7:00's Report

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

March 27th, 2014

Pre 7:00 Look

- Futures are higher while international markets were mixed o/n.
- Despite the "chatter" this morning about Russia/Ukraine the situation remains mostly static (not a material negative on risk assets).
- Economically it was a quiet night, as UK retail sales (which handily beat expectations) were the only material release.
- Banks are in focus this morning but the stress test results shouldn't be a major catalyst in the market today (outside of the banks).
- Econ Today: Final Q4 GDP (E: 2.7%), Weekly Jobless Claims (E: 323K), Pending Home Sales Index (E: -0.8%). Fed Speak: Pianalto (8:30 AM), Evans (9:30 PM)

Market	Level	Change	% Change
S&P 500 Futures	1846.00	3.50	0.19%
U.S. Dollar (DXY)	80.28	.111	0.14%
Gold	1295.8	-7.60	-0.58%
WTI	100.40	.14	0.14%
10-year	2.701	-.034	-1.24%

Equities

Stocks saw decent declines yesterday as "momentum" sectors remained heavy and eventually pulled the entire market down during the afternoon session. The S&P 500 declined 0.7%.

Stocks opened higher yesterday thanks to a better-than-expected durable goods headline, but quickly reversed and traded just above the flat for the better part of the morning. Then, shortly after 1 p.m., higher beta indices (Russell and Nasdaq) turned negative and stocks accelerated downward throughout the afternoon and closed on the lows of the day (all closed literally on the low tick of the day).

The Russell 2000 decisively broke through the 50-day moving average yesterday and closed at session lows.

There was no clear-cut single reason for the midday breakdown in stocks, but there were several potential catalysts. First, as mentioned, the "momentum" stocks that have gotten hit so hard over the past 2 weeks still couldn't bounce, and when NBI and QNET started to accelerate to the downside, that made people take notice. Second, we're four days from the end of the quarter, and no one wants to be a hero in this market at this point, so as a result we're not seeing normal support come in on sell offs. Third, Russia/Ukraine was blamed (although I don't think that had anything to do with it personally as that situation remains mostly static). President Obama's speech yesterday in Brussels contained generic threats to issue further sanctions on Russia. And there were reports of further military movement in western Russia (although again I think the "reason" for the sell off was much more due to weakness in momentum sectors and because of the calendar rather than geo-politics, not that it makes the declines any better).

Trading Color

Market	Level	Change	% Change
Dow	16,268.99	-98.89	-0.60%
TSX	14,184.10	-115.39	-0.81%
Brazil	47,965.61	-214.53	-0.45%
FTSE	6,579.23	-26.07	-0.39%
Nikkei	14,622.89	145.73	1.01%
Hang Seng	21,834.45	-53.30	-0.24%
ASX	5,350.09	-26.66	-0.50%
Prices taken at previous day market close.			

The exodus out of "growth" and into "value" continued yesterday., and the Nasdaq and Russell both traded very heavy and are now both below their respective 50 day moving averages for the first time since early February.

Market	Level	Change	% Change
DBC	25.92	0.00	0.00%
Gold	1303.10	-8.30	-0.63%
Silver	19.75	-.229	-1.15%
Copper	2.964	-.0415	-1.38%
WTI	100.28	1.09	1.10%
Brent	106.95	-.04	-0.04%
Nat Gas	4.402	-.009	-0.20%
RBOB	2.9035	.0207	0.72%
DBA (Grains)	28.12	.07	0.26%
Prices taken at previous day market close.			

Looking to sector trading, materials, financials, industrials and technology all underperformed, with materials standing out as the worst-performing components of the S&P. Value and defensive names relatively outperformed as consumer staples and utility outperformed. Energy stocks also outperformed thanks to a decent rally in both crude oil and RBOB gasoline futures prices.

Volumes and activity yesterday were elevated compared to earlier in the week, although I wouldn't define the selling as "heavy" or convicted.

On the charts the S&P 500 is now sitting at the lower end of the March range (1850). If that level is broken decisively, expect selling to accelerate.

Bottom Line

Headlines from the financial media this morning seem intent on placing the blame for yesterday's sell off on "Russian/Ukranian" tensions, but I don't think that's accurate and the bigger issue with the market is this exodus out of growth stocks. The two week dive we've seen in the momentum stocks is making people nervous, so the key in the short term for this market remains the stabilization of "growth" largely and those "momentum" sectors (NBI and QNET). Those are two indicators we need to watch going forward.

The breakdown in the Russell 2000 is starting to get me a bit nervous in the short term, but given the calendar and impending quarter end, I'm hesitant to take out any material protection unless we see a further breakdown of the S&P out of that 1850 range and through its 50 day moving average (1833.66).

Economics

Durable Goods Orders

- New Orders for February jumped 2.2% vs. (E) 1.0%
- Non-defense Capital Goods Ex-Aircraft fell by 1.3% in February from a downwardly revised figure of 0.8% in January.

Takeaway

The headline February durable goods report was strong and beat estimates, but in classic "durables" fashion, the headline was misleading. A large airline order skewed the data in February, and the details of the report were actually disappointing (and quite weak). First, the January report was revised lower to -1.3% from 1.0%. Second, the key number in this report (new orders for Non-Defense Capital Goods Excluding Aircraft, or NDCGXA) declined 1.3% in February, and the January gain was cut basically in half (1.5% to 0.8%).

NDCGXA is the "best" look at capital spending and fixed investment from businesses (durables in some ways are a proxy for non-residential fixed-asset investment in the GDP report). The bottom line is that it remains tepid in Q1 2014, confirming some of the recent sluggishness we've seen in the manufacturing indices.

While winter weather will be used as an excuse—and it's clear the manufacturing sector didn't see activity fall off a cliff the way December and January data implied—business is definitely on the slow side. It'll need to pick up in the spring if we're going to see the expected acceleration in economic activity over Q2.

Commodities

Commodities were mostly lower yesterday, led down by the industrial metals (which all fell more than 1%), while crude oil and RBOB gasoline broke out to the upside going into the end of the trading session. The PowerShares DB Commodity Index Tracking ETF (DBC) was flat for the second day in a row.

Crude oil and RBOB gasoline were the big winners in the commodity space yesterday, rallying 1.1% and 0.72% thanks to a deceiving EIA report. The headline supply data showed that crude oil stockpiles rose by +6.6M barrels vs. (E) +2.8M barrels. RBOB gasoline supply levels fell by -5.1M barrels vs. (E) -1.3M barrels. And lastly, distillate (heating oil) supplies grew by +1.6M barrels vs. (E) -1.3M barrels. (Note that the impact of the Houston Ship Channel closure and this week's late-season snowstorm were not reflected in yesterday's inventory report.)

The "surprise" within the details of the report was two-fold. First, inventories of crude oil at the WTI delivery point (Cushing, Okla.), which is where crude from Nymex futures contracts is delivered from, fell 1.33M barrels to a fresh two-year low (bullish supply influence). Secondly, gasoline demand surpassed 9 million barrels a day for the first time in 2014 (bullish demand influence). Both of these factors are closely watched by traders, hence the rally in both WTI and RBOB futures.

On the charts, crude oil futures posted an impressive rally in the last 15 minutes of the session, trading to a 2-week high but failing to close above resistance at the 200-day moving average at $100.36/bbl. So, the story remains the same: WTI continues to trade range-bound with a bias to the upside, with the potential to revisit recent resistance levels between $103-$105. Support lies below at $99.31.

Elsewhere in energy, trading in natural gas cooled off yesterday as futures fell 0.2% to $4.402 after rallying the most in 3 weeks on Tuesday. The drop in prices was again weather-driven, as forecasts predict mild temperatures for the foreseeable future. And, at the risk of sounding like a broken record, the elevated prices continue to support FCG and XOP.

Moving to the metals market, there was broad weakness yesterday but the industrial metals were under the most pressure. Copper, silver and palladium fell 1.38%, 1.15% and 1.11%, respectively.

Copper gave back the $3.00 level yesterday as investors continued to show concern over the Chinese economy and traders booked profits on short-term long positions. The "fear bid" that came into the market on Tuesday, because of a riot at a copper mine in Chile, continued to unwind. This led an increasing number of speculative longs to close positions yesterday.

Copper is still well off of last week's lows, pinned between that low tick of $2.877 and the psychological $3.00 level. Copper futures are still trading as a proxy for the health of the Chinese economy. Until we get a decisive or influential piece of news or data, it will likely remain there. Technically, futures have logged six-consecutive "higher lows" in a row, though, which is favorable for the bulls.

Gold has broken through the $1300 level overnight, and is threatening to break major support. Given gold's volatility, I'm hesitant to close long positions on an overnight break, but if gold can't get back above that $1300 support level during trading today, or worse moves to $1290 or below, I'll exit my gold longs, as clearly the situation will have changed. Incidentally, gold's inability to rally yesterday (and this morning) was another reason that I don't think "Russia or Ukraine" had anything to do with yesterday's sell off in stocks. If the market were legitimately worried about the Ukraine, gold would have rallied—and it did not.

Currencies & Bonds

Currency markets remained pretty subdued yesterday, although outside of the euro, there was an undercurrent of dollar weakness (thanks in part to the soft durable goods data).

The Dollar Index managed to eke out a gain yesterday (0.1%) thanks primarily to weakness in the euro (down 0.2%), as the ECB officials' dovish rhetorical assault on the currency Tuesday continued to weigh slightly.

Market	Level	Change	% Change
Dollar Index	80.14	.052	0.06%
EUR/USD	1.3791	-.0034	-0.25%
GBP/USD	1.6584	.0057	0.34%
USD/JPY	102.04	-.22	-0.22%
USD/CAD	1.1104	-.0061	-0.55%
AUD/USD	.9225	.0062	0.68%
USD/BRL	2.306	-.0048	-0.21%
10-year Yield	2.701	-.034	-1.24%
30-year Yield	3.551	-.028	-0.78%
Prices taken at previous day market close.			

But, as I've already covered, don't expect that rhetoric to lead to a material decline in the euro anytime soon. That's because the market is demanding action, and so far the ECB has proven unwilling to act further (rhetoric aside).

Excluding the euro, though, there was broad-based dollar weakness (albeit minor) as the pound, yen and Aussie all rallied vs. the greenback. The pound was higher ahead of some economic data released this morning (short-covering after the dip of the last few weeks), while the yen was drifting higher as stock markets turned lower (kind of a mild "risk off" move).

The Aussie was again the big mover yesterday. It continues to benefit from the rebound in all things China-related (industrial miners, FXI, etc.), and after RBA Chief Glenn Stevens didn't "talk down" the Aussie at annual testimony on the economy. That was a bit surprising, but he wasn't exactly "hawkish" either, and he played down inflation risks and did say the trajectory of the Aussie was concerning.

But, the reaction in the Aussie reflects how "short" the market is, and for now the pain trade remains higher in the Aussie, even if the fundamentals don't agree. However, based on fundamentals, I believe "legging into" an Aussie short at these levels remains a trade that, over time, will be profitable.

Bonds bounced a bit yesterday (the 10- and 30-year rallied 0.3%) on the weaker stock market and soft durable goods number. Bonds more broadly continue to consolidate recent data and FOMC news. It's process I think will continue for a bit longer, but one that ultimately represents more of an entry point for "bond short" positions for anyone with a time horizon longer than the very short term.

The dollar 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 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.**

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 & Add Around $1300: **Gold has broken through $1300 this morning, and unless it can trade back above that level today (or trades down through $1290), then I'll look to exit my long positions as the outlook for gold will have changed materially.**

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.**