7:00's Report

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

March 4th, 2014

Pre 7:00 Look

- Futures and international markets are sharply higher this morning after Putin ended military exercises in Western Russia.
- Economically it was a quiet night. British Construction PMI's (62.6 vs. (E) 63.0) and EU PPI (-.3% vs (E) -.2%) were the only releases and neither moved markets.
- In Asia, the Reserve Bank of Australia left the key interest rate unchanged at 2.5%, as expected.
- Econ Today: No reports today, Fed Speak: Lacker (4:15 PM).

Market	Level	Change	% Change
S&P 500 Futures	1862.00	19.00	1.03%
U.S. Dollar (DXY)	79.985	-.105	-0.13%
Gold	1336.20	-14.10	-1.04%
WTI	103.45	-1.47	-1.40%
10 Year	2.607	-.051	-1.92%

Equities

Market Recap

Stocks traded lower Monday but ended off the worst levels of the day as shifting and conflicting headlines regarding the Ukraine/Russia crisis dominated the market. The S&P 500 declined 0.74% and once again closed below the 1,850 level.

Stocks opened down nearly 1% Monday, as an "escalation" of events in Ukraine over the weekend weighed on global stock markets. (Europe was hit especially hard, dropping well over 2%.) Shortly after the

30 Year Treasury: A geo-political risk off bid sent the 30 year through the 200 day moving average, but unless 135'00 is violated I still think this is an opportunity to get more "short" bonds via TBT or TBF.

open we saw a small short-covering bid that came out of the better-than-expected auto sales and February flash PMIs, but there wasn't any conviction to it and that bid quickly evaporated and stocks resumed their declines.

Despite the good data, rumors regarding Ukraine were the real influences on trading yesterday. Stocks hit their lows shortly after noon on a report that a Russian naval commander had given a "deadline" for Ukrainian forces in Crimea to lay down their arms, and if they did not comply an assault would occur. But, Moscow quickly denied the rumor, and stocks began a slow rally that lasted pretty much the entire afternoon, as stocks closed well off their lows.

The Biggest Risk in Ukraine is Monetary, not Military.

Things improved overnight in the standoff. Putin ended the large scale military exercises in western Russia that implied he was prepping for an invasion of Ukraine, although Russian troops remain in de-facto control of Crimea. But, there has been no fighting and the threat of a protracted conflict where Russia annexes Crimea or larg-

Market	Level	Change	% Change
Dow	16,168.03	-153.68	-0.94%
TSX	14,212.74	3.15	0.02%
Brazil	47,094.40	-512.35	-1.08%
FTSE	6,813.53	105.18	1.57%
Nikkei	14,721.48	69.25	0.47%
Hang Seng	22,657.63	156.96	0.70%
ASX	5,400.23	15.91	0.30%
Prices taken at previous day market close.			

er parts of eastern Ukraine appear remote. There is no real strategic "reason" to take Crimea, and even if Russia did, "owning it" wouldn't be easy (all the infrastructure comes from Ukraine).

As far as a Western response, the U.S. and EU continue to threaten sanctions, but nothing appears imminent or effectual, and really the currency and Russian stock markets are exerting more pressure on Putin than Europe or the U.S. (and if anything that's likely responsible for his de-escalation overnight).

Market	Level	Change	% Change
DBC	26.46	.33	1.22%
Gold	1350.40	28.80	2.18%
Silver	21.445	.204	0.96%
Copper	3.1715	-.016	-0.50%
WTI	104.74	2.15	2.10%
Brent	110.93	1.86	1.71%
Nat Gas	4.468	-.141	-3.06%
RBOB	3.0125	.0351	1.18%
DBA (Grains)	28.04	.67	2.48%
Prices taken at previous day market close.			

So, the biggest risk remains a currency crisis, either emanating from the Ukraine and spreading to Russia, or emanating from Russia and spreading to the rest of the emerging markets. The IMF is starting to get involved in Ukraine and the U.S. and EU are making concrete pledges of aid, so the "cavalry" to a point has arrived. But, the Ukrainian Central Bank has limited daily withdrawals to 1,500 hryvnia (about $150) per day, as the country is in the midst of a banking run. So, while not an imminent risk at this point, the situation remains fluid. But, make sure to watch the money more than the military, as that's where the real danger lies from a market standpoint.

Trading Color

Yesterday was not a high conviction sell off, and doesn't imply this rally is over. First, yesterday's sell-off came on similarly low volumes as the recent rallies. Large mutual funds did little (meaning they didn't buy the dip or sell into the lift), and trading was dominated by fast-money funds. So, it seems as though the markets remain in a "wait and see" mode.

Second, market internals were actually a bit positive. The Dow and S&P 500 were the laggards yesterday while the Russell 2000 and Nasdaq relatively outperformed, falling 0.56% and 0.74% each.

Sector-wise, there was a pretty clear theme: Commodity-related sectors like basic materials, energy, natural gas E&Ps, and gold miners relatively outperformed, thanks to gains in the underlying commodities, as did defensive sectors. But, every S&P 500 sub-sector declined except for REITs, which closed up 4 cents.

On the charts the S&P 500 again closed below 1,850, and the index continues to have problems with that level. Support lies lower, at 1,822 (the 50-day moving average).

Economics

Personal Income and Outlays

- Consumer Spending rose 0.4% vs. (E) 0.1%.
- Core PCE Price Index rose 1.1% yoy vs. (E) 1.2%.

Takeaway

The major components for the Personal Income and Outlays Report for January were mostly better than expectations, although not quite as good as the headlines would imply, as the "Affordable Care Act" helped artificially increase both Personal Income and Personal Consumption (spending). The former was boosted by increased Medicare benefits and increases in other entitlements, while consumer spending was increased to factor in higher spending for healthcare now that prices have risen and more people are insured.

The truly "important" pieces of this release are the consumer spending numbers, which are critical to the PCE component of GDP, and the "Core PCE Price Index" — the Fed's preferred measure of inflation. Both were largely in-line with estimates.

Consumer spending rose 0.4% m/m vs (E) 0.1%, but the December data was revised exactly the opposite, down to 0.1% from an initial reading of 0.4%. So, the pace of consumer spending remains about the same as it has been, which is decent. With regard to the Core PCE Price Index, it softened a bit, and is now up just 1.1% year-over-year vs. 1.2% in January.

From a Fed standpoint, the takeaway is that inflation, statistically, remains very muted. While that won't cause a "tapering" of the taper, it remains in the doves' favor and speaks to keeping interest rates very low well after QE is over.

Bottom line is this report contained few surprises, but at least it was in-line to better than estimates, further breaking the trend of "misses" vs. estimates from recent economic data.

ISM Manufacturing PMI

- ISM Manufacturing Index rose to 53.2 vs. (E) 51.9 in February.

Takeaway

The ISM manufacturing index rose more than expected in February to 53.2 from 51.3 in January, recouping about a third of the drop in January. The February report turned positive month-over-month after slipping in both December and January, with January being the lowest reading since May of last year.

The details of the report were also strong as new orders, the leading indicator in the report, rebounded sharply to 54.5 from the rather weak January reading of 51.2. The employment component of the report was unchanged, which is consistent with most of the other recent employment reports showing status quo in the jobs market.

Much like with the income and outlays report, the market showed little reaction to the ISM manufacturing data release, despite the fact that it was good. Importantly, this report better reflects what most of us know to be the reality – that manufacturing activity slowed from Q4's breakneck pace, but it hasn't fallen off a cliff.

More broadly, the global ISM manufacturing reports imply that, while it has slowed since Q4, the global manufacturing recovery is still ongoing. While that was ignored thanks to the Ukrainian situation, that is a positive for global stock markets beyond the very short term.

Market	Level	Change	% Change
Dollar Index	80.08	.36	0.45%
EUR/USD	1.3733	-.0069	-0.50%
GBP/USD	1.6658	-.0085	-0.51%
USD/JPY	101.40	-.40	-0.39%
USD/CAD	1.1071	.0007	0.06%
AUD/USD	.8926	.00	0.00%
USD/BRL	2.3438	.0057	0.24%
10 Year Yield	2.607	-.051	-1.92%
30 Year Yield	3.557	-.035	-0.97%

Prices taken at previous day market close.

Commodities

Commodities were mostly higher yesterday as the situation in the Ukraine dominated the space, although given the "improvement" in the Ukraine situation overnight, we are seeing some of those gains reversed this morning.

Crude oil, gold and wheat all rallied more than 2% yesterday in spite of a stronger dollar (+0.5%) thanks to a broad geopolitical risk bid. Natural gas was the notable outlier as it fell 3% to start the week. The benchmark Commodity Tracking Index ETF, DBC, rose 1.3% and hit a six month high as commodities continue to be one of the best performing asset classes in the market this year.

Wheat was the strongest-performing commodity yesterday, as it rallied 5.27%. The Ukraine is one of the largest producers of wheat, and futures rallied on fears of disrupted supply as a result of the Russian occupation of the Crimean peninsula.

Gold also rallied 2.18% yesterday thanks to the same geopolitical risk bid and hit a five month high, trading above $1350/oz. But, despite the nice move yesterday, the fundamentals are becoming less supportive of the current rally and need to be watched. The Commitments of Traders report was published on Friday and it showed that net longs held by money managers increased for the third week in a row, up 27,486 contracts to 96,256, a 14-month high. The increase was largely a result of short-covering (similar to the short-covering rally we saw in silver a couple of weeks ago) as more than 23K of the spike was short-covering.

So, while not a condemnation of the rally (I remain a stout gold bull over the medium/longer term), like silver it appears the "easy money" has been made in gold. And while the uptick in "speculative" longs in the COTs doesn't, by itself, mean the rally will stall in the short term, it does re-enforce my preference to initiate or add to gold on a further dip from current levels.

Finally, WTI Crude moved higher because of the situation in the Ukraine, even though fundamentally, the conflict does not affect U.S. crude oil supply or demand at all. But, WTI remains an excellent global barometer of risk, and that's why WTI rallied. Yesterday's rally aside, WTI crude still remains range bound between the 200 day MA at $99.93 and the late 2013 highs in $104-$105 range. Unless the conflict escalates again, we should expect WTI to remain in that range.

As mentioned, commodities are giving back some of yesterday's gains on reduced geo-political tensions, but the asset class remains in an uptrend, and between an uptick in geo-political risk and "ok" global economic data, an allocation to DBC or some other broad commodity ETF on a further dip here does have some merit, as fundamentals remain positive.

Currencies & Bonds

Like in the commodity markets, as geopolitical concern regarding Ukraine was the dominant force in currency and bond markets Monday, as there was a distinctive "risk off" move under way. The Dollar Index and yen both rose 0.4% yesterday (both are the biggest "risk off" currencies in the market), while the euro fell 0.65% and the pound dropped 0.6%.

Interestingly, those currency moves were the exact opposite of what should have happened, as economic data from Europe was stronger than expected. The February manufacturing PMIs across Europe were universally better-than-expected, implying the slow economic recovery in the EU is ongoing. Between the numbers yesterday and the better HICP figure from last week, there is now virtually zero chance that the ECB will further ease policy at Thursday's meeting (which again should be positive).

It was the same with the pound. UK February manufacturing PMI beat estimates yet the pound declined, somewhat sharply, on peripheral Ukraine concerns. And, if this Ukraine-based selling is to continue, then the pound would be very attractive on any further dip vs. the dollar, and I would look to buy any further dip in the pound via FXB or the futures. The pound has been and will continue to be one of the stronger currencies vs. the dollar given the fact that the UK economy is humming along. Plus, the Bank of England will likely be the first major central bank to raise rates sometime later this year or early next (I believe it'll be the former unless something materially changes).

Turning to bonds, it was much the same there as the currency markets: A "risk off" sentiment trumped economic data and Treasuries rallied sharply (30-year up 0.54%, 10-year up 0.40%) despite the fact that economic data and auto sales beat expectations, implying the economy isn't as it appeared in January, and that it'll take an abysmal jobs number Friday to get the Fed to consider "tapering" the taper.

I was taught early on that you "trade the market you've got, not the one you want," so I have to note that due to the "risk off" bid yesterday, the 30-year Treasury traded through resistance at the 200-day moving average. Facts and experience tells me this Ukrainian issue is temporary, so I'm inclined to continue to use this rally to get more "short" the bond market, as the fundamentals continue to come my way (better economic data, a Fed committed to tapering). But, if 135 is taken out in the 30-year Treasury (it's at 133'26 now), I'll have to admit I was wrong that this counter-trend rally is ending, and reduce any short bond positions to minimal exposure – but we're not there yet.

No EM Contagion Yet, But the Ruble has displaced the Lira as the Epicenter of the Rolling EM Crisis.

The ruble and hryvnia continued to plunge to record lows vs. the dollar yesterday, and while those declines are weighing on neighbor currencies and emerging market currencies to a point, we still aren't seeing any material signs of contagion, yet.

The Central Bank of Russia raised interest rates to 7.5% from 5.5% to defend the ruble yesterday, and to a point it stopped the relentless selling, although the ruble finished 1% lower on the day. It's bouncing on the de-escalation from Russia this morning, but the ruble has overtaken the lira as the epicenter of any emerging market contagion, so that is now the currency to watch, regardless of what happens militarily.

Bottom line is we're not seeing emerging market contagion, but the right ingredients are there for a flare-up – let's hope cooler heads in Moscow, Kiev and at the IMF prevail.

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 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.**

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.**

U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index remains largely range bound, as a stronger euro will hamper any ability for the US DOlar 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.**

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.**