7:00's Report

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

August 8, 2013

Pre 7:00 Look

- Futures marginally higher this morning as Chinese and German trade data (particularly exports) were better than expected.
- Chinese exports rose 5.1% in June vs. expectations of 3.7% while German exports rose 0.6%. Both numbers further imply the global economy is stabilizing, and industrial commodities, especially copper, are rallying off the news.
- The other big event o/n was the BOJ meeting, which was a non-event as expected. The Nikkei finished down another 1.5% in volatile trading while the yen was up small vs. the dollar.
- Econ Today: Jobless Claims (E: 336K).

Market	Level	Change	% Change
S&P 500 Futures	1692.50	4.25	.25%
U.S. Dollar (DXY)	81.19	-.133	-.16%
Gold	1290.20	4.90	.38%
WTI	104.21	-.16	-.15%
10 Year	2.60	-.042	-1.59%

Equities

Market Recap

Stocks declined for the third-straight day Wednesday during another quiet and relatively boring session. The S&P 500 gave back 0.38%.

Stocks spent pretty much the entire day lower Wednesday, falling initially in sympathy with the 4% drop in the Nikkei Wednesday, and remaining in-the-red throughout the session. As far as "reasons" for the weakness, the most-cited excuse for why stocks declined again were the latest "hawkish" comments by a Fed president (this

Russell 2000: The If this is just another consolidation in an upward trending market, then the Russell should hold last month's lows.

time Sandra Pianalto from Cleveland) regarding a potential September QE taper. In fact, I must have heard two dozen times yesterday from the financial media that stocks were down because the Fed may "taper" in September. But, stocks were not down because of tapering concerns because, if that were the catalyst for the decline, you would see the dollar higher and bonds lower—and the opposite occurred yesterday. The bond market has already priced in "tapering" in September, and the stock market is OK with it as well.

The truth is that yesterday, like each day so far this week, was a very low-volume, low-participation consolidation of recent gains. The lack of volume results in a small amount of selling having an outsized effect on the averages. Regardless, stocks finished well off their lows during another quiet session.

Trading Color

It was another day of "safety" outperforming "cyclicals" as the Russell 2000 and small caps again underperformed, while utilities and healthcare were the only S&P

Market	Level	Change	% Change
Dow	15470.67	-4118.07	-.31%
TSX	12412.73	-56.59	-.45%
Brazil	47446.71	24.86	.05%
FTSE	6530.85	19.64	.30%
Nikkei	13605.56	-219.38	-1.59%
Hang Seng	21655.88	67.04	.31%
ASX	5064.80	53.50	1.07%

Prices taken at previous day market close.

500 sub-sectors to finish the day positive.

Homebuilders continue to experience a hangover from Tuesday's housing proposals by President Obama (down about 1.6% yesterday), while consumer discretionary and financials all lagged the market. Retail was weak again yesterday, as Ralph Lauren (RL) was the latest retail company to disappoint, following American Eagle Outfitters' (AEO) negative guidance Tuesday. (RL blamed the late start to spring for depressing sales.)

Market	Level	Change	% Change
Gold	1285.60	3.00	.23%
Silver	19.53	.01	.04%
Copper	3.18	.01	.35%
WTI	104.28	-1.02	-.97%
Brent	2.88	-.04	-1.35%
Nat Gas	3.25	-.07	-2.20%
Corn	4.58	-.01	-.22%
Wheat	6.99	-.03	-.43%
Soybean	11.99	.05	.46%
Prices taken at previous day market close.			

Volumes remain anemic, sitting well-below recent three-month averages. On the charts the S&P 500 bounced off support in the mid-1,680s yesterday, while the old high of 1,709 remains resistance.

Bottom Line

At this point stocks appear to be doing little more than consolidating recent gains, just as they did two to three weeks ago. More broadly, the market narrative remains largely unchanged: The macro horizon remains relatively clam and the market has accepted a September taper of QE. It is OK with that as long as economic data remains good domestically. Additionally, high levels of skepticism remain (on Tuesday when the market was down 10-12 points, it seemed everyone was again saying "This is it" with regard to an impending correction), and this continues to be one of the market's underappreciated tailwinds.

Lack of attendance on trading desks is resulting in some outsized volatility given the small volumes of shares traded. But unless the economic data all of a sudden turns lower or the Russell 2000 breaks the late-July low at 1,039 (the Russell has been a leading indicator for this rally), then this should be viewed as a consolidation in an upward-trending market.

Bottom line is the benefit of the doubt in this market still lies with bulls. That said, through, I continue to think the most-compelling trend in the market is of lower bonds/higher rates, and any rally in Treasuries should be used to get short the bond market via TBF/TBT/SJB/STPP. Incremental long equity exposure should look toward Europe (especially the UK and Ireland via EWU and ERIL, respectively), as I think those regions offer a better return profile in a rising market compared to the S&P 500 for the back half of the year.

Economics

No major reports yesterday, but I do want to point out that mortgage purchase applications rose last week for the first time since early June. The composite index increased 0.2% but, importantly, increased 0.7% for home purchases (as opposed to refinancings). The housing market remains an area of focus given both the moderation in the June housing-related economic data and the Fed's explicit mention of higher mortgage rates at last week's FOMC meeting.

The housing recovery remains key to the broader economic recovery, so seeing mortgage applications move higher—especially purchase applications—as rates have stabilized implies (at least anecdotally) that homebuyers are adjusting to modestly higher rates. If this trend continues, then that is a positive for the economy and implies greater certainty of "tapering" in September.

Commodities

Commodities were again broadly lower Wednesday, making it three days in a row of declines this week, despite the Dollar Index again hitting a multi-week low. Energy led markets lower while metals were the relative outperformers.

Copper again showed impressive relative outperformance, rallying 0.28% yesterday. The price action in copper was even more impressive considering it was down more than 1% Wednesday morning and recovered to finish slightly positive. The weaker dollar certainly helped copper to rally, but really I think yesterday was more about short-covering ahead of the important Chinese data released overnight.

The outlook for China, and whether that economy is seeing a stabilization in the pace of growth, remains the key driver of copper in the short term.

The “first volley” of Chinese economic data coming this week was released last night and it was universally positive, with both imports and exports beating expectations, and copper is more than 2% higher as of this writing, rallying through key resistance levels. There’s still a lot of data remaining this week, but so far it looks as though copper has broken its months long downtrend, a positive for China and global economic growth.

If the dollar index is still in an uptrend, then support at 81 should hold, and this correction should be close to over.

Gold was the only other major commodity to finish positive yesterday, as it rallied off early morning lows to close fractionally higher. The weaker dollar supported gold (and silver was basically flat as well). Although, sub-$1,300 gold with the dollar down nearly 1% on the week so far isn’t something celebrate. Unless we get extended dollar weakness (something I think unlikely) then the likely direction of gold is lower, and the downtrend accelerates if support at $1,273 is broken.

Energy was the worst-performing commodity sub-sector yesterday, as WTI crude fell more than 1% on general selling. The weekly inventory data didn’t really help the bulls’ cause yesterday, as the numbers showed a weekly drop of 1.3 million barrels, meeting expectations. Also weighing on the energy space (and WTI crude) was the continued plunge in RBOB gasoline prices, which fell 1.5% yesterday after weekly inventory data showed a 100K bbl increase in inventories vs. expectations of a 400K bbl decline.

Market	Level	Change	% Change
Dollar Index	81.295	-.363	-.44%
Euro	1.3343	.0036	.27%
Pound	1.5490	.0139	.91%
Yen	1.0365	.0122	1.19%
CAD $	.9586	-.005	-.52%
AUD $	.8969	.0008	.09%
Brazilian Real	.43095	-.00145	-34%
10 Year Yield	2.60	-.042	-1.59%
30 Year Yield	3.686	-.046	-1.23%
Prices taken at previous day market close.			

Earlier this week I pointed out the potential “double-top” in WTI crude prices as a negative signal, and yesterday’s decline now puts that theory to the test. WTI crude is now sitting right at support that should hold if the recent uptrend is intact. For those looking to allocate to energy and oil, now’s your chance. The stop on any long positions in WTI crude, USO or XLE should be last week’s lows (so $102.67 in WTI or $81.68 in XLE). Those levels should hold if the trend remain higher in the short term, and if they don’t, that’s a clear sign something has changed.

Currencies & Bonds

The Dollar Index was lower again Thursday, but like the rest of this week, the dollar was trading lower mostly in reaction to other currencies rather than anything fundamentally “dollar-bearish” happening here in the U.S.

The yen was the big mover yesterday, surging 0.25% to a six-week high vs. the dollar as yen bears covered shorts ahead of the Bank of Japan announcement, which was not expected to contain policy changes.

The economic data from Japan over the past week has been a bit disappointing, and it appears the market is testing the resolve of Prime Minister Shinzo Abe and BOJ Governor Haruhiko Kuroda and their respective easy-money policies. It will be interesting to see how the Abe administration and BOJ react to this uptick in the yen. It must be disconcerting to them to see a sub-97 yen/dollar—because they simply will not achieve their 2% inflation target or help the economy rebound with a sub-100 yen/dollar. Period. Given that fact, I’d expect some incremental policies from the government in the coming months designed to push the yen lower, because this simply isn’t going to get it done.

Longer term I remain a yen bear and I’m still penciling in the ultimate target of 115/120 yen/dollar—but it looks like officials will have to “do more.” Until they do, the yen will likely continue to rally in the shorter term.

The pound was also sharply higher yesterday despite the Bank of England issuing “dovish” forward guidance. In a first for the BOE, the bank said interest rates and the QE program will stay at current levels until the employment rate threshold of 7% is met, something the bank doesn’t expect to happen until 2016. What’s more, the BOE is prepared to “do more” QE if needed to ensure that target is met in a reasonable time frame. So, on balance the announcement was “dovish,” which begs the question: Why did the pound rally nearly 1% vs. the dollar?

The answer has to do with expectations. First, the BOE’s moves were widely expected. While the forward guidance was “dovish” in absolute terms, it largely met expectations. Second, the latest economic reports from the UK have all been much better-than-expected, so the market basically is reflecting the fact that the BOE’s projections about unemployment being above 7% for 2016 are simply too pessimistic ... and that the economy has recently been doing much better than the bank acknowledges. This implies that 0% rates and QE may end sooner than the official projections given in yesterday’s “guidance.”

Staying in Europe, the euro rallied 0.3% vs. the dollar as the latest economic data from Europe continues to beat expectations: German industrial production rose 2.4% in June vs. (E) 0.5%, and 2.1% year-over-year vs. (E) -0.1%. So, this recent rally in the euro—which is also at a six-week high—continues to come on the back of better-than-expected economic data, although none of it will have any effect on the monetary policy stance of the European Central Bank anytime soon. Relatively speaking, the data is better than we’ve seen in some time, implying stabilization in the economy. Yet, on an absolute basis, the EU economy is a long way from being healthy.

I am a “markets guy” in that I think the markets are seldom, if ever, “wrong.” But I’ve got to say that I think the currency markets are putting much too much focus on the very short term, given the recent Dollar Index plunge. Despite the Dollar Index hitting multi-week lows and the yen, pound and euro hitting multi-week highs, I continue to think this is just one big correction in an upwardly trending Dollar Index. I also think that the currency markets are simply looking too short-term. Yes, economic data in Europe is better, but the regions’ central banks will not be removing stimulus anytime soon (and, on balance, may add to it). The BOJ is not “done” either.

Perhaps I am wrong, but the fact remains the Fed is the only major central bank whose marginal direction of monetary policy is toward less accommodation (tapering) while the rest of the world’s major central banks are holding steady and, in some cases, being more-accommodative. That won’t change for a long time. But, a break of 81.00 on the Dollar Index tells me I’m wrong.

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 last week on the back of strong economic data. 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 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**

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.**