7:00's Report

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

April 7th, 2014

Pre 7:00 Look

- Futures are lower this morning, as are most international markets, thanks to a "hangover' from Friday's sell off. But, given Friday's declines, international markets are actually holding up decently well, so far.
- News wise it was a very quiet weekend, and economically the only release this morning was German industrial production, which slightly beat estimates.
- It should be a very quiet day today with focus remaining on tech and the momentum sectors specifically (QNET/NBI).
- Econ Today: No report today. Fed Speak: Bullard (11:45).

Market	Level	Change	% Change
S&P 500 Futures	1853.00	-7.25	-.39%
U.S. Dollar (DXY)	80.49	-.081	-.10%
Gold	1301.10	-2.40	-.18%
WTI	100.66	-.48	-.47%
10-year	2.730	-.060	-2.15%

Equities

Market Recap

The S&P 500 hit a new intraday record last week thanks to good economic data, but it only finished the week up 0.5% after "momentum" sectors broke down Friday and ignited a nasty sell-off. The S&P 500 is up 0.91% year-to-date.

Stocks enjoyed a nice rally early last week, as "momentum" sectors stabilized and economic data (specifically global PMIs and the ADP employment report) largely met expectations.

The S&P 500 broke to a new high Tuesday and added to the gains Wednesday, thanks to the strong ADP employment report. Stocks were flat Thursday ahead of the jobs report, and then traded to another new high Friday morning (following the jobs report) at 1,897 in the S&P 500 before reversing hard and diving into the afternoon, selling off more than 1%.

The Friday reversal was led by the renewed intense selling in the "momentum" sectors (NBI and QNET). Things accelerated into the close as the S&P 500 went out basically on the low ticks. It completed a negative daily "outside reversal," which undoubtedly will make market technicians nervous.

Trading Color

A continued exodus out of growth and into value remains the story of this market. Nasdaq and the Russell 2000 both finished Friday down more than 2%, and both are down year-to-date (Nasdaq down 1%, Russell 2000 down 0.8%).

Sector-wise, tech got crushed last week as NBI and QNET both broke through the lows of two weeks ago. And, in a potentially worrisome sign: Semiconductors, the market "darling" of 2014, fell 2.8% Friday. I'm pointing that out because previously semis had been able to hold up in the face of tech weakness. But if we are seeing the SOX begin to break down, it could be a sign this selling in the momentum/growth sectors is spreading, which would increase the chances for a broad market correction, if it continues.

Consumer discretionary also sold off hard Friday (reacting to the weak wage component of the jobs report) as did healthcare and banks.

But, importantly, not ever sector traded poorly Friday. Value and defensive names not just relatively outper-

Market	Level	Change	% Change
Dow	16412.71	-159.84	-.96%
TSX	14393.10	-9.11	-.06%
Brazil	51081.78	-326.43	-.63%
FTSE	663.67	-31.88	-.48%
Nikkei	14808.85	-254.92	-1.69%
Hang Seng	22377.15	-132.93	-.59%
ASX	5413.73	-9.10	-.17&
Prices taken at previous day market close.			

form, but actually finish higher Friday. Utilities and REITs were both positive Friday (thanks to the drop in interest rates), while consumer staples and energy were only off small.

Commodity-related sectors also rose Friday, as PICK (a global industrial miner ETF) was up 1.8%. Coal (KOL and ACI) and gold miners also traded higher Friday.

Market	Level	Change	% Change
DBC	26.08	.13	0.50%
Gold	1302.50	18.00	1.40%
Silver	19.91	.105	0.53%
Copper	3.019	-.008	-0.26%
WTI	101.12	.83	0.83%
Brent	106.68	.53	0.50%
Nat Gas	4.426	-.044	-0.98%
RBOB	2.9306	.0188	0.65%
DBA (Grains)	28.26	.26	0.93%
Prices taken at previous day market close.			

On the charts, intra-week despite the whiplash, the S&P 500 remains broadly in the 1,880-1,840 range it's occupied since early March.

This Week

Focus remains on the micro this week as the macroeconomic calendar is quiet. Investors will be watching how momentum and growth sectors trade more than anything else this week.

Alcoa (AA) kicks off earnings season Tuesday, but the first "big" day of earnings is Friday where we get some of the bigger banks. Earnings season really heats up next week.

Economic data is light in the U.S. and internationally (Chinese CPI/PPI Thursday is the "highlight" while Fed minutes will be the most-watched report domestically).

Finally in Japan there is a BOJ meeting (the post-meeting announcement comes tomorrow morning). While no one expects more accommodation to be announced, the language will be scrutinized for clues as to when and if the BOJ eases further.

Bottom Line

The "macro" economic remained static last week. Economic data largely met expectations while tensions in Russia/Ukraine continued to recede. This market is being driven much more by the "micro" than the "macro" at the moment.

Bottom line is the "momentum" sectors remain critical to monitor (so NBI and QNET) because it doesn't look like the selling is done. If we do get a correction here, it'll be because this selling starts to spread into other, more fundamentally sound sectors (like we saw in the SOX on Friday).

That said, though, the 1,880-1,840 range in the S&P 500 is still intact, and until that is broken I don't think there is any real reason to change larger equity allocations.

The bigger point here is that last week again reinforced that sector selection is the way to outperform in this market. **Not everything came for sale Friday, and this is not the same "risk on/risk off" market of the past several years.**

Finally, and perhaps most importantly, "international" (and especially Europe) has closed the performance gap between them and the U.S. Europe traded very well last week and is up 4% year-to-date. And, with an apparently (slowly) improving economy and a central bank that may actually become more of a tailwind, the case for Europe is becoming much more attractive. A "long VGK/short SPY" pair trade may the best place to park some capital at the moment if we're looking for something to do. "Long DXJ/short SPY" is also attractive, but I want to get through the BOJ meeting early this week first.

Economics

Last Week

Economic data last week importantly confirmed that the weakness we saw in December/January was weather-related and temporary. The decent March PMIs and jobs report likely put to bed any major concerns about the U.S. economy losing steam. But, given the trend of February data, last week's data merely confirmed what was widely assumed, so that's why we didn't see the markets react in a more positive fashion.

Internationally, it was a different story, though. The Chinese March PMIs (both manufacturing and service) weren't as bad as feared, and helped (for now) alleviate some worries about the pace of growth in China. Importantly, the official March manufacturing PMI held above 50 (50.3), while service sector PMI actually beat estimates (51. 9 vs (E) 51.0).

In Europe, the ECB meeting was the big event last week, as Mario Draghi did a good job convincing markets that QE in the EU is a real possibility. That potential ECB easing, combined with March PMIs that showed continued improvement in the EU economy, helped upgrade the outlook in Europe.

Both international markets reacted positively to the better-than-feared/-expected news, and resulted in decent outperformance of international vs. U.S. last week.

The big number domestically was Friday's jobs report, which obviously is getting a lot of attention given the Friday sell-off. First, the jobs number was fine. It was a slight miss vs expectations and the "whisper number" (192K vs. (E) 206K and whisper of 200K-ish). But, there were positive revisions of more than 30K to Jan/Feb. Most importantly, the jobs numbers confirmed that the dip in economic activity in Dec/Jan was mostly weather-related, and that 3% annual GDP growth in 2014 is still a reasonable expectation.

The one thing the market didn't like about the jobs report, though, was the salary/wage data. Average hourly earnings declined by 0.01 to $24.30, while year-over-year wages grew just 2.1% vs. (E) 2.3%.

That's important for two reasons. First, higher wages obviously reflect more economic activity. That's because, as firms get busier and the demand for employees goes up, the "cost" of those employees (or what you have to pay them) goes up as well because the entire industry sees more activity. Those employees, who are making more money, then go spend it in the economy, creating a virtuous cycle.

Second, we currently have very low inflation (statistically) here in the U.S., and as a result dis-inflation/deflation remains a threat (although not nearly as big of a threat in Europe). But, it's in everyone's interest to see inflation rise from its current levels, as it would be a positive for the economy. But, without wages increasing, it's very unlikely that we'll see inflation start to move higher in the immediate term.

The stagnation in wages is something to watch, but it didn't "cause" Friday's sell-off, and I think this is more of a situation where the analysts were looking for an excuse for the "dovish" response to the number. During the coming months, if we start to see a trend of further stagnation in wages, then it may be a legitimate problem, but one number doesn't make a trend.

So, bottom line is the jobs number and economic data were "fine" last week, and largely the economy is performing as expected (slowly improving growth).

This Week

It's a quiet week on the data front, with the most important data coming from China. Trade balance data comes Wednesday night and CPI/PPI come Thursday night, and while inflation isn't the threat it once was in China, it's still important that inflation stays contained, as the entire market expects Chinese authorities and the PBOC to remain supportive of growth. If inflation runs too hot, they may not be willing to be as accommodative as the market currently expects, so the risks into the number (while small) are to the downside.

Domestically there's not a lot on the calendar. FOMC minutes from the March meeting are released Wednesday, but they shouldn't contain any surprises given the March meeting was one with the Chair's press conference. Analysts will look into the minutes for "hawkish" or "dovish" leanings, but Fed policy expectations remain pretty well- known—they are going to continue tapering QE at $10 billion per meeting, and the first rate hikes will come in mid-2015 (April to July). And, only a material change in the economic outlook will change that policy expectation.

Market	Level	Change	% Change
Dollar Index	80.555	-.085	-0.11%
EUR/USD	1.3702	-.0016	-0.12%
GBP/USD	1.6577	-.002	-0.12%
USD/JPY	103.21	-0.70	-0.67%
USD/CAD	1.098	-.0051	-0.46%
AUD/USD	.9284	.0055	0.60%
USD/BRL	2.2432	-.0356	-1.56%
10-year Yield	2.730	-.060	-2.15%
30-year Yield	3.590	-.035	-0.97%
Prices taken at previous day market close.			

Weekly claims will also be watched to see if the downtrend in the four-week moving average will resume (and, in doing so, imply incremental improvement in the labor market).

In Europe it's also quiet, as the Bank of England policy meeting (Thursday) is the highlight, and there's no change expected to policy (it should be a relative non-event). Bottom line is this is a quiet week and shouldn't alter anyone's outlook on the global or U.S. growth.

Commodities

Commodities closed stronger Friday after a relatively quiet week of trading. Oil and gold rallied after the official jobs report was released while copper slipped slightly but was able to close well off the post-jobs-report morning lows. The benchmark commodity tracking index ETF, DBC, was little-changed for the week, falling just 0.2%

Gold caught a bid on Friday in response to the soft wage data in the jobs report (it was viewed as dovish), and also on stock market weakness. Gold finished the week up 0.56% and reclaimed an important technical and psychological level on Friday, $1,300/oz. But, I'm skeptical about just how "dovish" the wage data really was, and as a result am not sure we're about to see a big gold rally because of it.

But, remember gold has basically been trading inverse to the stock market this year, so if the stock market remains under pressure, we could see gold rally—and I'll just point out gold has been a very good equity hedge so far in 2014. Gold is slightly lower this morning (below $1300), and any long positions should use last week's lows ($1277) as the clear stop.

Crude oil reclaimed $100/barrel on Thursday and finished the week toward the highs at $101.06, but still registered a slight loss for the week, down 0.6% after WTI inexplicably declined nearly 3% last Tuesday. But, WTI recovered thanks to economic data (the domestic and global PMIs and the jobs report).

With economic data again trending higher, the fundamentals are starting to look up for the oil bulls. A few closes toward or above the $102 level would be technically bullish, and open up a run to the recent highs at $105.

Currencies & Bonds

The first four days of last week were dominated by US dollar strength and Treasury weakness, and it looked as though both were getting set to respectively break out and break down. But, that trade reversed hard on Friday courtesy of the soft wage data in the payrolls report and the big stock market drop, which saw a "dovish/risk off" reaction and a Dollar Index decline and Treasury rally.

The Dollar Index traded to a 2 month high while the euro hit a six week low after comments by ECB President Mario Draghi at the ECB press conference last Thursday increased the chances of the ECB eventually doing QE. The ECB meeting, and tone shift by the ECB, was the catalyst in the currency markets last week, and although it was incrementally "dovish" from a rhetoric standpoint, it likely won't result in a material decline in the euro/rise in the Dollar Index until the ECB actually makes a policy change, which is still months (at a minimum) away. So, expect a continued range bound trade in dollar/euro.

In Asia the yen temporarily broke above 104 yen/dollar, a multi-month low, but then bounced back on Friday after the dollar sell off. There is a BOJ meeting on going at the moment (statement tomorrow), and while we aren't expected to see any new stimulus announced, the expectation is growing for more action from the BOJ by this summer.

Turning to bonds, despite the big rally Friday, Treasuries still managed to close fractionally lower on the week. Friday's "dovish" reaction to the jobs report was surprising, as the soft wage data, on its own, shouldn't be enough to elicit the dovish response that it did.

Bottom line is the Treasury market remains buoyant—more buoyant than it *should* be given the Fed outlook and economic data. Part of the last week's stock market rally was because Treasuries started to sell off in earnest (10 year yield broke through 2.8% for the first time since January) and "confirm" the good economic data and improved sentiment towards stocks.

Friday was a frustrating day, but I still maintain that this counter trend rally in bonds has ended, and unless we get a very nasty correction in the equity market, we'll see yields resume the move higher over the next few weeks.

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**	**Bullish**	**Bullish**	*Stocks hit new highs last week but saw a nasty reversal on Friday, as renewed selling in growth and momentum sectors pushed markets lower. But,. 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 gave us a head fake last week, so the range remains 1880-1840. .*

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

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.**

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.**