7:00's Report

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

April 28th, 2014

Pre 7:00 Look

- Futures are slightly higher and European markets are strong this morning as more M&A chatter and earnings trumps worries about Russia/Ukraine.
- PFE and AZN merger chatter continues to heat up, helping to lift European shares.
- The G-7 announced new sanctions for Russian individuals over the weekend, but the situation remains the same.
- Economically it was quiet as Japanese retail sales was the only release (slightly missed expectations).
- Econ Today: Pending Home Sales (E: 0.6%).

Market	Level	Change	% Change
S&P 500 Futures	1864.50	4.50	.24%
U.S. Dollar (DXY)	79.64	-.178	-.22%
Gold	1301.20	0.40	.03%
WTI	101.35	.75	.75%
10-year	2.666	-.22	-.82%

Equities

Market Recap

Stocks finished trading last week basically flat (S&P 500 up 2 points) after an early-week rally on earnings reversed thanks to increased Russia/Ukraine tensions and renewed weakness in the "momentum" sectors. The S&P 500 is up 0.81% year-to-date.

Stocks were strong early last week on healthcare M&A (both actual deals and speculation) and as earnings largely came in better-than-expected, while the tone of conference calls was positive.

Industrials; "old" tech like AAPL, MSFT and others; materials stocks and even retailers posted better-than-feared results and this helped support stocks through Wednesday. (Although, keep in mind the only reason the S&P 500 closed higher Wednesday was because of AAPL, so it was a weaker day than the headlines implied.)

But, a ratcheting up in rhetoric between Russia and Ukraine (which really started last Tuesday) and the basic abandonment by the Russians of the "truce" negotiated two Thursdays ago weighed on sentiment.

Additionally (and perhaps more importantly) we saw renewed weakness in the "momentum" sectors of Internet stocks and biotech. Specifically, and disconcertingly, Internet stocks that posted good results couldn't hold the gains (NFLX, FB, P and AMZN had good earnings but the stocks couldn't hold initial post earnings rally and all got sold hard late in the week). Additionally, earnings "misses" by some larger biotechs (CELG and BIIB) late last week offset the positive M&A news.

Stocks saw their biggest declines of the week Friday as investors de-risked ahead of the weekend. The S&P 500 closed flat, while QNET basically ended the week at recent lows and NBI was just fractionally positive.

Russia Update

Over the weekend the G-7 announced it'll impose more sanctions on Russian individuals (not broad sectors of the economy) and we could get a specific announcement from the US today. That met expectations.

In Ukraine, Russian separatists took a group of observers from the Organization for Security and Cooperation in Europe hostage over the weekend. And, although worrisome for the hostages, this type of action doesn't exactly help Russia's negotiating leverage (as now everyone assumes Russian backed thugs just kidnapped a bunch of

Market	Level	Change	% Change
Dow	16,361.46	-140.19	-0.85%
TSX	14,533.57	-20.68	-0.14%
Brazil	51,399.35	-418.10	-0.81%
FTSE	6,709.53	23.84	0.36%
Nikkei	14,288.23	-141.03	-0.98%
Hang Seng	22,132.53	-91.00	-0.41%
ASX	5,536.07	5.07	0.09%
Prices taken at previous day market close.			

European diplomatic workers). And, it may help potentially de-escalate the situation going forward.

Bottom line is unless Russia invades Ukraine (still a low probability), this won't be a major negative on markets, despite headlines.

Market	Level	Change	% Change
DBC	26.57	-.02	-0.07%
Gold	1303.60	13.00	1.01%
Silver	19.75	.04	0.18%
Copper	3.09	.0015	0.05%
WTI	100.69	-1.25	-1.23%
Brent	108.83	.09	0.08%
Nat Gas	4.66	-.07	-1.42%
RBOB	3.07	-.02	-0.63%
DBA (Grains)	29.11	-.12	-0.04%
Prices taken at previous day market close.			

Earnings Update

Earnings-wise the season has been better than expected (thanks mostly to lowered expectations). According to Bloomberg, 75% of companies reporting so far have beaten estimates by an average of 5.85%. That compares favorably to Q4 (73% beat by an average of 4.7%). Revenues remain lackluster, though (only 53% of companies reporting so far have beaten on the top line).

The bottom line with earnings season is that the expectation for 2013 earnings (119-ish) hasn't changed, and as such the season isn't really a major positive or negative.

This Week

This week is full of macroeconomic catalysts, as the peak of earnings season (and the "systemically important" company results) are largely behind us. But, we will get results from European banks throughout the week, as well as earnings from some big energy companies (BP, COP, XOM), more tech companies (WDC, STX, FLEX) and consumer staples (CLX, K, KRFT, CVS). And, given the precarious nature of the "Internet" stocks at the moment, results from TWTR will be watched (Tuesday after the close).

Bottom Line

For all the volatility, the 1,880-1,840 range in the S&P 500 remains intact, and this market is continuing to trade frustratingly flat. Again early last week the S&P 500 threatened to break above 1,880 but couldn't do it, and we again start the week with the S&P 500 dead in the middle of the recent trading range.

Looking forward, I'm not crazy about the way the market is trading (momentum sectors remain a concern and NBI and QNET need to be watched). And, if we look at the sectors leading the market, they aren't exactly "pro-cyclical"

Case in point, while the S&P 500 is frustrating flat, there are sectors throwing off nice performance this year, they just aren't cyclical sectors. Energy (XLE) and natural gas E&Ps (FCG/XOP) hit new 52-week highs last week, as did utilities (XLU), REITs (VNQ) and consumer staples (XLP).

But, even through I don't like the way the market is trading, the benefit of the doubt still is with the bulls as long as that 1840 level holds. The key to outperforming remains finding the right sectors that are trading at a good value or that have positively turning fundamentals. (Energy and Europe remain attractive outright long, or hedged with a SPY short. And, the "global reflation trade" is something that's piqued my interest lately, and will do so further if Chinese data can further stabilize.)

Economics

Last Week

The April global flash PMIs were the most-watched event last week economically, and they met expectations, reflecting the fact that:

1) Chinese economic growth is showing signs of stabilizing,

2) The recovery in Europe is continuing to gain steam (but at a very slow pace on an absolute basis), and

3) The recovery in the U.S. is progressing and the economy is back on track for 3% annual growth after the "winter dip."

In China, the April PMI was 48.3, and while it remains below 50, importantly it went up from March (48.0). Along with some other metrics that imply the pace of Chinese economic growth is stabilizing (and if it does, it'll reduce any chances of a significant economic slowdown in China (a "hard landing") and remove a potential macroeconomic risk.

In Europe, the EU PMI hit 54.2, moving well above the

50 mark and confirming that economic activity in the euro-zone (led by Germany) is indeed picking up. However, in absolute terms, the recovery is still weak in Europe (but more importantly, it's going in the right direction).

Finally, in the U.S. the manufacturing PMI dipped a bit from March to 55.4, but that's still a strong number in an absolute sense. Most the details of the report were strong (new orders, production). So, along with last week's March durable goods report, which beat expectations, there continues to be a steady flow of evidence that implies the U.S. economic recovery is progressing (albeit at a slow pace).

Not all the data was good, though. We got some mixed signals from the housing market (March existing home sales were "ok" but new home sales plunged 14.5%). Nothing definitive can be drawn from the reports, but the takeaway here is that housing is not seeing activity rebound from the winter dip like other areas of the economy.

And, while generally the housing market is "fine," it needs to "join the party," so to speak, in the next month or two and confirm that we're seeing a broad resumption of the recovery. If housing stays stagnant into May/June, that could become a headwind. So, it remains an area to watch.

Finally, weekly jobless claims jumped higher last week to 329K, up 24K. But, there's apparently a lot of "noise" in claims due to Easter/Passover. Generally the four-week moving average has been trending downward and implies we're seeing some incremental improvement in the labor market. (The drop in claims over the past month is putting upward pressure on expectations for this week's jobs report.)

Market	Level	Change	% Change
Dollar Index	79.825	-.052	-.07%
EUR/USD	1.3831	-.0003	-.02%
GBP/USD	1.6841	.0038	0.23%
USD/JPY	102.33	.17	0.17%
USD/CAD	.9045	-.003	-.03%
AUD/USD	.9240	.0002	.02%
USD/BRL	2.2445	.001	0.04%
10-year Yield	2.666	-.22	-.82%
30-year Yield	3.439	-.25	-.72%
Prices taken at previous day market close.			

This Week

This is a very busy week, with Wednesday being one of the busiest and most important "macro" days of the year so far.

Things coming Wednesday that need to be watched (in order of importance):

- **April EU HICP** (this will likely dictate whether the ECB eases in May).
- **Official Chinese April manufacturing PMI** (out Wednesday night). This needs to stay above 50; otherwise it'll negate the recent signs of stabilization of growth.
- **Japanese semi-annual growth and inflation outlook.** There's a risk here the inflation outlook could be raised, and if so that will further reduce chances of more BOJ easing in the near term (bad for the "long Japan" trade).
- **FOMC meeting**: This should be pretty routine, but we need to watch commentary on inflation (some rumblings from Fed officials lately about upside risks).
- **BOJ meeting**: No policy changes are expected, but language will be key about the inflation and growth outlook post-sales-tax-increase.
- **U.S. Q1 GDP**: This number will get a big "asterisk" because of the weather, but regardless it's worth watching.

So that's Wednesday.

It's also "**jobs week**" so we get the April jobs number Friday, jobless claims Thursday and ADP Wednesday. As mentioned, due to the decrease in jobless claims recently, expectations are drifting higher for this number.

"Official" **manufacturing PMIs** are released in the U.S. Thursday and Europe Friday morning, and Fed Chair Janet Yellen is giving a speech Thursday, one day after the FOMC rate decision.

Bottom line with this week is that we could potentially get a lot more clarity on two big "unknowns" right now: 1. What, if anything, the ECB will do to ease policy (this is important for any "long Europe" trade) and 2. When, and if, the BOJ plans to unleash more stimulus on the Japanese economy (expectations are for mid-summer but they risk being pushed back).

Additionally, the official PMIs and employment data in China, Europe and the U.S. will help further confirm the "China is stabilizing," "Europe is recovering" and "U.S. is progressing" consensus of the market.

Commodities

There were several key developments in the commodities space last week including a break down in WTI oil futures, gold reclaiming the $1300 level, and copper breaking out of its recent trading range to close above $3.10 for the first time since early March. The benchmark commodity tracking index ETF, DBC, was essentially unchanged on the week.

Crude oil took a surprising leg lower on Friday to close the week down by 2.9%. The move lower came despite the increasing tensions in the Ukraine which has generally kept prices elevated since the issue began nearly 2 months ago. Based on Friday's sharp sell off, it looks as though the "supply bears" have taken control of the market from the "demand bulls." On the charts, we are looking to the 50 day moving average at $100.32 for support while there is resistance above at $102 per barrel.

Unlike WTI, Gold did rally late last week thanks to heightened tensions between Russia and the Ukraine, helped by the new sanctions in the works by both the EU and United States against Russia. Gold gained .67% on the week, breaking a rather steep downtrend and reclaiming the $1300 level. For now the theory of the "magnetic" $1300 level remains in tact. On the Charts there is initial support at the 200 day moving average at $1300.20/oz.

Copper has been trading better and better since hitting a multi-year low back in March. Copper futures broke out of the recent trading range to gain 2.7% on the week. Copper was able to rally through several key resistance levels including the 50 day moving average for the first time since mid January. A steady uptrend has formed since the aforementioned bottom was established back in March. And, as long as Chinese data remains "ok" and largely in line with expectations, we can expect that uptrend to remain in tact. On the charts former resistance at the 50 day moving average is now solid support at $3.077 while the level to beat is last weeks high of $3.127.

Currencies & Bonds

Last week was pretty tame in the currency markets, as the Dollar Index fell .5%, ignoring the largely better than expected economic data.

Instead, the Dollar Index declined because of strength in the euro and yen. The euro rallied last week on data (the flash manufacturing PMIs), while the yen was stronger vs. the dollar as expectations rose for the Japanese government to increase its outlook for inflation in this week's semi-annual growth and inflation outlook (if they do it'll delay when the BOJ does more stimulus).

The moves in both currencies were relatively small, though, as this week will potentially reveal a lot more about the expected path of monetary policy in both countries.

Elsewhere the pound hit a new multi year high vs. the dollar (above 1.68) thanks to strong data, while "Aussie" sold off about .5% on the week after Australian CPI missed expectations.

The Treasury market was again strong last week, as the thirty year Treasury recouped all of the previous week's losses, and the yield on the ten year again traded below 2.7%. The strength in the Treasury market again came despite good domestic data, and strength in the bond market remains a large "non-confirmation" signal for the equity market.

I continue to think that the rallying European bond market is putting "spillover' buy pressure on Treasuries, so it will be interesting to see how Treasuries trade Wednesday, when EU HICP is released. But, bottom line is bond have to start "confirming" what we are seeing in the equity markets by declining, and the longer they do not, the stronger the "caution" signal gets from bonds.

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**	*Gradual economic improvement domestically and globally is a tailwind on stocks, and as earnings season has largely com in "ok," the path of least resistance remains broadly higher. But, "momentum" sectors remain under pressure and QNET and NBI need to be watched closely for signs of a potential breakdown.* *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.**

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.**

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."**

Treasuries	**Bearish**	**Bearish**	**Bearish**	*Bonds remain surprisingly buoyant despite economic data confirming the winter slowdown in the economy was temporary, while the Fed has confirmed it intends to continue tapering. The longer term trend remains lower, but the counter trend rally in bonds is continuing in the short/medium term.*

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.**