7:00's Report

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

March 24th, 2014

Pre 7:00 Look

- Futures are slightly higher as better than expected economic data from Europe offset another miss from China.
- Chinese flash PMIs missed estimates (48.1 vs. (E) 48.7), but EU data beat (53.2 vs. (E) 53.1), although Asia rallied on the news while Europe is slightly weaker.
- Geo-politically it was a quiet weekend, and focus this week will be on Obama as he is touring Europe and meeting with G-7, NATO and EU officials regarding Ukraine.
- Econ Today: Flash PMI (E: 56.9). Fed Speak: Stein (9:00 AM), Fisher (1:45 PM).

Market	Level	Change	% Change
S&P 500 Futures	1860.25	3.25	.18%
U.S. Dollar (DXY)	80.40	.144	.18%
Gold	1323.40	-12.60	-.94%
WTI	99.66	.20	.20%
10-year	2.75	-.025	-0.90%

Equities

Morning Update

Chinese March flash PMIs missed estimates overnight (48.1 vs. (E) 48.7), but futures are higher because 1) The Chinese government is expected to "defend" economic growth and the real concern in China is liquidity, not economic growth and 2) there was a silver lining in that new export orders rose. It's too early to make the call, but the fact that Shanghai traded 1% higher on the news is another anecdotal sign we may be at a bottom in China.

In Europe the economic data was better, as French PMIs jumped back above the 50 level, helping to calm fears of a structural "two speed" EU economy, while the broad EU PMIs signaled a continuation of the recovery.

In Ukraine there was some mild progress over the weekend as Russia agreed to independent observers entering Ukraine to monitor the situation (that's another sign of de-escalation).

Market Recap

Stocks rebounded last week as the Chinese economic growth outlook improved some (thanks to rumored infrastructure spending), the Ukraine situation did not further escalate, and the Fed decision was re-assessed as not "hawkish" as initially thought. The S&P 500 rose 1.3% last week and is up 0.9% year-to-date.

Stocks started the week with a big short-covering rally last Monday, as the Crimean vote to join Russia went as planned. But there was no further movement of Russian troops into Ukraine, and Putin made comments strongly inferring he didn't want to "annex" any more of Ukraine.

The short-covering rally continued Tuesday ahead of the FOMC meeting, but it was Wednesday that saw the most volatility last week. Stocks sold off hard post-FOMC statement thanks to an upward drift in the "dots" and Yellen's "6 month" comment.

But, stocks closed Wednesday well off the lows and rebounded Thursday, as investors realized Yellen wasn't "hawkish" and that expectations for Fed policy remained basically the same as they were pre-FOMC statement (taper of 10 billion per meeting and expected interest rate increases sometime in mid-2015).

Stocks tried to extend the rally Friday and the S&P 500 actually hit a new all-time high intraday (barely). But

Market	Level	Change	% Change
Dow	16,302.77	-28.28	-0.17%
TSX	14,335.76	-26.07	-0.18%
Brazil	47,380.94	102.46	0.22%
FTSE	6542.88	-14.29	-.22%
Nikkei	14475.30	251.07	1.77%
Hang Seng	21846.45	409.75	1.91%
ASX	5346.89	8.81	.17%
Prices taken at previous day market close.			

there wasn't much conviction, and stocks sold off into the weekend and ahead of the Chinese flash manufacturing PMIs which came last night.

Broadly, the market saw a lot of volatility last week but we went "around the world for sport" as they say, as stocks remain largely in this 1,850-1,880 range they've occupied all of March.

Market	Level	Change	% Change
DBC	25.76	.02	0.08%
Gold	1337.00	6.50	0.49%
Silver	20.34	-.09	-0.44%
Copper	2.9505	.02	0.75%
WTI	99.41	.51	0.52%
Brent	107.00	.55	0.52%
Nat Gas	4.32	-.05	-1.24%
RBOB	2.91	.01	0.39%
DBA (Grains)	27.85	-.26	-0.92%
Prices taken at previous day market close.			

Trading Color

The Fed statement was the major catalyst from a trading perspective. It led to a big rally in banks, which hit new 52-week highs on big volume. Semiconductors also continued their significant outperformance this year (the Philly Semiconductor Index is up 10% this year).

Conversely, anything "bond proxy" badly underperformed last week. Homebuilders, consumer staples, utilities and REITs closed slightly negative on the week, as investors are again putting on the "higher interest rate" sector rotation we saw last year.

More generally, volumes and activity remained low last week, and this lack of conviction remains one of the few things the bears can hang their hat on. Volumes on rally days remain decidedly lower compared to days the market sells off (this is generally the case, but it's the fact that every rally comes on very low volumes that has people cautious).

On the charts the situation remains broadly the same. Major support and resistance in the S&P 500 remains 1,883 and 1,850, while 1,870 remains a near-term battleground as well (although not as critical as the two other levels).

This Week

It's a pretty quiet week from an event standpoint. Economically we've already received the critical numbers of the week (Chinese and European PMIs).

Geopolitically, Obama will be traveling through Europe, meeting with NATO and EU officials, and likely will be making multiple speeches on the Ukraine situation. But, rhetoric aside, the situation appears stable for now.

Looking at sector-specific news, we get the second (and more-important) round of bank stress test results Wednesday. (I'm not a bank analyst, but the release last week appears to be a relative non-event.) Meanwhile, things are quiet on the earnings front as the kick-off to Q1 earnings season is just two weeks away. CCL (Tues), CAN and LULU (Thurs) are the only big names reporting this week.

Bottom Line

The biggest investing trend emerging this year is this: **While the overall averages are flat year-to-date, we are seeing some large divergences within various sectors (so it's becoming a "market of stocks" as opposed to one macro-driven "stock market").** SOXX (semiconductor ETF) is up 10.5% year to date, while KBE is up 5% year to date and 13% off the early Feb lows. Conversely, global miners are down 9% and "China" (via the FXI) is down 11%. Point being, very few sectors in the S&P are close to flat. Instead, we have big out performance or big underperformance, and taken all together that equals a flat market. But, it's much more nuanced than that.

Turning to the three risks to the market: Chinese growth concerns have hit materials and Asian stocks, but not the entire market. The Ukraine saga has weighed on European equities (which have underperformed year-to-date) but not the S&P. And, the "hawkish" Fed last week caused a big rally in banks and a drop in "bond proxy" stocks, but didn't weigh down all of the market.

So, I continue to think the strategy for 2014 is much more nuanced than the last two years where the S&P 500 was already up 8% and 11% respectively.

To outperform this year, we need to continue to look for sectors that have positively turning fundamentals at their back (banks via higher net interest margins, natural gas E&Ps via positive supply/demand fundamentals) or where the case can be made for "value" due to specific macro or micro events (retail (RTH), coal (KOL or ACI) and anything "short bonds" (short bond basket of TBT/TBF/STPP/KBE).

Economics

Last Week

The major question for the market remains: "Was the slowdown in economic activity in Dec/Jan largely the result of the awful weather?" Last week the February and March data further implied the answer is "Yes," and that's a good thing for the stock market.

The first two data points from March, the Empire State manufacturing survey and Philly Fed survey, both bounced back from weak February readings. They imply we're seeing a modest bounce-back in manufacturing activity this month in those two regions (again implying the soft Jan/Feb readings were weather-related).

Turning to the FOMC, you know by now the Fed: Dropped its "quantitative" forward guidance and abandoned the 6.5% unemployment and 2.5% inflation thresholds, and replaced them with opaque, "qualitative" forward guidance. Additionally, there was an "upward drift" in the "dots" as 10 of 16 Fed officials believed the Fed Funds rate would be at or above 1% by the end of 2015, compared to 7 in December. Finally, Yellen's "6 months" comment about when rates would start to increase after QE ended was also taken as "hawkish."

But, all that aside, not a lot really changed with regard to the Fed. Tapering is expect to continue at the pace of $10 billion each meeting, and perhaps the expected date of the first increase in interest rates moved slightly forward from July/August 2015 to May/June 2015, but it's not like that is a monumental shift.

Finally, last week's housing data continued to disappoint, as both housing starts and existing home sales missed estimates and remained sluggish. The housing recovery is ongoing, and the data last week again got a "pass" because of weather. But while other measures of the economy have stabilized in Feb/March, the housing recovery continues to lose steam. It's a not a problem yet and likely we'll see stabilization in the coming months, but it remains something to watch.

Market	Level	Change	% Change
Dollar Index	80.23	-.123	-0.15%
EUR/USD	1.3798	.0019	0.14%
GBP/USD	1.6486	-.0007	-0.04%
USD/JPY	102.21	-.04	-0.04%
USD/CAD	.8902	.0025	0.28%
AUD/USD	.9034	.0048	0.53%
USD/BRL	2.3251	-.0028	-0.12%
10-year Yield	2.75	-.025	-0.90%
30-year Yield	3.609	-.051	-1.39%
Prices taken at previous day market close.			

This Week

The most important number to watch this week already passed, as we got the Chinese flash manufacturing PMIs last night (and the European numbers this morning).

But, the March U.S. flash manufacturing PMI comes at 10 this morning, and we'll want to see improvement similar to what we saw in Empire State and Philly last week (so, it doesn't have to recoup all of the Jan/Feb decline, but the market will want to see the number improve, again implying weather was the reason for the steep drop over the past two months).

Outside of the flash PMIs, most of the other economic reports will continue to shed light on whether the dip in economic activity was weather-based. Durable goods, (Wednesday) will be second-most-watched number this week, and jobless claims (Thursday) will also receive some attention for the first time in months. The recent trend has been downward in claims and, if it continues, people will start to think we're seeing incremental improvement in the labor market.

Final Q4 GDP and Personal Income and Outlays come Thurs/Fri, respectively, but they shouldn't move the market much. Finally, we get more insight into housing via new home sales (Tues) and pending home sales (Thurs). As mentioned, housing seems to be the one sector not showing a bounce-back in February. While that's likely weather-related, it'll be encouraging to see some decent data points, especially out of pending home sales.

Commodities

Commodities continued to sell off last week, dropping for the third week in a row. The benchmark commodity tracking index ETF, DBC, fell 0.65% over the course of the week and is now up just 2.3% this year (just barely outperforming the S&P 500).

The big story in commodities last week was copper. Copper futures have been plummeting recently (down 12%

so far this year) , primarily due to concerns surrounding the pace of Chinese economic growth as well as concern about the practice there of Chinese industrial companies using physical copper as collateral for loans. So, copper has become a "quasi" China-proxy.

Despite the declines, it appears copper futures are trying to bottom just under the $3.00 level, and while it's still early, it's encouraging that copper isn't selling off hard in the face of the soft China flash PMIs. Copper futures were able to post a marginal gain last week, up 0.15%—that was the first weekly rally of the month, and obviously a step in the right direction for the bulls. The level to watch now is last week's low tick of $2.877, as that level should not be violated if copper and China have bottomed. If we see this recent bottom hold, there will very likely be an opportunity in both copper and potentially Chinese equities. However we will need to continue to watch both markets closely as well as the economic data before opening positions in either market.

The energy space was quiet last week and, although WTI traded down to a multi-week low, it finished the week slightly higher, up 0.16%. Our expectation over the near term is for more sideways and range-bound trading. However, it is worth noting that if economic growth in the U.S. can grind higher like some leading economic indicators are calling for (such as weekly jobless claims being at multi-month lows), then we will inevitably see crude oil prices climb toward the $110/bbl level.

In precious metals, gold futures finally saw a correction, falling 4% last week on a combination of a stronger dollar (courtesy of the "hawkish" interpretation of the FOMC and on reduced tension in Ukraine). Gold prices found support at the 50-day moving average, which lies at $1,321.70, and that should be considered support for the near term. Fundamentals for gold remain constructive, though, and I'd be a buyer on this dip (cautiously at these levels, and more aggressively towards $1300).

Currencies & Bonds

The Dollar Index was strong last week, as it rallied 0.8%, with most of the gains coming Wednesday courtesy of the "hawkish" Fed surprise, although the dollar wasn't universally stronger on the week.

The euro was the weakest major currency vs. the dollar last week, as an overcrowded "long euro" trade was reversed after the Fed statement and press conference.

Prior to last week, most analysts would have said euro strength vs. the dollar was almost a foregone conclusion given the ECB's reluctance to ease policy further even in the face of a growing dis-inflation/deflation threat. They never factored in the Fed being more "hawkish" than expectations, and that caught people by surprise.

I expect the dollar/euro to remain largely range-bound for the foreseeable future until either central bank begins to change the current course of expected policy.

The yen also declined last week, but not by as much as you'd think. Until we get some resolution on when (and if) the BOJ will move to ease policy further, I don't expect a significant resumption in the downtrend in the yen (although I do expect the BOJ to do "more" so the short yen trade still has legs, but we have to be patient).

Commodity currencies were also on the move last week. First, the Aussie was the only major currency to finish the week higher vs. the dollar, as the RBA meeting minutes showed it is indeed "on hold" from a policy standpoint. Conversely, the Loonie very quietly traded to a 4.5-year low last week, thanks to dollar strength post-FOMC and after BOC governor Poloz said he expected economic growth in Q1 in Canada to likely be worse-than-expected.

Turing to bonds, the 10-year Treasury yield rallied from 2.67% last week to 2.75%, and if/when it breaks 2.80%, I'd expect the bond sell-off to accelerate a bit. But again, I don't think last week's FOMC meeting drastically will accelerate the decline in bonds/rise in yields, and expect declines will be gradual and "stair step." So, these levels remain attractive to initiate or add to short bond positions, as no one "missed" anything last week.

Have a good week,

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 continues to bounce between 1850 and 1880 as geo-political and China concerns are a headwind, 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 1880.*

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.**