7:00's Report

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

March 3rd, 2014

Pre 7:00 Look

- Futures and international markets are sharply lower as concerns regarding the Ukraine weigh on risk assets.
- Ukrainian concerns are overshadowing a decent night economically. In China, the official February manufacturing PMI slightly beat estimates at 50.2 vs (E) 50.0, importantly staying above the 50 level.
- In Europe the February manufacturing PMIs were universally better than expectations.
- Econ Today: ISM Manufacturing Index (E: 51.9), Personal Income and Outlays (E: 0.2%).

Market	Level	Change	% Change
S&P 500 Futures	1838.50	-19.00	-1.02%
U.S. Dollar (DXY)	79.865	.145	0.18%
Gold	1344.10	22.50	1.70%
WTI	104.33	1.74	1.71%
10-year	2.658	.016	0.61%

Equities

Ukraine Update

Futures and international markets are lower this morning on geo-political concerns regarding events in Ukraine, but despite the hundreds of headlines over the weekend, the situation remains largely the same as it was Thursday night/Friday morning.

Russia has basically taken control of the Crimean Peninsula in Ukraine without a shot being fired, a process that started on Thursday. Over the weekend, both Russia and Ukraine escalated rhetoric (Ukraine said it was mobilizing for war) but really at this point they are caught in a stare down, waiting for one or the other to blink (the Ukrainians blink by shooting back, the Russian blink by fully invading unprovoked).

Internationally, the response has been largely symbolic. Western leaders are yelling at Putin but nothing material has been done, except members of the G-7 have "stopped preparations" for the G-8 meeting in Sochi. And, despite Putin appearing to have the upper hand, this move hasn't come without costs to Russia—the Ruble hit a new all time low versus the dollar and the Russian stock market fell 9% Monday.

The bottom line is that while Putin's motives for the incursion into Crimea are unclear (Merkel said he is in "another world") at this point the situation hasn't really escalated since Thursday night/Friday morning, and with the international community now mobilizing diplomatically, the most likely outcome is that the situation gradually defuses itself. In its current state, while it's weighing on risk assets today, this isn't something that should materially alter the outlook for risk assets.

Market Recap

The S&P 500 traded to a new all-time high last week as better-than-expected economic data and retail earnings, combined with still-skeptical sentiment, resulted in a "squeeze" higher in the averages on Thursday and Friday. The S&P 500 is up 0.6% year-to-date.

Stocks started last week strong, as the S&P 500 finally broke above the critical 1,850 level a week ago today. But the move didn't have a lot of conviction to it, and the index wasn't able to close above 1,850 until Thursday. There was follow-through buying on Friday, but it again came on low volumes and little conviction. Plus, de-risking into the weekend amid an evolving situation in

Market	Level	Change	% Change
Dow	16,321.71	49.06	0.30%
TSX	14,209.59	-5.15	-0.04%
Brazil	47,094.40	-512.35	-1.08%
FTSE	6,714.58	-95.12	-1.40%
Nikkei	14,652.23	-188.84	-1.27%
Hang Seng	22,500.67	-336029	-1.47%
ASX	5,384.33	-20.49	-0.38%
Prices taken at previous day market close.			

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the Ukraine contributed to stocks closing well off their best levels.

There were plenty of "reasons" for the rally. I already mentioned the data and retail earnings, but stocks also benefited from negative news in China (the yuan was down big last week and the Shanghai market fell 2.7%) and in the Ukraine (because it was treated as a "local" problem). These negative headlines didn't cause sell-offs across other equity markets. So, think of it as proof that these events last week didn't pose any "contagion" risk. (We'll have to see if that holds true again this week.)

Market	Level	Change	% Change
DBC	26.11	.07	0.27%
Gold	1323.70	-8.10	-0.61%
Silver	21.18	-.172	-0.81%
Copper	3.1885	-.0125	-0.39%
WTI	102.53	.13	0.13%
Brent	108.95	-.01	-0.01%
Nat Gas	4.601	.09	2.00%
RBOB	2.7898	.028	1.01%
DBA (Grains)	27.35	.20	0.74%
Prices taken at previous day market close.			

But, the true reasons for the rally were positioning and negative sentiment causing a low-volume squeeze higher. And, given that, whether we get any material follow-through will be an important factor this week.

Trading Color

Cyclical indices confirmed the new highs last week in the broader market, as the Russell 2000 hit a new all-time high on Wednesday, while the Nasdaq traded to a new multi-year high. The Dow Industrials continue to lag and remain about 250 points from a new all-time high.

Sector-wise there was an interesting occurrence last week. Late in the week, despite the new highs, we saw a rotation out of the year-to-date "leaders" and into the year-to-date "laggards."

Retail stocks were the big winners last week (and the entire month of February). Homebuilders and banking stocks all outperformed as well, while utilities, semiconductors, "cloud"-based stocks and bio-techs all badly underperformed late in the week (and especially Friday). So, it's fair to say investors were booking some profits and re-allocating to more "beaten-up" areas of the market.

On the charts, the S&P 500 broke through 1,850, and the new intra-day high sits at 1,867. Support lies much lower at 1,820 (the 50-day moving average).

Bottom Line

Last week was a mixed bag: On one hand, markets made a new high, which regardless of the "reasons" or "conviction" is a very positive thing. Historically speaking, markets don't break from their highs (they break from a failure at those highs, which is why everyone was watching 1,850 so closely).

But, these new highs have come on very, very low volume and little conviction—meaning that investors aren't enthusiastically piling into stocks and materially adding long exposure. Most of the gains in the averages over the past two weeks have come via ETF and futures buying, not individual stocks (which implies buyers are more "renting" long exposure than they are committing to it).

So, does this mean we shouldn't "believe" the rally and de-risk? No. This absurdly resilient rally remains one of the most-hated I've ever seen in my decade-plus in the business. Last week's new highs seemed to be met with more groans than cheers. In the short term, the "pain trade" remains higher still, as skepticism of this rally remains very, very high.

What the low volumes and activity levels do mean, though, is that adding blanket long exposure at these levels may be a bit risky. Instead, the better play would be to selectively add long exposure to sectors that have underperformed and offer a bit of "value" and "catch up" potential, should the market break either way in the short term.

That worked with the retailers, which were left for dead two months ago, and it's starting to work for banks. I've said multiple times that selling bonds here is the idea that makes the most sense to me, and if I'm right about that and bonds once again start to decline and yields begin to rise, then we should see the banks play "catch up" in a big way.

Economics

Last Week

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Economic data was better-than-expected last week and helped further break the previously relentless string of "misses" versus expectations. And, although economic data was somewhat overshadowed last week by events in the Ukraine and as investors looked ahead to the critical week of data looming, there were some important anecdotal releases that imply the drop-off in economic data we saw in December/January is leveling off. That helped stocks rally to new all-time highs.

New home sales data were shockingly good, rising to 468K saar, a multi-year high (and the highest level since the economic recovery started). But, while the number was much better-than-expected, it was driven higher by big sales gains in the Northeast and South. Seeing as they were the hardest-hit regions weather-wise in January, it doesn't exactly reinforce the "weather" explanation for all the other disappointing data.

Regardless, the market liked the report and homebuilders caught a bounce because of very low new home inventories and strong pricing going forward. Looking beyond this one positive report, though, most of the January housing data showed the recovery is continuing to lose positive momentum. It'll be very important for the longer-term health of the market and the economy to see the housing data stabilize once the weather "noise" is out of the reports.

Durable goods was the other notable release from last week, as the key "New Orders of Non-Defense Capital Goods ex-Aircraft" rose 1.8%, after the December number was revised lower from –0.6% to –1.7%. The market also welcomed this number, as it implies we're not seeing the very steep drop-off in capital expenditures from businesses that the January durable goods repot implied.

Finally, the most-effectual piece of data from an investment standpoint last week came from Europe. The February flash HICP (their CPI) saw "core" HICP rise 1.0% year-over-year in February, higher than the 0.8% that was expected. That's important because it almost certainly removes any chance that the ECB will take further accommodative action at this week's meeting (or beyond that, for the foreseeable future). And, that is a continued positive for the euro and high-yielding European bonds, which remain my favorite destination for any fixed income capital that can stomach some degree of risk.

Turning to the Fed, Janet Yellen gave the Senate portion of her "Humphrey-Hawkins" testimony Thursday, after the initial date was postponed by weather. The testimony was expected to be a non-event, as everyone assumed she would largely repeat what she said at the House testimony two weeks earlier, and it met those expectations.

Yellen again reiterated that the Fed's strong preference is to continue tapering QE, although it's not on a "pre-set course." And, weather has played a role in the recent disappointing data, but to what extent isn't clear. Bottom line is the outlook for Fed policy remains the same: It will take seriously weak data this week to get the Fed to delay further tapering of QE at the March meeting.

This Week

Economically this is the most important week of the year, plain and simple. And, it's important because we are going to get a lot more insight into the two critical "macro" questions the market is currently facing: Was the dip in U.S. economic activity the past two months mostly due to weather? And, is the Chinese economy stable, or is it contracting further? Where the market goes in the coming weeks will depend on both answers.

Starting with the global manufacturing PMIs, we've already gotten the Chinese PMI (it beat expectations and importantly stayed above the 50 level) and the European data, while the U.S. report comes at 10 AM this morning. Global composite PMIs (both service sector and manufacturing) are released Tuesday night in China and Wednesday morning in the EU and U.S.

Market	Level	Change	% Change
Dollar Index	79.735	-.571	-0.71%
EUR/USD	1.3816	.0108	0.79%
GBP/USD	1.6746	.006	0.36%
USD/JPY	101.70	-.41	-0.40%
USD/CAD	1.1073	-.0045	-0.40%
AUD/USD	.8919	-.0042	-0.47%
USD/BRL	2.3444	.0227	0.98%
10-year Yield	2.658	.016	0.61%
30-year Yield	3.592	-.004	-0.11%
Prices taken at previous day market close.			

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In addition to getting the latest insight into the state of the global economy, it's also jobs week here in the U.S. ADP comes Wednesday, jobless claims and Challenger layoff survey is Thursday, and then the all-important government jobs report is Friday morning (early estimate is for 150K).

This jobs report, and to a slightly lesser degree the PMIs later this morning, are the doves' last chance for the data to alter the outlook for Fed policy. If the jobs numbers remain low (say another sub-100K print with the December/January numbers unrevised), then the outlook for a further tapering of QE in March will be called into question, although I personally think the data will have to be pretty bad to "taper the taper." But, if there's a chance for it to happen, it's going to be this week.

There is also a Bank of England and ECB meeting Thursday morning, although given events of last week (the EU HICP) neither bank is expected to alter policy. Both meetings should be relative non-events.

Bottom line is we will have a lot better insight into the state of the U.S. and global economy at the end of this week, and how those economies "look" will dictate which direction equity markets trade over the coming weeks, regardless of what happens in the Ukraine.

Commodities

The weaker dollar, down 0.6%, was not enough to help the Commodity Tracking Index ETF, DBC, to rally for a fourth week in a row as DBC slipped 0.27% on the week.

The big story in commodities last week was natural gas as the futures price fell nearly 30% from the fresh multi-year highs established early in the week. The reasons for the decline was two fold: First, the March contract expired and "rolled" into April, forcing speculators to sell early in the week. Second, natural gas has simply got massively overbought, and as weather forecasts turned slightly warmer, weak longs were quick to sell. But, more importantly, the fundamentals of natural gas are bullish as the term structure remains in backwardation, supply levels are extremely low historically (30% below the five year average), and winter is not over just yet. So we can still expect cold weather to continue to support demand. Technically, natural gas futures bounced off a supporting trend line very nicely on Friday (chart in Friday's issue), and it looks at though natural gas may have found an interim bottom.

Elsewhere in energy, crude oil grinded higher for the seventh week in a row and traded to a new 4.5-month high last week. WTI crude oil futures gained 0.46% on the week although the market was relatively quiet and more broadly we can expect crude to continue to oscillate in a broad range with the 200-day moving average acting as support at $99.85 while there is resistance above between $104-$105.

Moving to precious metals, gold eked out a marginal gain of 0.23% last week and also traded to a fresh four-month high. Gold is now up 7.4% year-to-date. Gold futures have benefited from multiple different events this year including emerging market turmoil, weak economic data, and most recently the evolving crisis in the Ukraine. I remain cautiously bullish on gold but would prefer to buy dips on this geo-political rally, as they have tendency to fade. On the charts we are looking at the first line of support around $1,320 while resistance hovers above toward the $1,360 area.

Currencies & Bonds

The Dollar Index declined last week and closed below the 80 level for the first time since October, thanks mostly to strength in the euro following the better than expected HICP reading. The yen also rallied versus the dollar last week, thanks to decent economic data (CPI was in-line), further muddying the debate regarding when, and if, the BOJ will ease further (I continue to believe they will).

We are seeing a definitive "Risk off" trade in currencies this morning, as the Dollar Index and yen are climbing, thanks to geo-politics. Treasuries are also sharply higher on Ukraine concerns, squeezing shorts, although if the situation doesn't further escalate, this Treasury rally should stall. Ukrainian developments aside, all major currencies and Treasuries will trade off the economic data and the ECB meeting later this week, and beyond the very short term, those are the key influences we need to watch. Have a good week—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 traded to a new all time high last week, although the gains came on low volumes and with little conviction. But, the 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.* *Resistance is now the all time highs at 1867, while support is the 50 day MA at 1820.*

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. Now, the banks seem to be the sector that has lagged recently, and if the market continues to rally, we should see them play catch up. KBE remains one of the "easiest" ways to get broad bank exposure.**

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 Deep, multi-national Cyclicals and Global Miners: **Domestically, I'd look to allocate to deep cyclicals like industrials (XLI), basic materials (IYM) and global industrial miners (PICK). It's a bit of a contrarian idea, and over the past few weeks these sectors have lagged. But, they most exposed to the "global economic recovery" thesis.**

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 Industrial Commodities: **Industrial commodities have stalled lately, as economic data, especially in the US, has shown a loss of some positive momentum, and it bears close watching as to whether this is a temporary blip, or a bearish game changer. But, if you believe the global economy Is recovering, the commodity space, and the ETF DBC, is one of the best "values" in the market, and a pretty contrarian idea right now.**

Long Gold: **Gold has now broken out above resistance at $1300/oz., as gold has benefitted from the recent dollar weakness due to soft economic data. Short term I'd only nibble above $1300 on the long side and feel more comfortable around the mid-$1200's, but it appears as though a longer term bottom is "in" in gold.**

	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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	**Bearish**	**Bearish**	**Bearish**	*Treasuries are stalemated in the short term as weak economic data is supportive, but the Fed clearly favoring continued tapering of QE, baring a big drop in economic data, has caused the counter trend rally to stall. Longer term, though, fundamentals remain negative and I view current levels as great entry points for short bond positions.*

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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