7:00's Report

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

March 21st, 2014

Pre 7:00 Look

- Futures and international markets are slightly higher after an uneventful night. There was no economic or geo-political news, so markets continued to digest the Fed.
- The Fed released the first round of "stress test" results. ZION was the only bank that failed, but overall the news isn't really moving markets.
- Today is a "quad witch" options expiration, which could support the market and likely will result in big volumes.
- Econ Today: No reports today. Fed Speak: Bullard (11:45 AM), Kocherlakota (4:30 PM), Stein (6:30 PM).

Market	Level	Change	% Change
S&P 500 Futures	1870.50	4.50	0.24%
U.S. Dollar (DXY)	80.29	-.063	-0.08%
Gold	1339.50	9.00	0.68%
WTI	99.09	.19	0.19%
10-year	2.775	.003	0.11%

Equities

Market Recap

Stocks recouped all of Wednesday's losses as the markets contemplated their overreaction to the Fed and economic data beat expectations. The S&P 500 rose 0.6%.

Stocks were weaker out of the gate Thursday, as markets were dragged lower by Fed-induced weakness in Asia and Europe. But, stocks shot higher almost exactly at 10 AM after the Philly Fed index beat expectations (demonstrating the point that with the Fed behind us,

Bank stocks surged to new highs yesterday on big volume. My first days on Wall Street I was taught "As banks go, so goes the market." So, these new highs are a good thing.

the focus is now squarely on economic data).

The Obama press conference announcing more sanctions against individual Russians caused a slight dip shortly after 11 AM, but like the first round of sanctions they were viewed as benign, and the trend on the day was clearly higher as buyers chased the market.

The afternoon was quiet from a news and activity standpoint as most traders turned on March Madness. However, stocks did catch a big "Market on Close" bid in the last few minutes of trading to go out basically at the highs. (The fact that today it was a "quad-witch" options expiration might have had something to do with the big jump higher into the close, and that "quad witch" should result in big volumes and some volatility today.)

Trading Color

It wasn't a typical "Risk On" rally as the Russell 2000 and Nasdaq lagged. But there were subtle signs of strength nonetheless, as cyclical sectors outperformed yesterday.

Banks were the stars of the show again yesterday, as

Market	Level	Change	% Change
Dow	16,331.05	108.88	0.67%
TSX	14,361.83	27.79	0.19%
Brazil	47278.48	711.25	1.53%
FTSE	6559.51	17.07	.26%
Nikkei	14224.23	-238.29	-1.65%
Hang Seng	21436.70	254.54	1.20%
ASX	5338.08	44.08	.83%

Prices taken at previous day market close.

KBE rallied 1.9% into the stress test release on anticipation of eventual higher rates and larger net interest margin. KBE made a new 52-week high yesterday on big volume.

Semiconductors were the other big winners yesterday, as the SOX rallied 1.9% as well, and semiconductors continued to be the best-performing major sub-sector in the market year-to-date (up 9.8%).

Market	Level	Change	% Change
DBC	25.77	-.09	-0.35%
Gold	1331.20	-10.10	-0.75%
Silver	20.395	-.431	-2.07%
Copper	2.9365	-.0505	-1.69%
WTI	98.75	-.42	-0.42%
Brent	106.34	.49	0.46%
Nat Gas	4.37	-.114	-2.54%
RBOB	2.8876	.0188	0.66%
DBA (Grains)	28.09	-.57	-1.99%
Prices taken at previous day market close.			

Conversely, "bond proxy" and "interest rate exposed" stocks lagged. Homebuilders actually declined 1% on a combination of the higher-rate trade and after existing home sales missed.

Utilities, REITs, and consumer staples all ended the day higher, but only marginally so, and badly lagged the market. Meanwhile, most other sectors (materials, energy, retail and healthcare) traded more or less in-line with the market.

On the charts it was a good day as the S&P 500 again reclaimed that 1,870 region, and now resistance sits at the old highs of 1,883.

"I guess this means my spring break in Siberia is off, my Gasprom stock is lost, and my secret bank account in Moscow is frozen."

- Senator John McCain responding to news Russia had imposed sanctions on him and eight other US officials.

Bottom Line

Markets shrugged off the Yellen hysteria (and rightly so) yesterday and, with economic data better-than-expected, they resumed their advance. And, although Ukraine and Chinese economic growth remain risks to monitor, banks and financials are hitting new highs, and as I was taught early on in my career, as banks go, so go the market. So, the path of least resistance remains higher.

Despite the resilient price action this week, though, I don't expect this market to "run away" from these levels, and unless we get good data from the flash PMIs this week, breaking through 1,883 may be a tall order in the short term.

Instead, I think the key to outperforming in 2014 will be continuing to focus on sectors with improving fundamentals and reasonable valuations, as opposed to throwing on generic long exposure via an index fund. Coal, banks (although they hit new 52-week highs, if Net Interest Margins move higher, these stocks are cheap), retail, and "bond short" positions remain attractive at these levels.

Economics

Weekly Jobless Claims

- Weekly Claims were 320K vs. (E) 325K

Takeaway

Weekly jobless claims increased by 5K to 320K from an unrevised reading of 315K the week prior. More importantly than that, though, the 4-week moving average dropped to 327K. That was the lowest level since Dec. 5, but this specific reading was artificially skewed lower because of the Thanksgiving holiday.

Looking beyond that, we have to go back to early October to find the 4-week moving average below 330K, but those figures were skewed lower because of software upgrades in California that artificially delayed the filing of jobless claims.

So, the point I'm trying to make is that claims appear to be finally trending legitimately downward, which anecdotally implies the labor market could be seeing incremental improvement. This is a positive for the economy. It's too early to say the jobs market is improving, but quietly we could be seeing a resumption of positive momentum.

Philly Fed Survey

- General Business Conditions Index for March jumped to 9.0 vs. (E) of 3.0

Takeaway

The Philadelphia Fed Survey's General Business Conditions Index was much better-than-expected yesterday, coming in at 9.0 vs. (E) 3.0. The jump in the headline number was an increase of 15.3 points month-over-month and essentially cancels out the weak number we saw in February.

Weather was cited as affecting the report in February. The bounce in the March reading confirms this and further validates the "extreme weather excuse" that has been used to explain the weak economic data. The details of the report were also strong, with new orders increasing 10.9 points to a positive 5.7 in March. This means we can expect to see decent strength in mid-Atlantic regional manufacturing going forward.

However, even though we saw a material bounce-back in the Philly Fed Survey for March, a headline number of 9.0 is still well-below the readings in the mid-teens we were seeing in Q4 last year. The main reason for that slowdown is the substantial build in inventories we saw in Q4, and that is having a lasting effect on the sector.

So, a reading of 9.0 is essentially exactly where it should be, given the current economic environment. Growth in the manufacturing sector should continue, albeit at a slower pace.

Commodities

Commodities traded mostly lower yesterday as precious metals continued to sell off thanks to Yellen's interview Wednesday being interpreted as "hawkish." Meanwhile, the refined products were the best performers, as they rose in sympathy with Brent crude prices. The PowerShares DB Commodity Index Tracking ETF (DBC) fell 0.35% yesterday.

Market	Level	Change	% Change
Dollar Index	80.36	.227	0.28%
EUR/USD	1.3777	-.0055	-0.40%
GBP/USD	1.6503	-.0038	-0.23%
USD/JPY	102.41	.08	0.08%
USD/CAD	1.124	.0006	0.05%
AUD/USD	.9038	-.0002	-0.02%
USD/BRL	2.3263	-.021	-0.89%
10-year Yield	2.775	.003	0.11%
30-year Yield	3.660	-.010	-0.27%
Prices taken at previous day market close.			

The correction in the precious metals market continued yesterday as gold and silver fell for the 4th day in a row by 0.75% and 2.07%, respectively. Both metals were lower thanks to further long liquidation courtesy of declining geo-political stress in Ukraine and because of Yellen's "hawkish" comments Wednesday.

Gold futures fell to a one-month low yesterday morning (a 4.5% dip for the week) but bounced off support at $1,320, where futures attempted to stabilize. Gold is bouncing this morning and although I'd be happier buying this dip more towards $1300, gold fundamentals are turning more positive beyond the very short term and if you are not invested in gold at all, now is a good time to start "nibbling" on the long side.

But, I believe that $1300 level, if we get there, is the one to "back up the truck" as they say, as $1,300/oz level has three solid supporting elements: The 200-day MA is sitting right at the level, The supportive uptrend line that has been in place since the low tick of December is just above $1,300, and lastly, it is psychological support, which can be more important than many believe.

Elsewhere in metals, copper futures dropped after they seemed to stabilize a bit. However, the drop was not as technically bearish as the other recent daily sell-offs have been because copper did not make a new low.

Yesterday, the yuan dropped further against the dollar and hit its lowest level in over a year, above 6.20 vs. the dollar. That yuan weakness caused copper to sell off as well, although copper held above the intra-week spike low of 2.88. And, it does appear that copper prices are trying to stabilize, and it is important to keep a close eye on copper as it continues to trade as a proxy for the health of the Chinese economy. And sooner or later, I believe there will be an opportunity in getting long both copper and Chinese stocks, but we need to see stabilization first.

Trading in the energy markets was rather uneventful yesterday as crude oil was little-changed, up 0.42% to $98.75/bbl, which leaves futures right in the middle of the range we pointed out earlier in the week. On the charts the 100-day moving average at $97.25 is the support level to watch, while the 200-day moving average is the level to beat at $100.28. Until this current range breaks one way or another, the only opportunity lies in selling straddles/ strangles and slowly collecting premium while the price drifts sideways.

Moving to natural gas, futures prices fell thanks to a smaller-than-expected draw in stockpiles (-48 Bcf vs. (E) -59 Bcf). Inventory levels remain a problem though and supply levels did dip below the 1 trillion Bcf level, according to the EIA report. Supplies are now 49.4% below where they were a year ago, and 47.9% below the 5-year average, which is obviously fundamentally bullish and should support natural gas prices at these levels regardless of short term weather outlooks (which is positive for XOP and FCG).

Currencies & Bonds

The dollar rally continued yesterday, as the Dollar Index rose 0.29%, but it wasn't nearly as universal a rise as it was Wednesday. Much of the dollar's gains came because of a drop in the euro.

The euro was the weakest currency vs. the dollar and fell 0.4% to hit a two-week low under 1.38, as euro longs continued to unwind their positions. The euro was by far the biggest consensus "long" vs. the dollar in the currency markets heading into the FOMC meeting, as currency traders who wanted to be long the euro only focused on risks coming from the ECB.

The rationale behind the trade was: "As long as the ECB doesn't ease, the euro will rally," and that worked for the last several months. Very few "euro longs" expected any risk to the trade from the Fed, as it was expected to stay the course of a gradual taper of QE. The result of that set-up was consistent upward pressure on the euro and a very crowded long trade.

So, the "hawkish" dots and the "six months" between QE3's end and interest rates beginning to rise somewhat blindsided the euro longs. We are now seeing the unwinding of that crowded trade, and I image that it will continue for some time longer. This is exactly why I don't think there is a discernible trend we can trade in the euro or the Dollar Index. Both will remain relatively range-bound over the coming months, unless either the Fed or ECB materially alters policy.

Away from the euro, currency markets were little-changed, as most other currency pairs weren't quite as "one sided" as the long euro trade and, as such, don't have to go through such an adjustment. The yen, Aussie and Loonie were all basically flat vs. the dollar, as those markets were much more balanced. The next catalysts for those currencies will come next from their own central banks and not the Fed.

But, longer term, I do think yesterday was a "warning shot" for the U.S. dollar bears. Fed policy will likely stay on course for the foreseeable future. The risk, if any, is toward a faster taper and sooner-than-expected rate increase – and we saw a preview of the market's reaction to that yesterday. So, although it won't make a difference in the very short term, this undercurrent of U.S. dollar strength is something I think can continue to gain (slow) momentum. Because of that, I am more convinced about my "Aussie short" and "yen short."

Both the yen and the Aussie have fallen over the past year because of actions by the BOJ and RBA to actively devalue their currencies – and the greenback has gained because of their weakness. Few analysts I read and talk to are considering and factoring in that we are entering an era of dollar strength against Asian and Pacific currencies. If we are, that will put further pressure on the yen and Aussie beyond the negative efforts of their own respective central banks.

Treasuries were flat yesterday as they digested the Yellen comments and Fed statement. To reiterate my point from yesterday's Report, while I think Wednesday's FOMC statement did further validate my "bond bear" stance and likely put an end to this three-month-long counter-trend rally in Treasuries, I don't expect the FOMC news this week to ignite a steep drop in bonds like we saw last May.

Instead, I think the "dots" and "six months" comments are like two more holes in an already sinking ship — one that, over time, will contribute to and make worse the decline in bonds/rise in yields. TBT, TBF, STPP and KBE (my 7:00's Report "short bond basket") remain attractive at these levels.

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 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.**

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.**

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.**