7:00's Report

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

March 5th, 2014

Pre 7:00 Look

- Futures are almost perfectly flat this morning as markets digest yesterday's rally.
- Geo-politically things continued to improve, as the US and Russia are set to have talks on the Ukraine, while the emerging market currencies are stable.
- Global economic data o/n was again good. Euro composite PMIs and retail sales beat expectations, while Chinese service sector PMIs were in-line.
- Econ Today: ADP Employment Report (E: 150K), ISM Service Index (E: 53.5), Beige Book (2:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1870.50	-1.00	-0.05%
U.S. Dollar (DXY)	80.24	.057	0.07%
Gold	1335.00	-2.90	-0.22%
WTI	102.89	-.44	-0.43%
10-year	2.691	.084	3.22%

Equities

Market Recap

Stocks surged to new highs Tuesday as de-escalation in the Ukraine led to a squeeze higher in the major averages as shorts were forced to cover and underinvested managers chased the market. The S&P 500 closed up 1.53%.

Futures were already sharply higher when I arrived at the office Tuesday morning off comments by Vladimir Putin that were interpreted as de-escalating the Ukrainian crisis, and the market never looked back.

The bank ETF KBE has seen a nice rally over the past few weeks, but still remains below it's all time high.

The S&P 500 eclipsed the old highs of 1,867 shortly after the open, and from there the chase was on as portfolio managers who weren't fully invested were forced to buy into a surging market. Stocks grinded steadily higher throughout the entire day despite the lack of any real, positive catalysts, and the S&P hit its new all-time high at 1,876 about 15 minutes before the close and ended the day just off those highs.

Trading Color

Market internals were strong yesterday. First, volumes followed the rally, as excepting Friday (which saw a late spike in volume on the close as Ukrainian details were breaking), yesterday was the biggest-volume day since early February (when the last period of emerging-market turmoil was in full bloom). So, yesterday we finally saw some conviction behind the move from a volume and activity standpoint.

Second, there was definitive cyclical outperformance on an index and sector level. The Russell 2000 surged 2.75% and is now above the 1,200 mark for the first time ever, while the Dow Transports and the Nasdaq also outperformed.

Market	Level	Change	% Change
Dow	16395.88	227.85	1.41%
TSX	14286.86	77.12	0.54%
Brazil	47094.40	-512.35	-1.08%
FTSE	6789.38	-34.39	-0.50%
Nikkei	14897.63	176.15	1.20%
Hang Seng	22579.78	-77.85	-0.34%
ASX	5446.23	46.00	0.85%
Prices taken at previous day market close.			

Sector-wise there was widespread strength (all 10 S&P sub-sectors were higher), but again cyclicals were the outperformers. Banks led the way, trading up nearly 2%, while basic materials, semiconductors, industrials and consumer discretionary all saw rallies well above 1%. Utilities and telecom lagged, although as mentioned both were higher on the day.

Market	Level	Change	% Change
DBC	26.39	-.10	-0.38%
Gold	1336.40	-13.80	-1.02%
Silver	21.22	-.265	-1.23%
Copper	3.2125	.0405	1.28%
WTI	103.19	-1.72	-1.64%
Brent	109.10	-2.10	-1.89%
Nat Gas	4.642	.15	3.34%
RBOB	2.9777	-.0426	-1.41%
DBA (Grains)	28.00	-.06	-0.21%
Prices taken at previous day market close.			

On the charts you know the drill: The new intraday high of 1,876 is resistance, while the old highs of 1,867, 1,850 and then the 50-day MA (which is now sitting all the way down at 1,823) are the next levels of support.

Bottom Line

It was an impressive move by the market yesterday, with the internals finally confirming a rally. But, despite that, this market remains far from loved. It seem that the higher stocks go, the more investors are viewing it as making the ultimate decline more painful. Despite stocks surging to new highs, I get the impression that very few people “believe” in this rally, which means it probably still has more legs in the very short term.

Looking at the market fundamentally, stocks didn’t rally yesterday because of the Ukraine. Certainty that helped, but really the de-escalation allowed investors to re-focus on the good data from Monday: Chinese, EU and U.S. ISM manufacturing PMIs all beat estimates, and auto sales were better as well. Those data points, combined with the skeptical sentiment and under-exposure of money managers, were the “reasons” stocks rallied.

And, that belies an important point. Economic data remains the key to this market. Ukraine is still a risk, as are the emerging markets as a whole (including China). But the pace of global and U.S. economic growth remains the key to a sustained rally, and focus should turn back to the very important data coming later this week starting today.

From a “Where Does the Market Go From Here” standpoint, the “pain trade” is still higher, but I don’t think we’re about to see a “runaway” rally from here, and likely some sort of chop should ensue even if the jobs report is good on Friday, as the market is now getting extended in the very short term.

As far as allocations, I continue to think shorting bonds via TBT/TBF remains the “best” play in this market, and from an equity standpoint I’m still a much-bigger fan of allocating to specific sectors than the broader market at these levels. I would continue to look to underperformers that have bottomed out and can play catch-up if the U.S. and global economy continues to gradually grow: banks via KBE, retailers via RTH, industrials (the Dow remains well off the highs) via DIA, and global miners via PICK.

Economics

There were no economic reports yesterday.

Commodities

Commodities were mixed yesterday as trading was again dominated by geopolitics. As tensions cooled between the Ukraine and Russia, so too did the “risk” commodities, primarily gold and both Brent and WTI crude oil. The Power Shares DB Commodity Tracking Index ETF (DBC) fell 0.4% yesterday.

Gold and silver futures were down by 0.87% and 1.09% respectively yesterday as the Ukrainian/Russian “fear” bid came out of the market. But, trading in the precious metals was much better than many expected, as gold only fell $13 yesterday after rallying $24 on Monday.

Historically, a “fear-driven” rally like the one we saw on Monday would have been followed by an even-larger sell-off the following day upon the resolution to whatever conflict ignited the rally to begin with. (The reason being that speculators find an opportunity to heavily sell the “good news” to push the short-term longs out of the market.) The fact that gold only fell by $13 yesterday shows there are buyers eager to buy dips in the market.

Gold continues to “act” better and better, and yesterday’s price action was somewhat bullish. I personally would still prefer to wait for a bit more of a dip before adding to or initiating any gold longs. But, if you're not long at all, nibbling a bit at these levels to at least get something on isn't the worst idea.

Elsewhere in metals, copper was one of the better performers yesterday as it added 1.28% and closed above $3.20. Copper rallied for two main reasons. First, it benefited from the general "risk-on" trade that was apparent across all asset classes. Second, copper futures played catch-up on "not as bad as feared" Chinese economic data. On Monday, copper traders, like most traders, were more concerned with what was going on between the Ukraine and Russia, and they largely ignored the better-than-expected data that has been coming out of China. So, yesterday we saw copper play catch-up after trading lower for 5 of the previous 6 sessions. I continue to recommend buying copper futures or the copper tracking ETF (JJC) with stops just below $3.15 (or the ETF equivalent). In the trade you risk 5 cents to potentially make 20 cents, a pretty good risk-return ratio.

Trading in the energy space was almost an exact mirror image of Monday's session as crude oil and the products were all materially lower while natural gas caught a bid off technical support.

WTI crude oil futures fell 1.6% yesterday, giving back just about all of Monday's gains. As I mentioned in yesterday's Report, crude oil has historically been a great barometer of global risk, and now that the Ukraine-Russia *risk* is behind us, the *risk bid* has been withdrawn from the market.

WTI futures prices are back to trading right in the middle of the range that has been in place since the middle of February (support at the 200-day moving average, $99.93 and resistance at Monday's high tick of $105.22).

Natural gas futures rallied 3.27% and it was the best performer in the commodity space yesterday thanks to the weather and technical support. Weather reports are forecasting colder-than-average temperatures across much of the country into the middle of the month, which is raising speculation of continued, late-season demand.

Meanwhile the inventory situation is still "critical" for nat gas as supply levels are 30% below the five-year average. On the charts, the technicals in nat gas also remain bullish as the "up-trend" line dating back to November (the very beginning of the big rally) continues to offer support. In addition to the rally in the futures, the natural gas E&P ETFs, XOP and FCG, were up 2.02% and 1.52% respectively yesterday, and both remain attractive at these levels.

Currencies & Bonds

The Treasury market (and specifically the 30-year Treasury) sold off hard yesterday, falling 1% (which is a big move for the 30-year) and dropping back below resistance at the 200-day moving average. This helped to calm my nerves about my enthusiastic "add to bond shorts here" call of the last week or so. The reasons were predictable:

- The "risk off" bid from Friday and Monday unwound on improvement in the Ukraine, and
- Bond markets refocused on fundamentals (like economic data) and played catch-up to the better-than-expected auto sales and manufacturing PMI from Monday.

Ukraine still matters in the short term, but the focus of the bond market now will turn to the jobs data. But, as I've been saying, barring a horrid number on Friday, I don't see much that can materially extend this counter trend rally in bonds, and continue to view these levels as excellent medium and longer term entry points for bond shorts.

Market	Level	Change	% Change
Dollar Index	80.16	.07	0.09%
EUR/USD	1.3739	.0005	0.04%
GBP/USD	1.6675	.001	0.06%
USD/JPY	102.22	.79	0.78%
USD/CAD	1.11	.0024	0.22%
AUD/USD	.8949	.0013	0.15%
USD/BRL	2.3406	-.0032	-0.14%
10-year Yield	2.691	.084	3.22%
30-year Yield	3.638	.081	2.28%

Prices taken at previous day market close.

Looking at currencies, the Dollar Index was very slightly stronger Tuesday, as the situation in the Ukraine failed to be the singular influence over currency markets like it was on Monday, and currencies resumed trading off individual news and policy outlooks.

The euro finished trading little-changed yesterday as a relief rally over the de-escalation in the Ukraine was countered by some potentially "dovish" news. Early Tuesday morning the euro was sharply higher, and recouped nearly all of Monday's declines. But, then a Reuters news article hit the wires saying that, at tomorrow's ECB meeting, the ECB will almost certainly decide to stop "sterilizing" bond purchases made through its SMP program.

To give a little context, the "SMP" (or "Securities Market Program") was basically the bailout fund the ECB created to help support Greek, Portuguese, Irish and other bailed-out countries' debt at the height of the euro-zone crisis. It's somewhat similar to our QE program, although there are some major differences.

To help get the Germans on board with buying PIIGS' debt, the ECB promised to "sterilize" their purchases by removing equal amounts of liquidity from the market. So, to keep things simple, if the ECB bought 100 million euros worth of Greek bonds, it would then sell 100 million euros worth of other, unrelated bonds to keep the simulative effect a net zero. (So, the ECB pumped 100 million into the economy, and pulled 100 million out.) If the ECB were to stop "sterilizing" these SMP purchases, then in theory the bond purchases would help stimulate the economy more (and over time increase inflation).

But, as usual with the ECB, this isn't as good as it seems. First, the SMP doesn't even exist anymore. It was replaced by the OMT (Outright Monetary Transactions) last summer/fall, and the OMT hasn't even bought any bonds yet (at least to my knowledge). So, this "sterilization" would be left to reinvestment of current debt as it matures (assuming the ECB is reinvesting its purchases like the Fed is). So, bottom line is that, while this is a nice headline and can be spun "dovish," this is *not* a major dovish move by the ECB. If the euro sells off on this announcement on Thursday, it's most likely a "buy."

Despite the volatility in the euro, the biggest moves in the currency markets came from Asia yesterday. First, the yen dropped sharply (0.8%) and traded through 102 yen/dollar. Most attributed the move to the unwind of the "risk off" move Monday, and certainly that had something to do with it. But, there was also another influence weighing on the yen, one that may be more important than any short-term "risk off" selling.

Prominent Japanese economist Heizo Takenaka gave an interview where he stated he thought the BOJ was preparing to unleash another round of accommodation to coincide with the implementation of the national sales tax in April. And, he gave this opinion after he recently met with BOJ Governor Kuroda.

Whether (and when) the BOJ eases further has been the dominant influence on the yen. I continue to believe the BOJ will act again, and at this point significantly accommodative policy is not priced into the yen or DXJ. Also, I continue to think there is relative "value" in both YCS and DXJ at these levels, although obviously it's a higher-risk trade at these levels than it has been in the past.

Staying in Asia, yesterday was a Reserve Bank of Australia meeting, and to the surprise of no one the RBA didn't change rates. But, they were very slightly "dovish" if you read the meeting transcripts. I say that for two reasons. First, they once again referred to the Aussie dollar as "high" (they didn't refer to it as high in the last statement) and second, their commentary on the economy was slightly less upbeat than the previous meeting.

The Aussie dollar didn't really react to this, but on balance I think this will likely equate to another volley of Reserve Bank of Australia governors trying to "talk down" the value of the Aussie in the coming weeks and months. As such, shorting Aussie here (or more enthusiastically above the $0.90 level) seems to be a good trade, as once again it appears we've got the RBA on our side, and that's a powerful ally.

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 1876, 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 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.**

	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.**