7:00's Report

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

April 21st, 2014

Pre 7:00 Look

- Futures are drifting slightly higher after a very quiet holiday weekend. Most European markets are closed today.
- Shanghai was the laggard o/n, dropping more than 1% on selling ahead of key economic data tomorrow.
- Japanese trade balance was the only economic release. Exports badly missed expectations, incrementally adding more fodder to the "do more" argument for the BOJ.
- Econ Today: No economic reports today.
- Earnings Today: HAL (E: $0.71), STI (E: $0.67), NFLX (E: $0.83).

Market	Level	Change	% Change
S&P 500 Futures	1860.25	2.25	.12%
U.S. Dollar (DXY)	79.915	.012	.02%
Gold	1287.40	-6.50	-.50%
WTI	103.15	-.22	-.21%
10-year	2.721	.084	3.19%

Equities

Market Recap

Stocks saw a nice rebound last week as failed sell-offs on Monday and Tuesday, combined with a good start to earnings season and largely better-than-expected economic data, boosted sentiment last week. The S&P 500 held support at 1,815, rallied 2.7% last week and is up 0.89% year-to-date.

Fundamentals remained very static and were unchanged last week, and the key to last week's rally was drastically improved price action. Officially, the market closed higher every day last week except Thursday, but things were much more nuanced than that.

Specifically, Monday and Tuesday were the keys last week, as both days saw their big initial rallies totally erased by midday. Importantly, support at 1,815 held those two specific tests, and the market was able to rally off that level and close materially higher both days.

That improved price action helped to alter sentiment. Subsequently, shorts stopped pressing and began to cover, and then they were followed by "dip-buyers."

Decent earnings results also arrived steadily last week (or, at least, results were "not as bad as feared"). JNJ, KO, MS and GS all saw nice rallies on decent outlooks and results.

Economic data also helped re-affirm (at least temporarily) that economic growth was continuing. "Beats" by retail sales, weekly jobless claims and the Philly Fed Manufacturing Index, combined with basically in-line Chinese data, also led to improved sentiment.

With improved price action and the backing of good earnings and economic data, stocks rose nicely Wednesday before treading water in quiet trading Thursday to end the week solidly positive and smack in the middle of the month-long trading range.

Trading Color

"Momentum" sectors appear to be trying to stabilize, as both QNET and NBI look to have (hopefully) put in a bottom. And, although earnings somewhat skewed the trading in semiconductors and banks, we did not see a continued "bleed" of selling from the high-multiple biotech and Internet "momentum" stocks into other sectors of the market with positive performance.

Markets were broadly positive last week and there was

Market	Level	Change	% Change
Dow	16408.54	-16.31	-.10%
TSX	14500.39	53.87	.37%
Brazil	52111.85	911.29	1.78%
FTSE	6625.25	41.08	.62%
Nikkei	14512.38	-3.89	-.03%
Hang Seng	22760.24	64.23	.28%
ASX	5454.23	33.91	.63%
Prices taken at previous day market close.			

some definitive "cyclical" outperformance as basic materials, energy, tech and healthcare all outperformed. Meanwhile we saw utilities, REITs and consumer staples lag the broader markets (but still finish solidly positive on the week).

Market	Level	Change	% Change
DBC	26.65	.07	0.26%
Gold	1295.00	-8.50	-0.65%
Silver	19.595	-.039	-0.20%
Copper	3.0495	.024	0.79%
WTI	104.34	.58	0.56%
Brent	109.68	.08	0.07%
Nat Gas	4.73	.20	4.41%
RBOB	3.0569	.0164	0.54%
DBA (Grains)	28.86	.34	1.19%
Prices taken at previous day market close.			

Volumes Monday/Tuesday were higher than one would have expected given it was a holiday week. This was especially the case Tuesday, where the rally off the lows came with good volume and activity (even with the holiday), and that contributed to the positive change in short-term sentiment.

On the charts, the S&P 500 is once again squarely back in the middle of the 1,840-1,880 trading range it's existed in for most of the last month. Once again, the S&P is flat on the year (which is where it's been pretty much the entire year).

With regard to momentum sectors, the levels to watch in QNET and NBI are 352 and 2,168, respectively. Those lows from last week shouldn't be violated for any reason if the selling is finally done in these momentum sectors (which it seems like it is).

<u>This Week</u>

It's all about earnings this week, as this is the "peak" week of the Q1 reporting season.

In particular, there will be many "momentum" names reporting this week: NFLX tonight, AMGN/GILD Tuesday, FB/NOW Wednesday, AMZN/P Thursday. So, in the context of "momentum" sectors trying to stabilize, this is going to be a critical week.

Even without the "momentum" names reporting, though, this would be a busy week, as many Dow and "systemically" important companies are announcing results (HAL, BK, CMCSA, MLT, T, YUM, BA, DOW, EMC, AAPL, QCOM, MMM, UPS, VZ, MSFT, SBUX, V and CL, to name just a few).

Economically it's mostly quiet outside of the global April flash PMIs (Wednesday night). On the central bank front it's also a pretty slow week, although ECB President Mario Draghi speaks Thursday morning. So, from a "will the ECB do QE?" standpoint and the recent rhetorical barrage from ECB members both "for" and "against" QE, his comments will be closely watched.

<u>Bottom Line</u>

The key question as we start the week is "Was that it?" with regard to the sell-off. While the answer is probably "yes," it really doesn't make that much of a difference as far as how to outperform in this market.

Even if the sell-off is over, I highly doubt we'll see a grind higher in the averages from here unless earnings are much better-than-expected. The S&P 500 is once again flat on the year and has spent the last four-plus months gyrating (sometimes violently) around flat.

The key to outperforming this market remains the same: *sector selection*.

Sectors that are trading with decent valuations and positive (or positively turning) fundamentals held up very well throughout the broad-market weakness (e.g., coal, natural gas E&Ps, PICK, industrials). Finding those sectors (energy transportation names are something I want to do some more work on this week, as that may be an attractive place for capital) and holding them or hedging with a broad equity short remains a good strategy.

Additionally, I continue to think there are attractive opportunities in the international sectors. (Specifically Europe, but there are some signs that the outlook for growth in China may be stabilizing despite very negative sentiment, although obviously this week will be key.)

Positioning and sentiment remain key as opposed to fundamentals. (There are no major "macro" influences on the market at the moment. While Russia and Ukraine dominate headlines, unless Russia invades Ukraine, the market won't really trade off it.)

If I had to choose a direction, given the bar for earnings results is pretty low, the path of least resistance in the very near term is probably higher. But, again I'd be surprised if this market does much more than continue to tread water in this 1,880-1,840 range for the next several weeks, unless earnings surprise materially to the upside or downside.

Economics

Last Week

Economic data last week was pretty good overall, and furthered the idea that the economy is indeed continuing to regain momentum following the winter-weather-induced slowdown. The fact that most economic metrics last week beat estimates did help markets to stabilize.

March retail sales, industrial production and the April Philly Fed manufacturing index all beat estimates. Each continued to show in increase in activity compared to the previous few months.

The one outlier last week was the Empire State manufacturing index, which missed expectations, although Empire isn't really reflective of greater national manufacturing trends. (The Empire State survey truly exists in its own world most of the time.)

Jobless claims also remained low, and the four-week moving average hit a new five-year low at 312K. Even though some are pointing to Easter hiring as having an impact on the weekly claims data, the trend lower in claims has been ongoing for over a month (the four-week moving average is 18K lower than a month ago).

That drop in claims is anecdotally positive for the labor market, and it will continue to put upward pressure on expectations for the April jobs report, which is less than two weeks away. Specifically, last week was "reference week" for the monthly jobs report. (Reference week is the week when the Bureau of Labor Statistics conducts its monthly surveys and takes the data.) It's worth noting that, from the March "reference week" to the April "reference week," weekly jobless claims have fallen by 19K.

Market	Level	Change	% Change
Dollar Index	79.915	.03	0.04%
EUR/USD	1.3814	-.0001	-0.01%
GBP/USD	1.6793	-.0003	-0.02%
USD/JPY	102.42	.20	0.20%
USD/CAD	1.1008	.00	0.00%
AUD/USD	.9326	-.0044	-0.47%
USD/BRL	2.2393	-.0037	-0.16%
10-year Yield	2.721	.084	3.19%
30-year Yield	3.517	.063	1.82%

Prices taken at previous day market close.

The one area of disappointment in the data last week remained the housing market. The housing market index disappointed and housing starts missed expectations. Permits (the leading indicator in the report) were also weaker-than-expected.

While the housing market is still in "recovery" mode, it remains the one area of the economy where we haven't seen a "bounce back" from winter weather. With interest rates again low and winter receding, it'll be important for the housing data to "catch up" to a point to other areas of the economy over the coming months.

Bottom line is the market entered last week with a greater sense of trepidation about the economy than it otherwise should have based on the hard data. And, the reason for that trepidation was mainly low bond yields. The data last week helped, at least temporarily, reassure markets the economy is moving back to trend growth. But until bond yields start moving decidedly higher, doubts about the strength of the economy will remain .

This Week

Focus this week will be on the global flash manufacturing PMIs for April, which come Tuesday night (China) and Wednesday morning (Europe and U.S.). As is the case, the Chinese data will be the most important, followed by Europe and the U.S.

Generally, the market will be looking for the data to confirm that: 1) China is slowing but not collapsing, 2) Europe is seeing a slow recovery but is indeed progressing, and 3) the U.S. economic recovery is progressing. As long as those assumptions are met, markets shouldn't react too much.

Outside of the global PMIs, there are a few key reports to watch domestically this week including durable goods and jobless claims (Thursday). There is also more housing data via existing home sales (Tuesday) and new home sales (Wednesday). As mentioned, any uptick in activity in those reports will be welcomed by the market.

Internationally it's pretty quiet outside of the flash manufacturing PMIs, as the German IFO (business climate) survey comes Thursday while Great Britain's retail sales come Friday.

Bottom line: This week is about the flash PMIs. After that, while there are reports to watch, don't expect them to materially alter the outlook for the global or domestic economy—even if they are a "miss."

Commodities

Commodities were higher last week as strength in industrial commodities (base metals, energy) offset weakness in gold. The broad based commodity ETF DBC rose just over 1% and hit a 7 month high, as commodities continue to be a surprisingly strong asset class so far in 2014.

Starting first with the laggards, though, gold dropped more than 2% last week and is trading well below \$1300/oz. this morning, as concerns about Chinese demand and slightly higher than expected CPI reading last week weighed on gold. The key negative catalyst last week was the China import data, as China has been the marginal buyer of gold over the last year and it appears that appetite may starting to wane a bit, given the slowing economic and recent drop on the Yuan.

\$1277 remains the key level in gold (it's the lows of three weeks ago). If the uptrend is still in tact, that level should hold—if it doesn't, a quick run to \$1240 wouldn't be surprising.

WTI Crude was flat last week after rallying early to the top of the \$102-\$105 trading range on Russia/Ukraine concerns. But, WTI then paused and sold off following a massive inventory build (the weekly data showed inventories in Cushing, OK rose 10 million barrels, well above expectations).

WTI remains largely in that \$102-\$105 range, but it was RBOB gasoline that broke out last week, hitting a new eight month high. And, it appears that strength in RBOB is helping to support the entire energy complex the way strength in Heating Oil did earlier this winter.

Production of gasoline should increase over the coming weeks as refineries complete normal seasonal maintenance and begin producing more product, but there's also a demand component to consider. As more people get back to work, more people are commuting and driving, and gasoline demand goes up. And, this uptick in demand and prices is an anecdotal positive for the economy.

Keys this week in the commodity space will be whether gold can hold support at \$1277 and whether WTI Crude can finally break out above \$105/bbl.

Currencies & Bonds

This is going to be a very interesting and important week in the bond market, as it remains a major non-confirmation signal with regards to higher stock prices.

Trading was volatile in bonds last week, as the thirty year Treasury hit a new high for the year, above 135'00, before reversing and selling off hard Thursday to close basically on the lows of the week. On a weekly basis, bond actually traded an "outside reversal," hitting a new high intra-week but finishing well below the previous week's lows (that's a bearish technical sign).

Bearish outside reversals aside, though, bonds have been strong all year so it'd be foolish to call a top after just one bad day. Longer term though I remain an ardent bond bear, and if Treasuries can start to sell off, then that will become a tail wind for stocks as bonds begin to finally "confirm" higher equity prices.

Currencies last week were pretty quiet and it'll be that way again this week. The Dollar Index rose last week on a combination of economic data and some "dovish" commentary in the EU, and now is sitting right below the 80 level. Conversely, the euro continues to trade almost exclusively off rhetoric regarding QE or "unconventional' policy measures that may be used by the ECB in the future. That will continue this week, as ECB President Draghi speaks Thursday night.

The British Pound was the star of last week, as it rose to a four year high vs. the dollar after a March Labour Market report was much stronger than expected. Lost in all the debate over what (if anything) the ECB will do next is the fact that the Bank of England will likely be the first major developed central bank to begin raising rates, likely later this year, and the Pound remains the most fundamentally strong currency versus the dollar.

Have a good 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**	*The S&P 500 saw a nice rebound last week off support at 1815, and is now back in the middle of a month long trading range. Gradual economic improvement domestically and globally is a tailwind on stocks, and unless earnings season is very, very disappointing, the path of least resistance remains broadly higher.* *The S&P 500 remains in the 1880-1840 trading range.*

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**	**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.**