7:00's Report

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

April 1st, 2014

Pre 7:00 Look

- Futures are drifting slightly higher while international markets rallied after a busy night of economic data largely met expectations.
- Official Chinese March Manufacturing PMIs met estimates at 50.3, importantly holding above the 50 level.
- Data from Europe was largely in-line (manufacturing PMIs and EU unemployment). Great Britain manufacturing PMI slightly missed, but it's still very high in an absolute sense (55.3).
- Econ Today: ISM Manufacturing Index (E: 54.0)

Market	Level	Change	% Change
S&P 500 Futures	1869.50	5.00	.25%
U.S. Dollar (DXY)	80.225	-.029	-.04%
Gold	1285.60	1.80	.14%
WTI	101.25	-.33	-.32%
10-year	2.723	.011	0.41%

Equities

Market Recap

Stocks enjoyed a nice rally in quiet trading Monday as more rumors of Chinese stimulus, quarter-end window-dressing, a "dovish" Yellen and news of some Russian troops being pulled back from the Ukrainian border all helped stocks to lift. The S&P 500 rose 0.8%.

Markets were strong out of the gate Monday thanks mainly to rumors of impending Chinese stimulus (Chinese state media reported plans were being drawn up for economic stimulus). Plus, Yellen's "dovish" comments during her speech in Chicago helped stocks trade solidly higher by 10:30. The S&P hit its high for the day at 12:30 following the "Russian troop pullback" headlines, and stocks basically traded in a 5-point range from there until the close as the afternoon was very quiet.

Japanese Yen: It's starting to look like this multi-month yen rally is ending, and a break above 104 vs. the dollar would cause the "short yen/long DXJ" trade to be back "on."

Trading Color

"Momentum" bounced back yesterday, although it seemed more like investors tepidly positioning ahead of an expected "start of the quarter" allocation than it did any convicted value-buying.

NBI and QNET rallied as NBI was up 3% thanks to some good corporate news from AMGN and BIIB, while QNET's gains were more muted (0.5%).

More broadly, growth indices also bounced nicely as the Russell 2000 rallied 1.8% and the Nasdaq rose 1%, both solidly outperforming the S&P 500.

Sector-wise, it was a good day as all 10 S&P 500 sub-sectors were higher. Banks led the way, as KBE rose 1.6% thanks to dip-buying and a steepening of the yield curve. And, the yield curve steepening from here is a trend I think can continue regardless of the absolute

Market	Level	Change	% Change
Dow	16,458.56	135.50	0.83%
TSX	14,342.69	81.97	0.57%
Brazil	50414.92	646.86	1.30%
FTSE	6631.93	33.56	.51%
Nikkei	14791.99	-35.84	-.24%
Hang Seng	22448.54	297.48	1.34%
ASX	5389.17	-5.66	-.10%

Prices taken at previous day market close.

moves in the broad Treasury market (so we don't have to see a massive sell off in bonds to get the yield curve to steepen further, which would be positive for banks).

Semiconductors were also up 1.6%, as that sector continues to handily outperform and remains one of, if not the, star of 2014.

But, it wasn't a true rotation out of value back into growth, as utilities, healthcare and REITs also traded up roughly 1% apiece.

Market	Level	Change	% Change
DBC	26.12	-.02	-0.08%
Gold	1284.50	-9.80	-0.76%
Silver	19.80	.01	0.05%
Copper	3.0285	-.013	-0.43%
WTI	101.48	-.19	-0.19%
Brent	107.72	-.35	-0.32%
Nat Gas	4.38	-.105	-2.34%
RBOB	2.911	-.0265	-0.90%
DBA (Grains)	28.33	-.10	-0.35%
Prices taken at previous day market close.			

Bottom line is that internally, while we did see a bounce-back in growth and momentum sectors, it wasn't done with a lot of conviction. And it certainly wasn't the type of trading that would make you think the big rotation we saw last week out of growth and into value has all of the sudden reversed itself. Yesterday felt more like positioning by fast money and window-dressing than anything else, but at least it was nice to see the growth and momentum sectors bounce.

On the charts the S&P 500 is now creeping back toward the upper end of the 1,880-1,850 trading range (after having been at the lower end just last Thursday). For all the gyration, until we break out of that trading range one way or the other, this market is largely spinning its wheels.

Yellen Wasn't Dovish

I read several interpretations of Yellen's comments yesterday that implied it was a very "dovish" speech. Jefferies Chief Strategist David Zerfoss (who I think is one of the best on the Street) called it the "most dovish speech ever."

Yellen made Fed policy feel more real when she told the stories of three people who can't find work (or enough work) since the Great Recession. The approach was touching, **but the bottom line is the media is making Fed policy look a lot less certain than it really is.**

The outlook for the Fed is about as certain as it can get: The Fed is almost universally expected to continue tapering QE at the rate of $10 billion per meeting, with the first interest rate hike coming in sometime in mid-2015 (as early as April, as late as July/August).

And, despite every Fed speech or comment being agonized over as "dovish" or "hawkish", the reality of policy expectations isn't wavering as much as the headlines would imply. (And it didn't waver yesterday, despite the pledge to keep rates low well into the future.) Bottom line is that unless economic data gets much worse or much better from current levels, the markets' expectations for the Fed won't change, regardless of speeches.

Bottom Line

Yesterday was mostly a day for window-dressing ahead of the economic data that came last night and other key catalysts later this week (ECB and jobs report).

Momentum stocks will remain in focus (I'll be interested to see where money flows now that it's a new quarter). While both NBI and QNET bounced yesterday, I don't think we're gotten an "all clear" from those sectors. NBI and QNET remain to proxies for "momentum" and "growth" to watch now that we're into a new quarter.

Economics

There were no economic reports yesterday.

Commodities

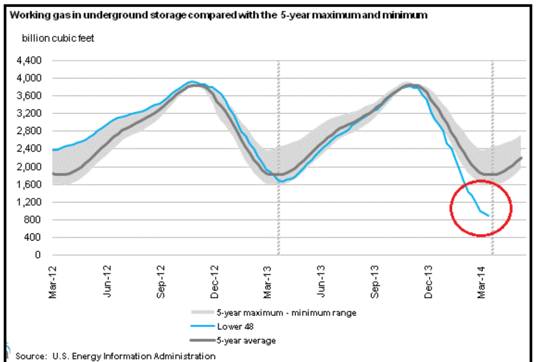
Commodities were broadly lower to start the week in mostly quiet trading, as commodities (along with most other assets) waited for the PMI data out overnight and this morning.

Natural gas was the biggest mover, dropping 2.9% on a combination of warmer-than-expected weather forecasts and continued positioning around the contract roll. You're undoubtedly seeing natural gas producers sell some production forward given that we're about to enter the "shoulder" period for inventories (the shoulder period is between the inventory draws that occur during the winter and the inventory builds that occur during the summer).

Anecdotally, I think it's interesting that, despite natural gas inventories sitting at 11-year lows (and less than half of what we had last year and over the past five years), there seems to be a high degree of complacency about summer production fixing the inventory problem.

Perhaps the consensus is right, but it seems like a "given" that we'll exit summer back near normal inventory levels.

So, again, I continue to think the risk in this market beyond the next few months is of higher, not lower, prices. Unless we get simply massive production and a cool winter, we'll still have an inventory issue next fall. As a result, I think any decent dips in natural gas over the coming weeks will be a potential buying opportunity, especially if we trade below $4.00/Bcf.



The only reason natural gas isn't trading much higher is because of the expectation of massive production this summer—which better come true. Otherwise these prices are cheap.

Gold was the second biggest mover in the commodity markets yesterday. It started the day higher but quickly turned negative mid-morning and broke through last week's lows of $1,286, all despite Yellen's supposedly "dovish" comments. If there were a "reason" to cite, it would be the news of the Russian troop pullback from the Ukraine. But the technical situation in gold is deteriorating rapidly, and it would appear that this year-to-date rally has ended, for now.

Fundamentally speaking, we did see a reduction in "speculative net longs" in gold last week, from 121K to 107K, but that reduction came almost entirely from gold long liquidation, not from an increase in shorts. At just 18K, there remain a relatively small number of shorts in gold. That means this decline, now that support is broken, can go a lot further before we get to extreme negative positioning, so be mindful of that. We aren't anywhere near the extreme negative sentiment that would result in a signal to get long.

Market	Level	Change	% Change
Dollar Index	80.255	-.08	-0.10%
EUR/USD	1.3776	.0024	0.17%
GBP/USD	1.6671	.0035	0.21%
USD/JPY	103.22	.43	0.42%
USD/CAD	1.1052	-.0008	-0.07%
AUD/USD	.9273	.0026	0.28%
USD/BRL	2.265	.0041	0.18%
10-year Yield	2.723	.011	0.41%
30-year Yield	3.561	.017	0.48%
Prices taken at previous day market close.			

Energy, ex-natural gas, was quiet yesterday, which is to be expected given the global PMIs released overnight. WTI and Brent crude were off small in quiet trading, and if I had to point to a reason, I'd again look to the pullback of some Russian troops from the Ukrainian border.

WTI remains dead in the middle of the March trading range of $105 and $97, and until we get some sort of economic catalyst one way or the other, WTI will continue to be range-bound (at an elevated level).

Currencies & Bonds

The Dollar Index was off small yesterday, thanks again mostly to euro strength rather than anything really dollar-"negative" (we already covered how Yellen wasn't as "dovish" as the media made it seem).

The euro, I'm sure much to the disappointment of Mssrs. Weidmann and Draghi, remained buoyant despite the March HICP figure missing estimates (0.5% yoy vs. (E) 0.7%).

But, again, the market remains skeptical of the ECB's willingness to take further action. Unlike in the EU financial crisis, when Draghi's "Whatever it Takes" pledge was enough to turn the tide, this dis-inflation issue isn't a confidence issue like the EU crisis. It's a real issue where large debt loads and stagnant employment across the EU is leading to slow money velocity and little to no upward pressure on prices.

And, while the EU recovery is progressing, it's not happening fast enough to combat the real dis-inflation they are seeing in the economy. Confidence problems (like the EU crisis) can be solved with pledges. Real problems can only be solved by policy. Until the ECB enacts more accommodative policy, the euro will remain stubbornly high and the economy will slowly grind toward a recovery.

And, although there is the possibility they will act further at this meeting, I expect more rhetoric—not actual, definitive policy changes.

The only currency to decline vs. the dollar yesterday was the Japanese yen, which dropped 0.35% and traded through 103 vs. the dollar for the first time since March 11th. The specific catalysts for the drop in the yen were weaker-than-expected March manufacturing PMI and February industrial production, but those are just accelerating a trend of yen weakness that has quietly been forming for the past two weeks. If 103.75 is broken in dollar/yen, look for the drop in yen to accelerate (and for Japanese stocks to rebound).

Bonds were broadly lower yesterday, but closed well off their lows thanks in part to the testimony by Ms. Yellen and positioning ahead of the rest of the week. At one point the 30year Treasury was down nearly 0.6%, but the "dovish" comments by Yellen halted the selling. Treasuries saw a mild lift throughout the remainder of the trading day, and actually closed not far off the highs.

Interestingly, though, the yield curve did steepen out a bit, a process which has been happening for the last several days. If it continues, it'll be a positive for banks (KBE) and the steepening ETF (STPP). Eventually a bond sell-off should follow that steepening of the yield curve.

Strength in Treasuries remains something that "shouldn't be" given everything else we know, so I'll be a lot happier with regard to my own multiple investment theses when bonds resume their declines and "confirm" what we're seeing in equities and economic data.

Have a good day and beware of pranks and outrageous claims—it's April Fools.

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

Gold broke through $1290 yesterday and as a result I sold my gold related positions, and will now wait and watch for gold to stabilize and regain positive short term momentum. Longer term I remain bullish, but in the short term the outlook is neutral at best.

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.**