7:00's Report

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

July 26, 2013

Pre 7:00 Look

- Futures modestly lower along with most international markets thanks to a sharp drop in the Nikkei and some disappointing earnings. The declines are pretty subdued across markets, however.
- The big news o/n was the uptick in Japanese CPI, which is resulting in a much stronger yen and lower stock prices. But, the number is a bit misleading: While headline CPI increased for the first time in a year, ex food and energy, CPI declined 0.2% yoy, as last June's energy prices were very low, causing the yoy change in energy prices to be exaggerated higher. The number is encouraging, but not as good as the headline implies.
- Econ Today: No Reports Today.

Market	Level	Change	% Change
S&P 500 Futures	1679.00	-5.00	-.30%
U.S. Dollar (DXY)	81.775	-.278	-.34%
Gold	1328.40	-0.50	-.05%
WTI	104.72	-.77	-.73%
10 Year	2.607	.019	.73%

Equities

Market Recap

Stocks opened lower Thursday but closed in the green, as declines in interest rates and the dollar (helped by a late-afternoon Fed article by Jon Hilsenrath, link here) helped offset some weak earnings reports and slightly disappointing economic data. The S&P 500 closed up 0.26%.

Stocks started the day modestly lower, as the jump in interest rates Wednesday caused declines in Asia and emerging markets. This weakness was compounded by several high-profile earnings misses from European companies.

Less-than-stellar economic reports from weekly jobless claims and durable goods (neither were really bad, but they weren't good either) helped the market trade to its lows right around the European close (11:30 a.m.).

But, just like the rise in interest rates pushed stocks lower Wednesday, the fact that bonds hit their lows of the day Thursday early in the morning … and then stabilized and started to rally (and yields to sell off) … helped markets to rally throughout lunchtime and into early afternoon.

Then, the Hilsenrath article hit late in the session. It basically implied that, while tapering is still "on," the Fed would tweak its "forward guidance" at next week's meeting to further drive home the point that short-term rates are staying low. The article was taken as slightly dovish so Treasuries rallied, the dollar sold off and stocks rallied into the close to finish not far from the highs of the day.

Trading Recap

Cyclicals outperformed yesterday as the Russell 2000 rallied 1%, leading all major averages, while Facebook (FB) helped the Nasdaq to outperform as well. Basic materials stocks (thanks to the China "stimulus" plan and decent earnings) were the best-performing S&P 500 subsector. Meanwhile energy, the aforementioned tech, and industrials also outperformed.

But, you can't discuss the sector trading yesterday without bringing up homebuilders, which got hit very hard on disappointing D.R. Horton (DHI) and Pulte (PHM) earnings. In particular, there were comments on the DHI conference call that were a bit concerning.

Market	Level	Change	% Change
Dow	1555.61	13.37	.09%
TSX	12669.14	-3.16	-.02%
Brazil	49065.75	692.52	1.43%
FTSE	6579.30	-8.65	-.13%
Nikkei	14129.98	-432.95	-2.97%
Hang Seng	21968.95	67.99	.31%
ASX	5042.03	6.42	.13%

Prices taken at previous day market close.

On the call, DHI's management confirmed that they did see a slowdown in sales in the back half of the quarter, and specifically cited higher mortgage rates as the reason.

So, while it's just one company and the information is anecdotal, this will keep alive the concern that higher rates will slow the housing recovery (which would be a drag on the economy).

Market	Level	Change	% Change
Gold	1329.10	9.00	.68%
Silver	20.18	.16	.80%
Copper	3.18	.30	.09%
WTI	105.62	.23	.22%
Brent	107.72	.53	.49%
Nat Gas	3.66	-.04	-1.11%
Corn	4.78	-.02	-.42%
Wheat	6.48	-.05	-.73%
Soybean	12.24	-.32	-2.61%

Prices taken at previous day market close.

Volumes and activity overall were on the slow side yesterday, excluding earnings-specific scenarios. Near-term support at 1,680 on the S&P 500 held, thanks to the late-day rally. 1,700 remains stiff resistance.

Earnings Season Recap

While only about half of the S&P 500 has reported so far (223 companies according to Bloomberg), earnings from "important" companies will pretty much be over after today, and the focus will return to the macroeconomic picture. Overall, this earnings season certainly wasn't bad enough to derail the rally, but it wasn't very good either.

So far, about 74% of the S&P 500 companies reporting have beaten earnings estimates, while a little more than half (57%) beat on revenues. Financials, healthcare and basic materials were the "winners" this earnings season, while tech was the big disappointment.

Within tech, two major themes seem to be playing out: the continued shrinking PC market (which hit bellwethers like INTC, MSFT and TSM), and the rise of "mobile" (which helped AAPL on iPhone sales and FB yesterday, which rallied big).

Bottom line with earnings is they were "good enough" this quarter, but the S&P at current multiples isn't particularly cheap. So next quarter, "good enough" is going to have to get better.

It's been years since we've seen really good revenue growth from corporate America—with markets at all-time highs, revenues have to start showing up in coming months; otherwise, this market is expensive.

Bottom Line

Stocks continue to act fatigued in the short term and look poised for some more consolidation ahead of an important week next week. But, with rates holding steady and earnings season largely behind us, the path of least resistance remains higher, and any consolidation/correction, at this point, should be relatively routine—unless we get some surprises next week from the Fed or the data. The two main risks to the rally remain an accelerated rise in rates, or a downturn in the economic data (the jobs report next Friday will be very important, as usual).

Economics

Jobless Claims

- Jobless Claims 343K vs. (E) 341K
- 4 Week Moving Average 345.25K

Takeaway

Jobless claims ticked up a bit last week, mostly in line with expectations. Despite the summer volatility in the weekly numbers (summer is a volatile time, given auto plant closures and temp jobs), the four-week moving average—which is a better indicator to watch than the weekly reports—has basically stayed flat since April. (The four-week moving average was 343K back then.) So, according to the weekly claims, we can expect a similar jobs report next week to the previous two months (around 200K jobs added).

Durable Goods Orders

- New Orders for Durable Goods in June rose 4.2% vs. (E) 1.5%.
- New Orders for Non-Capital Goods Excluding Aircraft rose 0.7%.

Takeaway

The headline number on durable goods was much better than expected, but as usual you can ignore the headline in this report, as it's hugely affected by airplane orders (as June's report was).

The number that gives a true look at equipment demand from businesses and people is new orders for non-defense capital goods excluding aircraft. That figure rose 0.7% in June, showing continued positive momentum after May's big 2.2% increase. So, the durable goods report, once you strip out all the statistical noise, further confirms we are seeing an uptick in manufacturing.

On the flipside, the report also showed that for the second quarter, demand for equipment was pretty tepid. Shipments for non-defense capital goods excluding aircraft fell 2% in June, and that's leading to economists reducing their GDP expectations for Q2 (which we'll see Wednesday).

And, here's a heads up—the Q2 GDP number is going to be pretty bad (probably showing between 0% and 1% growth). That's significantly lower than people thought it would be, but it shouldn't spook the market very much, as the focus now is on growth accelerating in the second half of 2013. But, I'm just pointing it out so a bad number Wednesday won't surprise you or your clients.

Commodities

Commodities were mixed Thursday, but in aggregate the complex traded pretty flat, which is a bit of a disappointment considering the Dollar Index was down nearly 0.5%.

The Chinese "mini-stimulus" program that was announced didn't really have much of an effect on the commodities markets either, as it won't make much of a positive difference with regard to the current pace of Chinese economic growth. As a reference, the market is looking for the People's Bank of China to cut back reserve requirements, which would be a big stimulus step. That's about the only thing out of China that would goose commodity markets at this point, and the chances of that are pretty slim, it appears.

Market	Level	Change	% Change
Dollar Index	81.972	-.319	-.39%
Euro	1.3239	.0038	.29%
Pound	1.5358	.0043	.28%
Yen	99.56	-.71	-.71%
CAD $	.9725	.0030	.31%
AUD $	.9219	.0056	.61%
Brazilian Real	.4432	-.0019	-.43%
10 Year Yield	2.617	.026	.99%
30 Year Yield	3.672	.023	.63%
Prices taken at previous day market close.			

Gold and silver were the big "outperformers" yesterday, rallying 0.6% each. I'm of two minds about gold's performance yesterday.

On one hand, gold clearly is continuing to trade off the dollar, and that in and of itself is a bit worrisome, as I'm not convinced the dollar is going much lower. Importantly, gold is **not** trading off inflation expectations yet, which is what it needs to do if we're going to see a decent rally anytime soon.

But, positively, gold didn't collapse yesterday and it appears that the relentless selling that defined gold and silver's trading over the last three months has ended.

Bottom line: In a market like this, let price action tell you the direction. Gold is now caught in a trading range between $1,300, which is support, and $1,348, which is the recent high and resistance. Whichever one is broken first will be the direction of the new trend. And, you'll want to wait until one of those two things happens, because the move out of this trading range should be pretty big (whether it's a rally or a decline).

Brent crude rallied 0.5% yesterday, thanks as much to the good economic data from Europe as the "stimulus" from China. WTI crude once again managed to recover from early losses. Oil traded nearly to $104/bbl, down about 1%, before rallying with the stock market and finishing basically flat on the day.

WTI is no longer overbought, so depending on how bullish you are on energy (I'm pretty bullish), nibbling at these levels makes some sense because, longer term, the trend seems higher. But, I'd feel more comfortable getting long energy (via USO or XLE) with crude in the $102-$103 range, and XLE closer to the $80.50-$81.50 range.

Elsewhere in energy, natural gas was the worst-performing major commodity (other than soybeans, which are in utter freefall this week, having collapsed nearly 10% since Monday). The drop in natural gas came despite a smaller-than-expected weekly inventory injection (41 Bcf vs. (E) 47-50 Bcf).

But, as I've been saying, natural gas is a weather-dominated market, and the outlook for the next 10 days to two weeks is for normal to lower-than-normal temperatures. This trumps any slight miss in inventories. I'd continue to look to be a buyer of natural gas (or XOP) on weakness toward the $3.50 level, but not up here. That is, unless you have a really good weather-prediction service.

Commodities in general recovered somewhat from Wednesday's sharp declines, but the jury remains out on whether the asset class has indeed broken its downtrend. DBC needs to hold the $26.00 level (it basically closed there yesterday) and, like gold, needs to trade to a new high to confirm the breakout. For those looking to embrace some risk, if you're a believer in the commodity sector, now's a decent time to take a shot on the long side. A close well below $26.00 on DBC tells you the decline isn't over, so you're not risking all that much to get long at these levels.

Currencies & Bonds

The Dollar Index was sharply lower Thursday, as some articles (especially an early one from Jon Hilsenrath in the WSJ) contradicted the "Larry Summers as Fed Chair Favorite" trend.

But, the real catalyst for the drop in the dollar late in the day was the other Hilsenrath article, which focused on more-dovish "forward guidance" from the Fed at next week's meeting. (Again, anyone who doesn't expect the Fed to continue to try and talk down rates isn't paying attention—the question is whether it'll work.)

But, the dollar traded to a new, multi-week low yesterday, and that means this decline probably isn't over … although I remain a dollar bull until 81.00 in the Dollar Index is broken.

Asian currencies surged against the dollar (undoing the declines from Wednesday) as the Aussie dollar and yen both rose 1% (the yen is now back below 100/dollar). The "stimulus" plan from China helped both currencies, but the rally was more about dollar weakness than it was anything really "positive" in Asia.

Turning to bonds, Treasuries finished yesterday marginally higher, rallying thanks to the Hilsenrath article. Although to be fair, the lows in the bond market were put in early in the session yesterday (the "soft" economic data and well-received seven-year auction helped bonds to rally yesterday), and the article from Hilsenrath only accelerated a rally that occurred throughout the day.

Importantly, emerging-market bonds (PCY and EMB) closed flat to marginally positive yesterday, but the key was that there was no follow-through selling from the Thursday overnight session, implying we're not seeing the start of another capital flow out of EM debt.

So, that's a positive for risk assets and implies we may be seeing a small correction/consolidation in equities, not a repeat of the June decline.

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	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.**

	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.**