7:00's Report

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

April 16th, 2014

This has been a tech led sell off, but the NASDAQ bounced almost perfectly off its 200 day moving average yesterday.

Pre 7:00 Look

- Futures are stronger globally as Chinese economic data was better than feared and the Ukrainian situation remains the same. Japan was the best performer o/n (up 3%).
- There was lots of Chinese economic data o/n but it largely met expectations. Q1 GDP was 7.4% vs. (E) 7.3% while retail sales, industrial production and fixes asset investment basically met estimates.
- Econ Today: Housing Starts (E: 965K), Industrial Production (E: 0.4%), Beige Book (2:00 PM).
- Earnings Today: BAC (E: $0.05), ABT (E: $0.35), AXP ($E: 0.95), STLD (E: $0.16), COF (E: $1.67).

Market	Level	Change	% Change
S&P 500 Futures	1848.00	8.50	.46%
U.S. Dollar (DXY)	79.785	-.103	-.13%
Gold	1303.10	2.80	.22%
WTI	104.79	1.04	1.00%
10-year	2.628	-.011	-.42%

Equities

Market Recap

Stocks were volatile again Tuesday as the S&P 500 traded in a 30-point range but again managed a late-day rally to finish solidly in the green. The S&P 500 rose 0.68% and surprisingly closed above resistance at 1,840.

Stocks were higher initially Tuesday, thanks to better-than-expected results from JNJ and an upbeat outlook from KO. But, the rally lost steam on the release of the Empire State Manufacturing Survey, and the sell-off accelerated as headlines about military operations in the Ukraine swirled before lunchtime. The S&P 500 fell for the rest of the morning and early afternoon, hitting its low for the day just above support at 1,815.

But, like Monday, support at 1,815 again held, and that caused shorts to cover and day traders to buy the dip. Stocks rallied hard again into the close, finishing near the highs of the day.

There were some "reasons" cited for the late-afternoon lift (chief among them was a call between Putin and Merkel, which is seen as potentially de-escalating the situation). But this market remains much more driven by short-term positioning by fast-money funds (hedge funds, day traders, etc.) than anything fundamental.

Trading Color

Yesterday was actually pretty encouraging from a price action standpoint, when you consider the S&P 500 rallied 26 points off the midday lows, and has now successfully held support at 1,815 twice. And, although the Nasdaq underperformed on the day, it also had a huge comeback and bounced off the 200-day MA at 3,942.

The big rebound in the market was driven by the pre-

Market	Level	Change	% Change
Dow	16262.56	89.32	.55%
TSX	14303.92	19.49	.14%
Brazil	50454.34	-1142.20	-2.21%
FTSE	6560.22	18.61	.28%
Nikkei	14417.68	420.87	3.01%
Hang Seng	22696.01	24.75	.11%
ASX	5420.32	32.16	.60%

Prices taken at previous day market close.

dictable sectors: Internet and biotech. In particular, an 11% rally in TWTR seemed to be the most-cited move in those sectors yesterday, and it apparently helped stabilize all of tech.

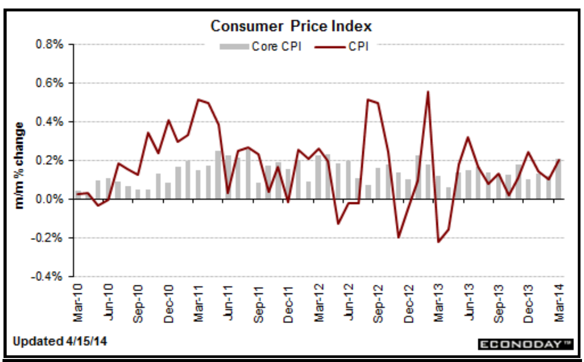
Market	Level	Change	% Change
DBC	26.52	.01	.04%
Gold	1304.30	-23.10	-1.74%
Silver	19.62	-.40	-1.97%
Copper	2.9945	-.053	-1.74%
WTI	103.50	-.54	-.52%
Brent	108.83	-.24	-.22%
Nat Gas	4.569	.01%	.20%
RBOB	3.04	.0016	.05%
DBA (Grains)	28.65	-.22	-.76%
Prices taken at previous day market close.			

Sector-wise, all 10 S&P 500 sub-sectors finished in the green, but it was the defensive and "under-owned" sectors that continued to lead. Utilities, REITs and energy all traded up more than 1%, while healthcare also rebounded thanks to the bounce in biotech.

More over-owned and cyclical sectors lagged. Banks, semiconductors and consumer discretionary all finished positive, but in-line with or lagging the broader markets.

Finally, trading volumes were a positive surprise yesterday. Volumes picked up into the afternoon and, for the first time in weeks, we actually saw some decent volume on a rally. It wasn't the level of late last week (and part of that is because Passover has started and many schools in the Northeast are closed), but activity definitely increased as stocks rallied.

Finally, on the charts the S&P 500 was able to close above 1,840, and now the 50-day MA (1,846) is resistance, while 1,815 is support.



The rise in core CPI was modest yesterday, but there is a growing list of indicators that are implying inflation has bottomed.

Bottom Line

Yesterday was an encouraging day given the way support again held in the averages, and I'm happier that we've seen stocks twice this week sell off to support at 1815, hold that level and then rally. That is more encouraging than if we just had two days of straight "dead cat bounce" rallies like we saw Tuesday/Wednesday of last week.

NASDAQ, NBI and QNET all put in big reversals yesterday, but it remains to be seen if this is indeed the bottom—and until they do bottom, this sell off isn't over. So, those remain the key indicators to watch.

Under-owned sectors with good or positively turning fundamentals continue to trade well in this tape (FCG and XOP both hit new 52 week highs yesterday) and I would continue to hold those types of sectors (Coal, natural gas equities, DIA, PICK) as I believe they can continue to hold up in this taper unless we see a material acceleration to the downside.

Finally, Europe got hit by Ukraine/ Russia headlines yesterday, but the fact remains the probability of a Russian invasion is very low. If you are looking to put on the "long Europe/ short SPY" trade, now may be a good entry point (this is easily done by going long VGK or FEZ and short SPY).

Economics

Consumer Price Index

- March CPI rose 0.2% vs. (E) 0.1%.
- March "Core" CPI rose 0.2% vs. (E) 0.1%.

Takeaway

Inflation statistics firmed up a bit in March. While, on an absolute level, statistical inflation remains very low, we are seeing some signs that the trend in inflation might be turning higher.

Looking at the core increase of 0.2% in March, that's the biggest increase in over a year (it's been 0.1% or lower for the past year). So, again, while not an absolute high number, it is noteworthy.

This all matters because of the Fed. Fed policy is predicated on very low inflation rates, and if inflation (finally) starts to trend higher, then the Fed's job of convincing the market that rates will stay "low for long" will get harder.

For now, though, it's just some "green shoots" in inflation, and we'll see where it goes next month.

Equity markets largely ignored the report. But gold, which was already down nearly 2%, spiked lower by nearly $15 — breaking below $1,300 immediately after the CPI report was released. (In an ode to "The market only cares about what's next," high CPI readings actually are short-term negatives for gold, as traders think it'll eventually lead to tighter monetary policy.) Interestingly, though, bonds didn't trade off the news, and again this is anecdotal that the bond market is looking at something the rest of us are not (bonds should have sold off on the release).

Empire State Manufacturing Survey

- Empire Manufacturing Index 1.29 vs. (E) 8.00.

Takeaway

The first economic report for April was surprisingly disappointing, as Empire State manufacturing actually fell 4.3 points to 1.3.

The details of the report were also soft. New orders, the leading indicator in the report, fell into negative territory (and the low of the year) at –2.77. Shipments also declined marginally.

Markets didn't really trade off this number, given that we get the "flash" national manufacturing reports early next week. Oftentimes, the Empire State report is not really predictive of broader national manufacturing trends. But, that said, in the context of angst about the future path of economic growth, this weak report will help to keep alive the debate about just how strong the economy really is.

That is, at least until Philly Fed reports later this week.

Commodities

Market	Level	Change	% Change
Dollar Index	79.875	.07	.09%
EUR/USD	1.3808	-.0011	-.08%
GBP/USD	1.6714	-.0005	-.03%
USD/JPY	101.84	.01	.02%
USD/CAD	.9098	-.001	-.11%
AUD/USD	.9313	-.0061	-.65%
USD/BRL	2.2327	.0186	.84%
10-year Yield	2.628	-.011	-.42%
30-year Yield	3.46	-.024	-.69%
Prices taken at previous day market close.			

China data weighed on the commodities markets yesterday, although the in-line reports this morning will likely bring some relief from the selling today. The metals were the big story in the commodity space yesterday as weak Chinese money supply data weighed on industrial and precious metals alike. The benchmark commodity tracking index ETF (DBC) was little-changed, however (-0.01%), thanks to strength in the grains offsetting the losses in the metals.

Gold, which has been working well as a loose hedge to the weaker stock market recently, sold off sharply yesterday morning following the weaker-than-expected money supply report from China. The weak data suggest that physical demand will weaken as the economy slows. Sellers pushed the price down through $1,300, which has been seen as solid support, and the breakdown began to trigger stop orders until gold finally found support in the mid-$1,280s (above our recommended sell-stop level in the $1,270s). Gold futures fell 1.91% yesterday, marking the biggest sell-off of 2014. However, although the 50-day moving average was clearly violated, gold was able to reclaim the $1,300/oz. level midday—which is somewhat comforting for the bulls. $1,300 continues to be a "magnetic" level in gold futures, and we continue to recommend holding longs as an equity hedge with stops below last month's lows in the upper $1,270s.

Copper also participated in the sharp metals sell-off yesterday as futures fell -1.74%. Like gold, though, copper was able to close well off the lows, and up toward the $3.00 level (which we consider to be similar to the $1,300 level in gold as far as being "magnetic" for the time being).

The reason for the selling was pretty obvious: When the Chinese economy slows, so too does manufacturing, production and construction — all of which contribute to China being the largest consumer of copper on the globe (40% of total consumption).

On the charts, the two most important support levels are the psychological $3 mark and last month's low tick of $2.87 while resistance is now down to about $3.05.

Moving to the energy markets, WTI crude oil futures chopped sideways most of the day, but pulled back from a six-week high — selling off into the close on analyst estimates calling for a build in this morning's EIA inventory report.

Analysts polled by Bloomberg are calling for a 1.75M barrel build in crude. But, as always, a surprise either way will send futures testing technical support/ resistance levels. For now, though, the story remains the same: WTI is largely range-bound between $102 and $105. And, for the time being, Brent is one of the main drivers in the market as traders try to gain clarity on the two major geopolitical influences on the oil market: Libyan exports coming back and the unrest between Russia and the Ukraine.

Currencies & Bonds

Bonds traded higher yesterday as the 30-year traded through my 135'00 stop yesterday. As a result, I reduced my "short bond" positions to just a core/long-term holding of TBF. I kept this core holding on because I believe bonds are indeed in a longer-term downtrend. I've learned the hard way over the years that it's dangerous to totally exit positions on bigger trends, as oftentimes you'll miss getting back "in." And, there's nothing more frustrating than being right and making no money.

But, the longer term aside, clearly the bond market rally in continuing. And, that makes me more nervous about the equity market and the economy going forward, despite yesterday's somewhat encouraging price action.

If what we "know" is true, that the Fed is going to taper and raise rates in mid-2015 and that the economy is going to accelerate in Q2 2014, then bonds shouldn't be this high. But bonds *are* this high, so something that we "know" must not be true. Either: 1) The Fed isn't going to continue to dial back accommodation, or 2) The economy isn't going to accelerate like we thought.

Either way, we're looking at a big disparity with the economic data or the bond market, and one or the other will have to correct itself.

I know that the 30-year ended well below the 135'00 level and Ukraine played some influence in the spike higher yesterday. And, we're seeing bonds lower this morning as equity futures are higher. However, Ukraine hasn't accounted for this rally in bonds we've seen since March 6. And, again, over that time we've definitively seen that: Weather was largely responsible for the soft Dec/Jan economic data, and the Fed continues to taper QE and, if anything, expectations for the first increase in interest rates has been pulled forward into mid-2015 from late 2015.

As far as how I'm playing this going forward, I'm going to sit with my residual TBF position and wait until this market shows some weakness before adding more "bond short" positions. Since I don't know "why" bonds are rallying, given that the fundamentals say it shouldn't, I'm hesitant to try and call a top. Instead, I would prefer to sell weakness, once this market begins to break back down (which I believe it will).

Turning to currencies, the Dollar Index finished the day little-changed, but that flat finish underscored the intraday volatility. The Dollar Index traded basically to 80.00 following the higher-than-expected CPI print, and then dropped nearly to 79.75 following the Empire State manufacturing data. But, reflecting the fact that neither data point really changes anything, the Dollar Index rallied off those lows to finish basically unchanged.

Internationally it was a quiet day, as the euro and pound were both flat, while the yen declined modestly (-0.13%). The yen continues to tread water just below the high for the year (100.74), and selling yen here remains one of the better risk/reward trades out there at the moment. Negative sentiment toward the "Japan reflation trade" is at the highest level I've seen in over a year.

Turning to the commodity currencies, the Aussie was actually the biggest mover among major currencies yesterday, dropping 0.7% vs. the dollar as the RBA meeting minutes revealed nothing new. We saw a "sell the news" reaction from the Aussie, which rallied into the release on Monday.

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	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 last week. 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.**

	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

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.**

	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. **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."**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	Bearish	Neutral	Bearish	*Bonds broke to new highs for the year yesterday, continuing a year-long rally in the face of normally "bond negative" fundamentals. Although the longer term trend in bonds remains lower, in the short term the rally likely will continue.*

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.**