7:00's Report

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

March 18th, 2014

Pre 7:00 Look

- Futures are slightly negative as markets digest yesterday's rally and await further information about the next steps in the Ukraine crisis.
- Geo-politically, it appears Putin is moving forward with the integration of Crimea into the Russian Federation, although gold and the yen aren't responding.
- European shares are mixed to lower as economic data missed o/n. Exports and the German ZEW Business Expectation both came in weaker than expected.
- Econ Today: CPI (E: 0.1%), Housing Starts (E: 910K).

Market	Level	Change	% Change
S&P 500 Futures	1849.25	-1.50	-0.08%
U.S. Dollar (DXY)	79.540	.021	0.03%
Gold	1363.30	-9.60	-0.70%
WTI	97.70	.08	0.08%
10-year	2.699	.054	2.04%

Equities

Market Recap

Stocks saw broad gains Monday as a lack of escalation in the Ukraine over the weekend led to a short-covering rally. The S&P 500 rose 0.96%.

Pretty much all the action yesterday came an hour before and after the open, as stocks started the week smartly higher Monday pre-open on a combination of several things: events going as expected in the Ukraine over the weekend, news of increased Chinese infrastructure spending, and some slightly better-than-expected economic data (industrial production).

But, stocks really caught a bid when details of U.S. and EU sanctions were unveiled (more on that below). The sanctions were viewed as pretty ineffectual and likely won't result in retaliation from Russia, so that caught the bears some what off-guard and the race to cover was on even before the opening bell.

Stocks basically opened on the highs of the day and, although we saw a mild dip almost immediately following the open, the market recovered and broadly traded in a tight 5-point range between 1854 and 1860 for the remainder of the day, as news flow quieted considerably.

Trading Color

It was a good rebound day for the bulls but there wasn't a lot of conviction to the move (again, most of the rally was painful short-covering by bears or fast money trying to add back long exposure after last week's dip).

Cyclical indices like the Russell 2000 and Nasdaq lagged both the S&P 500 and the Dow Industrials, although things were a bit better from a sector perspective.

First, all 10 S&P 500 sub-sectors were higher, and the gains were led by banks, semiconductors, materials, industrial miners (including coal) and homebuilders. All traded higher by more than 1%, while defensive sectors like REITs, consumer staples and utilities rallied, but underperformed.

Volumes, activity and participation were all subdued, though, and again there wasn't a lot of conviction to this rally as it was mostly short-covering.

On the charts 1,870-ish now is nearest resistance, as that was the level where markets broke down from last Wednesday/Thursday, and a recapture of that could elicit more momentum buying. On the downside, 1,850

Market	Level	Change	% Change
Dow	16,247.22	181.55	1.13%
TSX	14,231.89	4.23	0.03%
Brazil	45,117.80	152.14	0.34%
FTSE	6,553.53	-14.82	-0.23%
Nikkei	14,411.27	133.60	0.94%
Hang Seng	21,583.50	109.55	0.51%
ASX	5,344.56	27.00	0.51%
Prices taken at previous day market close.			

remains key as do the lows of last week (1,839) and the 50 day moving average (1828).

Ukraine/Russia/Crimea Update

Market	Level	Change	% Change
DBC	25.75	-.18	-0.69%
Gold	1367.30	-11.60	-0.84%
Silver	21.23	-.18	-0.85%
Copper	2.95	.01	0.07%
WTI	98.04	-.84	-.085%
Brent	106.34	-1.87	-1.73%
Nat Gas	4.52	.09	2.12%
RBOB	2.88	-.07	-2.58%
DBA (Grains)	28.44	-.18	-0.63%
Prices taken at previous day market close.			

The U.S. and the EU imposed sanctions against several individual Russian officials yesterday but did nothing close to large-scale economic sanctions, and the measures imposed are largely being viewed as benign, and likely won't see an retaliation from the Russian government.

Things appear to have escalated slightly over night, as Putin has signed legislation to absorb Crimea into the Russian Federation as a republic, potentially as early as the end of this week, according to the BBC.

But, the legislation Putin signed doesn't have any specific time table, and there is still the chance that this is all posturing, and that Crimea will remain in semi-autonomous limbo for the foreseeable future.

Markets aren't reacting to the news this morning so far (futures are flat as is gold). The sanctions yesterday have been dismissed by the Russians (the Duma, the lower parliament in Russia, voted unanimously this morning to get "black listed" by the West along with the senior officials who received sanctions yesterday in a show of solidarity). but the question now is will the West increase more sanctions.

Yesterday the White House implied there were three "tiers" of sanctions, each significantly more onerous than the previous. We know what tier one was, so the question now is whether the US imposes tier two sanctions if the absorption of Crimea actually occurs.

So, going forward the areas to watch remain: 1) Is there any further incursion of Russian forces into Ukraine (this seems to be getting less likely) and 2) Does the West heap more sanctions on Russia if Crimea officially joins Russia, and do we see an escalation from there.

For now, though, despite the Putin moving forward with apparent full absorption of Crimea, the market is more focused on further escalation, which isn't occurring, yet.

Putin is due to speak to the Russian Parliament right about now, so that obviously needs to be watched., although its not expected he'll reveal anything new that we don't already know.

Economics

There were two reports that gave insight into the level of activity in the manufacturing sector of the economy yesterday. And, while the results were mixed (one report beat estimates, one slightly missed), they did further imply that the answer to the key economic question for the market of "Was the weakness in economic data in December and January due mostly to the weather?" is "yes."

Industrial Production

- February Industrial Production rose 0.6% vs. (E) 0.3%.
- The manufacturing sub-component rose 0.8% vs. (E) 0.3%.

Empire Manufacturing Survey

- March Empire State Fed Survey was 5.61 vs. (E) 6.50
- New Orders rose to 3.13 from -0.21 in February

Takeaway

Industrial production, and specifically the manufacturing component, bounced back in February from a big dip in January (January was revised lower to -0.9% from -0.8%). And while that's nice to see, in an absolute sense the level of activity in the manufacturing sector remains subdued compared to the 4th quarter. (And that makes sense because we saw a big accumulation of inventories during Q4, which obviously will be a headwind on future production.)

The Empire State Manufacturing survey, which is the first economic report for the month of March, rose very slightly, from 4.48 in February to 5.61, but slightly missed expectations. Looking at the internals, similar to the headline they were very slightly positive. New orders, the leading indicator of the index, turned positive after dipping into negative territory in February, but only barely so at 3.13.

Bottom line is both of yesterday's manufacturing reports showed a bounce-back in activity from January and February's steep drop, but we still have an inventory headwind from the build up in Q4 which will likely will restrain manufacturing activity for the immediate future.

Commodities

Commodities started the week lower as a lack of any economic sanctions against Russia by the U.S. or EU removed some geopolitical risk out of the commodity space. Copper and natural gas were the only two major commodities to finish positive on the day while the benchmark commodity ETF, DBC, fell 0.69%.

The key catalyst for the declines was the situation in Ukraine, as

1) The weekend came and went with no further escalation, and
2) The sanctions imposed by the U.S. and EU are on select individuals, and not the broad sweeping economic sanctions that would limit output of energy or grain commodities (so, oil and wheat fell as a result) and increase tensions (gold fell more than 1%).

Brent crude was the worst-performing major commodity yesterday, falling 1.7% on a combination of the aforementioned benign sanctions and also on news that Iranian oil exports were over 1.3 million barrels per day last month, the highest in over a year as their sanctions were reduced.

Turning to the two commodities that did rally yesterday, copper traded basically flat as China sentiment improved slightly (it's widely expected that China will announce a major expansion of its urbanization plans and potentially accelerate transportation spending projects, which is obviously economically positive).

Market	Level	Change	% Change
Dollar Index	79.52	-.05	-.06%
EUR/USD	1.3919	.0016	.12%
GBP/USD	1.6623	.0004	.02%
USD/JPY	101.43	-.34	-0.33%
USD/CAD	1.1054	.0002	0.02%
AUD/USD	.9086	-.0001	-0.01%
USD/BRL	2.349	.0023	0.10%
10-year Yield	2.699	.054	2.04%
30-year Yield	3.63	.043	1.20%
Prices taken at previous day market close.			

Natural gas rallied on (what else?) short-term weather forecasts as colder than normal temperatures are expected now into late March. Short-term weather gyrations aside, though, the inventory situation remains stressed in the natural gas space. Although volatility will continue until the weather finally warms up for good, the low level of inventories will be supportive of natural gas even into the summer season.

Commodities appear more broadly to be continuing a bit of a correction, as the complex has benefited from winter weather (the energy complex) and geopolitics (gold) so far in 2014, but those trends appear to be subsiding for now. So, this commodity correction likely has a bit more room to go, as long as status quo remains.

Currencies & Bonds

Monday was relatively quiet in the currency and bond markets, with most of the action being dominated by the Ukraine situation.

There was definitely a "risk on" move in currencies as the yen dropped 0.5% vs. the dollar while the Aussie, Loonie, euro and pound all rallied vs. the dollar.

The Aussie was the big winner yesterday vs. the dollar, rising 0.7%. But, it was China, not Crimea, that was the reason for the jump. The announcement of a widening of the trading band of the yuan (from 1% to 2%) and the aforementioned speculation of an expansion of urbanization plans and transportation spending (which presumably would increase raw material demand) were responsible for the rally in the Aussie and, to a lesser extent, the Loonie.

The jump in the Aussie again shows how "shorted" this currency is, and that if you're going to trade it you've got to be able to stomach short covering rallies. But, beyond the very short-term, selling the "Aussie" with a 0.9 handle vs. the dollar remains one of the more fundamentally sound trades in the market, and I'd continue to methodically lay out short exposure at these levels.

European currencies were only slightly higher vs. the dollar (thanks to a peripheral bid from non-escalation of the Ukraine situation). But the gains were muted given the looming FOMC decision Wednesday. And, I wouldn't expect much volatility in European currencies today or tomorrow unless things drastically change in the Ukraine.

Bonds followed the "risk on" move in other assets yesterday, as the 30-year Treasury fell 0.49% while the 10-year dropped 0.30%. As with European currencies, I wouldn't expect too much volatility in bonds today or tomorrow given the FOMC meeting Wednesday. I'd also continue to methodically lay out "bond short" exposure around here, as again I don't believe the Fed changing its "Forward Guidance" is a dovish event and regardless of the short term, we likely aren't going to see a protracted "Risk off" bid from Ukraine unless things drastically change.

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 fell from recent highs last week on geo-political and China concerns, but 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.* *Critical support now sits at 1828.*

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 and banks. I think coal stocks (KOL, ACI) are now attractive, given positive fundamentals thanks to 1) high natural gas prices, 2) low inventories and 3) an attractive entry point due to China related basic materials sell off last week. I'd also 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 $1360/oz., as gold has benefitted from the recent dollar weakness due to soft economic data. Gold has been an excellent hedge against market turmoil this year, and that will likely continue. I'd look to add to positions on any dip back towards that break out of $1360.**

	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.**