7:00's Report

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

April 2nd, 2014

The S&P 500 appears to have broken out from a month long trading range, but a few more closes above 1880 are needed to confirm the breakout.

Pre 7:00 Look

- Futures are basically flat while international markets rallied off yesterday's new highs in the US.
- The Nikkei rallied more than 1% after corporate inflation expectations in the Japanese Tankan survey were well below the BOJ's 2% target, increasing the possibility of more stimulus.
- Economically it was quiet as Great Britain Home Price Index and Construction PMI slightly missed estimates.
- Econ Today: ADP Employment Report (E: 193K). Fed Speak: Lockhart (12:30 PM), Bullard (5:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1879.75	2.00	0.11%
U.S. Dollar (DXY)	80.23	-.019	-0.02%
Gold	1289.90	3.90	0.30%
WTI	99.59	-.15	-0.15%
10-year	2.759	.036	1.32%

Equities

Market Recap

Stocks traded to new highs (again) Tuesday on the back of good economic data and new quarterly allocations to stocks. The S&P 500 rose 0.7%.

Markets opened slightly higher Tuesday, helped by global PMIs largely coming in as expected (and importantly, in the case of China, better than feared). Other than new money being put to work in the market, the two positive catalysts yesterday that pushed stocks to new highs were economic, namely the in-line manufacturing PMI and strong auto sales. Interestingly, while the former got a lot more press, it was actually the latter that was the stronger number. Ford implied that light vehicle sales would be above 16 million saar (seasonally adjusted annual rate), which would be better than the 15.8 million expectation.

The markets dipped shortly after the open and it looked for a short bit like the market may not be able to hold the breakout. But, stocks resumed the rally after noontime and grinded steadily higher throughout the afternoon. Markets were actually able to close basically on the high ticks, finishing a surprisingly strong day.

Trading Color

The bounce-back in momentum sectors and "growth" broadly continued yesterday. NBI and QNET, the poster children for "momentum sectors," rose 2.13% and 2.68% respectively, while the Nasdaq rose 1.7% and the Russell 2000 rallied 1.3% (vs. the S&P's 0.7% gain and the Dow Industrials' 0.4%). Additionally, both the Russell 2000 and Nasdaq are once again back above their 50-day

Market	Level	Change	% Change
Dow	16,532.61	74.95	0.46%
TSX	14,380.55	45.24	0.32%
Brazil	50,270.37	-144.55	-0.29%
FTSE	6,670.03	17.42	0.26%
Nikkei	14,946.32	154.33	1.04%
Hang Seng	22,532.94	75.40	0.34%
ASX	5,403.30	14.13	0.26%
Prices taken at previous day market close.			

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moving averages (a positive technical development).

Sector-wise there was a much more definitive rotation out of value and into growth on Tuesday compared to Monday. Consumer discretionary and "old tech" like ORCL, MSFT, and CSCO all rallied hard; while banks and retail also rose 1%.

Market	Level	Change	% Change
DBC	25.82	-.30	-1.15%
Gold	1279.10	-4.70	-0.37%
Silver	19.70	-.052	-0.26%
Copper	3.0335	.008	0.26%
WTI	99.56	-2.02	-1.99%
Brent	105.47	-2.29	-2.13%
Nat Gas	4.282	-.089	-2.04%
RBOB	2.8658	-.0521	-1.79%
DBA (Grains)	28.18	-.14	-0.51%
Prices taken at previous day market close.			

Conversely, "defensives" badly lagged, as utilities and consumer staples both finished lower on the day (and utilities decidedly so, down 0.7%).

Friends on trading desks remarked that there was some real vanilla demand in some of the momentum names (again, likely allocating to a beaten-up space now that it's April), although activity slowed meaningfully into the afternoon and the lift higher from noon on came on low volumes and little conviction (which has been a hallmark of this rally for months now).

On the charts the S&P 500 is to new all-time highs, while support sits lower at 1,870 and 1,850, respectively.

Bottom Line

Stocks moved to new highs but this must be taken with a grain of salt, considering there was a lot of pent-up buying demand from last week given the turn of the quarter. But, new highs are new highs, so obviously yesterday was a good day for the bulls.

The key now will be the ability for markets to hold these levels. Skeptics will dismiss this as beginning-of-quarter allocations, so if the S&P closes below 1880 in today or tomorrow, that argument will gain some strength.

Instead of focusing entirely on the S&P 500, though, I think the key metric to watch is the Treasury market. If bonds can break down from here (and I've got more on that later that says they may start to), then we could see the stock market accelerate higher. I say that because as I and others have pointed out, bonds are the non-confirmation asset right now. They should be falling based on economic data and Fed expectations, but they are not. So, watch bonds—if they start to materially sell off, the S&P could move to 1,900 quicker than we think, as that will be the final confirmation a lot of sideline money will be waiting for.

Economics

ISM Manufacturing Survey

- ISM Manufacturing Index was 53.7 vs. (E) 54.0

Takeaway

Global PMIs from China, Europe and the U.S. were generally fine and implied we're not seeing a continued drop-off in global manufacturing activity. The China number, at 50.3 vs. 50.2 in February, was "not as bad as feared" and given the real worry in China is about a "hard landing," that 50.3 number was good enough yesterday.

In the EU and U.S., both manufacturing PMIs showed continued improvement, which again was all that the market was looking for. European PMIs were steady at 53.0, while the U.S. ISM Manufacturing Survey rose to 53.7 from 53.2 in February. The leading indicator within the report, New Orders, also ticked higher, increasing by 0.6 to 55.1. Production levels, which were held down by the below-average temperatures in the beginning of the year, jumped 7.7 points to 55.9. This is yet another piece of data to confirm the substantial negative effects of the extreme cold weather this winter.

Bottom line is globally the market cleared the first of set of hurdles this week, as manufacturing PMIs met expectations and, importantly, they didn't imply that we are seeing a further loss of momentum in the global economy. That fact helped stocks lift yesterday.

Commodities

Commodities were broadly lower Tuesday as the sector was led down by energy, while industrial metals caught a small bid. The benchmark commodity tracking index ETF fell 1.15%.

WTI and Brent crude oil futures traded lower to start the quarter yesterday, both falling more than 2%. There were several reasons cited for yesterday's sell-off in the oil markets (weak absolute level of Chinese PMI, global

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PMI numbers, further de-escalation in the Ukraine, expectations for the 11th supply build in a row). But, they were mostly excuses more than causes, and despite the big drop, the real "reason" was mostly money flows and technical.

WTI fell over $2 in the primary session, crashing through several technical support levels including the 200- and 50-day moving averages that it was trading between last week. So, the break to the upside and the several closes above the 200-day moving average ($101.42) we saw last week are looking to be nothing more than a head-fake.

Bottom line in crude oil, for the time being, is that, with so much conflicting information (on both the supply and demand side) out there, the market is essentially stuck in place—leaving physical players and day traders to dictate the price action. At the end of the day, the price remains right in the middle of the technical range that has been in place for two months now (between $97 and $105 per barrel). Until we see a material move one way or another we will maintain a neutral outlook on the market.

The EIA will release inventory data this morning and the expectations are bearish. Crude oil stocks are expected to have risen by 1.8M barrels last week, which would be the 11th weekly build in a row. But, traders will be keeping a close eye on the Cushing, Okla., data. Another draw there may be supportive of crude oil prices in the near term, despite the fact that there are record supply levels amassing on the Gulf Coast (traders always keep a close eye on Cushing because it is where settled Nymex futures are delivered from).

Moving to the metals market, the industrial metals were the best performers yesterday, thanks in large part to the "ok" Chinese PMI data that was released overnight. Copper rallied 0.26% and closed above the $3.00 mark for the third day in a row.

Copper continues to trade as a proxy to the health of the Chinese economy. As copper futures continue to trade "better," I am inclined to do some further research into taking another shot at a "long copper" trade, a "long Chinese equities" trade, or potentially both.

Moving to gold, futures fell 0.37% to a fresh 6-week low of $1,277.40. Trading in gold was quiet yesterday as futures drifted lower over the course of the day. Gold is in a well-defined downtrend on the daily chart. Now that the "4" major support levels that were in place last week have been broken, the next level of support we are looking to is the 100-day moving average at $1,272.80/oz., but metals traders are primarily looking ahead to the official jobs report on Friday.

Currencies & Bonds

The Dollar Index was flat yesterday as the ISM manufacturing PMI met expectations. Meanwhile, the euro remains stubbornly buoyant as we approach the ECB meeting, thanks to EU PMIs meeting expectations. Both currencies are largely treading water ahead of key catalysts Thursday (the ECB meeting) and Friday (the jobs report).

The big mover in the currency markets yesterday was the yen, which sold off 0.5% against the dollar and got progressively weaker as the day moved on. The catalyst was a weaker-than-expected Tankan survey, which showed large manufacturers had slightly less optimistic sentiment than expected (17 vs. 18), and that they expected a 4.2% drop in capex this year compared to a 4.5% increase last year.

The yen got very close to its multi-week lows vs. the dollar (at 103.75) yesterday and actually traded to a new 10 week low vs. the dollar overnight, as the corporate inflation portion of the Tankan survey disappointed investors. Corporations in Japan expect 1.5% inflation over the next year and 1,7% beyond that, well below the BOJ's 2.0% target. That's important because it means the BOJ will have to do more to increase inflation expectations, which raises the chances of more stimulus. The yen is flattish as of this writing, but pres-

Market	Level	Change	% Change
Dollar Index	80.255	.00	0.00%
EUR/USD	1.3789	.0019	0.14%
GBP/USD	1.6628	-.0034	-0.20%
USD/JPY	103.65	.46	0.45%
USD/CAD	1.1032	-.0016	-0.14%
AUD/USD	.9243	-.0019	-0.21%
USD/BRL	2.2644	-.007	-0.31%
10-year Yield	2.759	.036	1.32%
30-year Yield	3.604	.043	1.21%

Prices taken at previous day market close.

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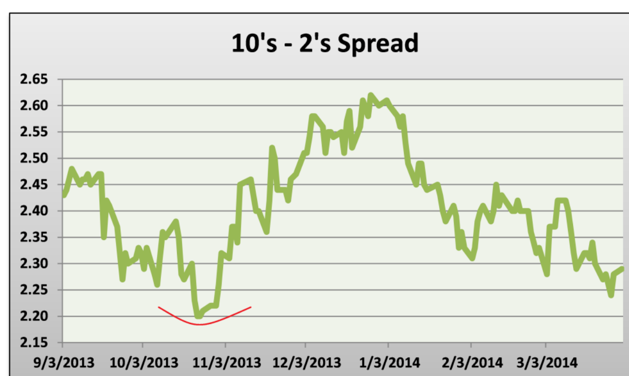
sure if mounting, and a break of 104 to the dollar would see the declines accelerate.

Also in Asia, the Aussie dollar sold off modestly (0.3%) on yesterday's near-perfect Reserve Bank of Australia meeting comments. (There was no change to policy, while language was cautionary but not "dovish.") But keeping in mind the Aussie has seen a run-up into this meeting, a "sell the news" reaction makes sense.

Also weighing slightly on the Aussie was the Chinese manufacturing PMIs. While they met expectations, in an absolute sense they are indicative of low manufacturing activity. Raw material export to Chinese factories is a major part of the Australian economy, so the absolute level mattered more than meeting expectations.



The Aussie seems to have lost a bit of momentum, and I continue to maintain selling Aussie here via the 6A (Aussie dollar futures) or CROC (the inverse ETF) is a fundamentally sound trade – although in the short term, we could see the Aussie go higher before ultimately again trading with an "0.8" handle vs. the dollar.

Bonds saw a decent sell-off yesterday thanks to the manufacturing data and the auto sales, as the 30-year dropped 0.45% and the 10-year fell 0.1%, resulting in a steepening of the yield curve (more on that in a second). Of note, the 10-year yield looks to have broken out from the downtrend in place since the highs of late 2013. If it can hold the breakout, this would be another signal this counter-trend rally is over. Although with the jobs report looming, there are obviously risks to that opinion.

The 10's—2's Spread Just Bottomed, and That's Negative for Bonds

I've been consistently pointing out that Treasury bonds themselves have been surprisingly resilient in the face of better-than-expected data and a "hawkish" FOMC statement back in March. Frankly, the yield on the 30- and 10-year Treasuries remains lower than I thought they would be a few weeks ago.

But, I think we may be getting a sign that the bond decline is about to resume in earnest, and it's coming from the yield curve. It looks like the yield curve has "bottomed," so to speak, as the spread between the 10-year Treasury and the 2-year Treasury (known appropriately as the "10's minus 2's Spread") "bottomed" a few days ago at 2.2%—the same level it "bottomed" at back in October.

A steepening yield curve is a characteristic of a declining bond market (and increased economic activity and potential inflation), because the "long" end of the curve is sold harder than the short end, causing longer-dated yields to rise faster.

So, as is my habit, I think we're found another "low risk/high return" trade by "buying" the 10's-2's spread. Back in late October, when the last "counter-trend rally" in the bond market ended, the 10's-2's spread bottomed at 2.20%, and subsequently rose over the next two months to 2.62%.

During that period, KBE (the bank stock ETF), rose from $31.44 on Oct. 24 to $33.23 on Dec. 31 (which was the recent high tick for the spread). That's a two-month return of 5%.

STPP (the Treasury steepener ETN) rose from $38.06 to $42.05 over the same period, a return of 10.5% over two months. I know these aren't new ideas of ETF's, but it looks like there's opportunity in both thanks to the turn in this spread. And, we have a clear stop that will tell us if we are wrong (2.20% on the 10's-2's).

I hate making moves like this ahead of jobs numbers, but in this specific case I think the risk is worth the reward.

Have a good day,

Tom

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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 again traded to new highs this week as 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.* *The S&P 500 is at new highs while support sits at 1870 and 1850.*

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.**

	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

Neutral on all commodities currently.

	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. **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."**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**

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