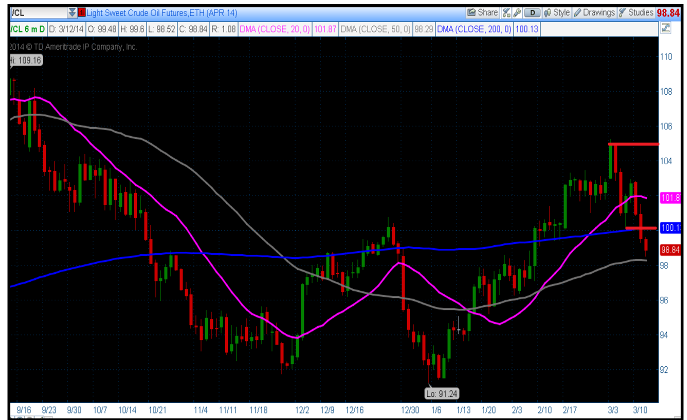
7:00's Report

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

March 12th, 2014



WTI Crude: The drop in copper is getting all the press, but oil broke down through support yesterday.

Pre 7:00 Look

- Futures are modestly lower, but there's significant weakness globally as Chinese growth concerns continue to weigh on markets.
- Asia got hit hard o/n on follow through selling from the US. But, the Shanghai Composite was the relative out performer and only off small, as there is already chatter in the market about Chinese officials moving to stimulate the economy.
- Europe is down 1% as Asia selling spilled over and EMU Industrial Production missed estimates (-0.2% vs. (E) 0.6%) m/m.
- Econ Today: No reports today.

Market	Level	Change	% Change
S&P 500 Futures	1861.75	-3.50	-0.19%
U.S. Dollar (DXY)	79.87	.025	0.03%
Gold	1356.5	9.80	0.73%
WTI	98.73	-1.30	-1.30%
10-year	2.766	-.018	-0.65%

Equities

Market Recap

Stocks declined modestly yesterday as news about another Chinese company sparked a mild "risk off" bid that saw stocks decline, while Treasuries and gold rallied. The S&P 500 fell -0.51%.

Stocks opened flat and drifted slightly higher throughout the morning as it looked like Tuesday was going to be as quiet as Monday. But, there wasn't much conviction to the move higher, as the market still feels overextended. Stocks turned lower late in the morning as a report about a halt in trading of another Chinese solar-related company made its way across desks.

Lack of progress in Russia/Ukraine negotiations was also cited as a reason for the weakness, but the market continues to be relatively comfortable with that situation in its present form, and it wasn't the cause of the weakness yesterday.

The reason I know it was a China-inspired decline was this: Starting at the same time (between 10-11 AM) stocks (which were led lower by the commodity names), along with copper and the Aussie dollar, all reversed early gains and turned decidedly lower. Meanwhile the yen, Treasuries and gold all simultaneously rallied.

Anytime you see that happen in markets, it's because of China.

The bulls tried to make a stand around the 1,870 level several times from 12-2 PM, but support eventually gave way and stocks sold off again during the last two hours of the day. They hit their lows during the last hour of trading before bouncing a bit into the close. The S&P 500 closed right at that initial support of 1,867.

Market	Level	Change	% Change
Dow	16,351.06	-67.62	-0.41%
TSX	14,263.99	-38.07	-0.27%
Brazil	45,697.62	164.42	0.36%
FTSE	6,625.95	-59.57	-0.89%
Nikkei	14,830.39	-393.72	-2.59%
Hang Seng	21,901.95	-367.66	-1.65%
ASX	5,384.20	-29.64	-0.55%
Prices taken at previous day market close.			

Trading Color

Activity picked up a bit from Monday's slow pace, but it certainly wasn't "busy."

Market	Level	Change	% Change
DBC	26.08	.01	0.04%
Gold	1348.20	6.70	0.50%
Silver	20.845	-.065	-0.31%
Copper	2.9495	-.082	-2.70%
WTI	99.74	-1.38	-1.37%
Brent	108.38	.30	0.28%
Nat Gas	4.613	-.038	-0.82%
RBOB	2.9654	.016	0.54%
DBA (Grains)	28.75	.24	0.84%
Prices taken at previous day market close.			

From an internals standpoint, we did see cyclicals underperform (consistent with the mild "risk off" move). The Russell 2000 and Nasdaq lagged, while energy was the big underperformer from a sector standpoint (down 1%). But, the selling yesterday was widespread, as every S&P 500 subsector finished in the red, while REITs were about the only sector to finish positive.

Materials also continued to lag, after they initially tried to bounce Tuesday morning but were dragged lower by the copper sell-off midday. Despite the steep drops, I want to see some signs of stabilization in the materials before buying the dip.

On the charts the S&P 500 is now sitting on initial (and somewhat weak) support at 1,867 (the old all-time high). Resistance remains the new all-time high at 1,887.

Bottom Line

China and the situation in the Ukraine are potential risks to closely monitor, but yesterday's declines were again more about positioning than anything else. The drop yesterday was due more to a mild unwind of those "late and weak" longs that were pulled reluctantly into the market late last week than it was anything truly negative from China or Ukraine influencing trading.

So far this year investors wild reactions in positioning have been the main driver of trading, as larger macro fundamentals have remained mostly static (and a tail wind for stocks).

Investors came in too "long" in early January expecting a continued melt up in the averages. But, when it didn't happen and we got another dose of emerging market turmoil, investors "de-risked" violently, only to find themselves "not long enough" when the correction stopped. As a result, the S&P 500 has rallied almost 9% off the late Jan/early Feb lows in a straight line as investors re-added long exposure, and now we're seeing that being corrected, a process that could last a bit longer. As they say in Ireland, "We've gone around the world for sport."

But, positioning aside, the fundamental back drop is still positive for equities, and I would look to add to those "laggard" sectors on any dip here in the market, baring significant deterioration in the China outlook or situation in the Ukraine.

Once Is Random. Twice is Coincidence. Is Three in a Row A Trend?

One of the catalysts for the market's decline yesterday was the trading halt in Baoding Tianwei Baobian Electric Co.'s (BTBE for short) stocks and bonds. BTBE, which among other things makes solar panels, lost 5.23 billion yuan last year, and its future is clearly in doubt.

This matters because it's the second company to have this sort of difficulty in a matter of five days, and although solar isn't the only business BTBE is in, it's certainly close enough to spook investors given Chaori's default last week.

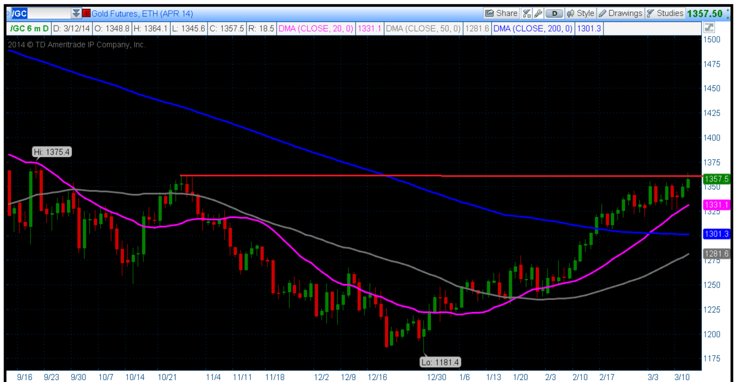
And, presumably, it's raising more concerns about whether we are finally starting to see some domestic credit problems surfacing in China.

Now, before the China bears take this and run too far, BTBE isn't Chaori and the company didn't default. In fact, BTBE is majority-owned by Baoding Tianwei Group, which is a government-owned company. And, Baoding Tianwei Group is required to repay bondholders if BTBE can't. So, there's a government guarantee on the debt, and it's not likely BTBE will default like Chaori.

But, we're starting to see a bit of a trend here. First it was the near-default of a "Wealth Management Product" offered by a Chinese bank. Then it was Chaori, which actually defaulted last week. Now it's BTBE in trouble.

China is a big country and its government has a lot of leeway to make decisions and assign winners and losers (they don't have to deal with that pesky democracy thing). So, these few instances are not indicative of impending doom for China. But, until we see some stabilization in China—whether it's in the currency (which is volatile again this week), the stock market or corporate debt—I'll continue to keep one good eye on the region (and to be perfectly honest, I am looking at China for an entry point on the long side, not as the next epicenter of a global crisis).

Finally, something to think about. According to what I read yesterday (the source was Bloomberg Businessweek), BTBE's 2018 notes are guaranteed by the state and were rated AAA– by a Chinese rating agency. But, the notes, which have a coupon of 5.75%, were halted yesterday with a yield of 11.13%. So, someone's not being totally honest about something!



Gold traded to a new 6 month high overnight, and a close or two above $1360 will see the rally accelerate.

Economics

There were no economic reports yesterday.

Commodities

The broad-based commodity ETF DBC rallied small yesterday, but that was mostly because of a 3% rally in wheat and really implies the commodity markets were stronger than they were.

Instead, yesterday was another rough day for the industrials. As you know, there was another bout of China angst in the market, which manifested itself in weaker industrial commodity prices.

Market	Level	Change	% Change
Dollar Index	79.88	-.014	-0.02%
EUR/USD	1.3865	-.0011	-0.08%
GBP/USD	1.6622	-.0021	-0.13%
USD/JPY	102.89	-.36	-0.35%
USD/CAD	1.1106	-.0001	-0.01%
AUD/USD	.8969	-.0046	-0.51%
USD/BRL	2.3608	.0122	0.52%
10-year Yield	2.766	-.018	-0.65%
30-year Yield	3.709	-.019	-0.51%
Prices taken at previous day market close.			

Leading the way lower, again, was copper. It declined 2.55% to trade to a 4-year low. Copper actually was holding up "ok" early in the morning, but when news of the BTBE trading halt made its way across the wires, copper came for sale again, as it's seeming like the next domino to fall in the Chinese solar sector. Now, BTBE isn't the same thing as Chaori, as I've covered, but it's enough to put further pressure on the commodity markets.

Turning back to the commodity—copper is in trouble here, as on the charts you need to go back to 2010 to find any support. $2.91 and $2.72 are the April 2010 lows and the last remaining lines of support. And, while the contrarian in me is interested in copper, I'm not going near it until it shows some signs of stabilization.

WTI crude was the other big decliner yesterday. WTI fell 1.4% and broke down below $100/bbl for the first time since mid-February. It closed below the 200-day moving average, which was the lower end of the multi-week range.

As far as reasons "why" WTI crude dropped, the continued unwind of the "winter bid" is certainly helping, but also we saw some positioning ahead of the weekly inventory data to be released this morning. It's likely we'll see inventories continue to build as refineries close for maintenance in preparation to begin producing gasoline instead of heating oil.

Conversely, Brent crude rallied 0.36% on more unrest in Libya. First, the Libyan navy "disabled" (as in, with their guns) that tanker mentioned yesterday that took on oil from a rebel-controlled port, as it was apparently trying to make a run for it.

Second, the Prime Minister was voted out by the Libyan Parliament yesterday, in part because of his inability to handle the rebels (and the tanker incident just reminded everyone of that fact).

Turning to metals other than copper, it was similar to Monday. Platinum, palladium and silver were all down (but less than 1%), mostly on peripheral selling from China. Meanwhile gold benefited from the mild "risk off" bid that hit the markets starting around 1:30 PM, and actually went out near the highs of the day. Gold continues to trade well, and it broke above $1360 overnight, trading to a 6 month high at $1364. If it can close a time or two above that $1360 level, it'll be a signal the rally is accelerating. Gold remains an interesting "hedge" against any geopolitical-inspired turmoil and against soft economic data, which are right now about the only two things that can make the stock market go down.

Currencies & Bonds

The US dollar and European currencies were quiet yesterday as not one of the major pairs on either continent (USD, EUR, GBP) moved more than 0.15% from unchanged and the Dollar Index was only fractionally higher on the day. The Dollar Index managed to trade above the 80 level briefly early Monday morning, but it was unable to hold the gains as the euro remains strong.

But, despite the lack of volatility from the developed major currencies, there was some China based influence in the markets that is important. Specifically, around mid-day (right when stocks started to move decidedly lower) we saw the Aussie Dollar begin to sell off and the yen begin to rally, reversing their previous respective gains and declines. And, whenever you see those two currencies moving simultaneously in opposite directions, it's almost always because of some sort of China concern.

The yen gained 0.35% as that subtle "risk off" bid continued all afternoon, and it's up another .15% this morning. The rally in yen was not a result of yesterday's Bank of Japan interest rate meeting, as some sites implied. The BOJ made no change to policy, as expected, but they did slightly downgrade their commentary towards the economy. The BOJ referred to exports as "leveling off" in yesterday's statement, which is a downgrade from the previous meeting (and provides some reasoning to ease further and weaken the yen). Bottom line, though, is yesterday's meeting didn't change anyone's opinion on the BOJ. I still believe they will ease further in the April-July time frame, and as that becomes more of a market consensus we'll see the "long DXJ/short yen" trade re-engage.

The Aussie was the worst-performing currency against the dollar yesterday, falling 0.75%. And, those losses are continuing this morning (Aussie is down another .24%). The move was largely due to nervous investors becoming more concerned with the state of the Chinese economy and the correlation with their trade relationship, as the majority of Australian exports are to China. (So, basically whenever there are fears about the Chinese economy, the Aussie takes a hit.) And, that move was confirmed by the decent sell-off we saw in U.S. equities.

Moving to the bond market, the subtle "Risk off" move appeared there yesterday as well. Treasuries, which were flat most of the morning, began to rally around the same time the yen, Aussie and U.S. equities began to move their respective ways (risk off). And, Treasuries rallied despite a slightly soft 3-year note auction. The bid to cover was 3.25, which was quite a bit below last month's b/c of 3.42 but was generally in-line with the overall trend. And, the rally is continuing this morning with the 30 year up .21%, as the market looks ahead to a 10-year auction this afternoon and a 30-year auction tomorrow.

A lot of investors missed this subtle "Risk off" move yesterday – but it was definitely there and it's continuing this morning. Keep an eye on Aussie, the yen and Treasuries. If we see yesterday's move continue to accelerate, the equity market will all of a sudden start paying attention and the possibility exists for stocks to "catch up" to the risk off move in other assets. These China concerns are probably a touch bigger than the consensus right now (although as I said earlier, not any sort of a bearish game changer at this point).

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**	**Bullish**	**Bullish**	*The S&P 500 traded to a new all time high last week, although the gains came on low volumes and with little conviction. But, the broadly speaking the positive backdrop for stocks (macro-economic calm, accommodative central banks, growing economic recovery, skeptical sentiment) remains, so the benefit of the doubt remains with the bulls.* *Resistance is now the all time highs at 1876, while support is the 50 day MA at 1820.*

Trade Ideas

Long Market "Losers": **So far in 2014 the right strategy has been to buy beaten down sectors that offer some value, as opposed to the broad market. It has worked with utilities and most recently the retailers. Now, the banks seem to be the sector that has lagged recently, and if the market continues to rally, we should see them play catch up. KBE remains one of the "easiest" ways to get broad bank exposure. I'd look to allocate to deep cyclicals like industrials (DIA), basic materials (IYM) and global industrial miners (PICK).**

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 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 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 around the mid-$1300's and would prefer to buy more towards $1300/oz. But, short term timing aside, 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 remains largely range bound, as a stronger euro will hamper any ability for the US Dollar Index to rally, despite continued tapering of QE.*

Trade Ideas

Short: Japanese Yen. **This year has been choppy for the yen as there have been several macro-inspired "risk off" episodes, most recently with the Ukraine. But, with the BOJ expected to ease policy further, fundamentals for a weaker yen remains in place, and I would view this rally as a longer term entry point in a still down trending yen.**

Short: Aussie Dollar. **Aussie saw a big short covering rally last week on better than expected data, but with risks to Chinese growth skewed to the downside and the Reserve Bank of Australia wanting a weaker Aussie, the trend remains lower. For those non-futures traders, shorting FXA or buying CROC is the easiest way to put this trade "on."**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	**Bearish**	**Bearish**	**Bearish**	*Economic data has turned a bit more positive and it appears as though the counter trend rally in the bond market is ending. The primary trend remains lower, as the Fed seems intent on further "tapering" of QE.*

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.**