7:00's Report

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

August 6, 2013

Pre 7:00 Look

- Futures flat once again as markets continue to digest the events of last week.
- European markets also flat despite another round of almost universally better than expected data. Highlights were UK industrial production and German manufacturer's orders, which both beat expectations.
- As expected, the Reserve Bank of Australia cut interest rates 25 basis points, and didn't signal an end to the rates cutting cycle, although the Aussie is seeing a "sell the news rally" this morning.
- Econ Today: No Reports Today.

Market	Level	Change	% Change
S&P 500 Futures	1700.25	-2.50	-.15%
U.S. Dollar (DXY)	81.80	-.136	-.17%
Gold	1292.60	-9.80	-.75%
WTI	106.88	.30	.29%
10 Year	2.64	.038	1.46%

Equities

Market Recap

Stocks traded virtually flat Monday in what was one of the quietest and least-eventful sessions of the year. The S&P 500 closed down 0.15%. Yesterday was, in truth, a pretty boring day, and nothing of substance occurred that changes the current market dynamic. So, I will keep my comments on the market brief.

The big news of the day came early in the session, as global non-manufacturing (service sector) Purchasing Managers' Indexes echoed last week's manufacturing

The next time the yen trades through 100/dollar will likely be the start of the next stage of the decline, and a time to get more short (or long DXJ).

PMIs and beat expectations across the globe (China, Europe and the U.S.). But, while that data gave China a boost, European markets—like the U.S. markets—were more concerned about further digesting last week's gains than rallying further.

Stocks, which were down modestly before the report, cut their losses in half and gradually traded back to flat throughout the day on very low volume and went out basically flat.

The other event of the day was some commentary by Dallas Fed President Richard Fisher about wanting QE to be tapered starting in September, but that didn't really have any effect on markets because 1) Fischer is a well-known "hawk" and 2) the market is comfortable with tapering in September as long as economic data is good (as it was yesterday).

While volumes were low, it's worth noting that tech and small caps (Nasdaq and Russell 2000) both finished positive yesterday and again outperformed. From a sector standpoint it was a pretty mixed bag, as consumer staples and industrials rallied, while there was continued weakness in "bond-proxy" sectors as utilities, home-

Market	Level	Change	% Change
Dow	15612.13	-46.23	-.30%
TSX	12603.25	9.29	.07%
Brazil	48436.44	-37.60	-.08%
FTSE	6619.33	-0.25	0.00%
Nikkei	14401.06	142.02	1.00%
Hang Seng	21923.70	-298.31	-1.34%
ASX	5105.63	-5.62	-0.11%

Prices taken at previous day market close.

builders and REITs lagged. Finally, transports were laggards yesterday as a Union Pacific (UNP) train carrying hazardous materials derailed in Louisiana (there seems to be a rash of train incidents lately) and the government announced new safety requirements for "crude by rail" following the tragedy in Quebec earlier in July.

Market	Level	Change	% Change
Gold	1302.00	-8.50	-.65%
Silver	19.72	-.20	-.99%
Copper	3.16	-.60	-.19%
WTI	106.93	-.01	-.01%
Brent	108.81	-.14	-.13%
Nat Gas	3.32	-.03	-.96%
Corn	4.59	-.04	-.92%
Wheat	6.44	-.16	-2.38%
Soybean	11.85	.04	.34%
Prices taken at previous day market close.			

Trading volumes were anemic yesterday (and if not at the lows of the year, then close to it) and on the charts nothing really changed.

What To Do If We're Underperforming

The market is basically at new all-time highs, and the S&P 500 is up about 20% through the first seven months of the year. And, as I've often pointed out, one of the biggest reasons this market has put on this relentless rally has been skeptical sentiment from both professional and retail investors, as well as a lack of long equity exposure.

I was thinking yesterday that, if I were still managing money, I would be underperforming this year. Until about six weeks or so ago, I was to be counted among the skeptics and would have been underweight domestic equities. So, I spent some time yesterday thinking about what I would want to be in from a allocation standpoint, if that's the position I were in.

First, I think if you're not long the broader equity markets, it's tough to just buy the S&P right here, with it up 20%. That's not because I think they won't go higher in the shorter term (they probably will), but the chances of the back half of this year being as good as the first half (so the market ending the year up close to 35%) are pretty slim, even for raging optimists.

So, I've been pointing these two areas out for the last 2+ weeks, but two areas I think have the potential to outperform if markets continue to rally are Europe—especially the UK and Ireland from a geographic region—and European banks and global basic materials stocks from a sector standpoint.

Europe and the basic materials sectors have been the big underperformers year-to-date. But if markets continue to rally, then it will have to be accompanied by continued stabilization of, or even an uptick in, global economic growth. That's something we haven't seen in years.

I'm not advocating chasing long exposure at these levels with reckless abandon, nor pointing out these sectors because it's just some "buy the worst performers year-to-date in hopes of a snapback rally" idea. (After all, catching falling knives is a good way to go out of business.)

Instead, I'm again pointing out those sectors because logically—given where we are with global central banks being about as accommodative as they can get—if markets continue to rally, it has to be accompanied by a turn in the global economy (especially Europe) so you'll see sectors with direct exposure to the global economy outperform.

Now, if you think the market is going to correct and you're underinvested, then that's fine—if you're right, you can catch up in a hurry, so disregard everything I just said.

So, again, if you're looking to play catch up, consider the iShares MSCI United Kingdom Index (EWU), iShares MSCI Ireland Capped ETF (EIRL), PowerShares DB Commodity Index Tracking Fund (DBC), iShares MSCI Europe Financials (EUFN) and others.

I'm not saying to pile into these things, as the risks surrounding them remain high. But if you think this market has legs, consider adding these at the margin; they could help you play catch-up if you're underperforming a bit.

Economics

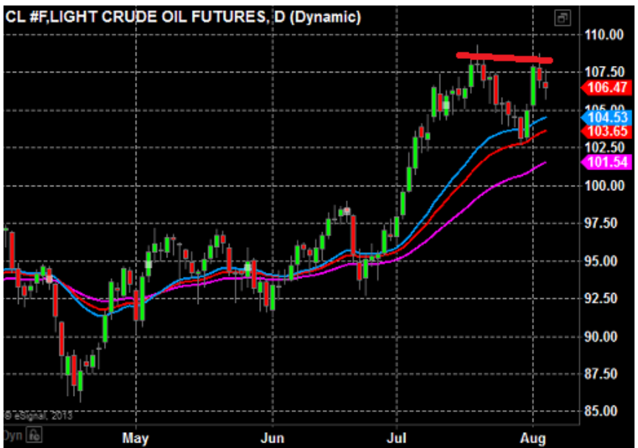
ISM Manufacturing Index

- July Non-Manufacturing index 56.0 vs. (E) 53.1.
- New Orders increased to 57.7 vs. 50.8.

Takeaway

Following on the much stronger than expected ISM manufacturing index from last week, the non-manufacturing, or services, index handily beat expectations—matching the high for the year set back in February at 56.0. The details of the report were also strong, although not as universally impressive as the manufacturing report.

New orders, the leading indicator, rose to 57.7 from 50.8 in June. The one disappointment in the report was the employment index, which fell to 53.2 from June's 54.7—not exactly "falling off a cliff," but still it would have been nice to see that move higher as well.



WTI Crude served as a leading indicator for this latest uptick in economic data, so it's a slight bit worrisome a potential double top may be developing on the charts.

Regardless, the jobs report notwithstanding, the economic data from July has started out very strong, implying the recovery may, finally, be accelerating. From a market and Fed standpoint, the data helped the market to cut early losses, but it really wasn't a huge market-mover. While the number was strong and implies acceleration in the service sector of the economy, it didn't shift expectations for Fed policy going forward.

Commodities

Commodities were universally lower Monday, as every single major commodity started the week lower, despite the flat dollar and better-than-expected global economic data. But, yesterday's selling was more about further digestion of last week's news with regard to the state of the economy and implications on the dollar. That can be reflected in the relative performance of commodities: industrial commodities (oil, copper) outperformed, while non-industrials (gold, grains) lagged as the dollar wasn't declining.

Market	Level	Change	% Change
Dollar Index	81.882	-.026	-.03%
Euro	1.3262	-.0014	-.11%
Pound	1.5352	.0058	.38%
Yen	98.49	-.45	-.45%
CAD $	.9647	.0025	.26%
AUD $	.8910	.0005	.06%
Brazilian Real	.4342	-.0041	-.94%
10 Year Yield	2.651	.05	1.88%
30 Year Yield	3.74	.052	1.39%
Prices taken at previous day market close.			

There was no fundamental news in the markets yesterday and trading, like in stocks, was quiet. As mentioned, gold and silver both fell modestly, (gold down 0.6%, silver down 1.2%) as both market remain shaky despite Friday's big rally. Gold (as of this writing) is holding above the lower bound of its recent trading range ($1,300/oz.) after violating that level overnight last Friday. But, gold continues to trade as a predominantly contra-dollar asset. Given that the dollar looks to be trying to bottom, that doesn't speak well for gold. A close below $1,300/oz. would signal a resumption of the downtrend.

Copper was a relative outperformer yesterday, trading basically flat thanks to the better-than-expected services PMI from China. This is a make-or-break week for copper, as it benefited the most from the strong economic data last week. If the economic data from China Thursday night beats expectations, copper could break a months-long downtrend. This would be a positive signal for global economic growth, and would imply continued outperformance from basic materials stocks.

Turning to energy, both WTI and Brent crude were little changed in quiet trading yesterday, as was natural gas. The terror alerts and embassy closures were in the news yesterday, but really had no effect on the energy markets. The better economic data remains a tailwind on WTI crude, although some crude bears will point out a potential double-top that's formed in the WTI crude market. It's too early to tell if that's correct, but it's worth watching—WTI crude is a great leading indicator of economic activity. It started rallying well before this recent uptick in the data for July, so seeing WTI break through that old high of $108 would further confirm the economy is indeed rebounding. I wouldn't read too much into one day's activity and I would be a buyer on any decent dips in WTI again, but a new high above $108 will settle some early nerves if it comes later this week.

Like WTI crude, commodity indices led this recent uptick we are seeing in global economic data, and the fact that the commodity rally has stalled a bit here reflects the fact that this latest uptick in data is "priced in" to the commodity markets.

And, despite that nice rally off the lows, it's still not clear commodities have broken their months-long downtrend, so they remain a contrarian investment—and ETFs like DBC still offer "value" if you think the global economy has indeed stabilized and finally turned for the better.

Currencies & Bonds

It was a flat-out boring day in the currency markets, as the Dollar Index was virtually flat, while the euro fell 0.2% in quiet trading, and the pound rallied 0.5% on a blowout services PMI number (continuing the trend of stronger data from the UK).

The biggest mover vs. the dollar was the yen, which rallied 0.6% for really no reason at all (economic data from Japan was tepid over the weekend, but argues for a weaker yen, not stronger). With a BOJ meeting later this week, mostly we saw covering as there are no new policy initiatives expected at the meeting.

While currency trading was quiet, Treasuries notched surprisingly steep declines for such a quiet day yesterday. The 30-year note fell 0.45% (although keep in mind it rallied 1.3% Friday). That drop was decent-sized given there was no real, impactful news (Treasuries were lower before the ISM non-manufacturing PMI).

After the whiplash we saw in bonds and currencies last week, I am coming to the conclusion that bonds, more so than currencies, are the best gauge of Fed intentions going forward. The reason I think that is because while the dollar has seen a big correction, Treasuries have slowly but surely traded heavily. They continue to have a downward bias to them—reflecting the fact that while Fed statements and conflicting economic data are giving us all whiplash, Treasuries, through their lower highs and lower lows, are signaling through the noise that the Fed is still on track to taper, as expected.

So, I know I sound like a broken record, but I'd continue to use any rally to lay out further short exposure.

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	*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 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 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: **WTI crude remains one of the more bullish commodities, as increasing domestic demand will help push oil higher over the coming months. For those who think the global economy will see an acceleration of growth over the coming quarters, then 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 stabilizes. Commodities and raw materials are the ultimate "contrarian" investment in the current market environment.**

U.S. Dollar	Bullish	Bullish	Bullish	*The outlook for FOMC tapering is more cloudy after the recent FOMC meeting, but despite the Dollar Index recent correction, the marginal direction of policy in the US is less accommodative, while it is of more "easy money" everywhere else, which is bullish for the Dollar in the medium term. I view this correction as a buying opportunity.*

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 (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.**