7:00's Report

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

February 18th, 2014

Pre 7:00 Look

- Futures are flat as traders return from the long weekend and digest conflicting economic data from Asia o/n.
- In Japan, the Nikkei rallied 3% after the BOJ surprisingly doubled the size of two loan facilities to further spur economic growth.
- Chinese markets were slightly lower as loan demand from Chinese banks hit a record high in January. But, the PBOC drained 7.9 billion yuan from the banking system overnight, offsetting the strong loan data.
- Econ Today: Empire Manufacturing Index (E: 8.5).

Market	Level	Change	% Change
S&P 500 Futures	1832.75	-2.25	-0.12%
U.S. Dollar (DXY)	80.16	-.019	-0.02%
Gold	1315.20	-3.40	-0.26%
WTI	100.89	.76	0.76%
10 Year	2.746	.01	0.37%

Equities

Market Recap

Stocks continued to bounce back last week as some positive news economically, governmentally and from the Fed helped improve sentiment. The S&P 500 rose 0.5% last week, its best weekly performance so far in 2014, and is down just 0.53% year-to-date.

Stocks started last week flat ahead of new Fed Chair Janet Yellen's first testimony before Congress, but rallied nicely Tuesday after she emphasized the continuity of policy and some of her comments were interpreted as incrementally "dovish." Stocks spent Wednesday digesting the gains, thanks in part to better-than-expected Chinese export and import data for January.

Thursday proved to be the pivotal day last week as stocks opened modestly lower, but then tested and held support at 1,809 in the S&P 500. Once that support held, buyers came in to add long exposure. A "chase" higher ensued that carried over through Friday, as stocks ended the week at multi-week highs. The S&P 500 has recouped virtually all of the 6.5% correction we saw in late January and early February.

Trading Color

While the absolute moves in the stock market over the past two weeks have been impressive, the skeptics will point to the fact that the rally happened on low volume and amidst poor internal leadership, and that was still the case last week.

Volumes remained well below the levels we saw when the market was correcting, and every decent rally since the bottom two weeks ago has come on low volume. From a participation standpoint, color from desks was that most of the initial rally was short-covering, but later in the week we did see some "real money" funds adding long exposure (especially on the dip toward 1,809.) But, that aside, there has not been a lot of conviction to this rebound.

From a sector standpoint, it's the same way. Cyclicals are simply not leading the way you would want to see if you're a bull. Regional banks, homebuilders and consumer discretionary all lagged the markets last week. Conversely, utilities, healthcare, media (thanks in part to the CMCSA/TWC merger) and energy outperformed. So, from a sector standpoint, the rally isn't being "confirmed," either.

Market	Level	Change	% Change
Dow	16,154.39	126.80	0.79%
TSX	14,054.76	53.11	0.38%
Brazil	47,576.33	-624.78	-1.30%
FTSE	6,736.00	72.38	1.09%
Nikkei	14,580.69	187.58	1.30%
Hang Seng	22,466.65	-69.29	-0.31%
ASX	5,384.20	1.31	0.02%
Prices taken at previous day market close.			

On the charts, the two key levels remain 1,850 and 1,811. The former is the all-time high, and it'll take a break of that level to turn sentiment more-positive than current levels. Conversely, 1,811 (the 50-day MA) remains key support and, as mentioned, the fact that it held Thursday was as much a catalyst for the late-week rally as anything else.

Market	Level	Change	% Change
DBC	25.79	.10	0.41%
Gold	1319.40	19.30	1.48%
Silver	21.405	1.01	4.95%
Copper	3.263	.013	0.40%
WTI	100.35	.00	0.00%
Brent	109.08	.56	0.52%
Nat Gas	5.215	-.008	-0.15%
RBOB	2.8045	.0273	0.98%
DBA (Grains)	25.56	.07	0.27%
Prices taken at previous day market close.			

This Week

It's a pretty straightforward week. Focus will be on econ, especially the global flash PMIs Wed/Thurs.

Washington is quiet and likely will be for a while, now that the debt ceiling is behind us. On the micro-economic front, we get WMT and HPQ earnings Thursday, but that's about it.

Bottom Line

As far as "why" stocks rallied last week, certainly the Yellen testimony helped, as did good trade-balance data from China, which helped ease concerns about the state of the economy over there. But, in truth, the main "reason" for the rally was that sentiment simply became much, much too negative in the short term. And when news over the past two weeks turned out to be "not as bad as feared," investors moved to add long exposure. Sentiment and positioning remain the driving factors of this market in the short term (and that's why I'm stressing technical levels more than I usually do).

Stepping back, though, despite all the gyrations and volatility so far in 2014, things remain very similar to late 2013. The "macro horizon" remains as clear as it's been in years, and things got "better" in that regard last week: The Italian political drama last week is being seen as a mild positive, while the U.S. House of Representatives passed a debt-ceiling-extension bill, ensuring Washington won't be the headwind it was last year.

In the absence of any systemic risk like an EU breakup, old-fashioned economic growth remains the key. If growth remains stable in Asia, and continues to move slowly higher in Europe and the U.S., stocks can and will rally significantly. If this recent softness in the data isn't weather-related, then this market is overvalued. It's just about that simple, all other distractions aside.

And, that leads me to an important point: **Stocks did not rally last week because the soft economic data implies the Fed may "taper the taper." Bad data is not good, nor is "tapering the taper."** Accelerating economic growth remains the key to materially higher stock prices, so this will be a big week for data and the markets because of the flash PMIs.

Sentiment, meanwhile, remains skeptical and distrusting of the multi-year rally. But, the recent correction was 6.5% peak to trough, putting it roughly in-line with the corrections of 2013 (they were between 3% - 5.5%). Valuations remain full but not stretched (15.5 X 120/share 2014 earnings), and the sum total means that, for now, the benefit of the doubt remains with the bulls.

Positioning and sentiment changes will continue to cause short-term volatility, and I'd expect a sideways chop to start the week as we move toward the flash PMIs Wednesday. But, unless 1,811 (the 50-day moving average) is broken, the path of least resistance in the short term remains higher.

Economics

Last Week

It was more of the same last week from both a Fed and an economic perspective. The highlight of last week was new Fed Chair Yellen's testimony before the House Finance Committee (the Senate testimony was postponed because of the weather). Although analysts tried to justify their paychecks by saying Yellen was "incrementally dovish," the bottom line is that the outlook for Fed policy remains unchanged, as the Fed is expected to taper QE by another $10 billion at the March meeting, and economic data would have to get demonstrably worse to alter that course

It's also worth noting that Ms. Yellen appeared poised, knowledgeable and confident during questioning (and honestly was much better than Ben Bernanke was during his first testimony—he was so obviously nervous, I felt bad for him). And, while it didn't have a direct effect on markets last week, it's a peripheral positive that this transition in the Fed appears to be seamless at this point. That's a comforting thought given we are in this period of unwinding QE and, ultimately, moving toward higher interest rates. "Continuity" with regard to the Fed is a good thing.

Turning to the data, as mentioned it was more of the same: Retail sales and industrial production both missed estimates, but again the disappointing economic data was given a "pass" by investors because of the unknown effect of the awful winter weather.

Retail sales fell 0.4% in January vs. (E) -0.1%, but more importantly, the "control" group, which excludes automobile, gasoline and building material purchases, fell 0.33% and declined month-over-month for the first time since January 2012.

January Industrial production also missed estimates, falling 0.3% vs. (E) 0.3%. And, the manufacturing index also fell 0.8% vs. (E) 0.1%.

Tempering the disappointment, though: The winter weather was cited in both reports as a negative factor. But it is safe to say that after 2+ months of generally bad data being relatively "excused" by the weather, economic data had better pick up in March; otherwise, this market is "over its skis."

Bottom line is last week gave some general reassurance in Fed policy and continuity, but the critical question of "Is U.S. growth slowing?" remains unanswered (although we're going to get a lot more insight this week).

This Week

The most-important economic release this week is the February global flash PMIs. China's numbers come Wednesday night, with Europe and the U.S. Thursday morning.

Remember, the catalyst for the correction was the weak Chinese January flash PMI, which dipped below 50 and raised concerns about the pace of economic growth in China (and the globe). So, the Chinese data will be the most-important release to watch.

The global flash PMIs aren't the only important thing coming this week, though. We also get the latest round of housing data, with housing starts Wednesday and existing home sales Friday. Housing has been moved to the back burner given weakness in other data, but the pace of the housing recovery remains a critical piece to the broader U.S. economic recovery.

Although they are somewhat overshadowed by the flash PMIs, we also get the Empire State and Philly manufacturing surveys (today and Thursday, respectively), which will give the market a bit more anecdotal insight into the state of the economy in February.

Finally, the minutes from the January Fed meeting will be released Wednesday. But, given we just heard from Yellen last week, there shouldn't be anything in the minutes that would cause people to change their policy outlook from the Fed. The one area there could be a surprise in the minutes, however, is regarding what to do with the 6.5% unemployment threshold, which has nearly been hit. Nothing conclusive will come from the minutes, but there may be some discussion toward abandoning that threshold, like the Bank of England did last week. If so, that may produce a knee-jerk "dovish" response from markets, but it would likely be temporary and not something to trade off of.

Bottom line is good economic data (both in the U.S. and globally) remains the key to materially higher stock prices. And, the market needs to see some proof that recent disappointing data is just a one-off caused by the weather, not a trend change.

Market	Level	Change	% Change
Dollar Index	80.165	-.185	-0.23%
EUR/USD	1.3698	.0019	0.14%
GBP/USD	1.6742	.0085	0.51%
USD/JPY	101.87	-.28	-0.27%
USD/CAD	1.0977	.0005	0.05%
AUD/USD	.9028	.0051	0.57%
USD/BRL	2.3853	-.008	-0.33%
10 Year Yield	2.746	.01	0.37%
30 Year Yield	3.700	.014	0.38%
Prices taken at previous day market close.			

Commodities

Last week was another strong one for the commodity space, as a combination of a weaker US dollar, more cold weather, and the better than expected trade balance data from China all led to a broad rally. The commodity tracking index ETF, DBC added 1.25% and is now positive on the year, compared to a slight loss for the S&P 500.

Natural gas continued to be very volatile, as it rallied 11.6% last week, thanks to continued forecasts for cold weather, and a slightly larger than expected weekly draw of supplies. And, that strength is continuing this morning as natural gas is up more than 5% as of this writing. Short term the weather outlook will continue to cause extreme volatility, but the bottom line is inventories are now 34% below one year ago and 28% below the five year average, and that will result in extended elevated prices compared to expectations earlier this year. As a result, I continue to think you can still buy XOP and FCG at these levels, because regardless of the direction of the next thirty cent move in natural gas, prices are still much higher than most analysts expectations, and will stay that way for the foreseeable future. For the technicians, the first line of support lies just above $5.30 while the level to beat is this years high of $5.737.

Gold and silver also broke out last week adding 4.23% and 7.59% respectively. Both metals traded to multi month highs as gold has quietly become the primary beneficiary of this string of soft economic data, which has weighed on the US dollar as some expect the Fed to "taper" the taper if data does not improve.

Elsewhere in energy, crude oil rose (barely) to fresh 4 month high as continued cold weather, and strength in heating oil, continues to support WTI as traders anticipate increased refining demand to replenish low heating oil inventories. Crude oil ended the week just marginally higher, up .34% to close at $100.40 per barrel. The two key levels to watch now are last weeks high of $101.38 as resistance while the 200 day moving average is solid support at $99.58.

Currencies & Bonds

I want to start today with the yen, as there was news overnight. The Bank of Japan, at its interest rate meeting overnight, increased the size of two loan programs designed to help cheap financing from the BOJ filter through to Japanese businesses and consumers. The BOJ doubled the size of one facility to 7 trillion yen from the previous 3.5 trillion, and effectively doubled the borrowing capacity for banks at the second program.

Although not actually additional monetary easing, it does show the BOJ is still "engaged" with regards to stimulating the economy, and this action will increase the expectation for further monetary accommodation later this year. The yen dropped .5% on the news and the Nikkei gained 3.13% overnight, and I continue to think shorting yen and buying DXJ at these levels is attractive over the medium term.

Turning to the greenback, the Dollar Index declined just under 1% last week on a combination of soft economic data (retail sales and industrial production) and strength in the euro, which rallied .7% after EU Q1 GDP came in slightly better than estimates (0.3% vs. (E) 0.2%).

Small gyrations aside, though, I continue to expect a range bound trade in the dollar and euro. Fed policy expectations are pretty solidified, and despite some rhetoric from ECB members implying the ECB is about to ease policy further, I remain in the camp that they are on "hold" unless inflation falls further (which is bullish euro and bullish European bonds). Staying in Europe, the British Pound rallied to a new 52 week (and multi-year) high after the most recent Bank of England inflation report was more "hawkish" than expected. The pound remains the strongest major currency versus the dollar, as the Bank of England will almost certainly be the first major central bank to raise rates later this year or in early '15.

Turning to bonds, Treasuries were basically flat last week, as early weakness in bonds off the Yellen testimony (which makes my point that despite claims otherwise, she wasn't "dovish") was offset by soft economic data Thursday/Friday. Bottom line unless economic data stays very soft, the Fed will continue to taper QE, and in that scenario, I continue to stress getting "long" the 10 year at 2.74% and 30 year at 3.7% remains one of the best longer term "values" in the market.

Have a good week—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 continued their rebound last week, recouping virtually all of the late January correction. 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 1811 (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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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 has now broken out above resistance at $1300/oz., as gold has benefitted from the recent dollar weakness due to soft economic data. Short term I'd only nibble above $1300 on the long side and feel more comfortable around the mid-$1200's, but it appears as though a longer term bottom is "in" in gold.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**