7:00's Report

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

April 14th, 2014

Pre 7:00 Look

- Futures are slightly lower this morning while international markets are mixed as investors digested last week's declines and watched Ukraine, as tensions there have risen.
- Tensions flared up again as the Ukrainian government is starting to militarily respond to growing unrest in eastern Ukraine, increasing the chances of a Russian response.
- Economically both Italian CPI and EU Industrial Production largely met expectations.
- Econ Today: Retail Sales (E: 1.0%)

Market	Level	Change	% Change
S&P 500 Futures	1810.50	-1.25	-0.07%
U.S. Dollar (DXY)	79.81	.287	0.36%
Gold	1323.30	4.30	0.33%
WTI	103.57	-.17	-0.16%
10-year	2.619	-.009	-0.34%

Equities

Market Recap

Stocks dropped to two-month lows last week as renewed selling in the momentum sectors spread to other areas of the market, dragging the S&P 500 below support at 1,840. The S&P 500 closed 2.6% lower on the week and is down 1.77% year-to-date.

Last week was volatile, to say the least. Monday saw another sharp sell-off, but stocks were able to hold support at 1,840. This resulted in a mild bounce, followed by a much stronger bounce Wednesday. Over a 48-hour period (Monday to Wednesday), we saw the S&P 500 trade from one end of the recent range (1,840) to the other end (1,880) before finally breaking down Thursday.

Stocks collapsed in steady and, at times, heavy selling Thursday, as the S&P 500 smashed through support at 1,840. Stocks tried to muster a small bounce Friday but there was no conviction. Any life in the "momentum" sectors was viewed as a selling opportunity, and the S&P 500 basically went out near the lows of the week.

Trading Color

Price action last week was very ugly. Growth and momentum all crashed through support and, while the S&P 500 is down just 1.77% year-to-date, the Nasdaq is down more than 4%. Meanwhile, NBI (biotech) is off 20% from the February highs and QNET (Internet stocks) is off 16%.

But, despite the weakness in markets late last week, there were places to "hide," relatively speaking.

Anything "defensive" and "under-owned" held up well, regardless of the specific sector. Case in point, we saw traditional defensive sectors like consumer staples and utilities relatively outperform last week. So too did macro-sensitive, but under-owned, sectors like energy, natural gas E&Ps (FCG/XOP), coal and global industrial miners (PICK).

Volumes were elevated during the Thursday/Friday selloffs, and we saw selling not just from hedge funds (which heretofore had been the major sellers) but also from vanilla mutual funds. Again, price action and market internals were bad (borderline horrible) last week.

On the charts, clearly the 1,880-1,840 range has been violated to the downside. Now 1,800 is next support, while 1,840 has become resistance.

This Week

Market	Level	Change	% Change
Dow	16,026.75	-143.47	-0.89%
TSX	14,257.69	-50.31	-0.35%
Brazil	51,867.29	739.81	1.45%
FTSE	6,520.12	-41.58	-0.63%
Nikkei	13,910.16	-49.89	-0.36%
Hang Seng	23,038.80	35.16	0.15%
ASX	5,358.95	-69.70	-1.28%

Prices taken at previous day market close.

The Ukraine/Russia situation appears to be deteriorating a bit and that needs to be watched. But most of the focus this week will be on earnings, as reporting season really gets moving.

Market	Level	Change	% Change
DBC	26.30	-.08	-.033%
Gold	1318.90	-1.60	-0.12%
Silver	19.955	-.136	-0.68%
Copper	3.04	-.005	-0.16%
WTI	103.60	.20	0.19%
Brent	107.26	-.20	-0.19%
Nat Gas	4.621	-.034	-0.73%
RBOB	3.0081	.0002	0.01%
DBA (Grains)	26.52	-.25	-0.89%
Prices taken at previous day market close.			

Techs (INTC, SNDK, GOOG, IBM) dominate the results this week, as do banks. There are also several industrials reporting Thursday/Friday.

Outside of earnings, Fed Chair Janet Yellen speaks tomorrow morning, but the outlook for Fed policy remains pretty clear ($10 billion taper per meeting, and interest-rate increases sometime in mid-2015).

Economically, retail sales data will be key domestically, while the latest round of Chinese economic numbers (Fixed Asset Investment, retail sales, industrial production and Q1 GDP) come Thursday.

Bottom Line

As far as "why" stocks dropped last week, there simply isn't any fundamental reason, despite multiple fundamentally backed catalysts being named. This sell-off isn't about slowing growth, valuation of the broader market, stagnant wage growth, European dis-inflation or any other fundamentally based "reason." The truth is that positioning and sentiment remain the major driver of this sell-off.

Most investors had thought the "momentum" sectors (and really, a better name for these stocks is "popular," because they were massively over-owned), had bottomed as we opened trading last Thursday. But the 40% implosion of Imperva (a cybersecurity firm that was a "popular" holding) following an earnings miss reminded everyone there was still a lot of money left in these sectors. This ignited another round of selling in QNET and NBI (the poster children for momentum).

And, as we cautioned about two weeks ago, that selling in "momentum" is now spreading into any sector that is remotely "over-owned" and has positive performance year-to-date. Case in point is the bank index (BKX) and semiconductors (SOX). Both got hit hard Thursday/Friday as funds locked in gains.

And, since this sell-off is more due to positioning than fundamentals, it's tough to answer "Is it over?" proactively. Unfortunately, we just have to watch the tape. (Given NBI and QNET are at new lows, the answer is "no.")

Buyers seem more interested in buying stocks 3% higher than 3% lower at the moment. Until we get some stabilization in the NBI, QNET, SOX and KBE, this sell-off isn't over.

At the same time, though, while we likely have some more downside ahead, other barometers of "risk" haven't gone crazy. That implies this isn't a broad "hedge up" event. Bonds and gold didn't spike last week, and WTI crude didn't drop (in fact, it went up). And, at least for now, sectors that are "under-owned" with positively turning fundamentals are holding up well (FCG/XOP/KOL/ACI/PICK). So, I don't think we need to sell these sectors, and if anything I would prefer to hedge them with an S&P 500 short (a trade that would have made money last week).

Bottom line is earnings, if they are good, could help stop this decline. But until we see this continued withdrawal from the "momentum" sectors stop, this market will continue to move lower. NBI/QNET/KBE/SOX will bottom before the rest of the market.

Economics

Last Week

Economic data was sparse last week. However, we did get a look at the job market in the form of Weekly Jobless Claims as well as the "minutes" from the most recent Fed meeting.

Fed minutes were considered "dovish" initially for two reasons: First, the minutes specifically undermined the "hawkish" Fed interest rate forecasts in the March meeting, and second, there was an expectation/fear in the market that the minutes might be hawkish, given Yellen's "6 months" comment at the press conference (the fear was that the six months figure would be discussed at the meeting, further validating it).

One of the surprises of the March Fed meeting was that the "dots" of Fed officials' expectations for interest rates in the future moved up. This implied that, while the rhetoric was dovish, most Fed officials were forecasting a rise in interest rates sooner than the market expected.

Interestingly (and if I were a conspiracy theorist, I'd have been going crazy last week) the FOMC minutes *directly* addressed this concern!

Stocks rallied hard on Wednesday following the release of the minutes, but my and others skepticism about how "dovish" the minutes really were turned out to be well founded as obviously there was no follow through to Wednesday's rally.

In reality, the minutes offered no change to the outlook for Fed policy (tapering at each meeting of $10 billion, rate increases next April-July).

The other notable report last week was weekly jobless claims. Claims fell by 32K to an even 300K, which was much better than analyst expectations that called for a more modest dip to 318K. The 4-week moving average resumed its decline, dropping to 315.75K—the lowest reading since the week before the government shutdown in October.

The 4-week average is now sitting 14.75K below where it was a month ago, and 21.75K below readings from 2 months ago. The data suggest that jobless claims are trending for the better, which is largely in-line with the improving monthly government jobs report as the labor market recovers from the severe weather we saw this winter. I point that out because even though the market largely dismissed last weeks report due to Easter skew (apparently retailers hire temps before Easter) the more important 4 week moving average is clearly trending lower, which is anecdotally positive for the labor market.

Market	Level	Change	% Change
Dollar Index	79.535	.085	0.11%
EUR/USD	1.3883	-.0004	-0.03%
GBP/USD	1.674	-.0043	-0.26%
USD/JPY	101.53	0.03	0.03%
USD/CAD	1.0966	.0033	0.30%
AUD/USD	.9396	-.0017	-0.18%
USD/BRL	2.2187	.0127	0.58%
10-year Yield	2.619	-.009	-0.34%
30-year Yield	3.477	-.026	-0.74%
Prices taken at previous day market close.			

Finally, on the international front, Chinese economic data was in focus last week, and while trade balance technically missed estimates, it didn't really shift anyone's outlook on the Chinese economy (there was some statistical noise in the data apparently). The bottom line with China is that everyone knows the economy is slowing, it's just a question of whether the slowing of growth takes Chinese GDP below 7%. So far, data doesn't imply we're seeing a precipitous drop off in economic activity.

<u>This Week</u>

It's busier this week than last on the economic front, with the highlight of the week being retail sales (this morning). We also get our first look at April data via Empire State Manufacturing (Tuesday) and Philly Fed (Thursday).

Also, the latest round of housing data starts Wednesday with Housing Starts. Again, housing remains the one area of the economy that seems to be "lagging" with regard to emerging from the weather-induced early-year weakness. A decent starts number will help confidence a bit that the housing recovery is starting to gain steam again.

At the moment things are a bit odd with regard to the economic data being released this week. In reality, there's ample evidence to show the weakness in the economy early this year was weather-related, and that the economy has resumed moving toward 3% annual GDP growth (which is the level everyone expects).

But, despite that, some are blaming fears about an economic slowdown as the "reason" for this recent drop in stocks. So, data this week, given the precarious situation the markets are in, will be looked at a bit more intently. Retail sales this morning will be especially important, and a good number would be a welcome surprise.

Finally, as mentioned, on the international front we get the latest round of Chinese economic data tomorrow night, and obviously given the anxiety around that economy, any better-than-expected numbers will be welcomed.

Commodities

Commodities were mostly higher last week, led by the energy space thanks to robust gasoline demand according to data released by the EIA on Wednesday.

Natural gas rallied 3.8% last week on the first build in inventories in 4 months being smaller than analysts expected. The EIA reported a build of 4 Bcf vs. analyst expectations of +12 Bcf. So, although we have exited the "draw" season and are now onto replenishing inventories, the fundamentals continue to favor the bulls.

Inventories now stand at 826 Bcf, which is 989 Bcf below the five-year average. Unless producers can start injecting substantial supply into the reserves, there may be a serious inventory crunch this fall. So, keep a close eye on the EIA reports in the next few weeks. If the builds are not on the rise, then expect the price to revisit the $5 level in the near future. On the charts, support has moved up to the $4.50 level while the first line of resistance is last week's high tick of $4.70.

Moving to crude oil and the products, WTI rallied 3% last week while RBOB gasoline added 3.1%. The reason behind the jump was plain and simple: gasoline demand. It appears that gasoline may be taking the reins from heating oil in lifting the energy markets. The demand situation has already driven crude back toward the upper end of the trading range, which is now between $101.50 and $105.

Moving to the metals, gold traded heavier than we would have expected in the second half of the week when selling in the stock market really accelerated. As equities plummeted, gold drifted in a tight $5 range ($1,317-$1,322) Thursday and Friday. Having said that, buying gold as a hedge to stocks (which we recommended as one option) early in the week would have made the second half of the week far less painful.

With the S&P falling 2.6%, a gold hedge would have eased the pain by 1.1% (if an even hedge was used), trimming the loss to just 1.5%. For now, gold is holding above the 50-day moving average ($1,314.20) which should be considered the first level of support. And, although it's not trading one-for-one, gold remains a viable hedge against falling equity prices, especially if things flare up in the Russia/Ukraine drama.

Currencies & Bonds

It was a volatile week in the currency space. The Dollar Index dropped to a one month low, falling below the 80 level on a combination of the "dovish" FOMC minutes and "hawkish" ECB speak.

The dollar started the week trading lower off of euro strength, as last week saw a parade of ECB speakers basically throw cold water on the ECB pursuing anything "QE like" any time soon. The declines in the dollar were exacerbated Wednesday with the "dovish" minutes, and then on Thursday ECB Governing Council member Peter Praet basically said what everyone already knew: That the ECB is trying to rhetorically ease policy by threatening QE, but is still a long way from actually conducting any unconventional measures. The euro rallied back above 1.38 on the week and recouped all of the post ECB meeting sell off.

The other currency that was volatile last week was the yen. The yen traded to a 3 month low vs. the dollar two weeks ago, but exploded higher last week following "hawkish" comments by BOJ Governor Kuroda. Kuroda basically said the BOJ isn't planning any more stimulus in the immediate future, and implied the economy was doing better than most people think.

At this point the lines in the sand are pretty clear with the "short yen" trade. 101.20 yen/dollar and then 100.74. Those are the recent highs, and if they are violated, then clearly we're going to see more yen strength over the medium term.

Turning to bonds, they continued to grind higher last week, although they didn't rally as much as I would have thought given the sell off in stocks. Strength in bonds in the face of a Fed intent on tapering QE remains on of the bigger worries on my radar screen, and it's this bond strength that is leading some to believe we are about to see a slowdown in the economy. I do not agree fundamentally and am still a bond bear, but 135'00 in the thirty year remains a level I would have to reconsider. Have a good short 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	Neutral	Bullish	*Stocks fell to nearly two month lows last week as continued selling in biotech and internet stocks spread into other sectors of the market. But, this decline remains more about positioning of funds than it does any fundamental negative change in the market outlook, so overall I remain bullish. .* *1840 is now resistance while support sits at 1800 in the S&P 500.*

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. I'd also look to allocate to deep cyclicals like industrials (DIA), basic materials (IYM) and global industrial miners (PICK).**

Long Japan: **"Hawkish" comments by BOJ Governor Kuroda sent the yen spiking higher vs. the dollar and DXJ near the lows for the year. I remain a fundamental bull on Japan, but a decisive break of 44.66 in DXJ will see me exit this trade, despite the fundamentals.**

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: **The outlook for gold remains unclear, and I'm not sure last week's jobs report was as "dovish" as Friday's reaction. But, gold has acted as a decent equity hedge all of 2014, so if you're nervous about the stock market here, buying gold isn't the worst idea. Use a stop at $1277.**

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. **Similarly to DXJ, the yen caught a big rally this week after nearly breaking down to new lows just two weeks ago. If the yen were to trade below the low for the year, 100.26 yen/dollar, I would exit this trade as the trend will have clearly changed.**

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 longer term 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.**

Buy A Steepening Yield Curve: **STPP and KBE give positive exposure to a steepening yield curve, as the 10's-2's spread appears to have bottomed and should rally from here. 2.20% in that spread is my stop on STPP and KBE longs.**