7:00's Report

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

April 25th, 2014

A Potential Positive "Macro" Sign: Copper has rebounded nicely over the past few weeks, and is now challenging a multi-month downtrend.

Pre 7:00 Look

- Futures and most international markets are lower this morning on geo-political angst thanks to escalating rhetoric between Russia and the Ukraine.
- Japanese CPI increased to 1.6% yoy mostly due to the consumption tax increase, but the result was inline.
- Great Britain March retail sales beat estimates, rising 0.1% vs. (E) -0.4%, but it's being largely ignored.
- Econ Today: March Flash Service PMI (E: 56.2).
- Earnings Today: CL (E: $0.68), F (E: $0.32), VFC (E: $0.64), WHR (E: $2.30).

Market	Level	Change	% Change
S&P 500 Futures	1870.25	-2.75	-0.15%
U.S. Dollar (DXY)	79.785	-.092	-0.12%
Gold	1296.00	5.40	0.42%
WTI	101.46	-.48	-0.47%
10-year	2.688	.02	0.07%

Equities

Market Recap

Stocks finished trading Thursday with small gains as more good earnings and a strong durable goods report again trumped the escalating rhetoric between Russia and Ukraine. The S&P 500 rose 0.17%.

Stocks opened stronger thanks to parade of good earnings (AAPL, FB, CAT, etc.) and on the durable goods report. But, within a half-hour of the open, reports of threats of military action from Russia weighed on the averages. For the second-straight day, the S&P 500 hit its low within an hour of the open.

Like Wednesday, though, there were buyers on the dip and by noontime, the S&P 500 was basically at its high for the day. The afternoon session was relatively quiet (more Ukraine rumors caused a dip around 1:30), but stocks mostly drifted as activity slowed during the afternoon. Markets closed relatively quietly.

Trading Color

Momentum traded poorly for the second-straight day. NBI and QNET both declined 0.5%, and word from desks was that shorts are getting more-comfortable laying out exposure in the Internet and biotech names. Although they've, to a point, moved to the back burner, it's not a foregone conclusion that the sell-off in momentum is over. Disconcertingly, FB gave back nearly 4% of its gains on the day despite strong results, and NFLX has now retraced the earnings rally.

In biotech, weak results also contributed to the weakness, lackluster numbers from CELG weighed and BIIB (which missed Wednesday) got hit for another 3.75%.

Market	Level	Change	% Change
Dow	16,501.65	0.00	0.00%
TSX	14,544.25	53.86	0.37%
Brazil	51,817.45	247.76	0.48%
FTSE	6,687.20	-15.80	-0.24%
Nikkei	14,429.26	24.27	0.17%
Hang Seng	22,223.53	-339.27	-1.50%
ASX	5,531.00	13.24	0.24%
Prices taken at previous day market close.			

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More broadly, yesterday looked stronger than it actually was. AAPL by itself added nearly 4 points to the S&P 500 (helping it close in the green), while the Nasdaq outperformance was also due largely to AAPL. The Dow was flat and the Russell declined 0.25%.

Market	Level	Change	% Change
DBC	26.66	.14	0.53%
Gold	1291.60	7.00	0.54%
Silver	19.685	.247	1.27%
Copper	3.117	.058	1.90%
WTI	101.87	.43	0.42%
Brent	110.34	1.23	1.13%
Nat Gas	4.704	-.026	-0.55%
RBOB	3.0885	-.005	-0.16%
DBA (Grains)	29.19	-.02	-0.06%
Prices taken at previous day market close.			

Internally most S&P 500 sub-sectors finished higher, with healthcare (weighed down by biotech), financials (weighed down by banks), industrials and basic materials all finishing slightly lower.

Banks were actually the big laggard yesterday, as KBE dropped 1.45% after several regional banks missed earnings, led by a 4.3% drop in VLY. The ever-flattening yield curve (the 5's-30's spread dropped to a multi-year low) didn't help bank sentiment, either.

On the plus side, tech (courtesy of AAPL), utilities and consumer discretionary (led by SPLS, TGT and LOW) were outperformers, although nothing was up more than 1%.

Volumes were in-line with levels earlier in the week, but it's a bit misleading. Things are busy around earnings, but away from those specific situations, things are actually pretty quiet.

On the charts, the S&P 500 again failed to close above the 1,880 level, and remains squarely in the 1,880-1,840 trading range.

Russia Update—What to Watch For Into The Weekend

Rhetoric has been ratcheted up this week, and any sort of "truce" deal announced last Friday is over with. And, there is potential for the rhetoric to escalate further over the weekend, as Russia is now conducting military exercises on the Ukrainian border. And, the U.S. may announce additional sanctions on individual Russians as early as today (although the sanctions won't be on sections of the economy—an important distinction).

Despite the uptick in rhetoric, though, the bottom line is that the market doesn't really care about this unless there is some sort of invasion (and then it will care a lot). Right or wrong, the prevailing logic is that if Putin had wanted to invade Ukraine, he has ample opportunity to do so over the past several weeks. So, in all likelihood, he is just using the rhetoric and operations as leverage heading into the May 15 national elections. (Putin's goal is to have leverage over the Ukrainian government, like he used to—not to *become* the Ukrainian government.)

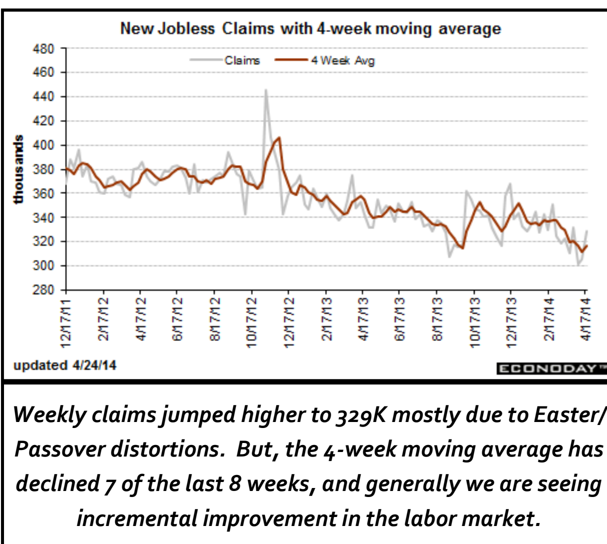
Economics

Durable Goods Orders

- March New Orders increased by 2.6% vs. (E) 2.0%

Takeaway

Yesterday's durables headline was a beat. But more importantly, the key details of the report were quite strong. Non-Defense Capital Goods Ex-Aircraft (NDCGXA) rebounded from a negative 1.1% reading in February to a positive 2.2% in March.



Weekly claims jumped higher to 329K mostly due to Easter/ Passover distortions. But, the 4-week moving average has declined 7 of the last 8 weeks, and generally we are seeing incremental improvement in the labor market.

Bottom line is this report further solidifies that the dip in the economy was temporary and due to weather. More importantly, capital expenditures remain a wild card in the economic picture. If activity can accelerate (as this durables report suggested) then that's an incremental positive for the economy that isn't really being factored in right now.

Commodities

Commodities were mostly higher yesterday, led by the metals, while natural gas was the notable outlier, falling 0.55%. The benchmark commodity tracking index ETF, DBC, gained 0.53% on the day.

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Metals were the best-performing sector in the commodity space yesterday as copper, gold and silver were up 1.9%, 0.54% and 1.27%, respectively.

Starting with gold, futures broke down through support in pre-market trading yesterday morning thanks to good economic data globally and several notable earnings beats. Gold fell through support at $1,275 and traded at a low tick of $1,268.40 before sharply reversing and rallying to positive territory. The rally came about upon release of headlines that tensions were rising between the Ukraine and Russia. Weak shorts got squeezed and futures rallied toward $1,300, which once again has proven to be a magnetic level.

On the charts, support at $1,275 remains intact, for now. And if you were long the ETF GLD, you likely got lucky and did not get stopped out of the long position. The technicals have turned slightly bullish as yesterday's bounce ended a nearly two-week downtrend, but prices are now pinned between support at $1,275 and resistance at $1,300/oz.

Copper finally broke out of the recent trading range that has corralled futures between $3.02 and $3.05. Copper gained 1.88% to close at a 7-week high yesterday. Better-than-expected global economic data as well as easing concerns regarding recent weakness in China spurred the rally. Copper handily broke through the 50 day moving average at $3.08 and closed well above it at $3.12. Initial support lies on the aforementioned 50-day moving average.

In energy, crude oil futures bounced back yesterday after falling due to bearish EIA data on Wednesday. WTI gained 0.42% thanks to the same Ukrainian geopolitical "fear bid" that sent gold futures higher. Nymex crude oil futures have held support at the $101.30 level, suggesting the bulls remain in control (albeit with the help of the Ukraine). On the charts, $101.30 is the line in the sand while $103 is the level to beat.

Market	Level	Change	% Change
Dollar Index	79.875	-.06	-0.08%
EUR/USD	1.3826	.001	0.07%
GBP/USD	1.6799	.0019	0.11%
USD/JPY	102.35	-.18	-0.18%
USD/CAD	1.1025	-.0006	-0.05%
AUD/USD	.9258	-.0031	-0.33%
USD/BRL	2.2181	-.0024	-0.11%
10-year Yield	2.688	.02	0.07%
30-year Yield	3.464	-.005	-0.14%
Prices taken at previous day market close.			

Elsewhere in energy, yesterday was inventory day for natural gas. The EIA reported that natural gas stocks increased by 39 Bcf vs. (E) 57 Bcf, but that proved to be disappointing to the speculative longs who seemed to unwind positions shortly after the release. Natural gas futures did however hold at the $4.70 level and that remains important support, while resistance is hovering at $4.80.

Currencies & Bonds

Currencies were relatively quiet yesterday as economic data and U.S. earnings were digested. The Dollar Index was little-changed as a strong durable goods report offset a miss in jobless claims.

The euro was the only currency with potentially market-moving news out yesterday as Mario Draghi was scheduled to speak. But, the chairman of the ECB didn't say anything the market didn't already know. To sum up his words, he basically said the ECB will likely take steps in policy such as lowering rates, issuing another LTRO, or adopting negative deposit rates. However QE is still a possibility as a last resort. Despite his verbal commitment to easing, the urgency to take the next step is growing, and the market continues to push for QE.

Elsewhere in Asia, the yen bounced 0.2% on general Russia-Ukraine angst combined with positioning of the Japanese CPI report due out tonight.

Bonds were again frustratingly resilient yesterday, as they sold off yesterday morning but then reversed off the lows thanks to soft jobless claims and geo-political fears from Russia (the Treasury sell off reversed hard at 9:30 when the Russia headlines hit. Bonds remain the major non-confirmation signal in this market, as they are simply much stronger than they "should" be given data.

A Bull Market in European Junk

The announcement of yesterday's record junk bond sale by Numericable (a French cable company) reminded me about the opportunity in high yielding European debt, and to that end, I want to explain directly why I think European high-yield debt is the best place to be in the fixed income market, and why it could make us all

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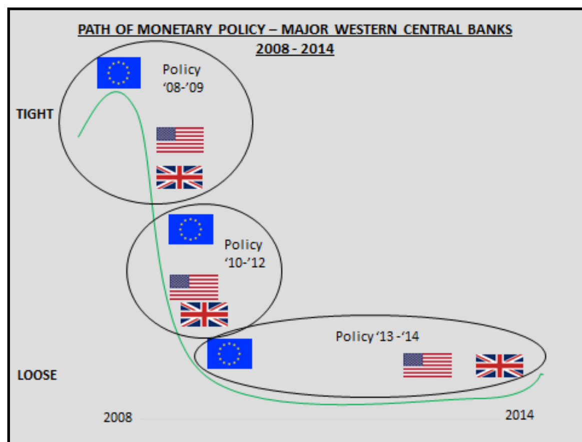
money over the coming quarters. The offering by Numericable crushed the previous record junk bond offering by Sprint (S) last summer (Numericable raised $10.9 billion vs. Sprint's $6.5 billion). And, not only was the offering huge, but so was demand as the deal was 10X oversubscribed. Now, there were certain things about this deal that made it specifically very attractive, but clearly there's evidence supporting a big-time hunt for yield occurring in the EU (we all know PIIGS' debt has rallied hard recently.)



The reason for this huge demand for high yield debt is the projected path of ECB policy. And, to better understand my bullish thesis on European high yield debt (both corporate and government), it's important to think about the ECB in the context of recent BOE and Fed policy.

Since the financial crisis, the BOE has been the most aggressive at easing policy, conducting QE and unconventional policies like "funding for lending" and others. As a result, their economy has recovered the quickest, and they are now on the cusp of starting to tighten policy.

The Fed wasn't far behind the BOE, but it did lag. That is why I say the BOE is the "leading indicator" for the Fed. We're about 6-9 months behind the Brits on an economic and policy front.

But, while the Fed is close behind the BOE, the ECB is way behind both on the policy front. The ECB was slow to act in '08 and is only now finally coming to grips with the fact that they will have to do "more" to ward off deflation (including unconventional policies).

So, keeping things simple because I'm a simple person: If the ECB is well behind the BOE and Fed, but headed down the same (or similar) policy path, then to make money in the EU we should just do what worked here in the U.S. over the past 2+ years. That is, to buy high-yielding bonds and growth stocks. They will rise in the EU for the same reasons they rose in the U.S. (like the Fed, the ECB is on hold indefinitely and if anything will ease further.)

Now, history rhymes but doesn't repeat, so this obviously isn't foolproof. (For instance, if there is military conflict between Russia and Ukraine, then all bets are off.) But the point here is that, barring some sort of destabilizing event, this strategy should produce.

The problem is execution. There are no euro-specific high-yield bond ETFs. The closest thing is IHY (5.29% yield) and HYXU (4.66% yield), both of which are very heavily weighted to Europe, but also have small portions of emerging-market debt in them (between 10%-20%). But, they are "trade by appointment." And, I spent more than 2 hours yesterday looking for a European high-yield mutual fund, and couldn't find anything yet for US investors, although there are a bunch in Europe so if you can do that, it gets a lot easier.

On the euro-stock front, obviously if I'm right about this theory, then the PIIGS will continue to rebound—Ireland (EIRL) being the favorite, but EWP (Spain) and EWI (Italy) also will do well. And then there are also the broader ETFs like VGK and FEZ.

I realize that high yield and euro equities have had big moves since last summer, but I'm maintaining there is a lot more room to run. Compared to other alternatives (U.S. primarily) there may be more "bang for your buck" here over the next 12-24 months than in the SPY or US debt.

Bottom line: Most Western central banks are all headed down the same road, and are just at different intervals. And, if the past few years of BOE and Fed policy teach us anything, it's that central banks can inflate the hell out of bond and stock markets—for a time, anyway. Nothing is certain in this market, but the one thing we "know" is that rates aren't moving higher in the EU anytime soon. As long as rates stay ultra-low like they have done in the UK and U.S., we should see European bonds and stocks follow the leader.

Have a good weekend,

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) 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, 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 added a long gold trade Wednesday with 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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