7:00's Report

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

July 9, 2013

Pre 7:00 Look

- Futures modestly higher on strength in Japan and after AA beat earnings, setting an early positive tone for the reporting season.
- The Nikkei surged more than 2.5% after the yen declined through 101 vs. the dollar ahead of the BOJ meeting today (no changes are expected in policy).
- The big economic report o/n was Chinese inflation data, which was mixed: CPI was higher than expected at 2.7% yoy, but PPI stayed stubbornly negative. Bottom line is the data implies that the PBOC will stay on hold for the foreseeable future.
- Econ Today: No reports today.

Market	Level	Change	% Change
S&P 500 Futures	1642.00	6.50	.40%
U.S. Dollar (DXY)	84.535	.21	.14%
Gold	1248.30	13.30	1.09%
WTI	103.04	-.10	-.10%
10 Year	2.645	-.07	-2.58%

Equities

Market Recap

The rally from last week continued Monday, as follow-through buying helped push the S&P 500 up 0.53% during a quiet session.

Stocks opened higher thanks to investors further embracing the good economic data from last week (especially the jobs report). But once they opened, markets barely budged, with the S&P 500 trading not far from 1,640 pretty much the entire day.

Here We Go Again: Commodities are once again trying to bottom, but until they can decisively break through the 23-, 30- and 50-day EMAs, the trend is still lower.

There were a few stories and events cited as "reasons" for the rally: Greece "officially" getting its bailout cash, better-than-expected consumer credit levels, and the FDIC increasing bank leverage ratios to 5%. (There was some worry it would be 6%.) But, these events were co-incident with the move higher in stocks yesterday, not causal.

Trading Color

From a market-internals standpoint, yesterday was a mixed bag, and certainly not a typical "risk-on" day. The Dow was the best-performing major index, while tech and transports underperformed. From a sector standpoint, there was a pause in the rotation out of "bond-proxy" and defensive sectors and into cyclicals. Utilities were the best-performing sub-sector thanks to the NRG Energy (NRG) spin-off, NRG Yield (NYLD), and some short covering, followed by consumer

CNBC

I'll be appearing on CNBC Asia's Squawk Box this evening at 6:40 P.M. EST, discussing the outlook for the commodity markets in light of the recent Chinese economic data.

Market	Level	Change	% Change
Dow	15224.69	88.85	.59%
TSX	12208.87	73.96	.61%
Brazil	45075.50	-134.99	-.30%
FTSE	6515.58	65.51	1.02%
Nikkei	14472.90	363.56	2.58%
Hang Seng	20683.01	100.82	.49%
ASX	4881.65	72.12	1.50%

Prices taken at previous day market close.

staples.

REITs also finished marginally positive, although homebuilders once again finished lower. Investors continue to flee the space, fearing higher rates will reduce sales.

Market	Level	Change	% Change
Gold	1236.00	23.30	1.92%
Silver	19.05	.31	1.68%
Copper	3.09	.03	1.09%
WTI	102.87	-.35	-.34%
Brent	107.26	-.46	-.43%
Nat Gas	3.76	.14	3.98%
Corn	5.00	.09	1.88%
Wheat	6.63	.03	.45%
Soybean	12.52	.24	1.97%

Prices taken at previous day market close.

Rails were the worst performers in the market yesterday, in response to the runaway train that derailed in Quebec over the weekend, which sadly leveled a third of the town of Lac-Megantic in Quebec, and killed as many as 50 people.

"Crude by rail" has been one of the more-compelling themes in investing for the last year. But between the Quebec incident and the compression of the Brent/WTI price spread (reducing the economic incentive to ship Bakken crude east to be refined), I imagine the rail sector will be under pressure for a bit.

UK Economic Indicators	Consensus	Actual
Halifax Home Price Index	3.60%	3.70%
June Services PMI	54.3	56.9
June Construction PMI	51.1	51
June Manufacturing PMI	51.5	52.5
National HPI (YOY Change)	1.10%	1.90%
Q1 GDP	0.30%	0.30%
June Distributive Trades (Retail Merchant Survey)	-11	-1
May Retail Sales	0.80%	2.10%
April/May Claimant Count (Jobless Claims)	-5500	-8600

Trading volumes were well-below recent averages, which isn't surprising as some people extended their weekends an extra day.

On the charts, the S&P is solidly above its 50-day moving average, but 1,650-ish is expected to be stiff resistance. It may take some earnings clarity for the index to breach that level.

Bottom Line

There's not a lot to say about yesterday's trading, so let's look at the bigger picture.

Overall the market narrative remains unchanged: We appear to be witnessing the market getting "comfortable" with higher interest rates and continued emerging-market weakness. The most-important takeaway is that it appears, for now, that higher interest rates and higher stock prices are not mutually exclusive. That will change if the rise in rates becomes disorderly again, but for now the market seems "OK" with it.

Is the UK a "Buy?" — and not because a Brit just won Wimbledon for the first time in 77 years.

Given the odd calendar last week, I didn't really get to focus much on this in Friday's issue. But now is a great time to circle back and touch a bit upon what happened in Europe with the Bank of England meeting last week.

In his first meeting as Governor of the Bank of England, former Bank of Canada governor Marc Carney made some waves. Normally, the BOE just issues a few sentences describing the decision of the Monetary Policy Committee. (Literally the June press release was two sentences long.)

But, Thursday's release included a three-paragraph statement basically telling the market that the BOE will begin using forward guidance as another tool to keep interest rates low. So, we've already seen more communication at the first meeting of the Carney regime.

More importantly, though, is that this reminds the market that the BOE is not relegated to the sidelines after the last several years of proactive monetary policy. While overshadowed by the actions of the Fed initially and the Bank of Japan lately, the BOE has acted much more like the Fed in combating the financial crisis.

It is important to note that the BOE has been much, much more-aggressive with QE, the "funding for lending" scheme, and other measures than the European Central Bank has been.

Unfortunately for the UK, it didn't have powerful German economic growth to soften the blow of the financial crisis. As a result economic growth, despite all the BOE's efforts, has been pretty sluggish.

But, that may be changing.

Whatever your opinion of the program, QE and Twist have helped the economy (if for no other reason than it helped resurrect the housing market). Eventually, all this QE does lead to a recovery, however tepid. Perhaps, then, we are finally seeing the seeds of that recovery being sown in the UK.

Economic data has very quietly been ticking higher in the UK since May, and that was reflected in a sharp rise in the pound prior to the emerging-market rout that resulted in massive U.S. dollar strength.

The reason for the pound's strength was simple: The UK economy appears to be starting to recover, so it was expected that the BOE would be "on hold" as that recovery occurs.

Well, it appears that Carney is more in the Bernanke camp than he is in the Draghi camp, and the BOE seems determined to not let higher rates in the U.S. and globally kill all the progress they've made through extraordinary efforts.

So, we can expect the BOE to be "easy" even in the face of a apparently recovering economy, and that means we should see UK markets out perform over the coming months and quarters, especially if the EU can behave itself and keep the political sagas to a minimum.

So, for those contrarians out there, perhaps taking a look at the iShares MSCI United Kingdom Index (EWU) makes sense—it gapped lower in mid-June, but it's fairly evenly weighted sector-wise (financial services are 20%, energy 17%, consumer defensive 17%). It's a pretty clear stop: the lows of last month at about $17.60, or a little over 2% from here. The highs in May were about $19.40, or about 7% from here, so you're looking at a realistic 3-to-1 potential risk-vs.-reward scenario.

If the rally since 2010 in the S&P and the recent outperformance of Japan have taught us anything, it's that you buy those markets where the central banks are going to be active and accommodative. The ECB is still too timid, but the BOE is not—it'll combat rising global rates to ensure the fledgling recovery continues, and that should be bullish for UK shares.

Market	Level	Change	% Change
Dollar Index	84.213	-.236	-.28%
Euro	1.2873	.0044	.34%
Pound	1.4952	.0061	.42%
Yen	100.93	-.27	-.27%
CAD $	.9472	.0022	.23%
AUD $	.9141	.0074	.82%
Brazilian Real	.4430	-.0009	-.20%
10 Year Yield	2.651	-.093	-3.51%
30 Year Yield	3.64	-.074	-2.03%

Prices taken at previous day market close.

Economics

No reports yesterday.

Commodities

Commodities rallied Monday as we saw a "reversion to the mean" day, where recent laggards (gold, copper, grains) saw an oversold bounce, and recent outperformers (crude, RBOB gasoline) sold off marginally.

It was a pretty quiet news day in the commodity space, so most of the trading was driven by the marginally weaker dollar and profit-taking by traders.

Natural gas was actually the best performer in the commodity space yesterday, rallying more than 3% and trading to a two-week high on expectations of hotter weather across the country, which in turn means more cooling demand from power plants.

Weather remains the key driver of natural gas. Bulls will cite the fact that inventories are 7% below 5-year averages, but that's only because last year's record storage skews the 5-year average. Supply of gas is pretty ample, so this remains a demand story. Hotter weather equals more demand, and it'll take sustained hotter weather to break the downtrend in place since April.

In the short term, given the increased power demand across the country, I think there's probably a bit more upside in the short term, but it'll take a trade above $3.82 (the 50-day moving average) to turn the medium-trend bullish.

Positively, though, the SPDR S&P Oil & Gas Exploration & Production ETF (XOP) has seen a good bounce since I mentioned it last week. I think, like natural gas, there's a bit more upside in the trade.

Turning to WTI crude, the situation in Egypt obviously is the primary driver. Regardless of the daily changes, it's safe to say that there's going to be some turmoil in that country for some time. So, don't expect any big wash out of the geo-political premium that's been put into WTI.

At the same time, however, it seems unless the situation in Egypt spreads across the region in another "Arab Spring"-type event or broader Islamist-vs.-moderate confrontation across the region, at $103/barrel it seems WTI is a bit over its skis, given the fundamentals and the state of the U.S. economy.

Point being, unless you have some political insight into Egypt/the Middle East, I'd take some money out of energy/oil until the market comes back in a bit. The trend is still higher, but I think we've got to see a bit of a correction first, again barring any great flare-ups.

Turning to metals, they bounced on Monday thanks to some short-covering and the lower dollar, but the bottom line is these commodities remain under relentless selling pressure, and will continue to be until we get some whiff of inflation, which is probably still a few months off.

Key levels to watch in the short term in gold, silver and copper (which is a proxy for China) are: $1,206, $18.18 and $3.04 (all lows from Thursday/Friday, which shouldn't be violated if these markets are trying to bottom).

Commodity ETFs, thanks largely to the rally in energy, appear once again to be trying to bottom and break this months-long downtrend. But like before, until they can decisively break their 23-, 32- and 50-day exponential move averages, then it's still not time to heavily allocate to the space. For now, if you're the contrarian type, I'd continue to nibble on down days on ETFs like the PowerShares DB Commodity Index (DBC), building a bit of a core position. The one thing about commodities is that you buy strength in the sector—trying to catch a falling knife in the commodity space is a good way to go broke.

Currencies & Bonds

Like we saw in commodities, Monday was a "reversion to the mean" day in the currency markets—one that was driven mostly be profit-taking from the big moves of late last week. The Dollar Index sold off modestly (down 0.3%) mostly due to a higher euro (which rose 0.3%) on short-covering. The media cited the "official" acknowledgement of Greece getting its latest bailout tranche as the reason for the rally. But honestly, everyone always knew they'd get their money. The saying "in for a penny, in for a pound" should be chiseled into the German and French Parliament buildings.

In Asia, the Aussie was the big mover, rallying 0.8% vs. the dollar on short-covering/profit-taking after the declines of last week and ahead of the Chinese data out overnight, while the yen rallied marginally in quiet trading.

But, nothing really happened of consequence in the currency markets yesterday. While we may see an extension of this profit-taking for the next few days, the larger trend remains that of dollar strength, and anyone looking to short the Aussie, euro or the yen should use any decent rally to add to or initiate positions.

Perhaps the most-important thing that happened yesterday across all markets was that emerging market bonds (EMB/PCY) both rallied. That's a welcome sign and further implies that the rout in emerging markets may be coming to an end. (That doesn't mean they will rally, but just a flat trade will help equities.)

Looking at Treasuries, both the 10- and 30-year notes bounced from the drubbing they experienced Friday, and that's to be expected given the big moves. But, the trend remains clearly lower. While we could see more of an oversold bounce, I'd use that bounce to further lighten up bond allocations or get short (via ETFs like TBF, TBT and SJB).

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**	**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.**