7:00's Report

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

February 14th, 2014

Pre 7:00 Look

- Futures are flat as markets digest yesterday's rally, while international markets rallied thanks to strength yesterday in the US and decent economic data o/n.
- In Europe, "flash" estimates of Q1 '14 GDP beat expectations for Germany, France and the EU (up 0.3% vs (E) 0.2%).
- Chinese CPI was 2.5% yoy in January, slightly above the 2.3% estimate, but unchanged from December.
- Econ Today: Industrial Production (E: 0.3%).

Market	Level	Change	% Change
S&P 500 Futures	1826.00	1.75	0.10%
U.S. Dollar (DXY)	80.185	-.193	-0.24%
Gold	1313.90	13.80	1.06%
WTI	99.94	-.41	-0.41%
10 Year	2.736	-.027	-0.98%

Equities

Market Recap

Stocks rebounded from a shaky start Thursday to grind higher throughout the day and close at a three week high. The S&P 500 was up .58%.

Stocks started Thursday lower thanks to soft earnings (CSCO and others), Italian political drama (more on that later) and a retail sales miss. Markets opened basically on the lows yesterday and it looked for a bit as though things might get a bit ugly.

But, yesterday while the fundamentals were lacking, the technicals were strong, support at 1809 held a test shortly after the open, and that support holding led to a reversal in the markets, which began to rally right at 10:30 AM.

The day got progressively more quiet news wise as stocks grinded steadily higher throughout the late morning and afternoon, and although there wasn't the "panic" buying that we saw Tuesday, there was the feeling that investors were again "chasing" a bit as stocks moved past Tuesday's highs.

The rally held late in the trading day and stocks went out fractionally off the highs of the day.

Trading Color

Volumes were still light yesterday (in part thanks to the snowy commute in much of the northeast, but the bulls got the cyclical outperformance they've been looking for. The Russell 2000 rallied 1.35% and the Nasdaq .94% (despite some soft earnings), handily outpacing the Dow and S&P 500. And, that cyclical outperformance jives with some anecdotal remarks I heard from desks yesterday that there were real buyers in the market yesterday adding to the long side (so it was more than just short covering).

Sector wise there was again broad strength, as all 10 sub-sectors were higher. Basic materials were the big outperformer yesterday, rallying more than 2.4% thanks in part to the gold miners (GDX, which has been pretty much the worst investment in the world for 2+ years, is surging, and was up another 4.44% yesterday). Semi conductors and utilities were the other S&P sub-sectors to rally more than 1% yesterday, while the banks, consumer discretionary and energy were the relative laggards (although each finished up around .5%).

Market	Level	Change	% Change
Dow	16,027.59	63.65	0.40%
TSX	14,001.65	101.16	0.73%
Brazil	47,812.83	-404.06	0.84%
FTSE	6,658.48	-.94	-0.01%
Nikkei	14,313.03	-221.71	-1.53%
Hang Seng	22,298.41	132.88	0.60%
ASX	5,356.26	48.15	0.91%
Prices taken at previous day market close.			

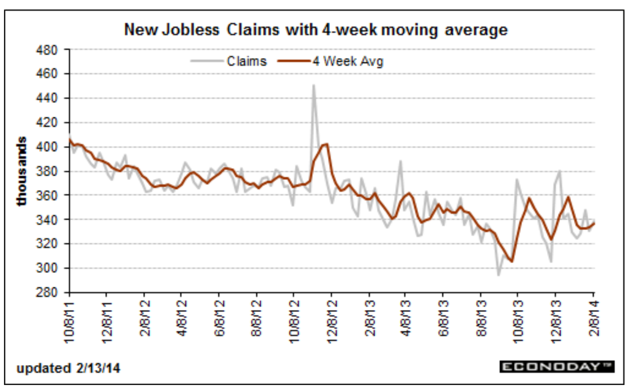
On the charts, it's a big sentiment boost that 1809 held in the S&P 500, but it'll take a break of 1850 to really embolden the bulls.

Market	Level	Change	% Change
DBC	25.66	.11	0.43%
Gold	1300.70	5.70	0.44%
Silver	20.44	.099	0.49%
Copper	3.25	-.006	-0.18%
WTI	100.29	-.08	-0.08%
Brent	108.70	-.06	-0.06%
Nat Gas	5.205	.383	7.94%
RBOB	2.768	.0049	0.18%
DBA (Grains)	25.48	-.01	-0.04%
Prices taken at previous day market close.			

Bottom Line

Yesterday was a quietly impressive day, as the S&P 500 rallied 20 points off the lows despite any really positive catalysts to propel markets higher.

But, although there was some "real" money that stepped in and bought the dip at 1809 yesterday, market movements in the short term remain more about positioning and sentiment than anything else, as no one thinks the fundamentals have gotten demonstrably more positive over the past week. Simply, markets got too bearish last week, and that has been corrected. Bottom line is the market remains largely stalemated ahead of the next round of key economic data, which starts Fed 20th with the February "Flash" Manufacturing PMIs.



Italian Politics Heats Up Again

There was another round of turmoil in the Italian political sphere over the past 48 hours, and the result is Italy will have its third Prime Minster in just over a year. But, unlike the last Italian political drama that occurred just over a year ago, this one shouldn't cause ripples amongst the rest of Europe, as this latest leadership change is more about an internal power struggle inside the majority PD party, and importantly shouldn't result in snap elections.

As far as what happened, Prime Minister Enrico Letta reigned yesterday after a de facto "Coup" by a member of his own party – Matteo Renzi, the 39 year old Mayor of Florence and resident "rock star" of the party. To keep it simple, Renzi withdrew his support for any of Letta's initiatives (despite the fact that they are in the same party) and as a result Letta was a general without an army with regards to the National coalition government. And, by sabotaging him, Renzi positioned himself to replace Letta once the inevitable resignation came.

There was a time not too long ago when this type of news would have sent the market down in a heap and PIIGS bond yields soaring. But, yesterday obviously stocks didn't mind, and sovereign bonds outside of Italy were well behaved. Obviously Italian bonds sold off initially on the news, but truth be told this is probably a buying opportunity in them for those that can do those sorts of things.

So, why didn't they react? There are several reasons (and they all underscore the progress Europe has made over the past year). First, the governing coalition should remain in place despite the change of Prime Minister, because the coalition parties will now support Renzi instead of Letta. So, as mentioned, no dissolving Parliament and no snap elections. Second, there is policy continuity between Letta and Renzi. This was more about personal ambition and leadership of the PD party than it was any rejection of economic reforms for Italy, so we can expect progress to continue at the current slow pace. Finally, and perhaps most importantly, the Italian economy is improving, as is the whole of Europe.

One of the truisms of macro-economics is economic growth cures all (or at least adequately delays all) and we can see that in Europe. With growth, slowly, turning for the better, the intricacies of Italian politics can no longer shake global investors sentiment, and given the volatility in Italian politics, that, as they say, is a good thing.

The political situation remains one to watch, but unless snap elections are called (which is very, very unlikely) this will remain a decidedly Italian issue.

Economics

Retail Sales

- Retail sales fell 0.4% vs (E) -0.1% m/m in January
- The control group fell 0.33% after rising 0.1% in December

Retail sales fell more than expected last month, down 0.4% vs. analyst expectations of 0.1% decline. The details of the report were also weak as the “control group,” which is retails sales ex automobiles, building materials and gasoline purchases (and the best single measure of consumer discretionary spending) declined month over month for the first time since June of 2012.

The report sent stock futures, which were already in the red, to fresh session lows. But, as with most disappointing economic data releases, the negative impact of retail sales was relatively short lived, as the weather was again blamed for the soft data (and, with regards to retail sales, there’s probably some legitimacy to that).

Regardless, though, the weather excuse is now being relied on very, very heavily by the bulls to explain consistently weak data, and certainly that could be true. But, and as we start to exit winter, the data better start to turn positive in March, otherwise this market is way over its skis (to use a winter analogy).

Commodities

Most commodities continued to grind higher yesterday thanks in part to the weaker dollar, which was down 0.5%. The commodity tracking ETF, DBC, rallied 0.43%.

Precious metals, which are obviously the most-sensitive to movements in the dollar, rallied yesterday with gold futures gaining 0.44% while silver added 0.49%. Gold futures have been grinding higher recently, up 7 days in a row now, and that rally is accelerating this morning. Yesterday gold was able to reclaim the $1,300 level for the first time since Nov. 7 of last year, and is trading above key resistance at 1308 in pre market trading.

Market	Level	Change	% Change
Dollar Index	80.36	-.381	-0.47%
EUR/USD	1.3677	.0085	0.63%
GBP/USD	1.6654	.006	0.36%
USD/JPY	102.26	-.26	-0.25%
USD/CAD	1.0974	-.0025	-0.23%
AUD/USD	.8987	-.0037	-0.41%
USD/BRL	2.3933	-.0317	-1.31%
10 Year Yield	2.736	-.027	-0.98%
30 Year Yield	3.686	-.037	-0.99%
Prices taken at previous day market close.			

The reason for gold’s rally has subtly shifted over the past few weeks. Initially gold rallied off a “crisis bid” given emerging market turmoil and correction in the market. But, this latest rally above $1260 has been because of weak economic data, which has weighed on the dollar and led traders to speculate that the Fed may be inclined to be more-dovish. Silver is also sharply higher this morning, up 2.5%, and also appears to be breaking out on the charts, confirming the bullish set up we pointed out last week.

The question now, obviously, is whether you buy gold or silver on this break out, and I’m inclined to say “yes,” as historically the way to trade it is to buy these break outs, although I’m not sure I necessarily “agree” with why gold is rallying (I don’t think the Fed will “taper” the taper). But, with gold rallying because of soft economic data and the potential implications on Fed policy, gold is now trading as a de-facto equity market hedge, which is an added bonus.

Copper was the only commodity to trade in the red yesterday, albeit only slightly, down 0.18% as copper saw some light profit taking following the big Chinese trade data inspired rally on Wednesday. On the charts, it does seem as though copper futures have found a near-term bottom here around the $3.17-ish level.

Switching to energy, natural gas rallied 8.0% yesterday in reaction to the EIA inventory report that showed a draw of 237 Bcf in supply vs. expectations calling for a draw of 220 Bcf. This was the first report in weeks that indicated a larger-than-expected draw (as opposed to a moderate miss of estimates), which in turn bucked the trend of natural gas futures breaking down after the EIA data was released. And, constant coverage of the snow storm battering the northeast helped the bullish sentiment as well. Fundamentally, the outlook in natural gas continues to get more bullish. Inventories are now 34% below last years’ levels, and 27% below the five year average, and because of that I continue to recommend adding to positions in the ETFs XOP and FCG, which were up 1.44% and 1.28% respectively yesterday.

Elsewhere in the energy space, crude oil was little-changed yesterday as it seems to be looking for direction. Traders are faced with a bit of a dilemma here as, technically, the price broke out of the range. But as I mentioned yesterday, that seems to be turning out to have been a head-fake. Fundamentally, supply news was bearish, but the headlines of frigid temperatures spanning much of the East Coast are supporting the space for the time being. On the charts it appears that CL has simply raised the "ceiling" of the current trading range, which is now Wednesday's high of $101.38 while $92.00 remains the low end.

Currencies & Bonds

The Dollar was almost universally weaker Thursday thanks to the soft retail sales data and strength in the euro. The only major currency to decline versus the US Dollar yesterday was the Aussie Dollar, and that's because Australian economic data was even more disappointing than the US data.

Starting with the strongest currencies vs. the greenback yesterday, the euro rallied .6%, and normally we'd chalk that up that strength to the drop in the dollar, but the euro was stronger versus the dollar even before the retail sales data. The reason was the ECB monthly bulletin which was released yesterday morning. In it, the ECB released updated inflation forecasts for 2014, 2015 and 2016. The inflation outlook for 2014 and 2015 was predictably revised lower to 1.1% and 1.4% respectively. But, it was the 2016 inflation forecast that caused the rally in the euro. The ECB expects inflation to be 1.7% in 2016, very close to their 2.0% target. That means that, at least according to their models, the dis-inflation we are seeing in the euro won't become a structural problem, a la Japan in the 90's and 00's. That forecast can be taken to imply that the ECB will be less prone to act decisively (so no additional easing) to combat dis-inflation, and as a result the euro rose.

Bottom line, it's another sign that the ECB remains intransigent with regards to the growing threat of deflation, and that is by default bullish euro and bullish EU bonds (especially higher yielding bonds).

Both the yen and pound were modestly higher versus the dollar, although there was no real bullish news in either region, and both currencies rose simply because the dollar was weak.

Finally, as mentioned, the Australian Dollar fell .5% after the January unemployment report showed a surprising 3700 jobs loss versus expectations for 15k jobs added. Aussie finished off its best levels off the worst levels of the day, but traded back below the .90 level. I'd expect Aussie to be range bound in the near term, but I continue to think that selling Aussie above .9 to the dollar (preferable in the low to mid 90's) remains one of the better trades out there, should the short covering rally resume over the coming days. So, if you're a currency trader, perhaps set an alert.

Bonds rallied hard yesterday and recouped all of Wednesday's losses, as the ten year rose .4% and the 30 year rose .6%. Obviously the soft retail sales data contributed to the rally, but there was also a surprisingly strong 30 year Treasury auction yesterday. The bid to cover was 2.27, which was just below the 2013 average, but more importantly the actual yield was 1 full basis point below the "when issued" yield, implying that while there weren't a huge amount of bids submitted, the people that were bidding showed some strong demand for the issue.

More generally, the bond market continues to react with the most volatility to the economic data, as it tried to figure out whether this constant drip of disappointing economic data will result in the Fed "tapering" the taper. At this point, I do not think that is the case, and unless the February PMIs come in soft and the February jobs report is another big miss, then tapering is very much still "on." Until that becomes more clear, though, I'd expect bonds to continue to chop in the current range (10 year yield between 2.6% and 2.8%, and 30 year yield between 3.6% and 3.8%).

Have a good long 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	Bullish	Neutral	Bullish	*Stocks stabilized last week after markets decided late in the week that economic growth was cooling, not collapsing. The pace of economic growth and the continuing adjustment in emerging markets remain potential threats to stocks, but for now the rally remains intact and the path of lease resistance higher for stocks.* *Support now lies at 1809 (50 day MA), while resistance is the old highs (1850).*

Trade Ideas

Long Japan: **DXJ has gotten hit hard as the yen has rallied, due mostly to emerging market angst. But, the Japanese economy is improving, and seeing as I don't think this latest EM angst is a bearish game changer, I believe the yen will resume its declines and DXJ is not done rallying.**

Long Deep, multi-national Cyclicals and Global Miners: **Domestically, I'd look to allocate to deep cyclicals like industrials (XLI), basic materials (IYM) and global industrial miners (PICK). It's a bit of a contrarian idea, and over the past few weeks these sectors have lagged. But, they most exposed to the "global economic recovery" thesis.**

Long Natural Gas E&Ps: **Term structure in the natural gas markets has turned bullish, as its in backwardation out nearly a year, implying a structural increase in demand. But, natural gas equities remain under pressure, and could potentially offer some value in the market over the medium/longer term. FCG and XOP are the two "pure play" ETFs in the natural gas E&P space.**

Commodities	Bullish	Neutral	Neutral	*The outlook for commodities remains mixed, as the global economy remains mired in stagnant growth. Given the severe underperformance of commodities last year, though, the asset class remains on of the last corners of value in the market, if the global recovery can accelerate.*

Trade Ideas

Long Industrial Commodities: **Industrial commodities have stalled lately, as economic data, especially in the US, has shown a loss of some positive momentum, and it bears close watching as to whether this is a temporary blip, or a bearish game changer. But, if you believe the global economy Is recovering, the commodity space, and the ETF DBC, is one of the best "values" in the market, and a pretty contrarian idea right now.**

Long Gold: **Gold is now threatening to break out of a months long downtrend, but given gold has rallied as a "crisis" hedge, I'm skeptical the move can last. A few more closes above the $1260 level would make me more bullish in the short term.**

U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index largely range bound as the market has priced in Fed tapering, while the question of what, if anything, the ECB will do to combat rising dis-inflation remains unanswered.*

Trade Ideas

Short: **The yen is seeing a massive "risk off" rally that can brought it below 102 dollar/yen. But, the fundamentals for a weaker yen remains in place, and I would view this rally as an entry point in a still down trending yen.**

Treasuries	Bearish	Bearish	Bearish	*Treasuries have seen a decent "counter trend rally" and traded to multi-month highs, as emerging market angst put a "fear bid" into bonds. But, with the Fed intent on tapering and inflation likely having bottomed, the larger downtrend remains in place, and I would use this bounce to add to "short bond" positions.*

Trade Ideas

Buy: **TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury). Finally, with the Fed committed to holding down near term rates, the yield curve will steepen dramatically, so STPP should continue to do well.**