7:00's Report

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

March 31st, 2014

Pre 7:00 Look

- Futures are drifting modestly higher on the last day of the quarter after a pretty quiet weekend.
- The big number o/n was EU flash HICP for March, which came in at a multi-year low (0.5% yoy vs. (E) 0.7%). That's furthering deflation worries and calls for the ECB to ease policy, but the euro is actually higher this morning as last year's early Easter likely skewed the data.
- Geo-politically, Kerry and Lavrov met Sunday, but no real progress was made other than to have more talks.
- Econ Today: No reports. Fed Speak: Yellen (9:55 AM EST).

Market	Level	Change	% Change
S&P 500 Futures	1855.25	4.75	.27%
U.S. Dollar (DXY)	80.24	-.095	-.12%
Gold	1294.80	.50	.04%
WTI	101.33	-.34	-.34%
10-year	2.712	.04	1.50%

Equities

Market Recap

Stocks ended last week slightly lower as an implosion in "momentum" sectors and a broader rotation out of "growth" weighed on the entire market. The S&P 500 is now up 0.5% year-to-date.

Stocks started last week broadly lower, thanks to a nasty sell-off last Monday in biotechs and specific sub-sectors of tech (cloud computing and Internet stocks). Those sectors had been market leaders (and massive outperformers) for months, and their breakdown raised questions about whether the entire market is about to roll over.

And, their inability to generate even a dead-cat bounce after the Monday drop (which was really an acceleration of two weeks of pressure) sent stocks to a two-week low by Thursday, and the S&P 500 traded to the lower end of the month-old 1,880-1,850 trading range.

Sellers in those momentum sectors (NBI and QNET are two good proxies to monitor as we start the week) finally showed some signs of exhaustion late Thursday. Markets were able to register a bounce on Friday to cut the weekly losses basically in half.

Looking at some market color, the big story was this large rotation out of anything "growth"-oriented and into lower-beta "value" sectors. Although the S&P 500 was off small last week, the Nasdaq and Russell 2000 fared less-well, making last week's trading look worse than the S&P 500 headline move implies. The Russell 2000 dropped 3.5% last week while the Nasdaq dropped 2.8%; both traded basically to two-month lows and broke through their 50-day moving averages to the downside.

While some of the market internals were pretty bad, from a volume and activity standpoint, there were some silver linings. Selling throughout the week wasn't panicked (outside of those aforementioned momentum sectors), and a lot of the broader-market declines were the result of buyers not willing to step into the dips, as opposed to aggressive de-risking.

Part of that may have to do with the calendar (the quarter ends tomorrow, and there's no reason to be a hero and step into a falling market when you can do it in a new quarter in a few days). The point being, despite the declines, we're not seeing a lot of urgency in the selling,

Market	Level	Change	% Change
Dow	16323.06	58.83	.36%
TSX	14260.72	81.88	.58%
Brazil	49768.06	121.27	.24%
FTSE	6622.92	7.34	.11%
Nikkei	14827.83	131.80	.90%
Hang Seng	22151.06	85.53	.39%
ASX	5394.83	27.89	.52%
Prices taken at previous day market close.			

which is positive.

On the charts the situation remains the same: The range for the last month in the S&P 500 has been (generally speaking) 1,880-1,850. Until we break out of that decisively, the charts in the short term remain neutral. The 50-day moving average in the S&P 500 sits at 1,834, and that remains a rather large line in the sand to monitor.

Market	Level	Change	% Change
DBC	26.14	.01	.04%
Gold	1294.50	-0.30	-.02%
Silver	19.83	.12	.62%
Copper	3.04	.047	1.57%
WTI	101.67	.39	.39%
Brent	107.98	.15	.14%
Nat Gas	4.47	-.06	-1.45%
RBOB	2.9295	-.009	-.34%
DBA (Grains)	28.43	-.02	-.07%
Prices taken at previous day market close.			

This Week

It's a fairly straightforward and busy week. Economically there's a lot of important data highlighted by the PMIs and March jobs report. Fed-wise, Fed Chair Janet Yellen speaks later this morning, and expectations are she'll dial back the "6 months" comment.

Geopolitically, Russian Foreign Minister Sergei Lavrov and Secretary of State John Kerry met yesterday, and the massive amount of Russian troops on the Ukrainian border is keeping people focused on the situation. But, unless there's an invasion (and the Russians said multiple times this weekend there won't be an invasion), markets shouldn't react all that much.

Turing to the microeconomic landscape, AA kicks off earnings season next Tuesday, so be on the lookout for any negative earnings pre-announcements, as this is when they usually start coming (shortly after the start of a new quarter).

Bottom Line

The S&P 500 continues to run in place, as it's done all year, and the market remains much more "micro" driven than "macro" driven.

The two dominant macro factors in the market currently, Chinese economic growth and Russia/Ukraine, remained static last week. Chinese economic data disappointed, but chatter about more stimulus and Chinese officials "defending" economic growth helped settle nerves about a Chinese "hard landing."

In Russia, troops are massing on the Ukrainian border, but until they move into Ukraine, the situation simply isn't a negative for stocks.

While the S&P 500 was flat last week, there were again large divergences in sector trading. You know about the implosion in the momentum biotechs and Internet/cloud stocks. But to make the broader point, the S&P 500 Low Volatility Portfolio ETF (SPLV) rose 0.05%, last week while the S&P High Beta Portfolio ETF (SPHB) fell 1.6%. That's a pretty big discrepancy, if you follow those two ETFs (as I do). So, point being, this remains much more a "market of stocks" rather than a "stock market."

I maintain that sector selection is the key to outperformance in this market, and I continue to like coal and natural gas E&P ETFs (KOL, ACI, XOP and FCG), all of which were positive last week.

Banks, which got hit on a "sell the stress test results news" move late last week, are again looking attractive, while Europe has also piqued my attention. (I'm going to flesh this out later this week, but re-visiting the "long Europe" or "long Europe/short U.S." pair trade is something I'm thinking of doing in light of recent ECB events/commentary, but I want to do a bit more research first.)

The question of whether this dumping of the momentum stocks is forecasting a broader market decline remains a legitimate one that needs to be watched, but right now the answer is "no."

If you're getting a bit nervous about the market here, consider hedging some of your sector trades with a short S&P position. The S&P 500 has been flat year-to-date, but as we've discussed, good sectors have hugely outperformed. In other words, you could still produce decent returns and be able to sleep at night, in the event of some macro "risk off" surprise.

Economics

Last Week

I'm not going to spend a lot of time recapping the economic data of last week, because the key question for the market remains "Was the dip in economic activity in Dec/Jan mostly weather-related?" While last week's data did further imply the answer is "yes," this week is critical and it'll give us much greater insight into a final answer. (So, whatever we learned last week will have a shelf life of about another day.)

That said, though, I do want to point out that China's flash PMI was slightly weaker than estimates, but everyone is expecting stimulus from Chinese authorities. As long as economic activity doesn't collapse, then it's not a huge negative on stocks.

U.S. flash manufacturing PMI for March slightly missed expectations (55.5 vs. 56.9) but, more importantly, it remained well above the January "weather induced" low print of 53.7.

The most interesting/important number last week was actually weekly jobless claims. The 4-week moving average dropped to 317K, the lowest level since October (and that wasn't a true read because of the government shutdown). So, we are looking at multi-year lows in jobless claims, which implies we are seeing improvement in the labor market. This should put some upward pressure on expectations for Friday's jobs report. No one is expecting the labor market to improve from current levels in the near future—if it starts to, that could be a nice tailwind for equities.

Finally, last week we got a litany of housing reports: new home sales, pending home sales, FHFA Home Price Index, Case-Shiller Home Price Index, etc. The collective takeaway is that the recovery in the housing market is still slowing, both from a sales activity standpoint and price standpoint. But, importantly the recovery is still ongoing (it's just still losing steam). But it would be nice to see the housing data "bounce" from the winter dip like other economic metrics have. Until it does, it'll remain something to keep an eye on.

Market	Level	Change	% Change
Dollar Index	80.345	.093	.12%
EUR/USD	1.3752	.0002	.01%
GBP/USD	1.6629	-.0006	-.04%
USD/JPY	102.80	.01	.01%
USD/CAD	1.1058	-.0002	-.02%
AUD/USD	.9024	0.00	0.0%
USD/BRL	2.2612	.0023	.10%
10-year Yield	2.712	.04	1.50%
30-year Yield	3.544	.034	.97%
Prices taken at previous day market close.			

This Week

This is a very busy week and importantly it could end the argument on whether or not the Dec/Jan dip in economic data was almost entirely weather-related. (The "yes" answer to that question is mostly priced into the market at these levels, so the risk is for a negative surprise this week, if anything.)

Tomorrow we get the official global March manufacturing PMIs, and the Chinese data will be key. Staying above 50 is important, and although most people expect Chinese authorities to help stimulate the economy at some point this year, a dip below 50 on the official PMI will not be a good thing. It won't elicit a "bad news is good" reaction without some announcement or hard foreshadowing of actual stimulus.

Global composite PMIs (Wednesday night/Thursday morning) will also be watched, again more so in China and Europe as they will give a good read into the pace of those two economies (and whether Chinese growth is slowing further and if the European recovery is gaining steam).

The U.S. PMIs (manufacturing Tuesday/non-manufacturing Thursday) will be watched to further confirm the rebound from the soft Dec/Jan readings. So, as long as they don't imply that the weakness in activity lasted into March (when weather isn't an excuse), the market should take in stride even a small miss.

Outside of the PMIs it's also jobs week, so we get ADP Wednesday, weekly claims Thursday and the March employment report Friday. Again, a nice rebound in the March data and positive revisions to Jan/Feb numbers will further signal the economic weakness was temporary.

Finally, from the Fed, Janet Yellen speaks today at 9:55, and these will be her first comments since the "6 months" slip-up at the FOMC press conference two weeks ago. Markets will be looking for her to dial back those comments and she likely will oblige.

But, regardless of whether she's taken as "dovish" or not, nothing she's going to say today will alter the outlook for future Fed policy (continued tapering of $10 billion per month and an inaugural interest-rate increase in mid-2015).

Commodities

Commodities markets were generally higher last week and were led by industrials, while gold was the big underperformer. The broad based commodity ETF DBC rose 1.5% last week.

Starting with the laggard, gold broke through multiple levels of support last week and traded to a six week low below $1300. Interestingly, the sell off came despite any real fundamental "reason," as geo-politics didn't improve significantly in Russia/Ukraine, and if anything the Fed speak was mildly "dovish."

It looked mid-week as though this sell off was about to get pretty nasty, but gold held support at $1290 by it's fingernails, and we're seeing a small bounce this morning. As long as gold can hold $1290, I'll nervously continue to hold my gold longs.

Turning to more industrial commodities, we saw broad gains from copper and the energy complex. Part of the reason for this broad move was the bounce of "all things China related" last week, which helped copper trade back above $3.00 and Brent Crude move off multi-week lows. WTI Crude rallied 2.1% to close back above $100/barrel thanks to decent economic data and some dip buying, and if economic data this week comes in at or better than expectations, we could see WTI move higher towards resistance around $103 and $105 (a multi-month high).

Finally, natural gas was the best performer last week, rallying 3.9% (although part of that rally was due to the contract "roll" which occurred late last week, so the price gains you see aren't quite as good as they appear). Nonetheless, there was another draw of inventories last week and natural gas inventories are now more than 50% lower than last year and the five year average, and that will continue to create opportunities in the natural gas space for some time to come.

Currencies & Bonds

The euro was in focus last week in the currency markets, as ECB officials launched a rhetorical assault on the currency, trying to push it lower by foreshadowing potential QE in the EU. Specifically, comments by Bundesbank president Jens Weidmann that implied the "hawkish" Germans may be open to QE to combat disinflation in the EU caught markets off guard. And, they were followed by pledges from ECB President Mario Draghi to act to fight the threat of deflation, and finally by a timely article in the FT that implied the ECB is trying to reliquefy the asset backed securities (ABS) markets to help lending in the EU, and once liquid the ECB would consider buying ABSes.

And, this morning we know why there was this sense of urgency. The HICP (the EU's CPI) for March came in at just 0.5% yoy increase, less than the .7% expectation, signaling deflation is a growing threat. But, the euro isn't selling off because last year's early Easter is likely skewing the data a bit to the downside.

Nonetheless, expectations are rising for action at this week's ECB rate meeting on Thursday. But I would be surprised if the ECB does ease policy further, and until they do the euro will remain buoyant, despite rhetoric.

Elsewhere in currencies, the Dollar Index rose small last week, thanks mostly to euro weakness, while the yen very quietly traded to a one month low, breaking through 102.50 vs. the dollar as the yen has recently been "stealthily" weak. There was no specific catalyst, but with the much anticipated sales tax increase hitting tomorrow, we could be seeing a bit of a "sell the news" reaction. I continue to believe selling yen here (via YCS) remains on of the better long term trades in the market.

Turning to bonds, Treasuries were surprisingly buoyant last week despite decent economic data and no real escalation in Russia/Ukraine, and the strength in bonds remains a non-confirming indicator that worries me from an equity standpoint (bonds shouldn't be this strong given the economic data and reality that if anything the Fed will err on the side of tightening policy, not being further accommodative). I still maintain selling bonds here is the right move over anything other than the short term (TBF/TBT/STPP), but this week will be key, given the critical economic data being released. 135'00 in the thirty year remains my stop on the upside.

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 & Add Around $1300: **Gold remains below $1300 but unless it trades through $1290 I'll hold my longs. If $1290 is broken, then I'll look to exit my long positions as the outlook for gold will have changed materially.**

	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.**