the next Fed chairman weighed on Treasuries.

It was widely assumed, up until a few weeks ago, that Bernanke would be replaced by Fed Vice-Chairman Janet Yellen, who is considered an "ultra-dove" and would err on the side of being "more dovish" whether tapering was occurring or not. Basically, she's viewed as an extension of Bernanke. Summers, if he gets the job, is relatively unknown with regard to his views on monetary policy—and it's almost a certainty that he wouldn't be as dovish as Yellen. So, Summers becoming the favorite to replace Bernanke is, in a way, a bit of a "hawkish" event compared to current expectations. This was the real catalyst behind the Treasury sell-off and the dollar rally yesterday.

The euro finished 0.3% lower vs. the dollar yesterday despite the better-than-expected manufacturing PMIs. And, that makes sense, as the good PMIs just imply the EU economy is stabilizing. They, in no way, imply the ECB will be less accommodative in the future—so it's really not that bullish of an event for the euro (although it's bullish for the EU economy).

Asian currencies declined the most vs. the dollar as the Aussie plunged 1.5% on the back of the weak Chinese PMIs. The yen fell nearly 1% vs. the dollar, and again rose above 100/dollar not just thanks to aforementioned U.S. dollar strength, but also after exports grew more than expected in Japan because of the weaker yen.

Increased exports should result in further improvement in the economy and further validate "Abenomics," which means we should see more of it in the coming months, which is of course yen-bearish. Japanese PM Shinzo Abe knows that 100 yen/dollar is not enough to turn the Japanese economy. People I talk to continue to point to the ultimate goal of 115—120 yen/dollar as the ultimate target, which means a much weaker yen, and likely much-higher Japanese stock prices.

Treasuries sold off hard yesterday, as the 30-year note fell 0.65% thanks to the Summers articles and the better than expected economic data. Rising yields remain the most fundamentally sound trend in the market today. The economy is rebounding; the Fed is turning "less dovish" both in practice and, it appears, in personnel (if Summers is nominated, which is a big "if"); and the job market is improving. On the charts, it looks as through the 30-year Treasury has failed at the first major resistance, and I think the downtrend in bonds/rally in yields is back on after this three-week-long, counter-trend rally.

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.**