7:00's Report

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

March 20th, 2014

Pre 7:00 Look

- Futures slightly lower this morning after a quiet night of news.
- The FOMC meeting was the major catalyst in international markets, as we saw knee-jerk selling in Asia (most indices down more than 1%), although Europe is holding in better (down modestly).
- Economically there were no material reports o/n.
- Econ Today: Weekly Jobless Claims (E: 325K), Philadelphia Fed Survey (E: 3.0), Existing Home Sales (E: 4.6M)

Market	Level	Change	% Change
S&P 500 Futures	1847.00	-5.75	-.31%
U.S. Dollar (DXY)	80.425	.292	.36%
Gold	1326.30	-15.00	-1.12%
WTI	98.75	-.42	-.42%
10-year	2.772	.091	3.39%

Equities

Market Recap

Stocks declined modestly Wednesday after the FOMC statement and press conference were taken as more "hawkish" than expected. The S&P 500 declined 0.61%.

Stocks were almost perfectly flat heading into the FOMC meeting, as markets looked past soft earnings from ORCL, STLD and FDX. (FDX cited very severe winter weather as the reason for the miss. This is actually an odd positive because it helps further legitimize the "weather excuse" for soft economic data.)

The 10 year Treasury yield is close to breaking a three month downtrend, and a trade through 2.80% will likely signal this "counter trend rally" in bonds has ended.

But, yesterday was all about the FOMC, and there were two specific catalysts that caused the sell-off in stocks.

First, there was an "upward drift" in the "dots" of the FOMC's future interest rate projections (more on that shortly). Second, during the press conference, Janet Yellen made a comment that implied interest rates would start to rise sometime around 6 months after QE ended. QE is widely expected to end later this year, so that would put the initial increase in interest rates in the April/May 2015 time frame, which is ahead of what the market expected.

Immediately following the "six months" comment stocks hit their lows down more than 1%, but the knee jerk reaction didn't last, and the market bounced modestly during the final hour of trading to finish well off the lows of the day.

Trading Color

Given the catalyst for the sell off (a "hawkish" Fed), market internals were predictable: Banks were the big beneficiary and KBE actually hit a new 52 week high yesterday, while "bond proxy" sectors such as utilities, REITs,

Market	Level	Change	% Change
Dow	16222.17	-114.02	-.70%
TSX	14334.04	-34.94	-.24%
Brazil	45567.23	416.27	.90%
FTSE	6517.54	-55.59	-.85%
Nikkei	14224.23	-238.29	-1.65%
Hang Seng	21182.16	-386.53	-1.79%
ASX	5294.00	-61.59	-1.15%

Prices taken at previous day market close.

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and consumer staples badly underperformed.

From a volume and activity standpoint, things were busier yesterday than they had been all week, although all the action took place post FOMC statement, and trading was dominated by algos, fat money hedge funds and day traders. Large, long only mutual funds didn't really react to the Fed yesterday.

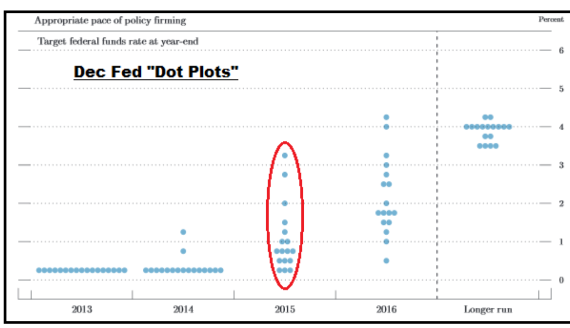
Market	Level	Change	% Change
DBC	25.88	.01	0.04%
Gold	1331.6	-27.40	-2.02%
Silver	20.635	-.227	-1.09%
Copper	2.9785	.027	0.91%
WTI	100.28	0.58	0.58%
Brent	105.81	-.98	-0.92%
Nat Gas	4.484	.028	0.63%
RBOB	2.8695	-.0333	-1.15%
DBA (Grains)	28.69	-.03	-0.10%
Prices taken at previous day market close.			

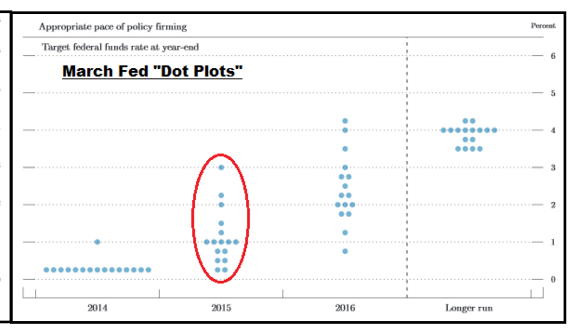
On the charts, the S&P bounced off support at 1850 while 1870ish is once again resistance.

Bottom Line

Despite the initial negative market reaction, yesterday was not a "game changing" day for Fed policy. Fed policy didn't become more "hawkish" yesterday, and the "six months" statement by Yellen at the press conference likely won't ignite a violent spike higher in yields and dip in the stock market the way Bernanke's initial "taper" comments did last May.

From a stock market standpoint the only concrete takeaway is that we'll likely see a the rotation into bank stocks and out of "bond proxy" stocks begin again (it's been on hold so far through 2014). So, if you have nice profits year to date in XLU or VNQ, consider booking them.





In fact, a sooner than expected uptick in rates should be looked at quasi-positively, as it means the FOMC thinks the economy will be strong enough to stomach the rate increases by early to mid 2015, **and that is much more positive for stocks longer term than any continuation of QE or infinite 0% interest rates.**

Bottom line is the key to an extended rally in stocks from these levels is increased economic activity, and higher earnings—not more central bank easy money policy.

To that end, expect focus to shift back to economic data and the upcoming earnings season, as the next set of critical numbers comes next week (March flash PMIs) and Q1 earnings season starts in just under three weeks.

Finally, Ukraine and China remain risks to watch, and while neither are on the back burner, unless events in both countries deteriorate further, expect the market to be much more focused on economic data and earnings.

Economics

FOMC Meeting – Dovish Language Couldn't Hide the 'Dots'

- The FOMC made no changes to interest rates, as expected.
- The FOMC tapered QE by an additional $10 billion to $55 billion per month, as expected.

Takeaway

The Fed abandoned previous forward guidance of the 6.5% unemployment threshold and 2.5% inflation. Instead, as expected, it adopted more "qualitative" forward guidance. That is, relying on multiple, unnamed factors to decide when interest rates increase.

The Fed statement was relatively in-line with expectations, although it was a touch surprising that the Fed fully abandoned its previous forward guidance framework at this meeting.

But, the surprise was countered by slightly more-dovish language, stating that the Committee will keep the Fed Funds rate well-below the normal, longer-run level "for

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some time"—even after inflation and unemployment are "near mandate-consistent levels."

But, the dovish language couldn't hide the dots.

The projections of where individual members of the FOMC expect the Fed Funds rate to end each year, which is known affectionately as the "dots," moved up decidedly in March compared to December. In yesterday's release, only 10 out of the 16 Fed officials believed the Fed Funds rate would be at or above 1% by the end of 2015. That compares to just 7 back in December.

The Fed Funds rate is at 0.25% to 0% right now. So, based on these "dots," the majority of Fed officials believe we will see at least one rate hike in 2015. (And, logically, more than one. That's because the FOMC isn't going to raise interest rates 75 basis points when they first start to raise rates, as it'd be jarring.)

So, put simply, the reason the market reacted so "hawkishly" to the FOMC was because of an "upward drift" in the "dots."

From a Fed standpoint, I expect we'll see some "dovish" rhetoric out of the Fed over the coming weeks, given the market's reaction. But at the end of the day, yesterday's stock declines aside, policy returning to normal is a good, healthy thing for the economy. That's because it'll happen when the economy gets stronger.

Despite being a loud bond bear, I don't think yesterday's Fed meeting will ignite a sharp sell-off in bonds, as again this is a trend that will evolve over time.

But, I think the "dots" are just a representation of what everyone knows – that the market will "force" the Fed higher as the economy improves, regardless of the FOMC statement or dovish speeches.

The bottom line is that yesterday only further confirmed that the trend lower in bond prices (and higher in rates) is still ongoing. It also confirmed that this is a trend with much, much further to run — one that will last months, quarters and years. And these levels remain extremely attractive entry points for a bond short position over the medium and longer term.

Commodities

The metals were the big movers in a generally quiet commodity space yesterday. Copper reversed off morning lows to turn positive on the day, while the precious metals fell ahead of the FOMC meeting announcement thanks to trader positioning. The benchmark commodity tracking index ETF, DBC, rallied 0.15%

The price of copper has been in focus for weeks now as investors look to the metal as a proxy for the health of China.

Copper futures sold off overnight and hit a 5-year low after the American markets opened, but then reversed to finish the session up 1.17%. The pre-market selling was largely the result of the yuan breaking through critical support at the $6.20 level, which triggered selling in copper.

But, not too long after that, a Goldman Sachs started circulating desks that defended copper and stated that the Chinese corporate practice of borrowing against physical copper was continuing in earnest. Whether that was the catalyst of some large fund finally took a stand, copper staged a huge reversal at the 5 year lows, and copper managed to close 1% higher on the day. Yesterday's low tick (2.88) is now the level to watch in copper, as copper continues to appear and try and find a bottom.

Elsewhere in metals, gold traded lower ahead of the FOMC announcement and then hit new lows afterward. Weak longs unwound positions and sellers chased futures lower as the price broke through support levels. On the chart, there is strong technical support toward the $1,300 level. ($1,300 is psychological support, the location of a supporting trendline, and the 200-day moving average.). I would recommend adding to long positions or taking a shot on opening new ones as the price dips toward that

Market	Level	Change	% Change
Dollar Index	80.16	.616	0.77%
EUR/USD	1.3828	-.0105	-0.75%
GBP/USD	1.653	-.0062	-0.37%
USD/JPY	102.52	1.10	1.08%
USD/CAD	1.1249	.0115	1.03%
AUD/USD	.9031	-.0096	-1.05%
USD/BRL	2.3503	.0163	0.70%
10-year Yield	2.772	.091	3.39%
30-year Yield	3.670	.043	1.19%
Prices taken at previous day market close.			

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level (and both gold and silver are getting closer to those big support levels, as they are sharply weaker this morning).

Moving to the energy markets, the EIA released supply data yesterday and the results were mixed.

- Crude oil inventories rose 5.9M barrels vs. (E) +2.3,
- RBOB gasoline supply levels fell by 1.5M barrels vs. (E) -0.9M, and
- Distillate supplies fell 0.6M barrels vs. (E) -3.1M.

The weekly build in crude oil supplies was the 7th in a row; however, WTI was able to close the day in the green, up 0.13%. The price of crude traded in a tight 80-cent range yesterday thanks to conflicting technicals. At the end of the day, though, the 50-day moving average held and a 3-week downtrend line was broken. It seems WTI is trying to stabilize and at least form a new range here, with the key levels to watch being Monday's low of $97.37 and the 200-day moving average at $100.26.

Currencies & Bonds

Before the FOMC announcement, currency markets were flat. The Dollar Index, euro, yen and Aussie were all just a tick or two from unchanged.

The one currency that was moving pre-Fed was the British pound, which rallied 0.33% after the Jan/Feb Labour Market Report was better-than-expected. (The number of unemployed claiming benefits declined by 34K vs. (E) 25K.)

Treasuries were somewhat surprisingly negative pre-Fed, as the 30-year was down 0.3% while the 10-year was down 0.2% on positioning ahead of the announcement.

Post-FOMC, the reaction in currency and bond markets was universal: Every major currency vs. the dollar and both the 10- and 30-year Treasury bond declined between 0.6% and 0.8% initially. This reflects the structural adjustment the currency and bond markets made to the prospect of sooner-than-expected Fed Fund rate increases — courtesy of the "upward drift" in the expected level of interest rates in 2015 (i.e., the "dots.").

Then, currencies and Treasuries took another leg lower during Chair Yellen's testimony when she referred to the "considerable" period of time mentioned in the FOMC statement between the end of QE and the first interest rate increase as about "6 months" or so, which the market took as "hawkish" comment.

At the lows following the "6 month" comment, most major currencies were down more than 1% vs. the dollar and Treasuries were down nearly 1%, although pretty much everything lifted a touch as the press conference ended.

The one outlier post FOMC was again the British pound, which declined once the FOMC decision was out. But it was only down about 0.3% even at the lows, again thanks to the strong data. This underscores my point that the UK is "further down the road" of economic recovery and interest rate policy change. As a result, we can expect the pound to continue being one of the stronger currencies, if not the strongest, vs. the dollar.

As far as what to expect going forward, obviously this is going to put further downward pressure on bond prices, but I don't think yesterday's events are going to ignite a steep drop in bond prices in the short term, although it will likely cap any further upside in bonds, and make obvious to everyone paying attention that, if anything, the risk is an acceleration in the pace of increase in interest rates, not a delay.

So, even despite yesterday's moves, TBT, TBF, STPP and other "bond short" ETFs are still very attractive at these levels.

Have a good day,

Tom

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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.* *Support remains in the 1850 area for the S&P, with resistance at 1870.*

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: **With a reduction in geo-political risk and a surprisingly hawkish FOMC statement, we are seeing some of the recent "froth" taken out of gold, as it's traded down towards $1300. I would look to buy or add to positions on this dip.**

	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.**

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