7:00's Report

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

February 27th, 2014

Pre 7:00 Look

- Futures and international markets are modestly lower this morning on geo-political concerns as the Ukrainian situation deteriorates further.
- Russia put fighter jets on ready alert and fighting is escalating in Ukraine's eastern regions as the prospect of civil war is rising.
- Economically it was mixed o/n. EU economic sentiment beat, but German CPI and EU money supply both met low estimates, furthering concerns about potential deflation in the EU.
- Econ Today: Weekly Jobless Claims (E: 335K), Durable Goods Orders (E: -1.6%), Fed Speak: Yellen (10:00 AM), Fisher (10:30 AM), Lockhart (3:15 PM).

Market	Level	Change	% Change
S&P 500 Futures	1834.50	-7.50	-0.41%
U.S. Dollar (DXY)	80.54	.077	0.10%
Gold	1332.20	4.20	0.32%
WTI	102.33	-.26	-0.25%
10 Year	2.673	-.028	-1.04%

Equities

Market Recap

The S&P 500 was unchanged yesterday as an escalation in the Ukraine situation offset more good retail sector earnings and a much stronger-than-expected new home sales report.

Stocks opened Wednesday slightly weaker on geopolitical concerns, but then rallied after the new home sales handily beat expectations and the S&P 500 once again temporarily broke above the 1,850 level. But, news that there were Russian military exercises occurring right next to the Ukraine, combined with a plunge in both the hryvnia and ruble, weighed on sentiment and stopped the bulls. Stocks spent most of the afternoon mildly lower before bouncing a bit into the close.

There have been few worse-performing international markets than Russia this year, as RSX is down some 12% year-to-date.

Trading Color

Another day, another low-volume affair. Activity levels continue to be depressed compared to late January/ early February. Despite the fact that the market "felt" heavier than it traded yesterday, there was simply no follow-through to the selling, although geo-political concerns are weighing on futures this morning. Markets remain in a "wait and see" mode ahead of the EU HICP report tomorrow and the critical economic data next week.

Most major indices were little-changed yesterday, but it is important to point out that Russell 2000 made a new all-time intraday high yesterday, confirming the recent highs in the Nasdaq and the S&P 500. The Dow is now the only major index to not make new all-time or multi-year highs in February, and remains about 400 points off the all-time high of 16,588.

Market	Level	Change	% Change
Dow	16,198.41	18.75	0.12%
TSX	14,188.58	-.40	-0.01%
Brazil	46,599.21	-116.70	-0.25%
FTSE	6,744.39	-54.76	-0.81%
Nikkei	14,923.11	-47.86	-0.32%
Hang Seng	22,828.18	390.74	1.74%
ASX	5,411.45	-45.55	-0.47%
Prices taken at previous day market close.			

Sector-wise, things were mostly quiet again yesterday, as most S&P 500 sub-sectors didn't move more than 1%, although there were still some takeaways to note.

Market	Level	Change	% Change
DBC	26.13	-.06	-0.23%
Gold	1329.30	-13.40	-1.00%
Silver	21.26	-.703	-3.20%
Copper	3.229	-.0295	-0.91%
WTI	102.59	.76	0.76%
Brent	109.51	.00	0.00%
Nat Gas	4.855	-.241	-4.73%
RBOB	2.7985	.0004	0.01%
DBA (Grains)	27.09	.01	0.04%
Prices taken at previous day market close.			

First, retail continued its rebound yesterday, as RTH rallied another 1% thanks to the 7% rally in TGT. The retail sector has come surging back since the lows in early February, and now sits just 2% off the all-time highs.

Homebuilders also rallied more than 2% yesterday, obviously off the strong new home sales data, while banks also played a bit of catch-up—rallying 0.9%. As I've been saying, I'll feel a lot better about this market when the banks confirm the news highs in the broader averages.

On the charts the S&P 500 continues to labor right below that critical 1,850 level, while support creeps steadily higher (50-day moving average at 1,815).

Bottom Line

I and others have been saying 1,850 is key—and that, to get decisively above this level, the market will need a positive catalyst. And, that catalyst, positive or negative, is going to come over the next 10 days as three key questions facing the market will be resolved:

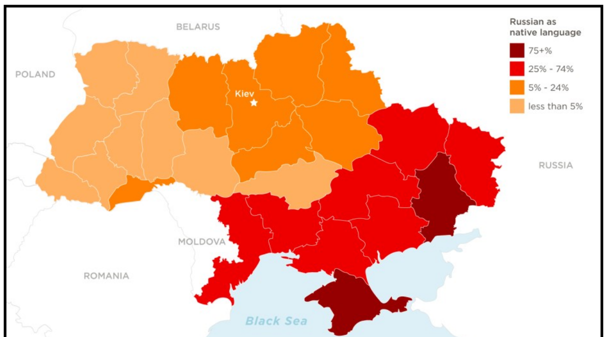
First, is economic growth truly slowing or is it just the weather? We won't get a 100% definitive answer till April, but if the official February PMIs next week are soft, and the February jobs number misses, markets may no longer give the data the benefit of the doubt.

Second, will the ECB ease policy further? Medium and longer term I'm not sure this necessarily matters either way unless the ECB does QE (which remains very unlikely). My opinion notwithstanding, the market could catch a nice bid if the ECB proves it's willing to do "more" and reminds everyone there remains a central bank "put" on major economies and stock markets.

Third, will the Ukrainian situation become the latest iteration of an emerging-market currency/debt crisis, or worse if Russia interjects militarily? Right now the situation appears contained, but how things unfold over the next week will be critical.

Another "wall of worry" has been constructed, but the truth is the benefit of the doubt remains with the bulls for now, as none of the aforementioned issues are bearish game-changers at this point.

Ukraine Update



A Tale of 2 Ukraines: Threat of all-out civil war is rising in Ukraine between the pro-Russian eastern half, and the pro-European western half.

Things are starting to deteriorate a bit in the Ukraine. The National Bank of Ukraine dropped the hryvnia peg to the dollar, and the currency continued its declines, falling another 4% yesterday.

Ukraine's central bank did that because, as I said yesterday, any European-linked bailout will almost certainly require a currency devaluation, so I suppose they figured why not let the market do it now? Astonishingly, the hryvnia is now down 20% vs. the dollar since Jan. 1.

I've been saying since last week that Ukraine, like all emerging-market turmoil, only mattered if there were signs of contagion starting to emerge. And, while it's fair to say that Ukraine is still a "contained" problem, things are starting to deteriorate a bit, and we're seeing that reflected in markets this morning. Specifically, the Russian ruble dropped to a five-year low vs. the dollar yesterday as the chances for a potential civil war between the pro-Russian eastern region of Ukraine and the pro-European western region are rising, and this is weighing on the ruble and the Russian stock market.

Bottom line is this remains a mostly "local" problem and as such its not a reason to de-risk, but the situation isn't improving and needs to be watched.

Economics

New Home Sales

- New Home Sales leaped 9.6% in January to 468K saar vs (E) 400K saar.

Takeaway

It was a surprisingly, if not shockingly, strong new home sales report yesterday, as new home sales reached their highest level since the recovery began—bucking the trend of recent soft economic data.

But, while positive in general, the report doesn't exactly jibe with the negative weather excuse the market has used to explain all the other soft data, as the biggest jumps in sales came from the Northeast and the South, two areas that got pounded by cold weather in January.

With regard to the market, stocks welcomed the first solid "beat" this week and rallied off the release, while homebuilders jumped as supply of homes dropped to a multi-month low at just 4.7 months' supply, which should help support pricing.

Bottom line is this report, while nice to see, only further muddies the waters as to how much the weather is skewing economic data. Anecdotally I think we can all agree that the housing recovery is slowing, regardless of January's new home sales. But to what degree, we won't know until we get some "clean" data from March (which will print in April).

Commodities

Commodities were mixed yesterday as the precious metals traded lower against a stronger dollar while the EIA inventory data supported the energy space. The benchmark commodity tracking index ETF fell 0.21%.

Market	Level	Change	% Change
Dollar Index	80.455	.29	0.36%
EUR/USD	1.3682	-.0063	-0.46%
GBP/USD	1.6662	-.0017	-0.10%
USD/JPY	102.39	.17	0.17%
USD/CAD	1.1124	.0043	0.39%
AUD/USD	.8957	-.0062	-0.69%
USD/BRL	2.3526	.0118	0.50%
10 Year Yield	2.673	-.028	-1.04%
30 Year Yield	3.635	-.026	-0.71%
Prices taken at previous day market close.			

Gold and silver were the most-notable movers yesterday as they fell 1.06% and 3.10% respectively, as weakness in the precious metals started pre-market as gold was lower in response to the stronger dollar. But, the selling accelerated shortly after 10:00 A.M. when the better-than-expected new home sales data was released. And, that sell off shouldn't be surprising, given that gold has rallied to multi-month highs primarily because of the poor economic data over the last few months prompting traders to realize that even if the Fed doesn't "taper" the taper, it likely will keep rates low for "longer" and that, ultimately, will lead to inflation and be good for gold.

The deteriorating situation in the Ukraine may put a mild "chaos hedge" bid into gold, as we're seeing this morning, but unless things get much worse there gold will continue to trade off the economic data more so than any other asset (including bonds). On the charts there is some mild support around $1,325, while the resistance is yesterday morning's high of $1,345.60. If you are not long gold here, I'd be inclined to wait for a bit more of a dip before initiating any positions.

Moving to energy, natural gas continued lower yesterday, falling for the third day in a row, this time losing "only" 3.37%. Futures price has fallen 30% since reaching a multi-year high on Monday, although a little less than 1/3 of that decline was due to futures contracts "rolling" from March to April.

The term structure in natural gas was the initial reason we got bullish on the commodity all the way back in November, as it was heavily backward-dated, implying strong demand. Yesterday, March futures expired and April became the active contract and, in looking at the term structure, we discovered that the front-month spread is the only contract pair in backwardation. (The further-out months have returned to a normal, less bullish contango pattern.)

So, it is fair to say that the fundamental picture in natural gas has become "less bullish" (it is not bearish). I still think the natural gas E&P ETF (FCG and XOP) can move higher from here, but I would look to buy a bit more of a dip if you are not already long those two ETFs. The easy money in both has likely been made already.

WTI Crude oil and RBOB gasoline rose just under 1% yesterday thanks to a bullish inventory release while heating oil declined slightly. Crude oil stocks rose by just 100K barrels vs. estimates calling for an 800K increase while RBOB gasoline stocks reportedly fell 2.8M barrels vs. estimates calling for a 1M barrel draw. Distillate fuel supplies, including heating oil, rose 300K barrels vs. estimates of a 1.1M barrel draw. Overall it was a quiet day in the energy markets ex-natural gas, and WTI remains range bound between $99.82 (the 200 day moving averages) and $105.

Currencies & Bonds

For the first time this week we had some motion in the currency markets, as the Dollar Index rose 0.4% to a two-week high and was universally higher again all its major trading partners. There were several reasons for the greenback's strength, but starting broadly it's fair to say there was a touch of Ukrainian/Russian angst in the markets yesterday. This was thanks to Putin putting 150K Russian soldiers on combat alert and staging war games right next to the Ukraine, and as both countries' currencies plunged. It wasn't a full-blown "risk off" day in the markets though (we know that because the yen was down vs. the dollar), but certainly there was some angst among traders and a bit of a "safety bid" emerged.

The euro, pound and yen all declined between 0.15% and 0.5% vs. the dollar yesterday, with the euro leading the way lower as traders positioned ahead of the flash HICP coming tomorrow morning. The pound fell modestly vs. the dollar after a revised look at Q4 GDP wasn't revised higher than that initial 0.7% gain, as expected. The Aussie dollar was actually the biggest loser vs. the dollar, dropping 0.7% and falling back below the $0.90 level, mostly on a catch-up move given the weakness in China so far this week. The Aussie remains one of the better longer term shorts when it has a "9" handle on it.

The real action yesterday again came from the emerging market currencies. I've already covered the big drops in the hryvnia and ruble, but the Turkish lira also fell sharply vs. the dollar again yesterday. It dropped another 1.8% on continued political turmoil in Turkey, as Prime Minster Erdogan is continuing to assert the voice recording between him and his son, discussing ways to hide vast amounts of ill-gotten funds, is a fake. But, not surprisingly, the Turkish people are a bit skeptical, considering the sons of three Cabinet members were just arrested for corruption! Protests occurred overnight, but for now the PM seems safe.

So, bottom line is the emerging markets remain an area of turmoil (as they have been for nearly a year) but for now what's happening in the Ukraine, Russia and, to a lesser degree, Turkey aren't bearish game-changers – but they are situations to watch closely.

Turning to Treasuries, they once again saw a nice rally, as the 30-year rose 0.4% and the 10-year rose 0.2%, which again reflects the fact that there was some "angst" in markets that sent Treasuries higher. (I imagine some money managers got some calls from Russian comrades yesterday telling them to buy some Treasuries, as they saw the ruble falling through the floor.)

In fact, if you look at a chart, bonds rallied steadily throughout the initial hour of trading, until 10 AM, and then basically treaded water until the 5-year auction results hit at 1 PM, when they took another leg higher. And, that's because the auction was very strong (the second-straight good auction this week). The bid to cover was 2.98, well-above the 2.59 last month and 2013 average of 2.65. Finally, adding to the bullish influences yesterday on bonds was the fact that the Fed was in the market buying $1.24 billion worth of 30-year bonds. All that combined to offset the better-than-expected new home sales data.

Bottom line, though, is bonds are still treading water ahead of a key week of catalysts next week, and I would continue to put bids in lower in an effort to accumulate TBT and TBF in and around these levels for longer-term accounts.

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	**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.**