7:00's Report

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

February 28th, 2014

The Thirty Year Treasury Bond is now against resistance at the 200 day moving average.

Pre 7:00 Look

- Futures are slightly lower as the market digests yesterday's record closing high following a busy night of data.
- European flash HICP was stronger than expected (core up 1.0% vs. (E) 0.8%), removing any change of further ECB easing next week and causing a strong rally in the euro.
- The Ukrainian situation remains fluid as tensions build over Crimea, but from a market standpoint it remains a "local" problem.
- Econ Today: GDP (E: 2.5), Pending Home Sales Index (E: 2.3%). Fed Speak: Fisher (5:00 AM), Stein (E: 10:15 AM), Evans (1:30 PM).

Market	Level	Change	% Change
S&P 500 Futures	1850.75	-3.25	-0.18%
U.S. Dollar (DXY)	79.93	-.376	-0.47%
Gold	1331.00	-.80	-0.06%
WTI	102.30	-.10	-0.10%
10 Year	2.642	-.031	-1.16%

Equities

Market Recap

The S&P 500 was finally able to close above the psychologically important 1,850 level yesterday thanks to good economic data, more "not as bad as feared" retail stock earnings, and some settling down in the situation in the Ukraine. The S&P 500 rose 0.49% and once again is positive on the year.

Early Thursday morning it looked like things were going to get a bit ugly. Fears of Ukrainian contagion spreading to Russia were on the rise, as were concerns Ukraine may be lurching toward all-out civil war. But, more decent retail earnings (KSS and SHLD rallied 2% and 6% yesterday) and a healthy durable goods report helped lift the futures, and the market opened basically flat.

Then, markets caught a tailwind mid-morning as news broke that the U.S. and Russia were in communication over the Ukraine. Despite the semi-autonomous region of Crimea scheduling a vote on total autonomy in mid-May, the feeling among traders was that the situation was settling down a bit (news that the IMF would be in the country next week also helped from a funding-concern standpoint).

Stocks held on to gains throughout the afternoon but never really strayed too far from 1,850. This made for an interesting close, as the S&P 500 had failed three times this week to close north of 1,850.

Despite dipping below that level with about 10 minutes to go, stocks caught a bid into the close and the S&P 500 went out at a new all-time closing high.

Trading Color

Once again the rally yesterday came on very low vol-

Market	Level	Change	% Change
Dow	16,272.65	74.24	0.46%
TSX	14,214.35	25.77	0.18%
Brazil	47,606.75	1,007.54	2.16%
FTSE	6,800.69	-9.58	-0.14%
Nikkei	14,841.07	-82.04	-0.55%
Hang Seng	22,836.96	8.78	0.04%
ASX	5,404.82	-6.63	-0.12%

Prices taken at previous day market close.

umes and little participation from "real" money. And despite the new closing highs, it seems as though most investors remain in "wait and see" mode ahead of a very busy and important week, next week.

Market	Level	Change	% Change
DBC	26.04	-.08	-0.31%
Gold	1329.20	1.20	0.09%
Silver	21.245	-.009	-0.04%
Copper	3.2015	-.014	-0.44%
WTI	102.30	-.029	-0.28%
Brent	108.98	-.54	-0.49%
Nat Gas	4.509	-.032	-0.70%
RBOB	2.7585	-.0407	-1.45%
DBA (Grains)	27.14	.03	0.15%
Prices taken at previous day market close.			

Looking at the market internals, for the third day in a row there wasn't much insight to glean. All major averages traded basically in-line with one another (up around 0.5%) while the sector trading was mixed. "Safety" sectors like utilities and REITs were the worst-performing S&P 500 sub sectors yesterday (falling 0.25%), implying there was a bit of a "risk on" bid in the market. Meanwhile basic materials (thanks to a nice move in CF), industrials, banks and homebuilders rallied, but all less than 1%.

The one outlier yesterday was semiconductors, which have been the best-performing sub-sector in the markets this year. They were flat in a stronger tape, but most attributed it to profit-taking as we are now on the eve of a critical week for the markets.

On the charts the S&P 500 finally closed about the 1,850 level, and now the Monday intraday high of 1,858 is the next level of resistance. Support remains at the 50-day (1,819).

Bottom Line

It wasn't exactly the most-convincing breakout above the 1,850 level yesterday for those of us who watched it, so follow-through today will be important to see. But, the fact that I, and others, are wondering if yesterday's new closing high really "counts" reflects just how skeptical most people remain toward this market, and because of that fact the "pain trade" remains higher.

Next week is shaping up to be the first "most important" week of 2014, so I'd be hesitant to do anything from an equity-allocation standpoint ahead of these critical events (i.e., PMIs, jobs report). If money needs to be placed, though, I think the short bond ETFs (TBT/TBF) remain the best destination for incremental capital at the moment.

How stocks react to disappointing data next week will be hard to gauge (it'll depend on how disappointing the data is), but unless it's absolutely horrible, the bottom line is the Fed isn't stopping tapering of QE. So, unless the Ukrainian situation blows up (literally), then Treasuries should almost certainly resume their declines, and these levels offer an attractive entry point.

Yellen Testimony

The Yellen testimony proved to be a non-event, and although some are spinning it as slightly dovish, it really wasn't.

Yellen repeated what we know: Fed tapering is not on a "pre-set course." The Fed's strong preference is to continue tapering QE, but they remain data-dependent. And if the economy starts to meaningfully slow, they will stop tapering. But, so far that hasn't happened. So, we should all continue to expect another $10 billion taper at the March meeting.

Economics

Durable Goods Report

- New Orders fell 1% vs. (E) -1.6%
- Nondefense Capital Goods Ex-Aircraft (NDCGXA) moved higher by 1.7% after falling 1.8% in Dec.

Takeaway

The headline new orders number in the durable goods report was a better-than-expected -1% vs. expectations that called for a -1.6% drop. The details of the report were also better-than-feared as Non-Defense Capital Goods Ex-Aircraft actually ticked higher by 1.7% after dipping into negative territory in December.

On the negative side, December NDCGXA was revised lower from -0.6% to -1.8%, but the important takeaway here is that the January durable goods report shows capital expenditures by businesses aren't falling precipitously, as the December report slightly implied.

S&P futures were already off the morning lows when the durable goods report was printed, but upon release, futures legged higher and were able to turn positive for the session. Durable goods is now the second "better than expected" piece of data we have seen this week (new home sales Wednesday was the other) and is helping to settle some nerves about the pace of growth in the economy.

One thing to expect out of this report, though, is that today's revised look at Q4 '13 GDP may be revised materially lower, as that 1.8% NDCGXA fall in December will certainly have an impact. Don't be shocked if Q4 GDP is revised into the mid-2% range this morning. (And don't let it negatively change your outlook on the economy, as the economy saw decent growth in Q4, regardless of whether it's a 3% or 2% handle. The major question now is growth going forward, not where we were 2 months ago.)

Commodities

Commodities were mostly lower yesterday as the EIA inventory data released Wednesday continued to weigh on the energy sector while metals were only marginally lower. The benchmark commodity tracking index ETF, DBC, was down 0.27%.

Natural Gas: The volatility has been absurd, but for those looking to get long, Natural Gas is into multi-month support.

There was broad weakness in the energy space yesterday as Brent crude, WTI crude and refined products all traded lower. Heating oil was the worst performer, falling 1.01% as traders digested Wednesday's EIA inventory report that showed there was a surprise build in distillate (heating oil) supplies.

Looking back to the past couple of weeks, heating oil has been offering support to the greater energy space because of its lower-than-average supply levels and high demand resulting from the frigid winter weather. Now that the weather seems to be improving (which puts a cap on demand) and supply levels are rising, the "heating oil bid" is coming out of the energy space.

Market	Level	Change	% Change
Dollar Index	80.335	-.128	-0.16%
EUR/USD	1.3705	.0018	0.13%
GBP/USD	1.6682	.001	0.06%
USD/JPY	102.08	-.27	-0.26%
USD/CAD	1.1141	.0015	0.13%
AUD/USD	.8959	-.0004	-0.04%
USD/BRL	2.3218	-.0277	-1.18%
10 Year Yield	2.642	-.031	-1.16%
30 Year Yield	3.596	-.039	-1.07%
Prices taken at previous day market close.			

The drop in heating oil futures led to some weakness in WTI crude oil yesterday, which fell 0.2%. WTI has been trading in a tight, choppy range since it initially broke out to the $103 level. On the charts, support and resistance are now the two extremes of this week's trading range: $101.02 on the low end, and $103.45 on the top end.

Moving to natural gas, the froth seems to have come out of that market now that the futures have fallen over 30% since hitting new highs earlier this week. Yesterday, natural gas was down just 0.9% (compared to the multiple 10%+ moves the market has seen this month).

Yesterday was inventory day, and the EIA reported that supply fell by -95 Bcf vs. (E) -101 Bcf, so a slightly smaller draw than expected. But, unlike in recent weeks, the market had little reaction and the fact that the market didn't sell off on the news is what leads me to believe the "froth" is indeed out of the market.

As we near the end of the draw season, supply levels are more than 35% below the five-year average. Approaching the critical 1,200 Bcf mark leaves natural gas users with little margin for error as we enter the build season. Technically the situation in nat gas is also bullish as front month futures hit support yesterday around the $4.45 level. That support level is the same technical up trend that has been in place since the "big rally" began back in early November.

You would have to have a big tolerance for volatility, but for the first time in 2+ months, I can make the case for buying natural gas itself at these levels (via UNG or the futures), as your stop is clearly a violation of that trendline dating back to November. I'd continue to hold natural gas E&P ETFs as well in here, and look to add or initiate positions on any further weakness.

Moving to the metals, gold was higher yesterday morning as the market continued to get a bit of a "Ukraine fear bid." However, once word started to circulate that progress was being made in the Ukraine, gold began to sell off, actually turning negative into the close. Gold is now in "wait and see" mode as traders look ahead to economic data being released next week. Technically the first level of support lies at the $1,322 level, while the resistance is now Wednesday's high of $1,345.60.

Turning to the base metals, copper was lower for the fourth day in a row yesterday, trading lower in sympathy with the Chinese property stocks that remain under pressure. The reason I'm pointing this out is because copper is nearing support on the charts, and taking a shot on the long side may be a good value play here.

Every copper sell-off for the last five months has stopped at the $3.15-ish level, about 5 cents from here. And, any decent rally should see copper trade at a minimum to $3.30, if not much higher toward $3.40. So, you'd be risking 5 cents make 10 or 20, a 1-to-2 or 1-to-4 risk/reward ratio. And, your stop is clearly defined ($3.15).

I'm hesitant to mention this heading into such a critical week of data, but I'm not as bearish on China as a lot of others out there. And, to me, there's some value in copper at these levels, seeing as I think we are in the midst of a global economic rebound. (JJC is the copper ETN. It doesn't trade all that much, but it's the best thing around.)

Currencies & Bonds

The evolving outlook for the situation in the Ukraine was the driving factor in both currency and bond markets yesterday more so than any fundamental data. Early Thursday morning that outlook was turning more negative, and as a result we had a clear "risk off" move in the currency markets as the euro briefly hit a two week low, while the yen and dollar rallied. But, as the outlook towards Ukraine improved throughout the day, that "risk off" trade unwound, and we saw the Dollar Index sell off despite the strong durable goods reports, as the euro rallied. At the end of the day the Dollar Index finished .2% lower.

And, that volatility is continuing this morning. The euro is sharply higher (.6%) while the Dollar Index has broken down through the 80 level and is sitting at a two month low. The reason for these big moves is clear: EU flash February HICP (their version of CPI) was stronger than expected. The headline HICP number met expectations (increasing 0.8% annual rate in Feb), but it was the "core" HICP that was surprisingly strong, as "core" HICP, which excludes food and energy prices, rose 1.0% versus 0.8%. The reason this is having such a big move is because very quietly the expectation for the ECB to do "more" at next week's meeting was moving higher, and this surprisingly good HICP reading virtually eliminates any chance that the ECB will act next week.

Bottom line, as I've been saying for months now, is that that ECB is much more reluctant to ease further than that mainstream financial media is making it seem. And, with dis-inflation continuing to creep into the EU (this one HICP report doesn't change that), the situation is de-facto euro bullish. PIIGS and other higher yielding European bond remain the #1 beneficiary of the current environment in Europe, and they remain my favorite destination for any money looking for fixed income exposure.

Moving to the bond market, bonds rallied across the curve yesterday as part of the aforementioned global "risk-off" trade and were further supported by a strong 7-year note auction. The bid to cover was a 16-month high of 2.72 and well above the recent average of 2.48, indicating there was strong demand. On the charts, the 30-year bond is now smack against the 200-day moving average, a level it has failed to break through multiple times, and given that fact, and as mentioned I think now is as good a time as any to increase of initiate positions in TBT or TBF, because the risk in the trade is as low as it has been in months. The stop is clear – if the 30 year bond decidedly breaks above that 200 day moving average, that'll be a signal that this counter trend rally isn't over. But, given the only way I see that happening is by the data next week being very soft or some military escalation in the Ukraine, I believe the risk is worth the reward.

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	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.**

	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 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.**