7:00's Report

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

April 8th, 2014

S&P 500: The index is now sitting on pretty key support at 1840 and the 50 day moving average (1839). If both are broken, the decline will likely accelerate.

Pre 7:00 Look

- Futures are flat and international markets are modestly weaker on an uptick in geo-political concerns as rebels in Ukraine have seized buildings in three eastern cities.
- The seizing of buildings is increasing speculation Russia will try and annex more of the Ukraine, as this is the same "playbook" that was used in Crimea.
- Economically the only report to note was Great Britain industrial production, which handily beat estimates.
- Econ Today: No reports today. Fed Speak: Kocherlakota (1:30 PM), Plosser (2:45 PM).

Market	Level	Change	% Change
S&P 500 Futures	1836.25	-1.75	-.10%
U.S. Dollar (DXY)	80.10	-.255	-.32%
Gold	1311.40	13.10	.99%
WTI	100.98	.54	.54%
10-year	2.695	-.031	-1.14%

Equities

The sell-off continued Monday as momentum and growth sectors traded to new lows and a late-day effort to rally the market failed. The S&P 500 fell 1.08% and is now fractionally negative on the year (and off 2.5% from the highs).

Stocks opened lower mostly on follow-through selling from Friday, although there were reports that pro-Russian groups (widely believed to Russian special forces posing as regular citizens) had seized two government office buildings in eastern Ukraine. This served to remind everyone that the situation isn't quite over yet. And, overnight that situation got worse as another eastern Ukrainian city had building seized by rebels. So, there is a legitimate uptick in tensions this morning as people are nervous about further Russian incursion into Ukraine (remember this is how the annexation of Crimea started).

That aside, yesterday's trading was again dominated by the performance of momentum sectors (tech and growth more generally). Worries that the selling was spreading from tech to the financials and industrials weighed on markets, which declined steadily throughout the morning in orderly trading.

Stocks hit their lows during the early afternoon, but importantly the S&P 500 held support at 1,840. Stocks tried to bounce during the last hour of trading before a large sell imbalance on the close led to a dip back toward the lows during the final 20 minutes of the day. The S&P 500 finished 4 points off the lows of 1,841.

Trading Color

Market	Level	Change	% Change
Dow	16,245.87	-166.84	-1.02%
TSX	14,270.33	-188.78	-1.31%
Brazil	52155.28	1073.50	2.10%
FTSE	6575.24	-47.60	-.72%
Nikkei	14606.88	-201.97	-1.36%
Hang Seng	22596.97	219.82	.98%
ASX	5410.63	-3.10	-.06%
Prices taken at previous day market close.			

Is the selling spreading? I raised that question in yesterday's Report when I pointed out the carnage in the semiconductors on Friday, and it arose again yesterday as homebuilders dropped nearly 3%, consumer discretionary dropped 2% while financials, industrials and energy (thanks to the drop in WTI crude) all sold off around 1.5%. On a very short-term basis, the answer to the question of "is the selling spreading" is "yes."

Market	Level	Change	% Change
DBC	26.03	-.04	-0.15%
Gold	1298.10	-5.40	-0.41%
Silver	19.925	-.021	-0.11%
Copper	3.042	.0195	0.65%
WTI	100.59	-.55	-0.54%
Brent	105.88	-.84	-0.79%
Nat Gas	4.476	.037	0.83%
RBOB	2.9244	-.0069	-0.24%
DBA (Grains)	28.48	.21	0.74%
Prices taken at previous day market close.			

But, importantly, it's spreading via hedge funds and not long-only vanilla funds, as it seems to be the case that hedge funds were simply too long high-beta sectors. And, as they are re-balancing, it appears they are now moving on to selling anything with positive year-to-date performance (like banks, industrials, semiconductors, etc.).

That's important because if it's just hedge funds de-risking, then the selling can end almost as quickly as it began, and doesn't represent a fundamental shift in the outlook for stocks. (If "long-onlys" start to sell, then we have a problem.)

Defensives were the again the outperformers, as consumer staples and REITs closed positively, while utilities were only down fractionally.

On the charts the S&P 500 has now moved to the lower end of its trading range at 1,840, which held yesterday. 1,840 and the 50-day moving average (at 1,839) are now key support, and if those levels are violated, we could see the declines really begin to accelerate (although unless we see a further uptick in Ukraine tensions I think that support will hold).

Why Are Stocks Falling?

I learned early in my career (and in life) that listening to people with more experience is a good thing, so I spend a lot of time reading people I think know the market very well. Art Cashin is one of them.

So, I find it a bit concerning that I disagree with his estimation of why stocks are correcting.

Yesterday on CNBC, he said he thought this correction was about the removal of QE, and there are several respected analysts who agree with him. Peter Boockvar echoes his sentiment, as does David Rosenberg (again, all well-known strategists/analysts).

I'm of a perfectly open mind to consider that the removal of QE could cause a correction. But if that's the case, how do you answer these two questions:

1. Why aren't bonds selling off like they did last summer?
2. Why is this happening now?

If it was the removal of QE that started the correction, then you would expect to see bonds falling on the prospects of higher future interest rates. Yet, as I and others have pointed out here, bonds are stubbornly buoyant. If anything, the strength in bonds can be interpreted to represent bond market worries about potential future economic weakness. This would likely result in the halting of the tapering of QE.

With regard to the timing, the Fed started tapering QE back in December, and Fed policy expectations have remained unchanged throughout 2014. (The expectation in January was for a $10 billion taper at every meeting and that's where we are now.)

So, if this drop is related to the removal of QE, does that mean the market ignored the removal of over $20 billion per month in stimulus in December and January … but now all of a sudden the incremental $10 billion announced in March is causing problems?

Instead of being QE-related, I continue to think this market is being driven by more "micro" factors than "macro" ones. And, here are two alternate ideas of why stocks are correcting:

First, economic growth is (at least according to the latest economic data) continuing to move toward 3% annual GDP growth (and that's the best we've seen in years). The general economy may be finally becoming a bit of a tailwind for stocks generally. Perhaps with this rotation out of momentum sectors and into value—because of that economic tailwind—investors won't have to go so far out on the risk curve to get exposure to growth industries. Point being, with general economic growth accelerating, maybe you can afford to be a bit more cautious but still get good returns.

A second potential reason for the correction (and one I think might actually be *the* reason) is earnings. No one has really been talking about this, but Alcoa (AA) kicks off earnings season today. And perhaps this sell-off, which started 2+ weeks ago, is the result of investors "de-risking" via a rotation into value as we approach earnings.

The reason they would do that is because many stocks with bad Q1 results will get a pass from the weather, just like the weak economic data did. But, it's logical to assume that lower-multiple stocks will be given more of a "pass" on an earnings miss than something that's trading at a huge multiples and also is up big year-to-date. So, if you anticipate a weak earnings season (as most analysts do), the rotation makes sense.

Now, whatever the reason, it doesn't make the decline in stocks any less painful. But it does reinforce that this isn't a singular "macro" event and that a "risk off" approach isn't the right thing to do at this point.

Again, I'm not comfortable disagreeing with more-experienced and -knowledgeable people like those mentioned earlier. But I continue to believe this market is being driven much more by the "micro" than it is the "macro," and that means the big correction everyone is looking for still isn't here, yet.

Economics

There were no economic reports yesterday.

Commodities

Commodities were mostly lower yesterday despite a weaker dollar. The exceptions were natural gas, thanks to updated weather reports, and copper, due to short-covering ahead of the Chinese economic data due later in the week. The benchmark commodity tracking index ETF (DBC) slipped 0.15%.

Market	Level	Change	% Change
Dollar Index	80.35	-.221	-0.27%
EUR/USD	1.3741	.0039	0.28%
GBP/USD	1.6609	.0031	0.19%
USD/JPY	103.16	-.12	-0.12%
USD/CAD	1.0967	-.0011	-0.10%
AUD/USD	.9266	-.0025	-0.27%
USD/BRL	2.2139	-.0215	-0.96%
10-year Yield	2.695	-.031	-1.14%
30-year Yield	3.558	-.027	-0.75%
Prices taken at previous day market close.			

Copper outperformed yesterday, rising 0.65% as shorts covered positions ahead of Chinese trade data due out Wednesday night and CPI/PPI Thursday night. Copper remains in the spotlight as it continues to trade as a "proxy" to the health of the Chinese economy.

On the charts, futures have closed above $3 seven sessions in a row, which is promising for the bulls. But copper has failed to break above a resisting downtrend line that dates back to mid-February when futures really broke down. A few closes above the $3.05 level would imply this down trend is over, and warrant a serious look at a long copper position (and potentially long China equities position as well).

Elsewhere in metals, gold futures gave back the $1,300 level yesterday despite a weaker dollar and another drop in the stock market. Gold futures fell 0.41% on the day. But, gold futures are up more than 1% and trading well above $1300 ($1312 as of this writing) on rising geopolitical concerns in the Ukraine.

Fundamentally, last Friday's Commitments of Traders (COT) report from the CFTC showed a drop of 15,560 net longs, bringing total net longs held by money managers to 91k. And, while certainly some of the "froth" is out of the gold market at these levels, positioning isn't where you could say you were buying value in the metal—so the COTs aren't a reason to get long gold.

But, gold continues to trade as a useful hedge to the equity market, and is doing so again. Since Thursday's close the S&P 500 is off about 2.5% while gold is up about 2.5%, so 5% outperformance in 3 days. If you do decide to put a hedge position on in gold, the stop is clear at $1,277, which was last week's low.

WTI crude futures rallied in the first hour of trading but reversed midmorning and closed down 0.54% for the day. WTI began to sell off in sympathy with Brent crude, which was under pressure on news that two Libyan oil terminals had been turned over by rebels to the government and two more will be returned in the coming weeks. The total estimated output of the four terminals is 740K barrels, or roughly half of the entire nation's output this time last year. So, the news was obviously supply-side bearish, which weighed on Brent and in turn WTI.

Technically speaking, WTI is getting squeezed between two technical levels. Due to the fact that futures are in backwardation (indicating heightened physical demand)—and WTI is above the 50-, 100- and 200-day moving averages—I would say the benefit of the doubt remains with the bulls, and if I had to put a new position on in oil/broad energy like XLE, it'd be a long position (besides the FCG/XOP and coal trades I have on currently). On the charts look for support around at the 50-day moving average ($100.16), while resistance is above at the monthly highs of $102.24/barrel.

Currencies & Bonds

Currency markets were relatively quiet to start the week, as the Dollar Index declined modestly (0.3%) in quiet trading. The euro remains the focus of the attention of the currency markets, and yesterday we had some marginally "hawkish" comments by ECB members Ewald Nowotny and Yves Mersch, which tempered some of the QE hopes from last week. Nowotny made comments yesterday that there was "no immediate need for further ECB action" while Mersch (governor of the Central Bank of Luxembourg) said that it's a "long way from theoretical concept to QE implementation."

While neither comment changes the ECB's outlook (the QE door was opened a bit last week, although it remains down the road a long way), the comments did help the euro rally. And, of note, the euro has recouped the entire post-ECB-meeting sell-off, as of yesterday's close (something that won't make Draghi & Co. very happy).

Bottom line remains the euro and Dollar Index should stay range-bound, as the ECB does seem legitimately open toward some form of QE in the future. But this remains well in the future unless things get materially worse in the short term.

The yen was up small vs. the dollar, as it drifted up into the BOJ announcement that came overnight, while the pound also saw a mild rally mostly on trading noise.

The BOJ meeting saw no change in policy and no hints at further accommodation, and while wasn't unexpected, we are seeing a yen rally this morning (up .5%) on a combination of that BOJ meeting (a "buy the news" reaction) and on peripheral Ukraine angst.

Looking a bit more closely at the Dollar Index, its weakness over the past two days sticks out at me. Over the past few years, any day the market was down 1% or more, you'd see dollar strength (on a risk-off move). But, that's not been the case over the past two days, and I'd again caution that this (to a point) further discredits the "QE is the reason for the sell-off" thesis. The drop in the dollar/rally in bonds isn't signaling a market concerned about the end of QE—and the dollar isn't receiving a "risk-off" bid—again further implying this correction is a lot more nuanced than what we're used to.

Bonds extended the rally from Friday as the 30-year rose 0.42% and the 10-year yield traded down below 2.7% (after rising above 2.8% just last Thursday). I'll say it again—the strength in bonds is puzzling and concerning, but unless I see the 30-year trade meaningfully through 135'00, I remain resolute that this counter-trend rally in Treasuries is ending—it's just taking a very long time to break.

Finally, last week I said I wanted to "buy" the shape of the yield curve, asserting that it was about to get a lot more "steep" and that the 10's-2's spread was about to increase. The yield curve has flattened a bit since I made that decision, but not meaningfully so—and not like you would expect if we were about to see a material rally in bonds. So, that reinforces my opinion on this bond market beyond the very short term. And, it gives me hope the KBE trade I put on late last week, while currently painful, is still the right play beyond the very short term.

Have a good day,

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.**