7:00's Report

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

August 13, 2013

Pre 7:00 Look

- Futures and international markets moderately higher, led by strength in Asia, as economic data o/n was almost universally better than estimates.
- The Nikkei rallied 2.5% mainly on speculation that PM Abe may introduce a corporate tax cut to offset the impending sales tax increase, but June machine orders also beat estimates, helping shares rise.
- European markets stronger as inflation readings (CPI & PPI) were in-line with expectations while EU industrial production and the German ZEW sentiment index both were better than estimates.
- Econ Today: Retail Sales (E: 0.3%).

Market	Level	Change	% Change
S&P 500 Futures	1692.75	5.75	.34%
U.S. Dollar (DXY)	81.60	.226	.28%
Gold	1327.50	-6.70	-.50%
WTI	106.82	.70	.66%
10 Year	2.605	.025	.97%

Equities

Market Recap

Stocks logged another slow day to start the week and finished basically unchanged. The S&P 500 was down 0.12%. There isn't much to recap from yesterday, so I'll keep my commentary brief.

The weak Japanese GDP print weighed on futures early Monday, but there was no conviction to the selling. Stocks rallied back to flat throughout the morning session and then basically treaded water for the rest of the afternoon.

From a catalyst/news standpoint, there was very little to talk about yesterday, hence the quiet trading.

Looking at market internals, it is worth noting that the Russell 2000 and Nasdaq again outperformed, with the Russell rallying 0.5%. The Russell, which has been the leader of the broader markets, appears to be bouncing off support (which is encouraging for the bulls).

Sector-wise we saw outperformance from industrials and basic materials (as sentiment toward China continues to get better). Meanwhile financials, energy, utilities and REITs all lagged. So, generally yesterday, we saw a continuation of the themes from last week: outperformance of international markets as well as basic materials and industrials (i.e., the year-to-date laggards).

Volumes remained well-below recent three-month averages while nothing changed on the charts: The S&P 500 continues to be range-bound between 1,680 and 1,709.

Bottom line is the S&P 500 continues to feel "tired," but it's no different than it felt a few weeks ago. As long as there is macro-economic calm, then the benefit of the doubt remains with the bulls. The current market landscape appears to be little more than a consolidation and pause, as opposed to the start of a bigger correction.

Sentiment—Still Not Bullish

I have made the case for weeks (months) that the lack of

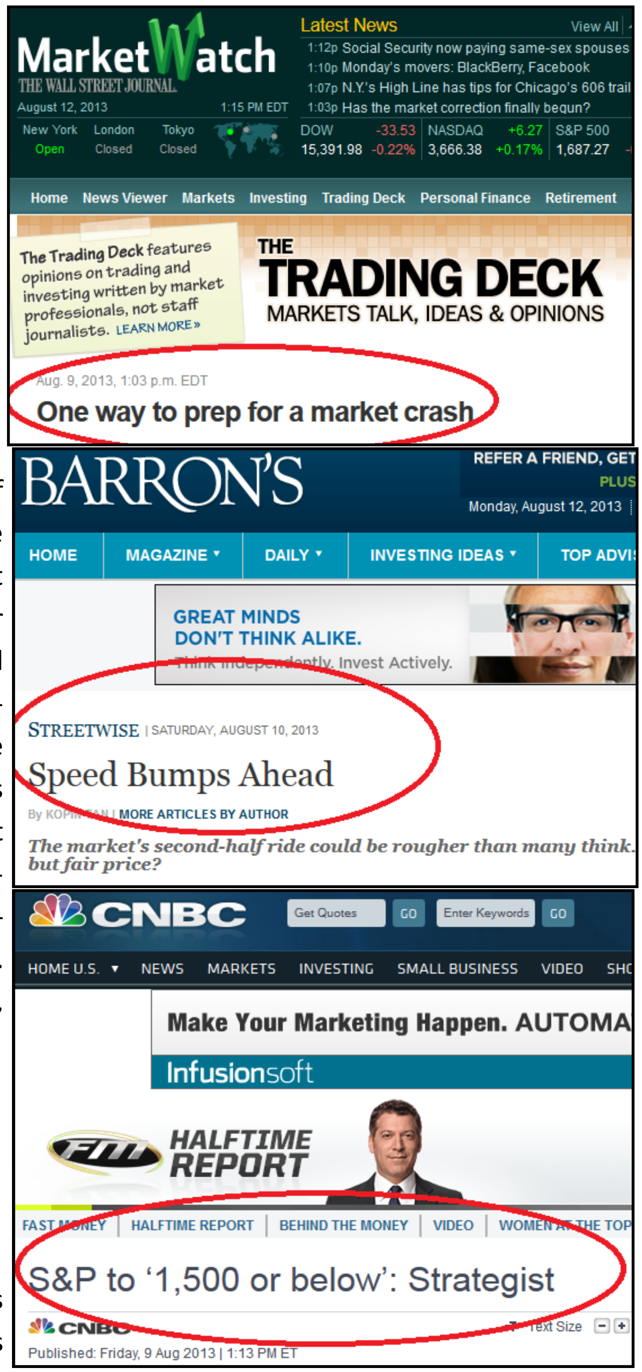
Market	Level	Change	% Change
Dow	15419.68	-5.83	-.04%
TSX	12594.27	52.14	.42%
Brazil	50299.49	424.59	.85%
FTSE	6616.76	42.42	.65%
Nikkei	13867.00	347.57	2.57%
Hang Seng	22541.13	269.85	1.21%
ASX	5157.70	49.05	.96%
Prices taken at previous day market close.			

bullish enthusiasm for this rally remains one of the most-underappreciated why reasons stocks keep grinding higher. With the market up nearly 19% through mid-August, you would think investors and analysts would be talking about Dow 20K. But, despite the incredible resiliency of this market and the almost-textbook "bull market" grind higher, sentiment remains very skeptical.

Market	Level	Change	% Change
Gold	1335.40	23.20	1.77%
Silver	21.34	.94	4.57%
Copper	3.31	.01	.15%
WTI	106.12	.15	.14%
Brent	109.04	.82	.76%
Nat Gas	3.30	.08	2.29%
Corn	4.64	.11	2.37%
Wheat	6.35	.01	.24%
Soybean	12.56	.38	3.12%

Prices taken at previous day market close.

I mentioned Marc Faber's call for an '87-like crash last week. Interestingly there were a lot headlines in the major financial media that also called for some sort of material correction or top in the market. (Note the headlines from Friday and over the weekend at right.)



Obviously there are a lot of different factors affecting this market, but the high levels of skepticism remain one of the underappreciated factors that have aided this rally all year long. While I'm not an uber-bull (in fact, I'm almost always skeptical), I think that as long as the macroeconomic horizon remains relatively clear, the "top" won't be in on this market until sentiment becomes much more enthusiastic than it currently is. The "pain trade" remains higher, as it has for the last year-plus.

Economics

No reports yesterday.

Commodities

Commodities rallied Monday, as the broad-based PowerShares DB Commodity Index Tracking Fund (DBC) rose more than 1%. This was led by a surge in precious metals and strength in the grains, while energy was flat. Impressively, commodities were able to rally in the face of a stronger U.S. dollar.

There wasn't a singular "macroeconomic" factor for the strength in commodities Monday, but instead there were a few "micro" catalysts that resulted in massive short-covering in metals and the grains.

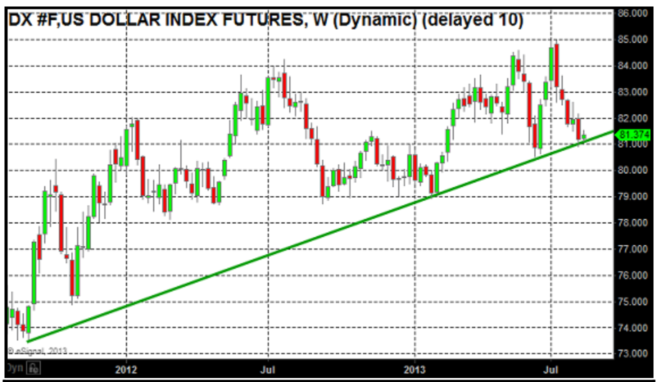
Silver was the best-performing commodity yesterday, rallying 4.8% to trade at nearly two-month highs and, importantly, breaking above its 50-day moving average for the first time since early February. Silver now joins copper as the second metal to break through overhead resistance in place since February.

Silver was higher yesterday initially in sympathy with gold, which was higher because of weak Japanese GDP and reports from the Chinese Gold Association that showed Chinese gold imports are on pace to double from last year. But, despite that news, yesterday's rally in silver was more of a trading rally than anything fundamentally driven.

Early last week silver and gold appeared to be breaking down, and as a result traders added heavily to what were already near-record short positions.

In fact, as of last Tuesday, short positions in silver had increased by nearly 1,300 contacts, or 6% of the previous week's short interest (which is a lot). But, both silver and gold arrested their declines last week thanks to the Chinese data, and that increase of “late shorts” set up the potential for a big short-squeeze. That’s what we saw yesterday as silver traded to multi-week highs.

I point this out because the same potential exists in the gold market, should it too break through overhead resistance at $1,349/oz. The latest Commitment of Traders report showed short positions in gold increased by about 14K contacts, from 56K as of July 30 to 71K as of last Tuesday. Certainly some shorts covered yesterday in gold, but undoubtedly there remain a lot of “late shorts” who will rush to cover if gold can break out—so if it does, expect a sharp rally.



The Dollar Index has bounced right at its month’s long uptrend line.

The picture in the metals continues to improve, with both copper and silver trading much better. But, I still think it’s too early to buy gold and would prefer to wait for that decisive breakout above $1,649/oz. If the downtrend is over in gold, the upside is potentially big during the coming months and quarters, but you want to be patient and wait for confirmation.

Looking at energy, WTI crude was flat yesterday in quiet trading, although natural gas rallied 2.5% on short-covering and as forecasts for the coming week show hotter temperatures moving across much of the country. Natural gas remains a totally weather-dominated market, but unless the weather turns hotter over an extended period (and I mean weeks), then natural gas will have a hard time sustaining any type of a rally until early winter.

Market	Level	Change	% Change
Dollar Index	81.43	.26	.31%
Euro	1.3301	-.0041	-.31%
Pound	1.5460	-.0049	-.32%
Yen	1.0320	-.0064	-.62%
CAD $	.9698	-.0025	-.26%
AUD $	.9125	-.0068	-.74%
Brazilian Real	.4357	.09	.20%
10 Year Yield	2.605	.025	.97%
30 Year Yield	3.666	.027	.74%
Prices taken at previous day market close.			

Finally, grains were higher yesterday after a surprisingly bullish WASDE (World Agricultural Supply and Demand Estimates) report. Expected yield for this summer’s corn crop was lower than estimates (154.4 bushels/acre vs. (E) 157.7 bushels/acre), while expected planted acreage for soybeans was reduced by 500K acres, as was the expected yield.

The bullish news caught two very oversold markets (corn and soybeans) by surprise, and each rallied more than 2% in trading yesterday.

I watch grains because, if you can catch a trend in them, you can make some good money (and with ETFs, now you don’t have to be a futures trader), but at this point we’re just seeing a deeply oversold market bounce. The corn and soybean crops this year are expected to be massive, if not a record. The only thing that can turn the bearish tide at this point is a drought between now and early September, or an early frost.

For you traders out there, given how beaten-up both corn and soybeans are, there’s probably some money in trading a bounce in the very short term for the PowerShares DB Agriculture ETF (DBA), iPath Dow Jones UBS Grains Total Return Sub-Index ETN (JJG) or Teucrium Corn Fund (CORN), but I think the bigger trend in grain prices remains lower.

Currencies & Bonds

Currency markets were relatively quiet yesterday, as the Dollar Index rallied small (0.2%) and continued to bounce off support at the 81 level while the euro and pound were both down 0.2% respectively.

The news of the day centered around the yen, which fell modestly (down 0.3%) vs. the dollar on the weaker-than-expected GDP report. The reason the yen fell, however, wasn’t so much because of the GDP miss, but instead because of the implications of the weak GDP report on the impending sales tax increase in Japan next year.

I covered this a few weeks ago in an issue, but to recap, Japan is in very poor fiscal shape—with debt and deficit to GDP ratios among the worst for developed economies. And, with a disproportionately old and aging population (a lot of elderly people and not a lot of young, working people to help support their entitlements), concern is growing that eventually (we're talking years here) the Japanese fiscal situation will become unsustainable.

One step Japan is taking to address these fiscal imbalances is to double its national sales tax from the current 5% level to 10% over the next two years. There has already been debate about whether Prime Minister Shinzo Abe will go through with the sales tax increase or delay it, fearing it may hinder the economic recovery, and the GDP miss has only reopened the debate.

So, with that context, here's why the yen fell yesterday: If the sales tax increase is postponed, that will send a message to markets that Japanese authorities aren't serious about fixing the fiscal issues facing that country. This could result in Japanese bond investors losing confidence about the fiscal soundness of those bonds.

When the market loses confidence in a country's ability to right the fiscal ship, bad things happen (see Greece, Ireland, Portugal, etc.). So, the fear is that the Japanese reluctance to tackle their fiscal imbalances could result in a severe decline in Japanese bonds over the next several years.

Stepping back, I think the takeaway here is that either way yen has to fall. Either:

1) The sales tax hike is postponed, and the market punishes Japan by reducing holdings of Japanese government bonds, which in turn will pressure the yen. Or,

2) The sales tax hike goes through, and to help the economy the Bank of Japan does additional stimulus to weaken the yen and stimulate the economy in the face of the tax hike.

On the surface, at least, either way the yen has to fall. So, this only strengthens the case for the ProShares UltraShort Yen ETF (YCS) over the medium and longer term.

Finally, Treasuries finished marginally lower yesterday, but that doesn't reflect a relatively big reversal we saw Monday. The 30-year note opened Monday nearly 0.3% higher, but slowly sold off throughout the day to close down 0.2%, potentially signaling this counter-trend rally may be losing steam.

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	Bullish	*Markets are consolidating recent gains, but the path of least resistance is 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 are stable.* *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.

Commodities	Neutral	Neutral	Neutral	*Commodities continue to try and "bottom," as recent global economic data appears to be showing signs of stabilization in Europe and China. But, at this point, commodities, as measured by broad based commodity ETFs like DBC remain range bound.*

Trade Ideas

Long: **WTI crude remains one of the more bullish commodities, as increasing domestic demand should help push oil higher over the coming months. A double top appears to have been traced out at $108, but I would look to be a buyer of oil on any material decline down to support at $103/bbl (using the ETFs USO or XLE).**

Copper has broken its months long downtrend as global growth appears to be stabilizing, and if that continues, industrial commodities offer some value, and an 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 continues to stabilize. Commodities and raw materials are the ultimate "contrarian" investment in the current market environment.

U.S. Dollar	Bullish	Bullish	Bullish	*The dollar index has traded to support at the 81.00 level, which should hold if the trend is still higher in the dollar. I remain dollar bullish based on the marginal direction of monetary policy: less accommodative for the Fed, equally or more accommodative for everyone else.*

Trade Ideas

Short**: Japanese Yen on any decent bounce (YCS being the ETF to use), like we've seen now, especially in the face of weak GDP reports. Short the euro (EUO) 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	*The outlook for FOMC tapering is more cloudy after the recent FOMC meeting, but the bottom line is whether tapering occurs in Sept or Oct, as long as economic data stays good, tapering will occur, which is bearish 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. Finally, with the Fed committed to holding down near term rates, the yield curve will steepen dramatically, so STPP should continue to do well.**