7:00's Report

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

March 19th, 2014

Pre 7:00 Look

- Futures are flat and international markets are little changed as traders digest yesterday's gains and look ahead to the FOMC Meeting Announcement this afternoon
- Economic data overnight did not materially move markets, but the Great Britain Labour Market Report was better than expected (Jobless Claims fell 34.6K vs. (E) -25K)
- Econ Today: FOMC Meeting Announcement (2:00 PM), Fed Chair Press Conference (2:30 PM).

Market	Level	Change	% Change
S&P 500 Futures	1865.50	1.75	0.09%
U.S. Dollar (DXY)	79.60	.056	0.06%
Gold	1346.30	-12.70	-0.93%
WTI	98.53	-.35	-0.35%
10-year	2.679	-.020	-0.74%

Equities

Market Recap

The bounce-back rally continued Tuesday thanks to further de-escalation in the Russia/Ukraine affair. The S&P 500 rose 0.72% and has now recouped all of the Thursday/Friday declines of last week.

It was pretty obvious what caused the rally yesterday. During his address to the Russian parliament, Vladimir Putin said he had no desire to further divide the Ukraine, ostensibly taking further incursions of Russian forces into eastern Ukraine off the table.

China: I'm not a fan of falling knives, but we're getting close to some sort of a value argument in China, although I'd like to see some more strength before getting bullish.

Those comments were followed by interim Ukrainian Prime Minster Arseniy Yatsenyuk saying Ukraine would not seek NATO membership (that had been a main concern of Putin's).

That positive geopolitical news helped markets ignore the soft CPI and housing starts reports, and those events were pretty much "it" for the day from a news and catalyst standpoint. The S&P 500 drifted in low volatility for the entire trading session, and the range on the day was only 7 points in the S&P 500 (1,867 to 1,873).

Of note, though, the market caught a small bid during the afternoon and closed just off the highs, implying that we once again are starting to see investors grudgingly adding long exposure. (The reason I say that is because they wait for a morning sell-off, and when it doesn't come, they capitulate and buy in the afternoon. We saw the same thing happen Monday.)

Trading Color

Volumes were again light (I'm wondering if spring break has something to do with it) as was participation, so

Market	Level	Change	% Change
Dow	16,336.19	88.97	0.55%
TSX	14,368.98	137.09	0.96%
Brazil	46,150.96	1,033.16	2.29%
FTSE	6,597.17	-8.11	-0.12%
Nikkei	14,462.52	51.25	0.36%
Hang Seng	21,568.69	-14.81	-0.07%
ASX	5,355.60	11.03	0.21%
Prices taken at previous day market close.			

again there wasn't a lot of conviction to the rally, just like Monday.

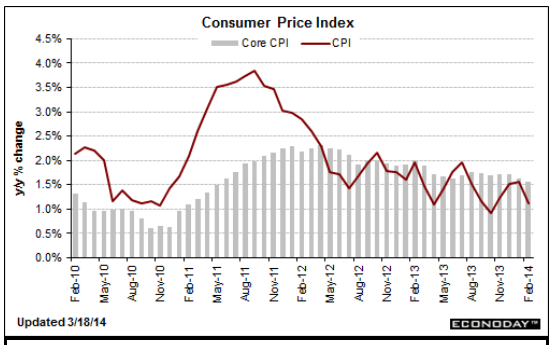
Internally, things were more positive yesterday, as the Russell 2000 rose 1.4% and the Nasdaq rose 1.25%, both handily outperforming the S&P 500 and Dow.

Market	Level	Change	% Change
DBC	25.90	.16	0.62%
Gold	1360.60	-12.30	-0.90%
Silver	20.88	-.395	-1.86%
Copper	2.954	.002	0.07%
WTI	99.66	1.58	1.61%
Brent	106.68	.44	0.41%
Nat Gas	4.46	-.076	-1.68%
RBOB	2.8995	.0184	0.64%
DBA (Grains)	28.71	.27	0.95%
Prices taken at previous day market close.			

Sector-wise, cyclicals again outperformed, as tech (thanks to MSFT rallying 4%), semiconductors, banks and materials out performed. Meanwhile, utilities were the only S&P 500 sub-sector to finish negative, as most "defensive sectors" broadly underperformed.

But, those positive internals aside, the rally so far this week isn't a strong one.

On the charts the S&P 500 retook the 1,870 level I mentioned yesterday (that in part was why we saw some light "chasing" of the market into the close, so now the old highs of 1,883 are next resistance).



Core CPI has now spent more than 12 consecutive months below the Fed's target of 2%.

Bottom Line

It appears that the Ukraine situation is now moving to the back burner, and going forward the two things to watch are:

1) If Russia does integrate Crimea, as they apparently are going to do, does the West apply more sanctions? The possibility is there (the White House strongly suggested it Monday), but at this point I think it's obvious to most watching that the West doesn't have the stomach for a fight on this unless things get much worse.

2) Ukrainian elections will come later in May. If "pro-European" parties win overwhelmingly, we could see a flare-up again, but that's a few months off.

Bottom line is we've probably seen about all we're going to get from the "Ukraine bounce," and focus will turn back to economics and policy. From an investment standpoint, I don't expect a material grind higher from here unless data turns more positive, and I continue to think focusing on sectors that offer "value" within the market remains the winning strategy in 2014. Coal (KOL and ACI) and "short bond" plays remain my two best ideas in the market right now.

FOMC Meeting Preview

Today's FOMC meeting is widely expected to see:

1) An additional taper of QE by $10 billion (down to $55 billion),

2) No material changes to the FOMC forecasts for economic growth or interest rates compared to the December meeting, and

3) Language that initiates the process of the Fed moving away from "quantitative" forward guidance based on a 6.5% unemployment threshold and a 2.5% inflation threshold, to a more "qualitative" forward guidance that is much less-defined and more-opaque.

And, it's this "forward guidance" shift that needs to be watched, as many analysts have said it will be "dovish." (That's part of the reason we saw Treasuries rally despite the gains in the stock market yesterday.)

The reason I'm pointing this out is because I believe we may see an opportunity come out of this meeting—an opportunity to get excellent entry points to initiate or add to "bond short" positions, including TBT, TBF, SJB, STPP and even KBE (if we see the banks sell off on a drop in rates or a flattening of the yield curve).

The reason I think we have this opportunity is because any change in "forward guidance" won't be "dovish," as some have predicted. To see why, all we need to do is look at the Bank of England, which abandoned quantitative "forward guidance" back in February.

In the February 13th Report, I wrote:

"You know by now that I've been pointing to the Bank of

England as a 'blueprint' for Fed policy going forward, specifically how the central banks will try to convince markets that interest rates will stay 'low for long' when all the measurable evidence shows the economy is getting stronger and stronger. Well, yesterday the BOE took the next step in evolution regarding forward guidance by basically throwing it out.

"The BOE said that instead of relying on unemployment and inflation as the 'thresholds' for when rates might start to rise, they are now using 18 separate statistics to measure 'spare capacity' in the economy.

"Translation: 'Our forward guidance didn't really work because we're already at the point (7% unemployment) where we should start raising interest rates. So, now we're going to make it so complicated to try and figure out when we'll decide to raise rates that there's no chance the market will be able to front-run us and push rates up ahead of us, because it won't know what we're looking at.'

"It's a nice trick, and I'm sure it works in theory. But to reiterate my point, the market isn't waiting for the BOE or the Fed. The BOE and Fed could use a Magic 8-Ball and it wouldn't make a difference – the market will force the BOE and Fed to move higher on rates, it'll be because the economies are stronger and the demand for money is increasing, and it'll be a good thing.

"From a practical point of view, there are two takeaways here. No. 1 – The pound is probably going to be the strongest currency vs. the dollar over the coming year, and I imagine new highs are just a matter of time. ***No. 2 – expect the Fed to use a similar tactic of redefining the 'thresholds' for when rates will rise, likely in the next few meetings (and remember it won't be a 'dovish' occurrence)."***

Market	Level	Change	% Change
Dollar Index	79.555	.036	0.05%
EUR/USD	1.3926	.0006	0.04%
GBP/USD	1.6584	-.0049	-0.29%
USD/JPY	101.48	-.28	-0.28%
USD/CAD	1.1142	.0091	0.82%
AUD/USD	.9122	.0036	0.40%
USD/BRL	2.3405	-.008	-0.34%
10-year Yield	2.679	-.020	-0.74%
30-year Yield	3.625	-.005	-0.14%
Prices taken at previous day market close.			

Since that BOE move on Feb 13, interest rates have stayed flat (except for the past week when a Ukraine-based "risk off" trade pushed rates down), while the pound has rallied small. So, the point is the change in "forward guidance" wasn't dovish, and I think this move higher in bonds/lower in rates that we've seen into the meeting will be an excellent entry point for anything other than very near-term bond short positions.

Economics

Housing Starts

- February Housing Starts were 910K vs. (E) 907K SAAR

Takeaway

On the headline, housing starts for February were largely in-line with analyst expectations, although the number wasn't nearly as good as it looked.

First, single-family housing starts, the key metric to look at in this report as a read on the residential housing market, rose just 0.3% after plunging 13% in January.

Second, building permits were viewed as the positive highlight of the report and beat estimates at 1.081M vs. expectations of 960K. But, the entire gain came from multi-family homes, while single-family permits actually fell 1.8% in February.

The bad data will be given a "pass" by the market because of the bad weather. But the bottom line is the housing recovery remains an area of concern, and we are simply not getting definitive signs that the recovery has stabilized after starting to slow mid-2013. The recovery is still ongoing, but having the pace of recovery stabilize would be a nice positive for this market.

Commodities

Commodities bounced back Tuesday, led higher by energy, as the de-escalating comments by Putin early Tuesday led to a short-covering rally in WTI and a sell-off in gold. The commodity ETF DBC rose 0.6%.

Gold finally took a breather yesterday, dropping as the geopolitical risk bid continued to bleed out of the precious metals. But, even though gold fell 1% and silver fell 2%, both commodities actually traded decently,

given how short-term overbought they both were. Gold ended nearly $9 off the lows of $1,351, while silver closed 20 cents off the lows, so both metals showed some resiliency.

Gold and silver are lower this morning as traders position ahead of the FOMC meeting today. If the metals break down following the FOMC decision, we could see a correction that takes us into the lower $1,300s for gold, although that would be a dip to buy.

The energy complex saw a reversal of Monday's trading, as natural gas fell 1.3% on more short-term weather outlooks, while WTI, Brent, RBOB gasoline and heating oil all rose close to 1% on short-covering and dip-buying into the API report yesterday and the official inventory report today.

With regard to the energy complex ex-natural gas, I'd expect more of a range-bound trade, with resistance at $99.51 a near-term key level for WTI crude. But, I don't see any material trends (up or down) in the energy commodities at the moment.

More Potential Trouble in China, But Copper Didn't Fall.

Copper traded flat again yesterday, and that caught my eye given there were reports circling about a Chinese property development company defaulting on its loans. The Zhejiang Xingrun Real Estate Co. (ZXREC) apparently has defaulted on over $400 million of loans, and the chairman and son have been arrested for illegal fundraising (apparently they were promising 30% interest on money to investors who would listen after the banks shut them out).

This isn't an industrial company so news of its default wouldn't have the direct effect on copper that the solar-related companies' troubles of last week did, because ZXREC loans aren't secured by copper (they are secured by land, hopefully). But, the fact that the market was able to shrug this off (for now) was somewhat impressive. The "China bears" have long warned about the impending implosion of the Chinese property market, so the fact that this didn't get more attention or reaction is a positive. Maybe that reaction will be delayed because of the FOMC meeting, but one of the oldest rules of trading is that when bad news breaks and stocks that should go down, don't go down, that's a sign a bottom is forming. I'm not ready to call a bottom in China-related assets yet, but the space is acting better and my interest is piqued.

Currencies & Bonds

It was a pretty quiet day for major currencies yesterday, which is to be expected with an FOMC meeting looming. The dollar was almost unchanged, as was the euro, which shrugged off the German ZEW Business Expectations Survey missing estimates (46.6 vs. (E) 52.0). The pound was actually the laggard of the developed market currencies vs. the dollar, as it fell 0.3% on profit-taking ahead of the Labour Market Report and BOE Monetary Policy Committee minutes released earlier this morning.

Commodity currencies continue to trade with the most volatility, as the Loonie was the biggest mover on the day, falling -0.82% and again trading below $0.90 vs. the dollar. The Loonie fell despite a decent January manufacturing report, as Bank of Canada member Stephen Poloz warned in a speech that economic growth may miss estimates in Q1. That obviously isn't bullish for the Loonie, and it fell as a result. The Aussie, on the other hand, rose 0.43% after the minutes from the recent Reserve Bank of Australia meeting confirmed the committee was "on hold" from a policy standpoint, and overall didn't reveal much new.

Finally, turning to bonds, we saw modest rallies in Treasuries, which is odd on a day the stock market was up nearly 1%. But, the economic data was light yesterday, and with the FOMC looming, undoubtedly there were investors and traders positioning ahead of the meeting.

Not to beat a dead horse, but if you think, as I do, that we are seeing the economic recovery continue to (slowly) progress, then any bounce in Treasuries is a bounce to sell into, as more qualitative "forward guidance" isn't going to hold down interest rates in the face of a growing economy, regardless of how "qualitative" they make it.

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.**

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.**

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.**