7:00's Report

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

April 23rd, 2014

Internet Stocks have rebounded and broken the downtrend started in early March. Now bio-techs (IBB) need to follow to imply the bottom in "momentum" is in.

Pre 7:00 Look

- Futures are drifting slightly lower as markets digest recent gains, despite global PMIs largely coming in "ok."
- China's March manufacturing PMI was 48.3 vs. (E) 48.4 and up from 48.0 in March. Generally the number is being views as implying some stabilization in China.
- European data implied the recovery is gaining traction as German and EU manufacturing PMIs rose to 53.3 and 54.2 respectively,
- Econ Today: Flash PMI (E: 56.3), New Home Sales (E: 455K).
- Earnings Today: BA (E: $1.54), PG (E: $1.02), AAPL (E: $10.21), FB (E: $0.25), RJF (E: $0.78).

Market	Level	Change	% Change
S&P 500 Futures	1871.75	-2.25	-.11%
U.S. Dollar (DXY)	79.82	-.175	-.22%
Gold	1286.80	5.70	.44%
WTI	101.40	-.35	-.34%
10-year	2.726	.005	0.18%

Equities

Market Recap

Stocks traded higher again Tuesday on more M&A news, better-than-expected earnings and continued disregard for the situation in Ukraine. The S&P 500 rose 0.41%.

Stocks opened higher thanks to better-than-expected earnings from NFLX, HOG, CMCSA and UTX and a second consecutive day of M&A announcements and chatter from the pharma sector.

Unlike Monday, there was no early morning dip, and stocks drifted steadily higher throughout the morning and early afternoon, hitting their highs right before 2 o'clock.

Interestingly, the market ignored some negative headlines regarding Ukraine, including: Russian Foreign Minister Sergei Lavrov saying Russia may need to "rescue" parts of eastern Ukraine. Additionally, the Ukrainian government resumed its anti-terror campaign in eastern Ukraine and late in the day there was news that U.S. troops (granted, a relatively small number) were conducting "exercises" in eastern Europe.

Stocks ended the day off the highs as investors de-risked a bit during the last hour of trading, which makes sense given the economic data that came overnight. (A Jon Hilsenrath WSJ article (link here) that implied the Fed was getting a bit worried about inflation was blamed for the late dip, but that was more an excuse than a cause.)

Trading Color

"Momentum" sectors continued to rebound as NBI and QNET rallied 3.2% and 1.35%, respectively, thanks mainly to the NFLX beat (the stock was up 7% yesterday). This

Market	Level	Change	% Change
Dow	16514.37	65.12	.40%
TSX	14555.97	62.29	.43%
Brazil	51976.86	-164.99	-.26%
FTSE	6673.59	-8.17	-.12%
Nikkei	14546.27	157.50	1.09%
Hang Seng	22509.64	-221.04	-.97%
ASX	5517.77	38.46	.70%
Prices taken at previous day market close.			

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helped to support the Internet stocks, while all this M&A is peripherally helping the biotechs.

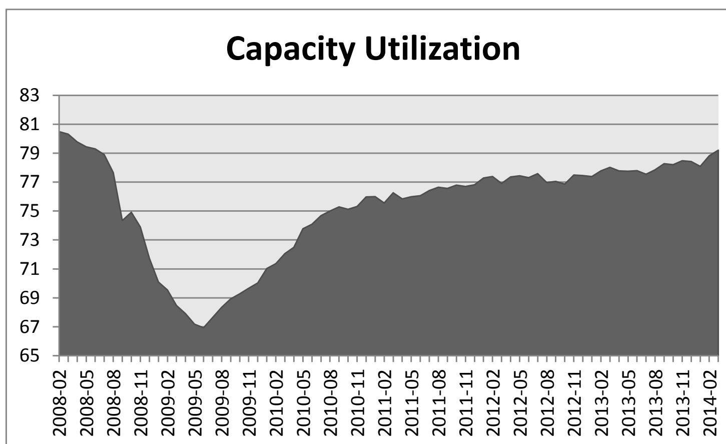
More broadly, we saw solid outperformance from cyclical sectors, as the Russell 2000 rose 1.12% and the Nasdaq rose 0.97% (compared to 0.4% for the Dow). Sector trading also saw pretty definitive "macro" outperformance, as 8 of 10 S&P 500 subsectors were positive, with just consumer staples and energy finishing very slightly negative.

Market	Level	Change	% Change
DBC	26.53	-.02	-0.08%
Gold	1283.00	-5.50	-0.43%
Silver	19.40	.049	0.25%
Copper	3.0595	.0165	0.54%
WTI	101.67	-1.98	-1.91%
Brent	108.83	.09	0.08%
Nat Gas	4.74	.043	0.92%
RBOB	3.0908	.0039	0.13%
DBA (Grains)	28.97	.48	1.70%
Prices taken at previous day market close.			

Homebuilders (they were helped by the better-than-expected existing home sales data), semiconductors, healthcare and consumer discretionary led markets higher, while banks also traded decently (up 0.67%) and defensive sectors like utilities and REITs lagged the market. So, internally it was a "risk on" day.

The one negative was that yesterday's rally again came on low volume and little participation from "real money." And, low volumes continue to plague rallies in this market. The S&P 500 briefly broke above the 1,880 top end of its recent trading range, but couldn't hold there and closed below that resistance.

Of note, QNET has broken the downtrend that started earlier in March. Now NBI, the Nasdaq and the Russell 2000 are approaching that resistance. So, if they can break through as well, it may be safe to say this correction in "momentum" is truly over.



Economics

Existing Home Sales

- March Pending Home Sales 4.59M (saar) vs. (E) 4.56M (saar).

March existing home sales declined marginally from February, but beat expectations and importantly showed signs of stabilizing. March existing home sales were 4.59 million (saar) vs. (E) 4.56 million (saar), just a -0.2% decrease month-over-month.

High prices and limited supply continue to weigh on sales as the median home price was up 7.9% year-over-year (which is a good thing and much more important than the pace of sales). Meanwhile, supply increased to 5.2 months' worth vs. 5.0 in February, but in an absolute sense supply remains tight.

More broadly, the important thing here is that the pace of recovery in the housing market shows stability, as we've seen a slowing in the housing recovery basically since last June. Yesterday's March Existing Home Sales data implied that stabilization may be starting to occur, which would be a peripheral positive for the economy and would also remove a potential source of risk (i.e., if the recovery slows further).

Green Shoots in Inflation?

Inflation remains the No. 1 "contrarian" idea out there right now, and if we look around the markets, inflation remains one of the very few "cheap" things out there. But, there are signs that we may be seeing "green shoots" in inflation, finally. And, in the context of my bond market analysis yesterday, I thought it'd be helpful to show just why I'm saying we're seeing some "green shoots" of inflation.

First, capacity utilization—which is basically a measure of how much "slack" there is in the industrial and manufacturing sectors of the economy—just hit a five-year high and is nearly back to its pre-financial crisis highs.

So, from a practical point of view, activity in the industrial and manufacturing sectors of the economy is heading higher. When that happens, it increases demand for re-

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sources, which puts upward pressure on those prices. (If 10 factories are running instead of 5, obviously there's more demand for raw materials and labor, which is inflationary.) "Cap U" is still below the long-term average of 80.1, but it's trending higher, which is worth noting.

Second, last week's March CPI report saw the biggest monthly increase in "core" CPI in over a year (0.2%). Admittedly that's small in an absolute sense, but it's the rate of change here that matters.

This uptick in CPI will likely translate into a higher-than-expected "Core PCE Price Index" when the Personal Income and Outlays report is released later this month. (Keep in mind the "Core PCE Price Index" is the Fed's preferred measure of inflation.)

Finally, at the end of last week, the Bureau of Labor Statistics released its "Usual Weekly Earnings Summary." For those of you who don't know it (and most don't; only nerds like me who love this stuff follow it), it's basically a quarterly survey the BLS does that shows the wage situation among hourly and salaried workers.

Normally this thing is a non-event, but the survey for Q1 showed that pay for wage and salary employees rose 3% year-over-year in Q1. That's the largest annual increase since 2008.

Now, I realize that, in last month's official jobs report, the hourly wage data disappointed. So we've got a bit of a mixed picture here. But, with things like wages, I prefer to see annual rather than monthly movements, as these are longer, stronger trends we're trying to monitor.

So, to recap, we're seeing some upward movement in: the demand for resources in the manufacturing and industrial sectors (capacity utilization), prices in the economy (CPI) and wages

Now, that doesn't mean we're about to see inflation appear tomorrow, but these are subtle signs that inflation is starting to gain momentum.

And, I point it out because, again "inflation," is about the cheapest thing out there right now. It may be worth taking a look at your (or your clients') portfolios with regard to your exposure if inflation does move higher, and developing an "inflation basket" of stocks, commodities, etc. that are positively correlated to rising inflation, should/when these rising price trends accelerate.

This is just off the cuff, but an "inflation basket" would be comprised primarily of equities—with overweighting to financials, high-beta sectors, energy, global miners, and other hard-asset-related stocks. Also, commodity ETFs like DBA and DBA, MLPs for income, and short term or floating rate debt securities. Oddly, and contrary to popular logic, historically speaking, stocks (especially certain sectors) can be a better hedge to inflation than gold, although obviously gold would go up, too.

Commodities

Commodities were mixed yesterday in active trading. Crude oil was one of the worst performers ahead of inventory data, while industrial metals and natural gas outperformed. The PowerShares DB Commodity Tracking Index ETF (DBC) was little-changed, though, down just 0.08%.

Crude oil was the biggest mover yesterday, falling 1.8%. Futures were down thanks to analyst expectations calling for the 13th inventory build in 14 weeks to be reported by the EIA later this morning (10:30 ET). Analysts are expecting supplies to rise by 3M barrels, which will push total reserves up toward the 400M-barrel mark. This is obviously a bearish supply-side fundamental.

On the charts, WTI traded down through initial support at the $102/barrel level, but remains above the 50-day moving average and a key trendline that has been in place since early January. That critical support level is sitting at $101.30 and it will be in focus today.

Elsewhere in energy, natural gas futures have held last week's EIA-report-driven gains, continuing to trade comfortably above the $4.70 level which should be considered the first line of support.

Market	Level	Change	% Change
Dollar Index	79.99	-.04	-0.05%
EUR/USD	1.3802	.0011	0.08%
GBP/USD	1.6826	.0036	0.21%
USD/JPY	102.62	.01	0.01%
USD/CAD	1.1028	.0019	0.17%
AUD/USD	.9358	.0032	0.34%
USD/BRL	2.2408	.0048	0.21%
10-year Yield	2.726	.005	0.18%
30-year Yield	3.503	-.022	-0.62%

Prices taken at previous day market close.

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Again, it is the critical supply situation (national inventories at an 11-year low) that is supporting prices here. Futures can be expected to remain in the upper-$4 range and potentially work toward $5, depending on inventory data. Bottom line, high natural gas prices continue to support the thesis behind the natural gas E&P ETFs FCG and XOP, which both made fresh 52-week highs yesterday.

Gold traded lower yesterday as futures briefly broke through support at $1,277 yesterday but were able to close well off the lows for a loss of just -0.43% on the day. There was no real catalyst for the drop in gold prices (China related selling could be blamed if we needed to point to something) as the move began pre-market and only accelerated as stops were hit in the low-$1,280s.

$1277 is key for gold, plain and simple. I remain a longer term gold bull (given my inflationist leanings) and will take a very low risk trade on the long side this morning in gold (as $1277 is the clear stop in futures and $123.11 in GLD). So, we're literally risking less than .5% to see if gold can indeed bottom in here.

Currencies & Bonds

Currency markets were broadly flat yesterday in what turned out to be a day of "looking ahead" to the economic data that came overnight. The Dollar Index was little-changed, slipping just 0.06% yesterday.

The euro was flat as traders anticipated this morning's EU flash PMIs, which came in slightly better than expected and further confirmed that the EU economy is recovering. Fundamentally, things were better than the euro implied yesterday as it was again looking ahead to the data. A measure of euro-zone consumer confidence was released yesterday and the results were better-than-expected (0.6 vs. (E) 0.3) for the month of April. Also, ECB member Luis Linde implied that if there was not an uptick in the HICP (the EU's CPI) report for May, the ECB may be forced into further action. The euro is now trading .3% higher on the news, bouncing off the lower end of the recent trading range.

Elsewhere in Europe, the pound added a modest 0.2% as traders positioned ahead of the BOE's most-recent meeting minutes. The minutes didn't really reveal anything new, so we're seeing a slight "sell the news" move in the pound this morning, although it remains just off a four-year high versus the dollar and will likely remain strong for now, given the BOE will almost certainly be the first major developed central bank to raise rates.

In Asia, the yen was essentially flat on the day, up just 0.01%, but that was enough to snap a six-day losing streak, and the yen is modestly higher this morning (.39%) on more chatter than the official government outlook for inflation and economic growth (out next week) will be stronger than expected.

The Aussie rallied 0.34% thanks to positioning ahead of the national CPI report that came out last night, but has since reversed hard after CPI came in lower than expectations (reducing any chance of a RBA rate hike) and on the soft China flash manufacturing PMI. Aussie is now .8% as of this writing, and while I'm not sure this is going to be the catalyst that ends this counter trend rally in Aussie, I do think selling "Aussie" in the mid-.90's remains a good trade for those who can stomach the risk and have a long enough time horizon. I don't know when it'll break again, but Aussie will not stay in the mid .90's vs. the dollar if the Aussie economy is going to recover the way the RBA wants it to.

Moving to the U.S. bond market, Treasuries were flat for most of the day, but the 30-year did catch a bid into the close on short-covering ahead of the global PMI reports. There was a 2-year note auction yesterday, and the results were mixed. The bid to cover was 3.35, which was relatively in-line with the 2013 average. This indicated decent buyer interest; however, the actual yield was slightly higher than the "when issued" yield, which shows somewhat weak demand.

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	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). A note on ACI—The stock got hit on earnings yesterday due mostly to reduced shipments of PBR coal and lowered sales guidance. The overall coal story remains intact and I wouldn't sell the shares here, but would likely lighten up on some sort of a bounce in ACI and reallocate to KOL as upside much beyond the highs 4's appears limited given yesterday's update.**

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, 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. I'm taking a low risk long trade on gold this morning, using a stop at $1277 in futures or $123.11 in GLD.**

	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.**

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