7:00's Report

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

February 24th, 2014

Pre 7:00 Look

- Futures are slightly higher while international markets dipped following a busy weekend of geo-political news.
- Starting with the Ukraine, President Yanukovych has fled and parliament is running the country. The key now, from a market standpoint, is funding. Russia pulled its bailout but the EU/IMF have pledged support. The market is "ok" with the situation now, but longer term funding for the Ukraine needs to be resolved.
- The G-20 meeting in Australia over the weekend was a non-event, while economically the only release was the German IFO Economic sentiment index, which was basically in-line.
- Econ Today: No reports today. Fed Speak: Hoenig (3:50 PM).

Market	Level	Change	% Change
S&P 500 Futures	1836.50	2.25	0.12%
U.S. Dollar (DXY)	80.24	-.03	-0.04%
Gold	1333.40	9.80	0.74%
WTI	102.05	-.15	-0.15%
10 Year	2.734	-.020	-0.73%

Equities

Stocks traded essentially flat last week as the market continued to give disappointing data the benefit of the doubt. The S&P 500 is down 0.66% year-to-date.

Stocks opened the holiday-shortened week quietly, and the market was little-changed until Wednesday afternoon, when a confluence of events caused a late-day sell-off. "Hawkish" comments by several Fed presidents, ongoing turmoil in the Ukraine and reports of another shoe-bomb terrorist plot saw stocks fall to their lows of the week into Wednesday's close.

But, there was no follow-through to the selling on Thursday thanks to U.S. flash PMIs beating expectations, and stocks drifted steadily higher throughout Thursday afternoon and basically treaded water on Friday to finish the week flat. Other than Wednesday's late-day dip, last week was very quiet.

Trading Color

There were two key takeaways from last week:

First, volumes, activity and participation were all very low compared to late January/early February. Granted, last week was a school holiday for most of the Northeastern U.S. (which would impact trading volumes). But, this also continues the trend of volumes and activity being materially lower (on this now-three-week-old bounce-back rally) than they were during the sell-off in late January.

Second, there was significant outperformance from cyclicals last week. The Russell 2000 rose more than 1%, easily outpacing the S&P 500, and is now positive on the year. The Nasdaq also continues to trade very well, and quietly hit a new multi-year high last week (the first major index to do so since early January).

Sector-wise, cyclicals didn't have quite as good a week as the Russell and Nasdaq. Semiconductors, Internet stocks (thanks to the FB/WhatsApp merger), airlines, materials, and utilities (good ED earnings) all outperformed, while banks and consumer staples lagged.

Semiconductors continue to be the stars of 2014, as the SOX is up more than 5.4% year-to-date, while the weakness in the bank sector is something I touched on last week as an odd non-confirmation of this snapback rally. I did some research over the weekend, and it seems like the recent underperformance is more sector-specific than macro-oriented. A slowing housing recovery, fear

Market	Level	Change	% Change
Dow	16,103.30	-29.93	-0.19%
TSX	14,205.72	-4.65	-0.03%
Brazil	47,380.24	91.63	0.19%
FTSE	6,816.59	-21.47	-0.31%
Nikkei	14,837.68	-27.99	-0.19%
Hang Seng	22,388.56	-179.68	-0.80%
ASX	5,440.22	1.52	0.03%
Prices taken at previous day market close.			

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over the looming stress tests and slow capital markets activity seem to be the "reasons" the banks are lagging. Regardless, I'll feel a lot better about being cautiously bullish on stocks when the banks get their act together.

Market	Level	Change	% Change
DBC	26.20	-.07	-0.27%
Gold	1326.00	9.10	0.69%
Silver	21.835	.151	0.70%
Copper	3.2870	.008	0.24%
WTI	102.30	-.45	-0.44%
Brent	109.78	-.52	-0.47%
Nat Gas	6.239	.175	2.89%
RBOB	2.8338	-.0128	-0.45%
DBA (Grains)	26.64	.01	0.04%

Prices taken at previous day market close.

On the charts, there are two rather large "lines in the sand." 1,850 (the all-time high) is resistance, while 1,814 is the 50-day moving average. On Friday, Art Cashin, whom I had the pleasure of meeting many times during my years on the trading floor given that I worked with his son Peter, said we could see "stampede buying" or a "severe pullback." Depending on which level is broken first, he very well may be right. Those are the two key levels—all else is secondary at this point.

This Week

This is a pretty straightforward week, as economic data will likely be the primary macro influence. Durable goods, revised Q4 GDP and housing data will be in focus, as will Yellen's Senate testimony. But don't expect any surprises from her, as it'll likely mirror the House testimony from two weeks ago.

On the "micro" front, there are a lot of retail earnings this week. HD/M tomorrow; LOW, TGT and TJX Wednesday; and KSS and SHLD Thursday. WMT's guidance wasn't great last week, but the Retail HOLDRs ETF (RTH) held in there pretty well. The retail sector is well-off the lows and not quite the value it was when I pointed it out 2+ weeks ago. But the outlook for the sector is overall pretty grim, so look for any dips as opportunities out of disappointing earnings/guidance.

Bottom Line

It seems as though we are nearing a bit of an inflection point in this market. In January, investors (primarily funds) came in much too "long," expecting a continued grind higher like we saw in 2013. When that didn't happen, and then we got a few pieces of bad news (China/Turkey), investors violently reduced exposure, and became too short-term negative (i.e., not "long enough").

Now, it seems as though investor positioning is about "just right." Given that stance, there is the potential for Cashin's "stampede" or "pullback," depending which technical level is violated first. In other words, we could see a violent "chase" higher if stocks break out, or a violent reduction of exposure if stocks break down.

I personally think the benefit of the doubt remains with the bulls, as the fundamentals of this market remain largely the same as they were in 2013 (quiet macro horizon ... ongoing, albeit slower, economic recovery in the U.S. and globally ... and not-rich valuations).

Plus, I and others have said this year we need to see earnings growth to push this market higher. Although it's been mostly ignored, last earnings season was pretty good.

Finally, sentiment still remains very skeptical of this market despite the resiliency. As I said Friday, I think many more people expect the 50-day moving average to be "given" than 1,850. And, it still seems as though the "pain trade" is higher, as that's the direction people least expect stocks to go.

Finally, whether you are a bull or a bear, Treasuries have been the fundamental "loser" over the past few weeks. As it has become clear the Fed is going to continue to taper QE, the counter-trend rally in bonds looks to have ended. Buying TBT/TBF remains the clearest fundamentally backed trade idea in the markets right now.

Economics

Last Week

Once again, last week was not a particularly good week for economic data. Starting with the manufacturing sector, data here in the U.S. was mixed. The Empire State and Philly Fed manufacturing indices both badly missed expectations, with the Empire State falling to 4.4 vs. (E) 8.5 and Philly plunging to -6.3 vs. (E) of 8.0. But, refuting the weak readings was the national flash February manufacturing PMI, which rose to a multi-year high at 56.7.

Bottom line is weather continues to play a presumably

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large, unknown effect on the economic data. (The horrible winter weather was blamed for Empire State and Philly weakness, and credited for the strength in the national PMI on a "bounce back" effect nationally in February.) The important thing to know is that, for now, the market is giving soft data a pass, and likely will continue to do so at least until next week.

Internationally, the data wasn't mixed. Both Chinese and EU PMIs missed expectations, with the China PMI moving further away from the important 50 level (48.3). But, the data didn't really spark a big sell-off like last month, and there are a few reasons for that. First, funds are not as "long" as they were in January, so they don't have to dump exposure. Second, the U.S. flash PMI was good. And third, despite the weak readings, no one is materially altering their growth outlook for China or the EU (7% and 1%, respectively), yet.

Turning to the Fed, there was a little bit of change on the margin regarding the market outlook for Fed policy. That's because the FOMC minutes and multiple Fed speakers throughout last week pounded home the notion that the Fed is committed to tapering, unless economic data gets materially worse from here. This caught the "tapering the taper" crowd a little off-guard, and as a result we saw some dollar strength and bond weakness (hawkish response) on the week. But, bottom line is the outlook for Fed policy (another $10 billion taper coming in March) didn't change last week.

Finally, housing data was disappointing last week, as housing starts badly missed expectations (880K vs. (E) 950K) while existing home sales are now down 5.1% year-over-year. And, while weather and low inventories are negatively affecting the housing data, the broader point that the housing recovery is slowing remains. This is a critical piece of the overall economic recovery.

Market	Level	Change	% Change
Dollar Index	80.295	-.021	-0.03%
EUR/USD	1.3726	-.0011	-0.08%
GBP/USD	1.6619	.0005	0.03%
USD/JPY	102.50	-.02	-0.02%
USD/CAD	1.1105	-.0004	-0.04%
AUD/USD	.8971	-.0003	-0.03%
USD/BRL	2.3448	-.0005	-0.02%
10 Year Yield	2.734	-.020	-0.73%
30 Year Yield	3.696	-.030	-0.81%
Prices taken at previous day market close.			

This Week

Economic data this week is largely "second tier" and won't materially resolve the key question of "Is U.S. and global growth materially slowing?" In the context of a critical week of data coming next week (final global PMIs and the jobs report), this week shouldn't cause any material downgrades of the growth outlook or changes to Fed policy, unless something really comes out of left field.

That said, there are some reports to keep an eye on, especially in housing. This week we get Case-Shiller (Tues), New Home Sales (Wed) and Pending Home Sales (Friday).

The housing market recovery has definitely seen a loss of positive momentum lately, and while the recovery is ongoing, the pace of that recovery has slowed materially from this time last year.

We'll get durable goods data Thursday, and given the conflicting manufacturing PMIs in January, it'll be interesting to see which PMI the durables confirm—the weak January flash PMI or the better ISM January PMI. Keep in mind PMIs are derived from surveys, while durable goods and industrial production are actual, hard manufacturing data.

Fed-wise, Janet Yellen speaks Thursday, which is the rescheduled Senate testimony that was delayed two weeks ago due to a snowstorm. Expect the prepared remarks to be identical to the House testimony. Given the 6+ hours of Q-and-A the House Finance Committee already gave her, it is very unlikely this testimony will yield any surprises.

Finally, the most "important" piece of data we get this week comes from Europe. The flash HICP (their version of CPI) will be released Friday. Dis-inflation remains a significant risk to the EU economy, so if the flash HICP comes in below January's reading of 0.8, that would likely send European stocks and the euro lower. Additionally, it will further press the ECB to provide more accommodation, which they seem unwilling to do.

Bottom line is the next week of critical data is March 3rd to the 8th, so unless durable goods or the housing data

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is plain awful, don't expect any changes to the growth outlook or Fed policy.

Commodities

It was more of the same in the commodity space last week as precious metals continued to rally and natural gas traded to yet another multi-year high. The benchmark commodity tracking index ETF, DBC, added 1.6% for the week.

Nat gas gained 15.9% last week as weather reports continue to be revised to show that March could potentially be another colder-than-average month. (Things are lining up to look a lot like last year, with an extended cold season in the works.) The colder weather forecasts suggest that demand will remain elevated, and this—paired with the fact that supply levels are at historic lows—means we can expect the futures to continue to trade at an elevated price.

Futures aside, the natural gas E&P equity ETFs (FCG and XOP, as well as XLE) should all benefit from the elevated natural gas prices, and I continue to recommend buying them on dips.

In the precious metals space, gold added 0.5% as the rally continued last week (gold has now traded higher 8 of the last 9 weeks) despite a marginally higher US Dollar. Gold rallied last week on emerging market turmoil in the Ukraine, as well as continued soft US economic data. With regards to the data, gold isn't rallying off of "tapering the taper" expectations. Tapering is already priced in. Instead, gold is trading off the fact that the soft data will likely delay when the Fed starts to raise rates, and given we're in a growing economy, that means greater potential for inflation.

Expect gold to be volatile given geo-political headlines, but it's at a new multi-month high this morning, and positive momentum is building. I'd be hesitant to put on a big initial position here if you don't own it already, but gold has a tendency to not correct the way you typically expect, so putting a small initial position on around here does make some sense, if you're looking to get long.

It is worth pointing out that the commodities sector has been on a tear lately, with DBC rallying 2.7% so far this year, outperforming the S&P 500. In particular, agriculture has really been breaking out. It's high atop my to-do list this week to research whether the ag sector, and commodities in general, are really poised to continue moving higher or if this was simply a short-term move/huge head-fake.

Currencies & Bonds

Things were quiet last week in the developed currency markets, as the dollar rallied small on "hawkish" Fed speak and minutes last Wednesday, while the euro rose despite conflicting data (Q1 GDP was better but the PMIs missed). Bottom line is the dollar index and euro should continue to be range bound given the policy outlook for the Fed remains stable and the ECB is still not committed to providing more accommodation despite rising deflation. As mentioned, Friday's flash HICP will be very important with regards to the euro and ECB policy.

Emerging market currencies came back into focus last week given the political turmoil in the Ukraine. The Turkish Lira, which is the current barometer of the broader emerging markets, fell hard versus the dollar Wednesday and Thursday off the events in the Ukraine, but has since recovered. With an apparent new government in place, Ukraine now needs to find a funding source to avoid default, so keep an eye on the lira. If the market begins to get concerned about Ukraine's solvency, the lira will start to fall first.

Bonds were basically flat last week and remain short term stalemated. On one side, the soft economic data is supporting bond prices, while on the other the Fed appears committed to tapering QE despite the recent soft economic data. While likely range bound in the near term, the key here that the bullish thesis for bonds (that the Fed will taper the taper) is losing credibility, unless the economic data gets much, much worse, which is unlikely. And, this multi-month counter trend rally has provided an excellent medium/long term entry point to get short or "more short" the space via TBT or TBF.

Have a good week,

Tom

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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 are at an inflection point, as they have recouped all of the late January/early February correction. Concerns about US and global economic growth remain, but generally the fundamentals remain supportive of higher equity prices, so the benefit of the doubt remains with the bulls.* *Key levels to watch will be the 50 day moving average (1814) and the old all time highs of 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 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.**

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 are stalemated in the short term as weak economic data is supportive, but the Fed clearly favoring continued tapering of QE, baring a big drop in economic data, has caused the counter trend rally to stall. Longer term, though, fundamentals remain negative and I view current levels as great entry points for 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.**

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