7:00's Report

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

March 14th, 2014

Pre 7:00 Look

- Futures are bouncing small this morning as markets lick their wounds from Thursday's sell off. There was no material economic or geo-political news o/n.
- Asian shares got hit hard again on follow through selling from the US. The Nikkei fell 3%, but encouragingly the Shanghai Composite again outperformed, falling just .7% and showing some signs of relative strength.
- Focus this morning will be on geo-politics, as Kerry and Lavrov meet in London (but an agreement isn't expected).
- Econ Today: PPI (E: 0.2%), Consumer Sentiment (E: 81.8).

Market	Level	Change	% Change
S&P 500 Futures	1842.75	3.00	.16%
U.S. Dollar (DXY)	79.65	-.105	-.13%
Gold	1371.00	-1.50	-.11%
WTI	98.40	.20	.20%
10-year	2.653	-.073	-2.68%

Equities

Market Recap

Stocks saw their worst one-day loss since early February yesterday as Ukraine and China concerns weighed on risk assets. The S&P 500 fell 1.17%.

Thursday looked like it was going to be a pretty slow day, as markets opened slightly higher following the release of the only two economic reports this week (retail sales and jobless claims). But, two specific catalysts came after the open that sent stocks lower (more on that in a second).

Stocks declined sharply right around lunchtime and the sell-off continued throughout the afternoon, with stocks hitting their lows about 2:30, before bouncing a bit into the close.

The Two Catalysts for the Sell-off and the Key Points to Watch in Ukraine and China.

First, a New York Times article (link here) circulated around Thursday's open that Russia was staging massive military exercises on the Ukrainian border, while the new Ukrainian Prime Minister was quoted as saying he feared Russia was preparing for an invasion.

This article, as it circulated, caused a mild dip in the markets. Importantly, it underscored what the market cares about in Russia (which we need to keep in mind as events continue to unfold over the weekend). **The market does not really care if Russia annexes Crimea. So if the vote is to Russia, don't expect a knee-jerk negative reaction, as that's expected. But, if there are further incursions into eastern Ukraine, that is a different, and negative story**. The NYT article implied this may be possible (till now, it was not), and that's why stocks initially got spooked at the news.

But, it was a Reuters article (link here) about Chinese lending that hit shortly after 11 AM that really prompted the "risk off" move in markets.

The article stated that the Chinese Banking and Regulatory Commission has called on Chinese banks to include in their regular reporting of loan data any loans that are linked to derivative products or debt financing.

That is a change from previous protocol, and it implies that the Chinese authorities are now concerned about some of this commodity-linked lending I described earlier in the week.

Market	Level	Change	% Change
Dow	16108.89	-231.19	-1.41%
TSX	14245.14	-73.85	-.52%
Brazil	45443.83	-417.98	-.91%
FTSE	6546.07	-7.71	-.12%
Nikkei	14327.66	-488.32	-3.30%
Hang Seng	21539.49	-216.59	-1.00%
ASX	5329.40	-83.22	-1.54%

Prices taken at previous day market close.

Like with Russia, yesterday provided a good example of what the market really cares about with China. Stocks didn't react negatively to the fact that February economic data missed expectations, because it's assumed that Chinese officials will simply become more-accommodative with inflation so low and stimulate the economy via reserve ratio cuts or infra-structure spending. **So, a decel-erating economy isn't really the fear.**

Market	Level	Change	% Change
DBC	25.88	-.13	-.50%
Gold	1373.40	2.90	.22%
Silver	21.22	-.143	-.67%
Copper	2.92	-.04	-1.47%
WTI	98.22	.23	.22%
Brent	107.31	-.71	-.66%
Nat Gas	4.385	-.11	-2.34%
RBOB	2.9301	-.03	-.87%
DBA (Grains)	28.78	.04	.14%

Prices taken at previous day market close.

But, the market is afraid of a liquidity crisis in China (remember last June when the Shanghai Interbank Offered Rate spiked). China bears have been predicting China will experience the same type of crisis we saw in '08, so the real "China nerve" for the market is anything to do with credit or liquidity.

To that end, the Reuters article also said Chinese bank lending to "bloated industries" in China may be cut by up to 20%. I don't know which "bloated industries" they mean, but I'm sure industrial companies (that would use copper as collateral) are included in that.

Bottom Line

Last Friday I wrote: "*Additionally, during these last few days, the rally has 'forced' people in on the long side. When that happens, the potential for a quick, violent dip rises, as everyone who has come in over the past few days is a 'weak hand' and likely will sell at the first sign of trouble.*"

Well, we got our first signs of trouble, and the "late and weak" longs bailed. Ukraine and China are concerns, and neither situation is improving. But, they didn't materially change yesterday despite the articles, and the sell-off was more about positioning than anything fundamentally turning negative.

Point being, based on the fundamentals I don't think this is going to turn into a January style sell off, unless things get materially worse with regards to Chinese liquidity of Ukrainian geo-politics.

Selling yesterday wasn't heavy or panicked, and the declines were as much a result of lack of buy interest as it was long sellers aggressively de-risking.

This 1850 area in the S&P 500 is again critical. It's been an area of resistance from almost a month, and it'll be important for the bulls to get back above that level sooner than later.

Below that, the 50 day moving average (1828) is critical support, and if we break through that level, then the technical outlook will start to deteriorate significantly.

For now, though, I view this week's declines as a typical shake out in a market that got a touch overextended in the short term.

Economics

The only pieces of economic data this week were both better than expectations. While they won't materially lift anyone's outlook for the economy, they did both reinforce that the weak economic data we saw in December and January was likely temporary.

Retail Sales

- Feb Retail Sales rose 0.3% vs. (E) 0.2%.

Takeaway

It was a mixed bag in the Retail Sales report, but the main takeaway was that it appears sales are on an upswing (which is a positive). February beat estimates but we saw some pretty steep revisions to December and January (January retail sales were revised to -0.6% from -0.04%).

But, positively, the "control" group of retail sales, which excludes automobiles, gasoline and building materials, rose 0.29% in February, the biggest increase since October.

Oddly, this data doesn't totally jive with the weather excuse, as February was the coldest month this year. But the bottom line is retail sales confirm other recent data that show economic activity started to pick back up in February. They also help further reinforce that the loss of momentum in the economy earlier this year was likely temporary.

Jobless Claims

- Weekly claims fell to 315K vs. (E) 330K.
- The 4-Week Moving Average declined to 330K, a drop of 6,500.

Takeaway

This was a surprisingly good number. Weekly claims hit their lowest level since early December (and that data was skewed by Thanksgiving) while the 4-week moving average, which is the better metric to watch, fell to the lower end of a multi-month range (and the lowest reading since December 12th).

Weekly claims are volatile, but if this trend continues it'll imply we're seeing an uptick of momentum in the labor market, which has basically been treading water since last August.

Commodities

It was more of the same Thursday as industrial commodities, led down by copper, once again came for sale. The entire commodity complex traded off the same thing as equities: concerns about geopolitics and a concerns about Chinese credit.

There were two key takeaways from the commodity complex yesterday: First, copper is now the epicenter for China angst, as it's become a quasi-proxy for liquidity concerns, and until copper bottoms, China will be a headwind on stocks. Second, gold remains about the best equity hedge out there right now (which is odd but it's working).

Market	Level	Change	% Change
Dollar Index	79.73	.011	.01%
EUR/USD	1.3863	-.0039	-.28%
GBP/USD	1.6609	.0006	.04%
USD/JPY	101.60	-1.15	-1.12%
USD/CAD	.9025	.0052	.58%
AUD/USD	.8973	.0046	.52%
USD/BRL	2.3628	.0073	.31%
10-year Yield	2.653	-.073	-2.68%
30-year Yield	3.601	-.066	-1.80%
Prices taken at previous day market close.			

Prior to the two key articles hitting mid-morning, it looked like we would have a bit of a "risk on" day in the commodity space, as gold was slightly lower, while most industrial commodities were holding near flat.

But, geopolitical concerns put a bid under gold, and when the Reuters article hit about Chinese loans, copper went into a tailspin, again, and closed basically on the lows of the day, down 1.5%. $2.90 remains the spike low from earlier in the week, but with copper closing yesterday at $2.91, it's safe to say we're seeing that support tested.

Silver, palladium and Brent crude all finished in the red yesterday, although they weren't down nearly as much as copper. Bottom line is the industrial commodities are trying to bottom, but they'll need a bit of good news (or "not bad" news) to do it.

Turning to energy, WTI crude actually rallied small yesterday (up 0.18%), bucking the trend of industrial commodities. It was mostly an oversold bounce, given WTI crude is down nearly $4 on the week, but the better-than-expected U.S. economic data peripherally helped as well. But, there's been some significant technical damage done, and I'd expect WTI to consolidate unless we see some sort of material escalation in the Ukraine situation over the next few days (which would put a bid into WTI crude).

Gold remains the star of the commodity complex and the single-best equity-market hedge out there. The two main negative influences on the market right now are geopolitics and soft economic data—and both are positive for gold.

You know why gold rises during periods of geopolitical tension. But, gold may be getting an additional tailwind should the PBOC begin to ease policy and try to stimulate the Chinese economy. I say that because China has been the largest buyer of gold over the past year (surpassing India), and if the market begins to expect China to cut reserve ratios or take other forms of stimulus, that should be good for gold demand (as an inflation hedge).

Bottom line is gold remains an attractive hedge in this market, even at current levels (the long stocks, long gold trade has worked well this year).

Finally, the worst performer yesterday was natural gas. It dropped 2.2% despite the weekly inventories showing a draw of 195 Bcf (meeting expectations) and inventories now sitting at 46% below the five year average and 48% below a year ago.

But, in the short term, the outlook is key, and yesterday saw the Commodity Weather Group (one of the most-respected weather forecasting firms out there) predict warmer weather over the coming weeks. Given that the momentum has turned short-term negative, natural gas fell sharply.

But, with inventories low and natural gas still in backwardation, the fundamentals remain positive. Higher natural gas prices are here to stay, which should continued to benefit my the next step in this trade, which is the coal stocks.

Currencies & Bonds

I closed yesterday's Report by saying:

"I always consider the bond market the 'smartest' market. And the fact there was such strength yesterday makes me nervous we may not be done on the downside in stocks."

Well, as my manager Jack on the NYSE floor used to say, "One in a row, young man." Yesterday currency markets went from risk "on" pre-NYT and Reuters articles, to "risk off."

Treasuries surged despite a lackluster 30-year auction (Santelli gave it a "C") as the 30-year rose 0.92% and the 10-year rose 0.5%, sending the 10-year yield back below 2.7%.

The 30-year Treasury spiked through resistance at the 200-day moving average again yesterday (something it has done 4 times so far in 2014). But, each time, shorting more bonds there has been the right trade. Although I'm nervous to do so, given the geopolitics, I imagine that holding your nose and buying a little more TBT or TBF is the right thing to do here.

Turning to the currency markets, the biggest action came in the Asian currencies. The Aussie dollar soared yesterday morning, trading up well over 1%, through $0.90 vs. the dollar, and closing up 0.4%. And, you're no doubt (reasonably) asking how the Aussie could be up while the market was down on China angst yesterday. That's a good question, but yesterday the Aussie rallied off a very Labour Force Survey that rose by 47,300 vs. (E) of 15,000. Based on the population differentials, that would be like our monthly jobs report showing an increase of nearly 500K jobs!

That caught the Aussie shorts (of which I am a proud card carrying member) off-guard and the Aussie rose 1.5% before the negative Reuters article. And, that did weigh on the "Aussie," as it sold off with other risk assets and finished over 1% lower than the highs of the day.

So, the Aussie did get hit by China, but it was up so much already that it still managed to close positive. And, the takeaway is that regardless of the domestic economics, if China is backsliding, the Aussie isn't going to be able to rally. I still like shorting this thing anytime it has a "9" handle on it.

The other currency that gyrated wildly yesterday was the yen. The yen closed up over 1% vs. the dollar and closed at a 2 week high. And, if you look at the minute chart, you can see when the NYT article and Reuters article caused two massive legs higher in the yen.

Turning west, the Dollar Index was flat despite the better-than-expected domestic economic data, as the Dollar Index was at the mercy of the huge rally in the yen and modest decline in the euro, which fell in a standard "risk off" move and after ECB Chief Mario Draghi made some mildly "dovish" comments, apparently in an effort to cool the recent rise in the euro (although comments implied no change to policy).

As I mentioned yesterday, currency and bond markets are implying that the situation in the Ukraine and China aren't quite as calm/easy as stocks have made them out to be. But, I continue to think that, unless we get further deterioration in either of those situations, the primary trend of lower bond prices and a weaker yen remain very much in place. This spike, like the one in January, will be viewed as a selling opportunity , although we may have to feel a touch more short-term pain first.

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**	**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.**

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.**

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."**

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.**