7:00's Report

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

July 29, 2013

Pre 7:00 Look

- Futures drifting slightly lower after a quiet weekend of little new news.
- Japan remains in focus, as the Nikkei traded down another 2% as the yen rallied further on continued short covering from last week. But, the Nikkei finished off its worst levels of the day and the yen is coming back after a speech by BOJ Chairman Kuroda (he didn't say anything new, but re-affirmed current policies and a 2% annual inflation target).
- European shares slightly higher after Italian industrial out put and UK retail sales beat expectations.
- Econ Today: Pending Home Sales Index (E: -1.4% m/m).

Market	Level	Change	% Change
S&P 500 Futures	1682.75	-3.75	-.22%
U.S. Dollar (DXY)	81.655	-.11	-.13%
Gold	1333.30	11.80	.90%
WTI	704.72	.02	.02%
10 Year	2.561	-.046	-1.76%

Equities

Last Week

Last week, the S&P 500 was mostly unchanged despite it being the busiest week of Q2 earnings season, one that also saw the release of several important pieces of economic data (flash PMIs, especially from Europe) and multiple conflicting reports on who will replace Fed Chairman Ben Bernanke.

Although earnings results were very mixed last week, in aggregate they were considered "OK." Earnings season (for all practical purposes) is now over and, from a macro perspective, the results (which were neither stellar nor horrible overall) will not result in any sort of a broad multiple change for the entire market. In other words, earnings aren't going to de-rail this rally nor cause investors to become aggressive buyers. Focus continues to be on the second half of the year, where corporate results are expected to move higher. (So the bar will be raised a bit for Q3 earnings, but that's well in the future.)

While earnings results dominated daily trading in the market, the biggest "news item" of the week came Wednesday, when multiple press reports signaled Larry Summers is the new favorite to replace Bernanke. That news caused some volatility in bonds (sold off Wednesday) and the dollar (rallied Wednesday). But those moves were largely undone when a Thursday WSJ article by Jon Hilsenrath implied Bernanke and the FOMC will use this week's meeting to make their "forward guidance" more dovish. The Fed news had a much greater effect on bonds and currencies than equities last week.

I'll be discussing the outlook for the commodity markets on CNBC Squawk Box Asia this evening at 6:40 PM EST.

Friday pretty much encapsulated the week: Stocks opened lower for no real, direct reason. Then they sold off in the early morning, close to the lows of the week, on continued signs of market fatigue. And finally they abruptly turned in the afternoon and managed to close slightly positive. Point being, the market looks and acts fatigued, but it's very tough to get any sustained selling in this market with the macro-economic horizon clear.

Looking at market internals, the Russell 2000—which has led the rally—underperformed last week, so that's a potential sign of caution in the short term. Looking at the sector trading, earnings results largely drove perfor-

Market	Level	Change	% Change
Dow	15558.83	3.22	.02%
TSX	12647.90	-21.24	-.17%
Brazil	49422.05	355.30	.72%
FTSE	6554.79	-33.16	-.50%
Nikkei	13815.44	-314.54	-2.23%
Hang Seng	21879.52	-89.43	-.41%
ASX	5044.10	2.08	.04%
Prices taken at previous day market close.			

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mance, so there's not a ton of broad-market insight to glean from sector trading last week.

But, one thing I do want to point out is that homebuilders got killed thanks to earnings misses and less-than-great housing data. The S&P homebuilding index fell 9% last week, as concerns mount that higher mortgage rates are starting to be a headwind for the housing market. Elsewhere, tech outperformed as earnings results turned a bit better (AAPL, FB) compared to the previous week. But the main takeaway in tech land from earnings remains the continued decline of PC demand (hurting MSFT, INTC, etc.) and the rise of mobile (helping FB, AAPL, etc.) Volumes were largely in-line with recent averages, with earnings situations heavier. On the charts, the S&P 500 held near-term support at 1,680, while 1,700 remains stiff resistance.

Market	Level	Change	% Change
Gold	1333.70	4.90	.37%
Silver	19.95	-.21	-1.04%
Copper	3.10	-.08	-2.56%
WTI	104.49	-1.00	-.95%
Brent	107.13	-.52	-.48%
Nat Gas	3.56	-.08	-2.31%
Corn	4.76	-.03	-.57%
Wheat	6.50	.01	.15%
Soybean	13.49	-.05	-.41%

Prices taken at previous day market close.

This Week

Focus shifts back to the "macro" from the "micro" of earnings this week, and things get busy starting Wednesday. Central bank decisions (Fed Wednesday, Europe/England Thursday), jobs data and global manufacturing PMIs (Wednesday night/Thursday morning) will be the main drivers of the market. However, earnings from Europe are heavy this week, especially from the banks.

Bottom Line

Largely, the market narrative didn't change that much last week: The market remains comfortable with Fed "tapering" in September, as long as emerging-market debt markets remain calm and the economic data continues to be OK. The "macro horizon" remains subdued (meaning Europe), which is helping to support risk assets, and sentiment remains far from enthusiastically bullish. "Tail risk" events do remain out there, like Spanish political problems and a hard landing in China, and it seems as though investors continue to quasi-expect "the other shoe to drop" with those or other negative "tail events." That's restraining bullish enthusiasm, which leads to underinvestment and pushing the "pain trade" higher. Sentiment remains one of the underappreciated tailwinds for equities.

All that said, there were three important takeaways from last week: *First*, Washington is a factor in the markets again, but not because of debt-ceiling posturing. (Politicians started on this again last week, but the market doesn't care at this point.) The key question from Washington is "who will replace Bernanke," and as we saw last week, this will move markets.

Second, the European economy appears to be turning, finally, and Europe is a very under-owned region at the moment. If the economy continues to turn, allocations there could be a source of significant outperformance. I've pointed out the EWU (UK ETF) and EIRL (Ireland ETF) as two potential ways to play a recovery in Europe.

Finally, there are signs that China may start to defend economic growth from a policy perspective, after allowing growth to slow so far this year. Chinese Premier Li Keqiang said last week sub-7% growth wouldn't be tolerated, and there was a mini-stimulus package released by China on Friday. But, the key catalyst the market is looking for is a reserve-ratio cut, and this appears to be off the table for now. China has been a drag on the markets, but if growth can stabilize and Europe can return to growth, then—for the first time in many years—we'll have a global economy where the biggest players (U.S., China, EU, Japan) are all growing again. This would be a very good thing for markets and the basic materials sector, specifically.

Economics

Last Week

There were four key takeaways from the economic data last week: *First*, and most importantly, the EU economy appears to be stabilizing, as flash manufacturing PMIs hit their best levels in months.

Second, manufacturing continues to rebound domestically, and it looks like that rebound is accelerating. Durable goods saw a further increase of new orders in core

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goods, and the flash manufacturing PMIs beat expectations and were at multi-month highs.

Third, while the housing recovery remains firmly in gear, there are legitimate concerns about whether higher interest rates will slow the recovery. Housing data for June last week (new home sales, existing home sales) and the previous week (housing starts) were generally good. But there was anecdotal evidence that higher mortgage rates are starting to have at least some effect because, relatively speaking, most housing indicators cooled off a bit from the pace of April and May. And, DHI mentioned on their earnings call that sales did slow in the back half of the quarter, and cited higher mortgage rates as the reason.

Fourth, the Chinese economy is continuing to see slowing economic growth, as the flash manufacturing PMIs missed expectations and moved lower. But, that weak data was offset by a "line in the sand" declaration of 7% economic growth from the Chinese premier (he said they wouldn't allow growth to go below 7%). So, the weak data wasn't quite as damaging to the market as it otherwise would have been.

From a WWFD (What Will the Fed Do) standpoint, however, nothing last week was material enough to shift current expectations of "tapering" at the September meeting. From an investment standpoint, the positive data from Europe is the occurrence to note from last week, and speaks to potential outperformance of European markets over the coming weeks ... if the momentum can be maintained. Europe appears to be finally stabilizing economically, but while markets there have bounced nicely, they are a long way from being "overweight" in investors' portfolios.

Market	Level	Change	% Change
Dollar Index	81.79	-.263	-.32%
Euro	1.3279	.0033	.25%
Pound	1.5378	.0023	.15%
Yen	1.0186	.014	1.39%
CAD $	.9713	.0003	.03%
AUD $	.9228	.0046	.50%
Brazilian Real	.4405	0.00	0.0%
10 Year Yield	2.561	-.047	-1.76%
30 Year Yield	3.62	-.047	-1.28%
Prices taken at previous day market close.			

<u>*This Week*</u>

This is an extremely busy week of potential macroeconomic catalysts and for more color into what the Fed might do next.

First, there is an FOMC meeting Wednesday. This is an "old school"-type meeting, so don't expect economic projections or a press conference. There is no change expected to interest rates or the QE program. "Tapering" at this meeting would be a huge surprise, although most do expect the Fed to further attempt to "talk down" rates, as they have (successfully) been doing for the last three weeks. In particular, Hilsenrath's article in the WSJ Thursday implied the Fed will potentially extend its "forward guidance" on how long interest rates will stay low, or perhaps lower the "thresholds" that would warrant tightening (currently unemployment below 6.5% or inflation above 2.5%). So, there is some form of "rhetorical" easing expected from this meeting.

Second, it's jobs week (and I'm sure the Fed will have the numbers when they meet Wednesday, so their statement may give some clues about the jobs report). As usual, we'll get the ADP report Wednesday, weekly claims Thursday, and then the government report Friday. Given weekly claims have remained relatively stationary for four months, no one is expecting this jobs number to deviate significantly from the past few months' reports.

Third, we get the official ISM manufacturing reports for China (which includes the government report), and the EU and the U.S. on Wednesday night/Thursday morning. These are more important for China and Europe, and investors will be looking for confirmation of the "flash" estimates we got last week. Especially look at Europe, if the report stays above 50 (which signals expansion in the manufacturing sector)—we could see some more upside in European shares.

Fourth, there's an ECB meeting Thursday morning. The fact that the ECB relaxed collateral requirements at smaller commercial banks for access to ECB funds has some thinking that there could be some additional programs announced at this meeting. But no one expects interest rates to change. The key will be the commentary on the EU economy (it should be a bit more upbeat)

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and the pledge that the ECB will remain extremely accommodative for a long time.

Fifth, we get the first look at Q2 GDP, and as I said last week, this number is going to be ugly. Most are expecting between 0.0% and 1.0% GDP growth in the second quarter, but a negative number is not out of the question. But, the market shouldn't really react that much, because everyone is expecting growth to materialize in the second half of the year (and it must; otherwise stocks are expensive).

Finally, to end the week, personal income and expenditures will be released Friday after the jobs report, and that's important because it contains "core PCE," which is the Fed's preferred measure of inflation. Inflation is currently running too low, and that's making some Fed officials nervous about "tapering" too soon, lest we get a whiff of deflation. But, if core PCE starts ticking up, like CPI did earlier in July, then "tapering" will become more solidified, and it'll be taken as marginally "hawkish" (i.e., bonds-negative, dollar-positive).

Commodities, Currencies & Bonds

Major commodity indices fell a bit more than 1% last week, weighed down by a more than 3% fall in WTI crude as weak Chinese economic data and a correction in an overbought commodities market offset the Dollar Index falling to a one-month low.

WTI crude corrected after its recent big run, mostly on profit-taking, although the Chinese economic data (the miss in flash manufacturing PMIs) weighed on industrial commodities generally. Natural gas was one of the worst-performing commodities, falling nearly 8% on forecasts for cooler summer weather, which will result in less cooling demand. On the positive side, gold broke above its 23- and 30-day exponential moving averages for the first time since March on dollar weakness, and looks to be trying to bottom.

Commodities in aggregate are still trying to break the multi-month downtrend they have been in, but continued weakness in the Chinese economy is proving to be a stiff headwind. This week, the economic data (official PMIs Wednesday/Thursday) and the dollar (which will trade off central bank announcements) will be the major catalysts for commodities. But, if global growth is turning positive (which remains to be seen) then commodities are a value at current levels. But, with so many head fakes, I'd wait to add to any existing positions or initiate new ones until this week's news is behind us.

Looking at currencies, the Dollar Index traded to a one-month low last week, thanks mostly to continued expected "dovish" rhetoric from the Fed at this week's meeting. Incremental Fed expectations remain the driver of the dollar, evidenced by the fact that the Dollar Index didn't rally despite good economic data last week. (The data was good, but not seen as good enough to alter the current expectations of Fed policy.) Most other currencies (euro, pound, loonie) traded higher vs. the dollar last week, but that was because of dollar weakness, not anything particularly positive in those regions. (EU and UK economic data was good, but not good enough to change current policy. The ECB and BOE will be accommodative for a long time.)

The one currency that did trade off its own fundamentals was the yen, which had a big rally vs. the dollar last week (rallying nearly 3%) to finish at a one-month high below 100/dollar. The catalyst was positive CPI, although I continue to believe firmly that this is a countertrend rally, and the yen will trade much, much lower vs. the dollar in the coming weeks and quarters. Economic data tonight in Japan will be the next catalyst, and while the rally is impressive and could continue further, fundamentals still point to a lower yen. More generally, the dollar's weakness has been surprising, but I continue to view this as a dip to be bought. Despite Fed rhetoric, the path of policy is toward "less accommodation" and ultimately tightening, while the rest of the world remains firmly in "easing" mode. A violation of support of 81 on the Dollar Index would tell me I'm wrong.

Finally, Treasuries fell with the dollar (a bit of an odd occurrence) as bonds seem to be more accurately reflecting current economic data and Fed policy than the Dollar Index. Treasuries and currencies will obviously trade off of central bank decisions this week and economic data, but I would expect the broad trends of dollar strength and Treasury weakness to resume this week if the economic data is strong. Have a good week, Tom.

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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**	*After trading to new record highs, markets are now consolidating those gains ahead of several big catalysts later this week. The path of least resistance remains higher for stocks, however, as the market is comfortable with Fed "tapering" of QE, investors sentiment remains less than enthusiastic, and cross assets like emerging market debt have stabilized.* *The S&P 500 has near term support at 1680 and 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.**

Internationally, European economic data shows the EU economic is finally stabilizing, so long EWU (UK ETF) or EIRL (Ireland ETF) are two ways to potentially get exposure to a recovery in Europe. Also, the "Long Japan" DXJ trade appears to be back "on" and I'd use any decent dip to initiate or add to positions (like we are seeing right now).

	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 seen a steep correction 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.**

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