7:00's Report

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

July 8, 2013

Pre 7:00 Look

- Futures drifting higher in a continuation of Friday's rally. The weekend was pretty quiet.
- European shares sharply higher as those markets play "catch up" to Friday's rally in the U.S., and more headlines imply that Greece will get its next tranche of bailout cash.
- Geo-politically, Egypt remains in turmoil as multiple clashes occurred over the weekend between supporters of former President Morsi and the military. Oil prices remain elevated as a result.
- Econ Today: No reports today.

Market	Level	Change	% Change
S&P 500 Futures	1636.25	8.75	.55%
U.S. Dollar (DXY)	84.565	-.124	-.15%
Gold	1228.90	16.40	1.36%
WTI	102.95	-.27	-.26%
10 Year	2.715	.214	8.56%

Equities

Last Week

Stocks ended last week slightly more than 1% higher thanks to a jobs-report rally, as good domestic economic data outweighed geo-political concerns in Europe (Portugal) and the Middle East (Egypt). The S&P 500 is up 14.42% year-to-date and is about 4% off its all-time intraday high hit back in May.

The holiday-shortened week was a volatile one, as early in the week a series of geo-political issues popped up, led by resignations of two prominent officials in the Portuguese government. Political turmoil in Egypt also contributed to stocks' weakness early in the week, as the military removed President Mohamed Morsi from power, which has plunged the country into some degree of chaos. Finally, there were peripheral concerns that the Italian government might collapse, and that Greece might not get its next tranche of bailout cash from the "Troika."

But, while the U.S. was closed for Independence Day, these issues largely resolved themselves as quickly as they appeared: First, Portuguese Prime Minister Pedro Passos Coelho brokered a deal with minority parties to keep the government together. Second, Italian P.M. Enrico Letta held a "clear the air" meeting with former P.M. Mario Monti's party to ensure they stay supportive of the majority coalition. Third, unsurprisingly the "Troika" said Greece will get its money. (What choice do they have at this point?)

Traders who were at their desks on Friday were greeted by these events in the morning. Add in the good jobs report, and that's a recipe for a rally—which is just what we got.

From a trading-color perspective, the big theme of last week was the spike higher in bond yields. Much of the sector trading was dominated by that trend. Anything cyclical or with positive exposure to higher rates outperformed (banks, consumer discretionary, tech, energy, industrials) while safety and "bond-proxy" sectors lagged (utilities, telecom, REITs, consumer staples and homebuilders). That exodus out of "bond proxy" sectors and into more growth oriented sectors has been the dominant trend in the equity market for over a month, and last week only further accelerated that rotation.

Trading volumes were close to in-line with three-month

Market	Level	Change	% Change
Dow	15135.84	147.29	.98%
TSX	12134.91	-31.75	-.26%
Brazil	45210.49	-552.67	-1.21%
FTSE	6451.76	76.24	1.20%
Nikkei	14109.34	-200.63	-1.40%
Hang Seng	20582	-272.48	-1.31%
ASX	4809.53	-32.22	-.67%
Prices taken at previous day market close.			

averages last week, which is pretty good for a holiday-shortened week. On the charts, the S&P closed above resistance at its 50-day moving average for the first time since June 19, so the technical picture for the market improved last week.

Market	Level	Change	% Change
Gold	1222.40	-29.50	-2.36%
Silver	18.85	-.85	-4.29%
Copper	3.07	-.10	-3.17%
WTI	103.63	2.39	2.36%
Brent	107.74	1.98	1.87%
Nat Gas	3.62	-.07	-1.90%
Corn	4.91	-.11	-2.29%
Wheat	6.60	-.05	-.75%
Soybean	14.32	-.09	-.64%

Prices taken at previous day market close.

This Week

While the macro is still important, the focus of the market will shift a bit toward the "micro economic" as Alcoa (AA) kicks off earnings today after the close, and JPMorgan (JPM) and Wells Fargo (WFC) both report Friday. But, the true "meat" of earnings season really starts next week.

On the macro front, the Fed will remain the key topic, as Federal Open Market Committee minutes are released and several Fed speakers (including Ben Bernanke) are on the calendar this week.

Finally, more Chinese data comes tonight (Consumer Price Index, Producer Price Index and Fixed Asset Investment). Slowing Chinese growth is, to a point, the fly in the ointment for the bulls, so any positive uptick will be welcomed by the market.

Bottom Line

Something very interesting happened Friday. Stocks spiked higher after the open but, as bond yields continued to shoot higher and emerging-market bonds started tanking, stocks began to sell off—in a repeat of the pattern we've seen since early June.

Although yields remained elevated throughout Friday, equities stabilized after turning slightly negative, and began an afternoon rally **that saw both the S&P 500 *and* the 10-year yield go out at the highs of the week.**

What's happening in the emerging-market debt and currency markets is the major headwind for equities, as I've been pointing out. But, Friday may have given us a glimpse into the fact that, unless emerging markets begin to collapse violently, equity investors have become comfortable with rational weakness in those markets now.

That change in sentiment towards a declining emerging market could be occurring for two reasons: First, the yield on the 10-year Treasury note has gone from sub-2% on May 21 to 2.71% on Friday. During that time period, the S&P 500 is off about 40 points (from 1,670 to 1,630), so I imagine this is a result that Bernanke would generally be pleased with. So, the increase in yields has not resulted in a collapse in stock prices.

Second, while the emerging markets remain the biggest-potential threat to the bulls, perhaps the rotation out of bonds and into stocks is simply too powerful.

To quasi-quote hedge-fund manager David Tepper, stocks are the only place to be in this environment: Bonds are falling, commodities are sluggish, cash loses you money, so where else are you going to go? Generally, I'm not a fan of using the "there's no where else" strategy in my asset allocations, but it's hard to disagree with that logic at the moment.

So, I could see the case for an equity-market rally as long as emerging markets don't totally implode (which is certainly possible). But, I continue to think the best thing to do in this environment is continue with the strongest trends in the market: higher rates, which means TBF, TBT, SJB and banks, and out of "bond-proxy" stocks. Given the big run last week, I'm sure we'll see a pullback in these names, but use any weakness to continue to add positions.

Economics

Last Week

Friday's jobs report capped what was a good week for domestic economic data, and the main takeaway was that Fed "tapering" expectations in September were further cemented by the data.

Looking at the jobs report, it was a pretty "Goldilocks" number. The June report was a bit better than expectations (195K vs. 161K) but, almost more importantly, we saw a net 70K increase in the May and June figures. The unemployment rate held steady at 7.6%, but that came with a welcomed increase in the participation rate and employment-to-population ratio. Overall, this was a very solid report.

As mentioned, the rest of the data from last week was also pretty solid. The final reading on both manufacturing PMIs and the non-manufacturing PMIs were in-line or better than expectations. Plus, evidence continues to build that manufacturing is seeing a bit of an uptick in activity.

So, in the context of "WWFD" (What Will the Fed Do?), the good economic data last week—which generally shows there is no loss of economic momentum from Q1, as many expected there would be—further cements the likelihood that the Fed will taper QE in September.

While the domestic data was good and it implies "less-accommodative" monetary policy going forward, the same cannot be said for the rest of the world. Outside of the jobs report Friday, the surprisingly dovish European Central Bank and Bank of England meetings Thursday were the biggest events of the week.

Mario Draghi and new BOE Governor Marc Carney both implemented "forward guidance" to emphasize the different directions of monetary policy between the Fed and the ECB and BOE, respectively. While the Fed looks to taper, both the ECB and BOE remain firmly in easing mode, with a bias toward more accommodation in the future.

Looking at the actual data in Europe, the takeaway from last week is that we are seeing signs of stabilization in the European Union's economy (small signs, but at least it's a step in the right direction). Manufacturing PMIs and EU retail sales both showed improvement, and of particular note were the UK numbers, which continue to get better and better.

Market	Level	Change	% Change
Dollar Index	84.71	1.2549	1.51%
Euro	1.2833	-.0184	-1.41%
Pound	1.4893	-.0373	-2.44%
Yen	.9886	-.0108	-1.08%
CAD $	.9435	-.055	-.58%
AUD $	.9018	-.0018	-.20%
Brazilian Real	.4387	.0027	.62%
10 Year Yield	2.715	.214	8.56%
30 Year Yield	3.677	.18	5.15%
Prices taken at previous day market close.			

Finally, China remains the area of greatest concern, economically speaking. Manufacturing and composite PMIs both were in-line with pretty low expectations, and it is clear from the data that the Chinese economy is losing momentum. And, the People's Bank of China's recent actions to burst the credit bubble in the property market will only slow growth further.

Seven-percent growth is now the number to watch—if you see expected 2013 GDP growth dip below 7% for China in the coming months (or if a lot of sell-side firms downgrade their growth expectations below 7%) then look for more weakness in China.

Bottom line with data last week was that it 1)Cemented the expectation that the Fed will begin to "taper" QE in September, and 2) Reinforced the monetary-policy divergence between the U.S. and the rest of the world.

So, we can expect recent trends of the higher dollar/ lower "everything else" and higher yields to continue until the domestic data becomes soft, or international data improves.

<u>This Week</u>

Focus turns from the "macro" to the "micro" as the economic calendar is very slow this week, and the market's focus will turn toward earnings.

With little actual data domestically (jobless claims Thursday is the highlight, and PPI Friday is the only other number), the Fed will remain a focal point.

FOMC minutes will be released Wednesday but, given the large amount of communication from Fed presidents over the past two weeks, I'm not sure there's going to be a lot of additional insight to glean from the minutes. The market expects "tapering" in September, and I doubt anything in the minutes will alter that expectation. (The risk, if anything, is that they are slightly hawkish.)

There are also multiple Fed speakers this week: Bernanke Wednesday, Daniel Tarullo Thursday, and James Bullard and John Williams Friday). Their comments bear watching, as I imagine the

Fed will continue trying to "talk down" interest rates and reinforce the "tapering is not tightening" PR campaign. So, expect them to be on balance dovish, but again I doubt any of it will change current market expectations.

Commodities

While most commodity indices finished last week nearly 2% higher, it was a very bifurcated week, as a big move in energy (particularly WTI crude) help offset weakness in the precious metals and grains.

The dichotomy in the commodity markets couldn't have been any bigger last week. WTI crude rallied to new highs for the year and broke through $100/barrel thanks to two developments: political unrest in Egypt adding some geo-political risk premium, and economic data showing that the domestic economy continues to recover (which should increase energy demand).

WTI crude, Brent crude, RBOB gasoline and heating oil all rallied last week between 4% and 7%.

Metals, on the other hand, had another terrible week as Thursday's ECB and BOE dovish "forward guidance" and Friday's jobs report led to a surge in the dollar, which in turn crushed gold, silver and copper.

Friday's declines in the metals (Gold down 2.5%, silver down 4.3%, copper down 3%) reversed what were nice gains for the metals throughout the week, as the surging dollar was simply too much to bear for non-energy commodities.

Even the grains weren't immune to the dollar strength, as December corn traded to a new low for the year (below $5.00/bushel for the first time in years) on dollar strength and expectations of a huge crop.

This week the Fed (minutes and speeches), Chinese economic data and the political situation in Egypt should drive commodity prices. But, with the dollar in a clear uptrend, only commodities that have positive exposure to the growing domestic economy will be able to outperform (and that means WTI crude, RBOB gasoline and, to a point, natural gas, although expect some sort of a short term correction in WTI and energy as progress occurs in Egypt).

Copper, while an industrial commodity, is more linked to China than the U.S., so don't expect much outperformance there unless the Chinese data gets better.

Finally, until we start to see inflation picking up, gold will continue to be weak—these are the doldrums for gold, but if inflation comes like I think it will in the quarters ahead, these are bargain prices, if you can wait it out.

Currencies & Bonds

The dollar index saw a big rally last week (up 1.5%) thanks to strong economic data and a decline in the euro. The dollar index is now trading at a three year high.

The slew of positive economic data, capped by Friday's jobs report, helped support the dollar, but the surprisingly dovish "forward guidance" issued by the ECB and BOE at their rate meetings Thursday also helped push the dollar index sharply higher.

Last week the ECB, BOE, BOJ (Bank of Japan) and RBA (Reserve Bank of Australia) all either expressly or implicitly implied that, while the Fed may be on course to "taper," they are committed to record monetary easing, and the likely direction for future interest rates future in those regions is lower, not higher.

So, while the absolute level of interest rates around the world didn't really change last week (or over the last several months) it is clear that the marginal direction of change for short term interest rates is now higher in the U.S., and lower everywhere else. That is a trend I expect will stay in place for some time, and as a result it's fundamentally dollar bullish.

Treasuries fell sharply Friday, thanks to the strong jobs report. Yields on 10 and 30 year Treasurys traded close to two year highs (last time yields were this high was August of '11) and given the strong U.S. data and the Fed's desire to "taper," the trend in rates remains higher (although there will be a bounce in bonds given how short term over sold they are.)

Emerging market debt fell on Friday as you'd expect, but the key now is whether another rout occurs. Watch PCY and EMB this week. If they take out the closing lows from last month ($103.69 in EMB, $25.86 in PCY) that will create a headwind for risk assets.

Have a good week—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**	**Neutral**	**Neutral**	*Domestic equities rallied last week thanks to strong economic data, and it appears that the markets are becoming more comfortable with the rise in interest rates and the decline in emerging market debt and currencies.* *The S&P 500 broke through it's 50 day moving average on Friday for the first time in weeks, and next resistance sits at 1652.*

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	**Bearish**	**Bearish**	**Bearish**	*Commodities continue to try and put in a bottom, but are facing stiff headwinds from a "hawkish" FOMC and a slowing growth in China. While commodities reflect a sector with some value in the market, at this point its too early to declare a bottom is "in."*

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 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 dollar is in full rally mode, and should be 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.*

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 traded to new lows for the year last week on good economic data. The decline in bonds is accelerating, and every oversold bounce should be used to initiate or add to short or inverse positions.*

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.**