7:00's Report

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

August 2, 2013

Pre 7:00 Look

- Futures flat as markets consolidate yesterday's gains ahead of the jobs report. Asian markets rose in sympathy with the US (Nikkei rallied more than 3% on a weaker yen).
- European markets also flat, although UK economic data continues get better: UK Home Price Index and Construction PMIs both beat expectations.
- Gold is sharply lower this morning, breaking through support at $1300/oz. on a stronger dollar and ahead of the jobs report.
- Econ Today: Employment Situation (E: 185K), Personal Income and Outlays (E: 0.4%).

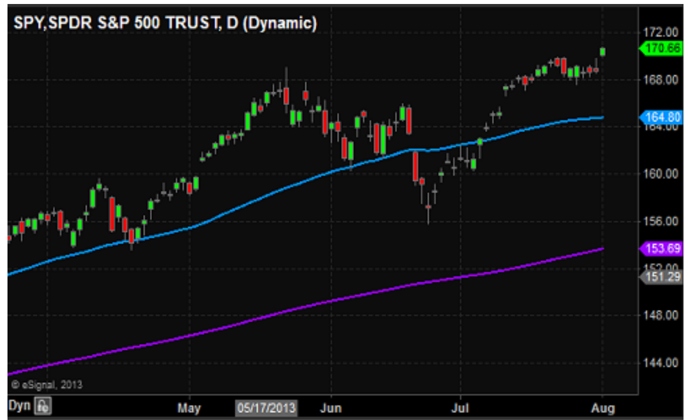
Market	Level	Change	% Change
S&P 500 Futures	1702.50	2.25	.13%
U.S. Dollar (DXY)	82.50	.073	.09%
Gold	1289.10	-22.0	-1.68%
WTI	107.59	-.30	-.28%
10 Year	2.723	.13	5.01%

Equities

Stocks surged yesterday as the S&P 500 broke through 1,700 to close at a new all-time high, thanks to strong global and domestic economic data. The index rallied 1.25%.

Some days, figuring out why the market rallied or sold off is like putting together a puzzle. Yesterday was not one of those days.

Futures were sharply higher yesterday morning, thanks to better-than-expected economic data overseas. (The positive European Purchasing Managers' Indexes were



Rule #1 of technical analysis states that you buy what's making new highs, and sell what's making new lows. The S&P 500 hit a new high yesterday, so this rally has more room to run.

the major catalyst.) The bullish trend accelerated after the jobless claims numbers, and then kicked into overdrive after the Institute for Supply Management's manufacturing PMIs hit at 10 a.m.

There was clearly some "panic-buying' shortly after the open and also after the ISM PMI report, as many investors remain under-exposed to a rally in equities. But as has been the case, things quieted significantly in the afternoon. There were no news headlines to speak of during the afternoon session. However, there was a constant bid under stocks all day, and markets stayed close to their highs throughout the session before going out near their best levels.

Trading Color

Like Wednesday, sector trading and market internals were bullish, as cyclical indices and sectors outperformed, volumes were elevated and markets traded to new highs.

The Russell 2000 and the Nasdaq both outperformed again yesterday, while the Dow lagged (thanks mostly to XOM's disappointing earnings). From a sector stand-

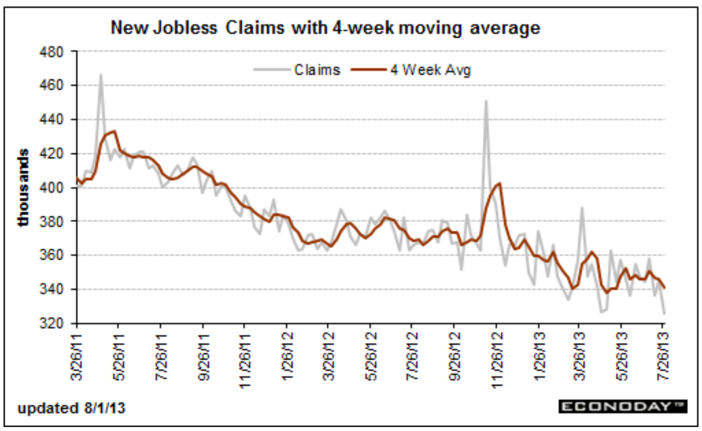
Market	Level	Change	% Change
Dow	15628.02	128.48	.83%
TSX	12593.96	107.32	.86%
Brazil	49140.78	906.29	1.88%
FTSE	6673.81	-8.17	-.12%
Nikkei	14466.16	460.39	3.29%
Hang Seng	22190.97	102.18	.46%
ASX	5116.76	55.27	1.09%
Prices taken at previous day market close.			

point, there was a clear rotation out of safety and "bond -proxy" sectors and into cyclicals.

Market	Level	Change	% Change
Gold	1312.00	-1.00	-.08%
Silver	19.64	.01	.04%
Copper	3.16	.05	1.56%
WTI	107.84	2.81	2.68%
Brent	109.39	1.69	1.57%
Nat Gas	3.38	-.06	-1.80%
Corn	4.67	-.12	-2.51%
Wheat	6.58	-.06	-.94%
Soybean	11.92	-.14	-1.14%
Prices taken at previous day market close.			

Transports surged more than 3% while industrials, financials, energy, tech and consumer discretionary all outperformed—rallying between 1% and 2.5%. All 10 S&P 500 sub-sectors rose yesterday, although telecom, homebuilders, consumer staples and utilities lagged while REITs actually finished negative on the day.

So, the internals of the market were about as bullish as the headline moves from the indices, implying this rally isn't done yet. Volumes were elevated but not hugely so, and on the charts the S&P broke through resistance at 1,700 and is at an all-time high.



Bottom Line

If we step back and look at this independently, yesterday was about as good as it gets for equities:

- The economy clearly shows signs of accelerating.
- Europe appears to finally be stabilizing.
- Chinese officials are promising to defend growth and prevent a hard landing.
- Every major central bank in the world remains massively accommodative and, this week, pledged to remain so well into the future.

If you're an equity bull, you couldn't write a better scenario. Now, I'm not saying I'm wildly bullish. But the fact is this market wants to go higher. Whether it's because of continued cautious sentiment, accelerating economic growth, stabilization of Europe, or whatever, the simple fact is that this market, for now anyway, wants to head higher.

But, I'm not advocating 100% allocations to equities, as obviously risks remain. In particular, a lot of people started noticing that bond yields were moving pretty fast yesterday, so we're back to watching yields. Remember, it's the pace of the acceleration, not the absolute level, that markets will be watching.

So far, the pace of the increases is OK, but if the rise becomes disorderly, or if we see emerging-market bonds go into freefall again, then that will be a headwind for equities. So, we are back to watching 10-year yields, via the iShares JPMorgan USD Emerging Market Bond ETF (EMB) and the PowerShares Emerging Markets Sovereign Debt ETF (PCY). If yields gaps higher (toward 3% and beyond) and the latter two start going into freefall again, equities won't react well (like we saw in June).

For now, though, it's Goldilocks for the stock market (assuming the jobs number today is "OK") and the path of least resistance for equities remains, obviously, higher.

Economics

Economic data Thursday was resoundingly positive, and that was the reason for the big rally. Domestically, jobless claims and the official ISM manufacturing PMI both moved to levels not seen in years, while data internationally implied that the European economy is indeed stabilizing. Even the official Chinese government manufacturing PMI surprised to the upside, although as with all "official" Chinese statistics, there is more than a little doubt about the validity of the numbers. But, coupled with recent rhetoric from Chinese officials about defending the pace of economic growth, it seems at though the tone surrounding the Chinese economy is turning a bit for the better.

Jobless Claims

- New Claims 326K vs. (E) 345K.
- Four-week moving average fell to 341K, close to the

multi-year lows set earlier this year in May.

Takeaway

The headline jobless claims number fell to a five-and-a-half-year low (Jan '08), although that has to be taken with a grain of salt given that July is one of the "noisiest" months for jobless claims data due to automobile plant closures, Fourth of July holiday, etc. Nonetheless, it at least anecdotally implies that the job market may be taking another step forward. This print, combined with the ADP report Wednesday and the employment component of the ISM manufacturing index, have resulted in higher expectations for the government jobs report this morning. (Whisper numbers have a "2" handle on it.)

ISM Manufacturing Index

- July ISM Manufacturing PMI 55.4 vs. (E) 53.1
- New Orders rose 6.4 points to 58.3.

Takeaway

To use an earnings analogy, this was a "blowout" number. Not only did the headline move to a two-year high, but the details of the manufacturing report were almost universally strong. New Orders, the leading indicator in the report, rose to a multi-month high; production increased 11.6 points to 65, the higher reading since 2004; and employment rose from 48.7 (which signals contracting employment at manufacturers) to 54.7 (signaling expanding employment).

Additionally, this big jump doesn't appear to be the result of channel-stuffing (increasing production and building inventories). The inventory component declined from 50.5 to 47.0. All in all, this looked like a very healthy number, and shows that the rebound we've been tracking in manufacturing since the June data is accelerating nationally. This is an economic positive.

Market	Level	Change	% Change
Dollar Index	82.300	.848	1.04%
Euro	1.3219	-.0083	-.62%
Pound	1.5134	-.0073	-.48%
Yen	99.40	1.54	1.55%
CAD $	.9667	-.0064	-.66%
AUD $	.8938	-.0042	-.49%
Brazilian Real	.4349	-.0045	-1.02%
10 Year Yield	2.698	.116	4.30%
30 Year Yield	3.745	.107	2.86%
Prices taken at previous day market close.			

Bottom Line

The last 48 hours have been somewhat tumultuous with regard to expectations for the Fed. The statement Wednesday was dovish, but given the strong economic data yesterday, most people still believe "tapering" will occur in September. (If this morning's jobs number has a "2" handle on it, then "tapering" expectations in September will be cemented.) So, although the Fed statement threw some uncertainty into the future, the data is strong and apparently getting stronger, which favors "tapering" sooner rather than later. (And, importantly, the market is "OK" with September tapering—that will not derail this rally.) Of course, if the jobs number whiffs this morning, we'll all have to re-assess.

Commodities

Commodities mixed Thursday, although commodity averages finished higher thanks to strength in WTI crude, as industrial commodities surged on the back of the globally strong manufacturing data, while non-industrial commodities like gold and grains, lagged, and that makes sense, given the more than 1% surge in the dollar index.

WTI crude was the best-performing commodity yesterday, surging 2.5% on better global and domestic economic data. This week, WTI corrected exactly into that \$102-\$103 range, right where I expected it would.

For those who are interested, I picked that \$102-\$103 level because it was between the 23- and 30-day exponential moving averages, which are little-followed and serve as uncannily good moving averages for commodities. And, commodities tend to gravitate toward those two averages on corrections and rallies in upward or downward trending markets. They aren't as accurate with stocks, but for commodities, those two moving averages are key to follow.

More broadly, I remain bullish on crude for a simply reason—the economy is recovering, and demand is picking up. And, while the crude-oil bears hail the boom in shale oil as a negative factor, I think they are missing two points: First, as our domestic production grows, we're just using more of our own oil and importing less. So, our increased supply is more of a problem for the Saudis, who may need to find someone else to buy their product. Our oil supplies may be surging, but our demand is also rising—the supply situation isn't becoming as unbalance, as some would believe, because it's offsetting imports previously needed to meet demand.

Second, there is a lot of shale oil and gas, but keep in mind energy exploration is a tough business, and just because it's "there" doesn't mean it'll always be easy to commercially extract. Yesterday, Shell's shares fell 5% in trading, partly because they took a $2 billion write-down on North American shale exploration and production. So, its an anecdotal reminder that finding, extracting and producing all this shale oil and gas isn't necessarily as easy as we all think it is.

Bonds matched their low for the year yesterday, but don't think you've missed the move if you don't own TBF. Looking at a weekly chart, there's still a long way to go, if the trend continues.

As long as the data stays good, energy will continue to outperform (two ETFs to watch: USO and XLE), and I expect that crude will trade to a new high for the year sooner rather than later.

Copper, which I pointed out earlier in the week, rallied 1.4% yesterday on the good economic data. It is now, once gain, smack against its months-long downtrend at $3.16. A few closes above that downtrend, and I think that's a good thing for the global economy, industrial commodities, and basic materials stocks (which I've been pointing out have quietly done well in July). So, watch $3.16 today post-jobs, although until that downtrend is broken, the benefit of the doubt remains with the bears.

Gold and silver were flat yesterday, both got hit hard overnight, and gold has smashed through support at $1300/oz, meaning the downtrend is not over. If the jobs number is good today and the dollar rallies, look out below, as things will get ugly in gold.

Currencies & Bonds

There wasn't a ton to analyze in the currency markets yesterday, as the Dollar Index simply surged yesterday as the better economic data trumped Wednesday's "dovish" Fed interpretation. Interestingly, the dollar was already much stronger yesterday morning before the U.S. data hit. I think this speaks to the fact that currency traders realized that, perhaps, the currency market had overdone it a bit on dollar weakness, as both the ECB and BOE were expected to reiterate their extremely accommodative monetary policy, which they did. In that light, whether the Fed tapers in September or December, they *are* tapering this year, and in that context the dollar was simply too oversold against many of its peers.

Dollar strength was universal and dictated currency trading yesterday as shorts covered and value buyers stepped in. The euro fell 0.9%, pound 0.8%, Loonie 0.9%, Aussie 0.8%, and the yen 1.8%, as it appears this Dollar Index correction appears to be ending, as long as economic data continues to show improvement.

Bonds got hit very hard yesterday on the back of the strong data, as the 30-year Treasury note fell 1.3% (a huge move of the bond market) and is now basically sitting at lows for the year. If the jobs number is good this morning, things could get ugly in the Treasury market. The lows the year would almost certainly be broken, and we could see yields move sharply higher (the 10-year yield moved from 2.59% to 2.72% yesterday, matching the high for the year).

The decline in bonds appears to be accelerating, as it should be, given the improving economic data, and TBT and TBF (along with STPP and SJB) remain some of the best "pure plays" out there on the declining bond market.

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**	*The S&P 500 rallied to a new all time high this week on the back of strong economic data. The path of least resistance remains higher for stocks as the market is comfortable with Fed "tapering" of QE, investor sentiment remains less than enthusiastic, and cross assets like emerging market debt have stabilized.* *The S&P 500 broke through resistance at 1700, while support is lower around 1680.*

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.**