7:00's Report

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

April 4th, 2014

Pre 7:00 Look

- Futures are flat and international markets are slightly higher as everyone looks ahead to the jobs report.
- Economically it was uneventful overnight. German Manufacturer's Orders slightly missed yoy, but the market isn't really paying attention.
- Outside of that release, and a lot of commentary/analysis of the ECB meeting, there was little news.
- Econ Today: Employment Situation Report (E: 206K).

Market	Level	Change	% Change
S&P 500 Futures	1886.75	3.75	0.20%
U.S. Dollar (DXY)	80.645	.005	0.01%
Gold	1291.60	7.00	0.54%
WTI	101.01	.72	0.72%
10-year	2.790	-.013	-0.46%

Biotechs: It seems like most of the worst selling in the momentum sectors ended last week, but it's still important for NBI to hold last week's lows of 2390.

Equities

Market Recap

The S&P 500 was off small yesterday but we saw a resumption of the sell-off in momentum and growth sectors, and the market was weaker than the headlines conveyed. The S&P 500 fell 0.11%.

Stocks started the day quietly higher, and largely ignored a slight uptick in weekly jobless claims and a slight miss from the ISM non-manufacturing PMI. The other big event yesterday, the ECB meeting, was generally a positive as ECB President Mario Draghi stressed that he really, really meant it when he said the ECB was considering QE – but more on that later.) But, those comments resulted in a rally in Europe, not in the U.S.

Despite that positive, another bout of weakness from the momentum sectors led markets to the downside once all the numbers were out (right after 10AM). Stocks drifted lower throughout the late morning and early afternoon, hitting their lows just above support at 1,880 right before 3:00.

Once again, though, buyers stepped in as we neared the close (this happened on Wednesday as well) and stocks again rallied into the bell on light volume and a lack of offers to go out basically flat.

Trading Color

Momentum again came for sale (NBI and QNET were both down about 2.5% yesterday) and growth largely underperformed (the Russell and Nasdaq both fell nearly 1% each). But unlike last week, certain sectors were able to ignore the weakness and it was much more of a mixed market yesterday.

Market	Level	Change	% Change
Dow	16,572.17	-.83	-0.01%
TSX	14,397.66	62.35	0.43%
Brazil	51,408.21	-292.84	-0.57%
FTSE	6,673.47	24.33	0.37%
Nikkei	15,063.77	-8.11	-0.05%
Hang Seng	22,510.08	-55.00	-0.24%
ASX	5,422.83	12.94	0.24%
Prices taken at previous day market close.			

As mentioned, tech lagged, but consumer discretionary and healthcare also traded decidedly lower yesterday. But, the majority of S&P 500 sub-sectors actually finished higher. Energy, utilities, industrials, banks and semiconductors all logged small gains (and in the case of the banks and semiconductors, they showed decent resilience in the face of renewed pressure on the momentum, and best performing, sectors in the market). Point being people again sold the best performing sectors in the market yesterday, but banks and semiconductors we able to hold up, which is an anecdotal positive.

Market	Level	Change	% Change
DBC	25.95	.21	0.82%
Gold	1287.10	-3.70	-0.29%
Silver	19.83	-.22	-1.10%
Copper	3.0285	-.017	-0.56%
WTI	100.47	.85	0.85%
Brent	106.30	1.51	1.44%
Nat Gas	4.437	.073	1.67%
RBOB	2.9097	.0429	1.50%
DBA (Grains)	28.01	.18	0.65%

Prices taken at previous day market close.

Volumes were slightly heavier than they had been earlier in the week, although it would be a stretch to say the market traded with a high degree of conviction yesterday.

On the charts, the S&P 500 held the breakout at 1,880, although again the market "felt" heavier than it traded yesterday. Near-term support remains at 1,880 and 1,870.

Bottom Line

It's possible that regardless of the number this morning we see a "sell the news" reaction in stocks as we've rallied to news highs into the number. How "momentum" holds up (NBI and QNET are proxies to watch) and whether the S&P 500 can hold 1880 remain key, but unless we see "momentum" through last week's lows, I'd expect any dip in the indices to be relatively mild.

Jobs Report Preview (Repeat From Yesterday).

The consensus expectation is for 195K jobs added, although given economic data and yesterday's ADP report, the "whisper number" has crept above 200K.

The "Too Hot" Scenario: >250K. Unlike last month's report, there is a bit of a short-term risk of a number that is "too good." A very strong jobs number may result in an acceleration of Fed tapering of QE and sooner-than-expected interest rate increases (maybe this year). That will cause a short-term negative reaction in most assets, as it simply isn't priced in at these levels.

If This Happens: Bonds and gold would sell off hard (maybe very hard); the dollar would rally very hard; and stocks would trade flat to down (although that dip would be a buying opportunity beyond the very short term as better growth is more bullish for stocks than Fed policy at this point).

The "Just Right" Scenario: 250K-150K. This is exactly what the market largely expects, and it wouldn't have any effect on perceived economic growth in '14 or on Fed policy (still a $10 billion taper per meeting and first rate increase in mid-'15).

If This Happens: The only thing that will likely trade off this result is bonds, which should see their recent sell-off accelerate. Commodities, the dollar and stocks likely won't react to a number in this range unless there is something odd in the revisions.

The "Too Cold" Scenario: <150K. "Whisper" numbers for this report have been creeping up all week (and ADP added some upward pressure to them yesterday), so a number below 150K here would be a big disappointment. While it won't by itself alter the outlook for growth and Fed policy, it will call into question the health of the economy, and that is definitely not priced into markets at these levels.

If This Happens: Stocks will sell off, potentially hard. The dollar will drop, while bonds and gold will rally (potentially hard).

Economics

Weekly Jobless Claims

- Weekly Claims jumped to 326K vs. (E) 320K
- The 4 Week Moving Average ticked up 0.5K to 318K

Takeaway

Weekly jobless claims rose more-than-expected last week, jumping 16K to 326K vs. analyst expectations of 320K. The 4-week moving average rose for the first time in 6 weeks. However, the increase was nominal, just 500 to 318K. The market reaction to weekly claims was light, as most traders were more concerned with the ECB announcement and commentary out of the ECB's Draghi.

Despite the slight uptick, the 4-week moving average remains well below where it was a month ago, which implies an incrementally improving labor market.

ISM-Non Manufacturing

- March ISM Non-Manufacturing PMI 53.1 vs. (E) 53.3

Takeaway

Much like the global manufacturing PMIs earlier in the week, global non-manufacturing (or service sector) PMIs largely met expectations. Most importantly, Chinese service sector PMIs beat estimates (51.9 vs. 51.0). While this report isn't as important as the manufacturing PMI, any positive China data is a welcome sight right now.

In Europe and the U.S., data readings were a slight miss but basically in-line, and again they both showed continued improvement in the service sectors of each economy (meaning, they remained comfortably above 50).

In the U.S., the March reading was 53.1 vs. (E) 53.8, but the details of the report were positive. New orders (the leading indicator in the report) rose 2.1 points to 53.4. Importantly the employment sub-index, which plunged in February down to 47.5, bounced nicely, rising 6.1 points to 53.6. Like the production sub-index in the manufacturing PMI, the bounce in employment in the service sector again implies that horrid weather had an effect on the weak February reading.

Bottom line is that that the global PMIs (both manufacturing and non-manufacturing) were largely in-line and importantly showed some stabilization in China and continued improvement in the EU and U.S. And, expectations for the pace of global growth remain unchanged (meaning they aren't getting worse, which is a positive).

Market	Level	Change	% Change
Dollar Index	80.62	.248	0.31%
EUR/USD	1.3715	-.0051	-0.37%
GBP/USD	1.6593	-.0032	-0.19%
USD/JPY	103.90	.05	0.05%
USD/CAD	1.1038	.0009	0.08%
AUD/USD	.9226	-.0021	-0.23%
USD/BRL	2.2809	.0124	0.55%
10-year Yield	2.790	-.013	-0.46%
30-year Yield	3.625	-.024	-0.66%

Prices taken at previous day market close.

Commodities

Commodities were mostly higher yesterday, led by natural gas, which was up on inventory data while the metals lagged ahead of this morning's jobs report. The PowerShares DB Commodity Tracking Index Fund added 0.82% on the day.

Natural gas futures finished the day up 1.67% thanks to an inventory draw of 74 Bcf last week, which was in-line with expectations (75 Bcf). Natural Gas was down ahead of the EIA release but futures turned positive due to ongoing supply concerns. After last week's draw, supply levels are now sitting at an 11-year low of 822 Bcf, which many analysts expect could take the better part of the "build" season to restore supplies to last year's levels — given, of course, that there are no interruptions in production nor is this summer unusually hot.

Bottom line, supply remains a concern in natural gas, and is supportive of elevated prices going forward. And, higher natural gas prices means more upside potential in the natural gas E&P ETFs XOP and FCG which were up 0.5% and 1.2% respectively yesterday.

Elsewhere in energy, crude oil grinded higher yesterday, finishing up 0.85%, comfortably above the $100/barrel mark, which is certainly a step in the right direction for the bulls. But, WTI futures have been chopping sideways in a range between $97 and $105/barrel for the better part of two months now as traders and speculators try to interpret the changing dynamic in supply levels between Cushing, Okla., and the Gulf Coast (thanks to Keystone); the skewed supply data from the Houston Ship Channel debacle; as well as the effects the extreme weather had on the economy this winter.

And, since many refineries have been offline for seasonal maintenance recently, the effects are even less clear. So with clouded fundamental data, namely on the supply side, traders have shown a heightened interest in economic data, and the resulting demand estimates. Energy traders will be watching this morning's jobs report closely, and any surprises will likely materially move markets. We remain cautiously bullish based on the assumption that, with an improving jobs market and a better economy, comes more demand (fuel consumption) and therefore higher energy prices.

Moving to the metals, both precious and industrial metals underperformed yesterday, but a lot of the movement was, again, positioning ahead of the jobs report this morning. Gold was little-changed yesterday, slipping just 0.29% in relatively uneventful trading. Looking at the charts, there is no real trend to speak of. Where we go from here could easily be decided by a big "beat," or big disappointment, in this morning's jobs report (resulting in a sharp sell-off or material rally, respectively). The 100-day moving average is offering support below at $1,273 while there is resistance at the former "break point" of $1,300/oz.

Currencies & Bonds

The euro was in focus yesterday, as Draghi and the ECB chose not to change policy and instead relied on dovish rhetoric at the press conference, as expected. His comments, though, were more forceful than most expected (including me). And, it was easy to come away from the press conference thinking the ECB may actually one day do QE. As a result, the euro weakened 0.33% yesterday vs. the dollar, which is probably about as good of an outcome as the ECB could have hoped for.

First, Draghi specifically said that the ECB is open to unconventional instruments to combat low inflation, and he specifically said this included QE. More importantly, though, he said the ECB discussed QE at the meeting and unanimously agreed to pursue unconventional instruments if the dis-inflation threat grows. That "unanimous" comment was important, because it offers more proof that the Germans are finally on board with doing "more" to help the EU economy.

So, you could come away from the meeting thinking that Draghi "meant it" when he said the ECB will use QE if necessary (kind of like you knew your parents "meant it" when they threatened some punishment). But, does that mean we'll see QE in the EU anytime soon?

No, it does not. The ECB road to QE is a long one, and there is still a lot that has to happen for the ECB to do QE. But, I'd say that Draghi succeeded yesterday in shifting market sentiment from "they'll never do it regardless of what they say" to "maybe they just might."

From an investment standpoint, this situation remains very positive for EU bonds (and specifically PIIGS bonds), as dis-inflation will continue to creep while the ECB ponders QE. It is also likely positive for European equities, because we may be witnessing the formation of a "Draghi put" in the EU equity markets if the ECB is serious about QE. The reasoning goes: "If things get worse, they'll do QE and stocks go up. If things get better, stocks go up. Either way, stocks go up." It's the same argument made here from 2010—2013 (and it was right). So, we could be on the cusp of a big rally in both EU bonds and stocks, similar to what we saw from March '09 to May '13). Not coincidentally, European stocks, which were flat heading into the press conference, rallied afterward and logged a nice day (up 0.6%).

Looking specifically to the euro, it traded to a nearly two-month intraday low before bouncing off support. 1.3700 remains key – if that support is broken, a decline to the mid-1.36s and then 1.35 isn't out of the question.

Away from the euro, the currency markets were mostly quiet. The pound sold off a bit (down 0.17%) after service PMIs missed expectations (but still are at high absolute levels) while the yen drifted slightly lower (and surprisingly broke through 104.00 yen/dollar) ahead of the jobs report. If it's a strong number today, we could see that drop in the yen accelerate, as it's now at multi-month lows vs. the dollar.

Finally, the Aussie also was off small thanks to disappointing retail sales data (and I still think selling the Aussie in the low- to mid-$0.90s remains a very fundamentally sound trade, even if there is the chance of a bit more of a short-covering rally in the near term).

Bonds had a small bounce yesterday, due mostly to positioning ahead of the jobs report this morning. The 30-year rose 0.17% while the 10-year was flat (and we saw mild flattening in the yield curve). Watch bonds closely today, as I said in the jobs report preview. We could see bonds trade off the number more so than any other asset class. Unless it's shocking weak, I would expect to see bonds sell off from current levels, as the decline accelerates.

Have a good weekend,

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**	**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.**

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.

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."**

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.**