7:00's Report

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

July 31, 2013

Pre 7:00 Look

- Futures flat again this morning ahead of economic numbers and the Fed.
- Markets slightly higher in Europe, which saw mixed data o/n. German retail sales badly missed expectations, but weather appears to be a factor, while EU unemployment and inflation largely met expectations.
- Asia was mixed: China outperformed as officials again were in the press promising to defend growth (although the rally was small) while the Nikkei resumed its decline on yen strength.
- Econ Today: ADP Employment Report (E: 179K), GDP (E: 1.1%), FOMC Meeting Announcement 2:00 PM EST.

Market	Level	Change	% Change
S&P 500 Futures	1687.00	2.25	.12%
U.S. Dollar (DXY)	81.885	-.034	-.03%
Gold	1332.90	8.90	.67%
WTI	103.48	.40	.39%
10 Year	2.603	.018	.70%

Equities

Market Recap

Despite a lot of earnings and headlines yesterday, stocks were little changed ahead of a slew of catalysts coming the rest of the week. The S&P 500 rose 0.04%.

Stocks opened modestly higher yesterday, taking cues from a stabilization in the Nikkei and generally positive earnings from Europe. Yet, there was never much conviction behind the rally and, as has been the case for over a week now, things got pretty quiet shortly after the open and stayed that way.

The big news item yesterday was Obama's proposed "grand bargain" on corporate tax reform. Despite lofty headlines, his speech at 2 p.m. failed to move markets. That's because most everyone thinks the proposals, which again were vague, are basically DOA on Capitol Hill. Stocks drifted around during the last hour of trading, finishing the day off the highs and barely positive.

Trading Color

There wasn't a lot to read into from a market-internals standpoint yesterday. The Russell 2000 did bounce back and outperform, despite a negative article in the WSJ on small caps. Looking at the sector trading, tech and industrials outperformed thanks to some impulse-buying on Obama's proposal for a repatriation holiday for offshore money. Although, again the likelihood of that getting passed seems very slim.

Most other S&P 500 sectors were little-changed (plus or minus fewer than 50 basis points) with the exception of homebuilders, which saw a bit of an oversold bounce, rallying 1%.

Volumes were again well-below recent averages, which is to be expected on the eve of the Fed, ADP, etc.

On the charts the S&P was basically unchanged, so the situation remains the same: near-term support at 1,680, resistance at 1,700.

Bottom Line

The market continues to feel tired, but nothing says that some continued consolidation or further mild declines can't be the pause that refreshes. (Keep in mind the market has gone nowhere in two weeks.) With a lot of catalysts starting today, we'll have a lot more color into economic data, and that will help tell us which way equities are headed in the near term.

Market	Level	Change	% Change
Dow	15520.59	-1.38	-.01%
TSX	12581.75	-87.29	-.69%
Brazil	48561.78	-650.55	-1.32%
FTSE	6608.47	37.52	.57%
Nikkei	13688.32	-201.50	-1.45%
Hang Seng	21883.66	-70.30	-.32%
ASX	5051.98	4.74	.09%

Prices taken at previous day market close.

Central Bank Previews

Although the European Central Bank and Bank of England don't have their interest-rate meetings until tomorrow, I'll give you a preview in today's edition because I know not everyone reads the Report before 7:45 a.m. Eastern, by which time the BOE and ECB will have made their announcements.

Market	Level	Change	% Change
Gold	1325.00	-4.60	-.35%
Silver	19.69	-.17	-.88%
Copper	3.03	-.07	-2.19%
WTI	102.87	-1.68	-1.61%
Brent	106.75	-.70	-.65%
Nat Gas	3.43	-.04	-1.24%
Corn	4.76	.03	.74%
Wheat	6.55	.04	.65%
Soybean	12.02	-.18	-1.45%

Prices taken at previous day market close.

Broad Expectations

- Neither the Fed, ECB nor the BOE are expected to change the level of interest rates or their respective QE programs.

Potential Surprises to Watch For.

FOMC

It appears from recent speeches that Fed Chairman Ben Bernanke wants to 1) extend "forward guidance" for 0% interest rates beyond the current 2015 times frame, or 2) lower the "threshold" at which interest rates would start to move higher from the current 6.5% unemployment rate to 6.0%.

Bernanke and the Federal Open Market Committee hope that by extending forward guidance or reducing the thresholds, they will, in effect, help negate the upward pressure on interest rates from expected tapering. It's the ultimate form of trying to "talk rates down." Those measures could be announced today, although the consensus is they will likely only be alluded to (it should be the September meeting when tapering is officially announced or even initiated).

Bottom line is the market appears more fixated on Bernanke's replacement than any policy tweaks at the moment. (Don't expect the lowering of thresholds or extended guidance to be taken as "dovish." They are largely expected by the market at some point.) So, the meeting shouldn't be that much of a market-mover.

European Central Bank

Simply put, the ECB surprised markets by issuing dovish forward guidance at last month's meeting. So, it stands to reason they'll stick to the script at this meeting.

No change is expected to the "extended period" language of the "continued low rates" forward guidance announced at July's meeting. Anything new in the meeting will likely be aimed at changes to liquidity or lending programs (tweaking LTRO repayments or further altering collateral requirements). There are slim chances of both, and neither will result in much volatility. Bottom line is this meeting should be a pretty standard one, although the Mario Draghi press conference always has the potential to be market-moving.

Bank of England

While the first two central bank meetings should be relatively boring, there is some uncertainty surrounding the BOE meeting. First, the BOE surprised markets last month by announcing the contemplation of using "forward guidance" to help exert further pressure on interest rates. Second, the BOE statement—which until last month used to be literally one sentence describing the change, if any, to the level of interest rates and QE program—was altered under new BOE Governor Marc Carney to include some description of the economy and as well as to announce the initiative to use forward guidance from this point on.

So, there is some uncertainty regarding what the statement will contain, and whether any clues as to whether forward guidance will be implemented, and when. Bottom line is more details on the implications of forward guidance are forthcoming on Aug. 7, so don't expect a lot of details in tomorrow release.

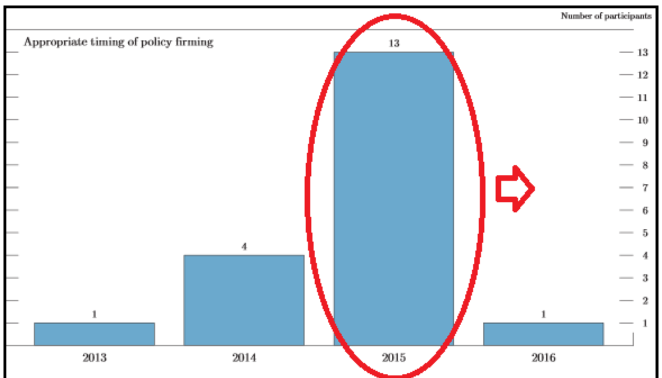
What is Forward Guidance?

I feel like I used that term 100 times in the above preview, so I want to take a minute and make sure everyone understands it. "Forward guidance" is a monetary policy tool only an academic could love. The general idea is that if you promise to keep short-term interest rates low (in the case of the Fed, the Fed Funds rate at

0%), this "promise" will lead investors and businesspeople to continue to invest and search out a return on capital. That's because, ideally, the 0% Fed Funds rate should keep all interest rates low across the yield curve, punishing those who don't invest their capital.

The fact that a "promise" to keep Fed Funds low for years in the future should, theoretically, entice investors to extend both the time horizon and amount of investment to compensate for the extended period of extremely low interest rates. That additional investment should in turn drive risk assets higher and help the economy. That is the goal of "Forward Guidance."

I have no idea whether this actually works. (I don't think anyone does, not even the Fed, because to my knowledge it's never been tried on this big a scale.) Personally, I'm skeptical.



Forward Guidance: 13 of the 19 FOMC members think interest rates will be 0% until at least 2015. Expect that number to move to the right over the coming months as the Fed uses guidance to extend the expected period of 0% rates.

First, although the Fed can theoretically keep the Fed Funds rates low forever, they can't keep shorter-, medium- or long-term rates low just by decree (as we've seen over the past month). So if long-term rates continue to rise, then all Forward Guidance does is create an yield curve you'd like to ski down, which is a license to print money if you're a bank (borrow short at low rates, lend long at high rates).

Second, I can't believe that a promise to keep Fed Funds at zero until '16 instead of '15 would actually carry any material weight with investors, seeing as no one can seem to predict where the economy is going to be 6 months from now, let alone 2 to 3 years from now.

Market	Level	Change	% Change
Dollar Index	81.862	.199	.24%
Euro	1.3260	-.0002	-.02%
Pound	1.5235	-.0104	-.68%
Yen	98.06	.10	.10%
CAD $	.9704	-.0037	-.38%
AUD $	.9060	-.0146	-1.59%
Brazilian Real	.4393	-.0020	-.45%
10 Year Yield	2.609	.003	.11%
30 Year Yield	3.679	.003	.08%
Prices taken at previous day market close.			

So, I believe the takeaway from "forward guidance" is this: Although it can exert some dovish influence in the very short term, it will not stop, or even really slow, the rise in interest rates that I believe is coming. So if you are in the "bond bear" camp with me, "forward guidance" doesn't de-rail the thesis.

Finally, as an aside, if the Fed follows through with its guidance and keeps Fed Funds at 0% for years, then STPP (the yield curve steepening ETN) is going to absolutely skyrocket. This is why I think it makes some sense to own a small bit of it in portfolios looking to get positive exposure to declining bond prices.

Economics

No reports yesterday.

Commodities

Commodities fell marginally yesterday as the dollar rallied and traders positioned ahead of the central bank meetings and important economic data coming today, tomorrow and Friday.

Industrial commodities badly underperformed Tuesday, with copper and WTI crude falling 2% and 1.4% respectively, leading commodities lower overall. There were no specific catalysts for the weakness in the commodities, although peripheral concern about China was cited as a reason. But, I would imagine a lot of the declines were late longs selling ahead of the Purchasing Managers' Index data tonight/tomorrow morning.

Copper hit basically new lows for the month. Looking at the chart, it's clear copper remains firmly in a downtrend, as weakness and concern in China weighs on industrial metals. $2.98, the low from late June, is now the last line of support for copper, and if it is broken, that can't be a very good omen for Chinese shares.

WTI crude declined yesterday on more profit-taking and positioning ahead of the big news events of the week, and WTI fell right to that $102-$103 level I was looking for. At this point, depending on the data, I'd say nibbling a bit on the long side here in energy (either via USO or XLE) makes some sense. The uptrend in crude now lies around $99/bbl (about 3% lower), while a renewal of the rally should take us to new highs. (So, $4 risk for about $7 in reward, or nearly 2-to-1.)

This morning we should see a pretty awful GDP report (as I mentioned in Monday's weekly preview) and any dip from WTI on that number, or inventories, would be a good place to initiate/add to positions if so inclined, as the U.S. economy is performing a lot better today than Q2 GDP will imply.

Turning to the metals, gold and silver were relatively flat, which is a bit of a positive surprise given the dollar was higher. Gold and silver continue to trade with a resiliency not seen in months, especially given that the Indian rupee traded to a multi-week low yesterday as the Reserve Bank of India basically hedged against the actions it recently took to strengthen the rupee. (They said those measures could be removed once the rupee stabilized, and of course those comments caused the rupee to—surprise!—destabilize and trade sharply lower yesterday. Despite the recent strength, though, bottom line is gold remains range-bound between $1,330 and $1,340 ahead of the Fed and economic data.

This is a disconcerting chart for those looking for a bottom in China or commodities, as copper rolled over exactly where it was supposed to.

After two relatively uneventful trading days (outside of WTI crude and copper), the FOMC, global PMIs and the jobs report should give us some good color into whether commodities have indeed bottomed.

Currencies & Bonds

Currencies traded with a bit more volatility Tuesday than they did Monday, although once again the Dollar Index and the euro were both basically flat ahead of central bank meetings.

The pound, however, dropped sharply, 0.75%, vs. the dollar, despite the absence of any news to explain such a move. Presumably, traders are positioning ahead of the BOE rate decision tomorrow, either by booking profits in long positions or getting short. The reason is relatively simple: If any of the major central banks are to be a bit more "dovish" than expected, it's the BOE, given no one really knows what to expect from BOE Governor Marc Carney—especially after the surprise statement at his first BOE meeting on July 4.

Turning to Asia, the yen halted its rally vs. the dollar, declining marginally on some weak headline economic data. The biggest mover in the currency markets yesterday was the Aussie dollar, which plunged 1.5% vs. the dollar after Reserve Bank of Australia Governor Glenn Stevens said basically that a recent uptick in inflation wouldn't preclude the RBA from cutting rates at next week's meeting, and that the Aussie dollar remains elevated. That caught markets off-guard, and the Aussie gave back more of its two-week rally yesterday.

Finally, Treasuries fell modestly ahead of the FOMC yesterday in light trading, but more and more the 30-year note looks to be rolling over again on the charts, although obviously the catalysts later this week will dictate whether the decline resumes in earnest.

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	*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).

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 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.**

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.**