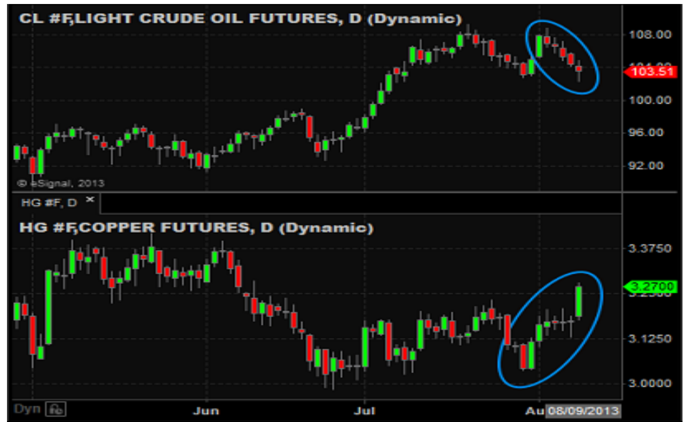
7:00's Report

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

August 9, 2013



Copper & Crude: The recent divergence in performance between the two commodities may be forecasting a period of outperformance for international markets.

Pre 7:00 Look

- Futures modestly lower despite almost universally good economic data o/n.
- Chinese data was again positive. July CPI was stable at 2.7%, implying Chinese officials have some scope to stimulate the economy, while industrial production beat expectations and retail sales was basically in-line, adding to recent signs of economic stabilization.
- Only other data was UK trade balance, which beat expectations and further implied the UK economy is stabilizing.
- Econ Today: No reports today.

Market	Level	Change	% Change
S&P 500 Futures	1687.50	-6.00	-.35%
U.S. Dollar (DXY)	81.02	-.007	-.01%
Gold	1310.90	1.00	.08%
WTI	104.66	1.26	1.22%
10 Year	2.587	-.013	-.50%

Equities

Market Recap

Stocks broke their losing streak this week Thursday, as markets rallied thanks to positive data from China. In another quiet session, the S&P 500 rose 0.39%.

Stocks started the day higher for the first time all week on continually improving international economic data. The level of exports and imports from China beat expectations, and German export data also exceeded estimates, further implying the global economy is indeed stabilizing.

Thursday was eerily similar to every other day this week, only we saw mild gains, not losses. Stocks basically treaded water shortly after the open and never really moved much throughout the entire day. There was little in the news and no real catalysts other than the early-morning international data, and stocks went out pretty much exactly where they started the day. Simply, not a lot happened yesterday other than stocks rallied a bit.

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Trading Color

The Chinese data was the only real market catalyst yesterday, and as a result basic materials were the big outperformers. This continues a trend that started in early July with Alcoa's (AA) earnings beat. The most major

Market	Level	Change	% Change
Dow	15498.32	27.65	.18%
TSX	12552.92	140.19	1.13%
Brazil	48928.82	1482.11	3.12%
FTSE	6541.98	12.30	.19%
Nikkei	13615.19	9.63	.07%
Hang Seng	21807.56	151.68	.70%
ASX	5055.21	-9.59	-.19%

Prices taken at previous day market close.

basic materials indices rose 1.75% yesterday, making them easily the best-performing S&P 500 sub-sector. Consumer discretionary and homebuilders (recovering from weakness earlier in the week), and energy and industrials all beat the broader averages. Telecom was the only S&P 500 sub-sector to finish negative, and it was weighed down by several bad earnings reports.

Market	Level	Change	% Change
Gold	1312.00	26.70	2.08%
Silver	20.215	.71	3.62%
Copper	3.2620	.09	2.80%
WTI	103.88	-.49	-.47%
Brent	106.73	-.71	-.66%
Nat Gas	3.32	.08	2.37%
Corn	4.60	.02	.33%
Wheat	7.01	.02	.29%
Soybean	12.28	.29	2.40%
Prices taken at previous day market close.			

So, while yesterday was technically a day of "cyclical outperformance" it was really because of the Chinese data. Exclude that and there wasn't really anything insightful in the sector trading yesterday.

Volumes were a bit busier than earlier in the week, but still well-below three-month averages, and it was again very quiet out there. On the charts, nothing really changed: Near-term resistance sits around 1,680, while support is at the old highs of 1,709.

What Copper and Crude are Telling Us About the World

Over the past decade or so, most industrial commodities have traded together. Generally speaking, copper, oil and other base metals all rallied or fell together depending on the prevailing macroeconomic winds. But, this year, that relationship has broken down. Especially during the last four months, copper and WTI crude have traded in opposite directions: The latter rallied while the former fell sharply.

Well, this week those respective trends have reversed, and I point that out because perhaps that's giving us a signal with regard to which areas of the world will relatively outperform going forward.

Broadly speaking, WTI crude is a proxy for U.S. economic growth, while copper is a proxy for Chinese economic growth. They tend to rise and fall with the pace of their respective economies and can often indicate periods of acceleration or slowing in those respective economies. The return numbers this year bear that reality out.

As of yesterday's close, WTI crude is up about 14% year-to-date, while the S&P 500 is up about 18% year-to-date. Conversely, copper is down about 10% while the Chinese market is down about 9.8% in that same time frame.

Over the last week, we've seen the fortunes of WTI crude and copper appear to change. Copper looks to have broken a downtrend that has been in place since mid-February, thanks to the recent stabilization in Chinese economic data (specifically, the better-than-expected trade numbers yesterday). Meanwhile WTI crude, after a big run, appears to have traced out a "double-top," implying in the short term the rally is over.

So, this got me to thinking: All year, the way to be positioned has been long U.S. equities, and underweight or short the rest of the world.

But, recent economic data from around the world has been picking up, which I've noted repeatedly recently with regard to the UK and Europe.

So, the question is this: Is copper, by breaking out, telling us that the best way to outperform is to reverse the trade: Long China/Europe/Natural Resources/Emerging Markets (the laggards so far this year) and underweight the U.S.?

I'm not saying that because I think there is about to be a big correction in the U.S., or that the economy is about to slow meaningfully. WTI crude has declined this week for a multitude of factors, some of which pertain to the physical trading aspects of the business that aren't reflective of the macro-economy. But, on a relative performance basis, the case can be made that other areas of the globe will outperform if economic data continues to improve.

Think about it this way: Year-to-date the S&P 500 is up 18%, while "Europe" is up about 6%; China, as mentioned, is down about 9%; and emerging markets, as measured by the Vanguard MSCI Emerging Markets ETF (VWO), are down about 12%. So, from an incremental return standpoint, what's more likely: the S&P 500 rallies another 18% or some of these markets play catch-up, assuming the economic data continues to improve?

So, it may be that copper and WTI crude are giving us a signal of where we'll see relative outperformance in the second half of 2013, as long as global economic data continues to get better. Keep an eye on the iShares MSCI United Kingdom Index (EWU), iShares MSCI Ireland Capped Index (EIRL), iShares FTSE/Xinhua China 25 Index (FXI) and VWO as a potential destination for any incremental long exposure.

Economics

Jobless Claims

- Weekly jobless claims 333K vs. (E) 336K
- Four-week moving average declined to 335K, a multi-year low.

Takeaway

Jobless claims ticked up a bit and last week's multi-year low print was revised higher slightly. But more importantly, the four-week moving average made a new multi-year low, implying that we are seeing incremental improvement in the labor market since the spring/early summer.

But, July is a notoriously, statistically "noisy" month for employment reports, so that tempers the positive sentiment coming from the numbers. But, we do know this: The labor market is, at a minimum, holding at its current level and is not backsliding, which is a positive for the economy.

Commodities

Most commodities indices rallied Thursday as strength in the metals and grains offset weakness in oil. The major catalyst in commodity markets yesterday was the better-than-expected Chinese trade data. In particular, commodity imports saw a big increase, which in turn led to massive short-covering in copper and other industrial metals, as well as gold and silver.

Market	Level	Change	% Change
Dollar Index	81.085	-.238	-.29%
Euro	1.3391	.0057	.43%
Pound	1.5544	.0052	.34%
Yen	1.0362	-.0016	-.15%
CAD $	.9684	.0099	1.03%
AUD $	.9098	.0132	1.47%
Brazilian Real	.43610	.0053	1.23%
10 Year Yield	2.587	-.013	-.50%
30 Year Yield	3.672	-.014	-.38%
Prices taken at previous day market close.			

Silver was actually the best-performing commodity yesterday, rallying 3.8% on short-covering given the surprising surge in Chinese demand in June. Importantly, and as I discussed earlier, copper rallied nearly 3% to clearly break through resistance at both the $3.18 and $3.23 levels.

More data was released this morning, and copper will continue to be Chinese-data-dependent, but the fact that copper was able to so convincingly break through that downtrend yesterday is impressive and potentially signals a trend not only in copper but also in global economic growth.

Gold rallied 2% both in sympathy with the industrial metals and off of continued dollar weakness. Gold, after spending two days below $1,300/oz., is once again in the $1,300-$1,348 range. But, while the bounce-back was impressive, it's very hard to be bullish short term on gold unless that $1,348 resistance is decisively broken. For now, it appears the downtrend (or at least a sideways chop) remains intact.

Energy, which has been the leader for the commodity indices over the past seven weeks, continued to lag Thursday. WTI crude has been under pressure all week from a variety of factors, including the Environmental Protection Agency reducing some of the renewable fuel standards for 2014 (which is a short-term negative on the price of WTI). And, although yesterday's inventory data was in line with expectations, the Energy Information Administration reported that crude production domestically hit a record 7.084 million barrels/day. (So, anecdotally bearish in a falling market.)

I have been nervous about a double-top in energy since Monday when I pointed it out, and have been watching last week's lows of $102.67 as key support. Although WTI traded through it on an intraday basis (down to $102.22), it rallied back sharply to close at well-above $103.80/ Given that WTI crude has seen some big intra-day dips lately and recovered, I'll consider that low of last week to be intact, for now. Bottom line is, there remains a decent risk/reward setup in energy. A close or two below that $102.67 level is your clear exit point, while the recent highs of $108 are reasonable for a rally. (So, $1 of risk for $4+ of potential reward—not a bad trade if it works.)

The lone energy commodity that rallied yesterday was natural gas, which rose 2% after some confusion over the weekly storage data. The announced weekly injection was 96 Bcf, above the 78 Bcf expected. But, that 96 Bcf included 14 Bcf that was "reclassified" from earlier supply releases, so the actual increase was just 82 Bcf.

Natural gas plunged initially on the headline number, but shorts were quick to cover, and that, more than anything, resulted in the rally. Bottom line is, inventory levels are now back above the five-year average for the first time in months. Unless the weather gets very hot in the near future, natural gas will remain under pressure.

Currencies & Bonds

The dollar was weak again Thursday—falling and temporarily breaking support at 81.00 before recovering during the afternoon session.

Once again, as has been the case all week, the weakness in the Dollar Index was due to strength in other currencies, as the only piece of economic data out yesterday was mildly dollar-positive (jobless claims).

The euro rallied 0.4% vs. the dollar to move to another multi-week high on the back of stronger-than-expected German export data (a continuation of good data all week long). Meanwhile the pound extended its gains as the market has largely ignored the Bank of England's "forward guidance" contained in the Inflation Report released earlier in the week.

The big mover in the currency space yesterday was the Aussie, which rallied 1.3% vs. the dollar thanks to the better-than-expected Chinese data. One of the tenets of my "Short Aussie" thesis months ago was the slowing Chinese economy. But if commodity imports are back on the rise and China might be stabilizing, then it's fair to say that—while I think we won't see parity with the greenback for a very, very long time—the additional downside in the Aussie may be somewhat capped vs. the potential for a rally. I said earlier this week that, with the Aussie in the high-80s, this trade is getting a touch long in the tooth. Yesterday's price action reinforced that opinion.

Finally, staying in Asia, we saw a classic "sell the news" reaction from the yen. It declined marginally vs. the dollar after the Bank of Japan meeting and subsequent announcement met expectations. BOJ Governor Haruhiko Kuroda seems content to let current policies work for the time being, although the market may try and force his hand to take further steps to more actively put pressure on the yen.

Turning to bonds, they continued their counter-trend rally on Thursday, as the 30-year note rose 0.3% despite a lackluster auction yesterday that saw the lowest bid-to-cover since February 2009. But, while that on the surface is bearish, the internals of the auction were decent ("OK" international demand). Plus, August is a seasonally weak period for long-bond auctions due to low attendance, given vacations and holidays. So, while it certainly wasn't a good auction, it wasn't bad enough to change the tide of short-covering and consolidation occurring in bonds in the short term.

Beyond the very short term, Fed tapering of QE appears to be on schedule for the September Federal Open Market Committee meeting, which means any substantial counter-trend rally in bonds should be shorted. The bigger trend remains lower for the 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**	**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.

	Fundamental Outlook	Technical Outlook	Overall	Comments
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**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**