7:00's Report

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

April 9th, 2014

Pre 7:00 Look

- Futures are fractionally higher while international markets, ex-Japan, rallied overnight in sympathy with US markets.
- Economically it was quiet. German trade balance showed a decline in exports, but it's not really effecting markets. Positively in Europe, Greece announced it will return to the bond market and is looking to sell 5 year paper.
- The situation in Ukraine was mostly unchanged from yesterday, but obviously tensions remain high.
- Econ Today: FOMC Minutes (2:00 PM). Fed Speak: Evans (3:30 PM), Tarullo (7:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1846.25	1.25	.07%
U.S. Dollar (DXY)	79.875	.04	.05%
Gold	1309.40	.30	.02%
WTI	102.50	-.06	-.06%
10-year	2.681	-.014	-0.52%

Equities

Market Recap

Stocks bounced yesterday after critical support in the S&P 500 held and caused a mild short-covering rally. The S&P 500 rose 0.38%.

Stocks opened slightly better Tuesday morning, but the bid was weak. Shortly after 10 a.m., the market rolled over and actually broke through support for a short time below 1,839 (the low yesterday was 1,837) before buyers stepped in.

Japan: DXJ fell hard yesterday thanks to the surge in the yen, but it's into support and if it's going to turn around, it'll happen right here.

The catalyst for the sell-off was commentary by Secretary of State John Kerry. He said that, given the uptick in unrest in eastern Ukraine, Russia may be laying the groundwork for an invasion.

We have seen an increase in angst with regard to Ukraine, but it also felt like sellers would have tried to break the 50-day moving average (at 1839) in the S&P 500 even if Kerry hadn't been testifying—his comments just provided an excuse to push stocks lower.

But, support at the 50-day M.A. did hold, and this caused a mild short-covering rally that saw stocks move slowly and steadily higher throughout the morning and into the afternoon. The bears tried again to push the market into negative territory with about two hours to go in the day, but there wasn't any conviction to the move. Stocks lifted into the close to go out toward the upper end of the range (the high on the day was 1,854, the S&P 500 closed just under 1852).

Despite the macro headlines, yesterday was all about positioning as the bears tried to break support. Once it didn't work, it was almost a certainty that this oversold market would bounce. But, don't mistake the rally for a

Market	Level	Change	% Change
Dow	16,256.14	10.27	0.06%
TSX	1,851.93	6.89	0.37%
Brazil	51629.07	-526.21	-1.01%
FTSE	.23	46.54	.71%
Nikkei	14299.69	-307.19	-2.10%
Hang Seng	22843.17	246.20	1.09%
ASX	5463.78	53.15	.98%
Prices taken at previous day market close.			

strong day in the markets—the bounce yesterday was weak and came on little volume, and it didn't imply this dip is over and we're about to see a reversal higher.

Market	Level	Change	% Change
DBC	26.34	.33	1.27%
Gold	1309.40	11.10	0.85%
Silver	20.025	.118	0.59%
Copper	3.052	.0125	0.41%
WTI	102.58	2.14	2.13%
Brent	107.72	1.90	1.80%
Nat Gas	4.536	.06	1.34%
RBOB	2.9825	.0565	1.93%
DBA (Grains)	28.62	.14	0.49%
Prices taken at previous day market close.			

Trading Color

Tech traded decently for the first time in nearly a week yesterday, as QNET saw a decent bounce (more than 2%) and the Nasdaq outperformed (rallying 0.8% and was the best-performing major index). Additionally, we didn't see a continued "bleed" of selling into other strong sectors: Semiconductors rallied 1.3% and banks also caught a small bid (keep in mind earnings loom for the banks starting Friday, so that should cap any material upside over the next 48 hours). And, we also saw a bounce-back in consumer discretionary and industrials.

Interestingly, the commodity sectors continued to trade very well and were again the outperformers yesterday (and frankly, they have been the place to hide during market dips this year). XLE traded up 1% and is just off 52-week highs; XOP and FCG bounced nicely and are just off 52-week highs; KOL and ACO surged; and even industrial miners rallied (PICK rose 1.7%).

The "hard assets" sectors continue to quietly have a very good year. And, that makes sense given why stocks are declining. Many of these commodity related sectors are so beaten-up over the longer term, there aren't many hedge funds dumping them to lock in gains, like we're seeing in better performing sectors like semis and banks. And, that's a trend I think can continue.

On the charts the S&P 500 held 1,839 (the lower end of the range and the 50-day moving average), and that remains key support.

Bottom Line

Much like January, flows and positioning are dominating this market more than anything truly fundamental. A lot of the selling in momentum sectors we've seen over the past 2+ weeks has been by hedge funds that simply were too "long." Once they started to rotate out of those sectors it started a cascade—not dissimilar to what happened in January when the market came into the year too "long," funds started selling emerging markets to reduce risk and it spread to the rest of the market.

Undoubtedly, much of the adjustment in positioning that needs to take place has occurred, but the question remains whether the selling will spread further into other sectors. So, we need to continue to watch semiconductors and banks. If they begin to get dumped like the "momentum" sectors did two weeks ago, then a move toward 1,800 in the S&P isn't out of the question. But, I don't think that's the most-likely case.

I would continue to advocate buying more sectors that have lagged over the past several months and, as a result, don't have such hot money (coal is still attractive, as are energy and global industrial miners, as well as Europe. None of these sectors are "over-owned.") And, consider hedging with an SPY short if you need some help sleeping at night!

4 Reasons Why I Don't Think The Japan Trade Is Over

A customer wrote in asking if my bullish opinion had changed on Japan, which is apropos given the yen surged 1.5% yesterday to trade below 102 vs. the dollar, less than a week after breaking to a multi-month low vs. the dollar above 104.

There were two reasons for the yen rally.

- The first was because BOJ Governor Kuroda was taken as "hawkish" when he gave a surprisingly upbeat assessment of the Japanese economy and the inflation outlook.
- Second, he said, "I do not think that additional easing is needed for now."

Also contributing to the yen rally was the potential escalation in the Ukraine, and specifically the Kerry comments about Russia potentially laying the groundwork for an invasion.

DXJ also got hit hard yesterday on the yen strength, falling more than 3%.

So, the question is, "Does this mean the Japan trade is over?" And, I believe the answer remains "no" although obviously I'm taking a long term view at this point.

I say that because of four reasons:

1. BOJ Policy: No one expected the BOJ to ease further yesterday – and while Kuroda's comments were surprising, the truth is that most analysts still expect the BOJ to ease policy in July. So, while the rhetoric was "hawkish," the outlook for policy didn't really change. (Keep in mind between now and July we'll start to see the effects of the sales tax increase on the economy.)

2. Japan Remains a Relative Value Globally. The Nikkei is trading at 17.1 times next year's earnings, compared to a five-year average of 18.4 times (according to Jefferies). Other than China, Japan is the only major equity market (if you can call China a major equity market) trading with a multiple below its five-year average.

3. BOJ Success is Good for DXJ: If the BOJ doesn't ease again this year (an unlikely outcome), it'll be because it feels inflation is on target to hit 2% and the economy is growing—two outcomes that are positive for Japanese stocks and DXJ. So, to a point it's not unlike David Tepper's comments several years ago on CNBC with regards to QE: If the economy falters, the BOJ will do more QE and stocks will go up. If the BOJ doesn't do more, it's because the economy is growing and stocks will go up.

4. Money Rotation: There have been rumblings for months about Japanese pension funds allocating more money into Japanese equities and ETFs. If inflation does continue to move toward the 2% target, rumors of that rotation will become reality—putting a big tailwind behind Japanese equities.

Now, with all that said, am I a lot less comfortable with this position than I was this time last week? Of course I am – I'm losing money. But, I believe the fundamentals remain bullish. Keep in mind this entire run in the DXJ has come solely on stimulus – nothing has actually worked yet to spur the Japanese economy toward growth. Growth and additional stock investment is Japanese-equity-bullish.

The low for the year in DXJ is $44.66. If that is violated decisively and the Nikkei trades to a new low (14,008) I'll have to re-think my thesis and agree that regardless of fundamentals, this trade is over. But as of this morning I am buying more DXJ with a stop at that $44.66 low.

Economics

There were no economic reports yesterday.

Commodities

Commodities were universally higher yesterday thanks to a geopolitical fear bid that came into the commodities markets. The benchmark commodity tracking index ETF, DBC, added 1.2%.

Crude oil futures continued to grind higher and closed up 2% on peripheral geo-political angst and on positioning ahead of the EIA inventory report this morning. The consensus of analyst expectations is for an overall build of 750K barrels in crude supply last week. However, inventories in Cushing, Okla., are expected to fall for the 10th week in a row as crude travels out of Cushing and down to the Gulf to be refined. And, since Cushing is the delivery point for NYMEX futures contracts, we saw a bid come into the market on expected reduced inventory levels. Such are nuances of physical commodities.

More broadly though, WTI appears to have broken out above resistance, and with economic data trending higher and geo-political risks looming, oil has a tailwind. The first level of support is now at $100.75 while resistance sits at $102.69 and $105.

Market	Level	Change	% Change
Dollar Index	79.83	-.525	-0.65%
EUR/USD	1.3793	.0053	0.39%
GBP/USD	1.6747	.0139	0.84%
USD/JPY	101.64	-1.45	-1.41%
USD/CAD	1.0927	-.0044	-0.40%
AUD/USD	.9354	.0084	0.91%
USD/BRL	2.207	-.0114	-0.51%
10-year Yield	2.681	-.014	-0.52%
30-year Yield	3.540	-.018	-0.51%

Prices taken at previous day market close.

Natural gas rallied with the rest of the energy space yesterday, and the technicals turned favorable as futures gained 1.43% to close above the 100-day moving average at $4.50. I say "favorable" because the price action has been more consistent with sideways, range-bound trading going forward. But that is better than "bearish," which is typical this time of year. Supply remains a concern and will continue to support prices, which in turn supports FCG and XOP.

Copper underperformed the commodity space yesterday but was able to rally 0.5% and, more importantly, close above the resisting downtrend line that has been in place since the major sell-off to multi-year lows we saw last month. The break is strong technically, but copper has been trending sideways since last Thursday as traders look ahead to Chinese economic data due out tonight and tomorrow night.

But, a close above last week's high of $3.074 would be a further bullish sign. And, although the risk-reward isn't quite compelling enough to get long copper, it is a potential opportunity to watch into the Chinese economic data later this week.

Gold gained 0.89% yesterday thanks geo-politics and finished the day comfortably above $1,300/oz. Gold remains tough to gauge here in the very short term, but it remains an interesting hedge against the stock market and a trade with clearly defined risk (last week's low of $1277 is the clear stop).

Currencies & Bonds

The dollar was broadly weaker yesterday as the yen and euro rallied on central bank chatter while the pound gained thanks to stronger-than-expected economic data. The Dollar Index fell 0.5% to a three-week low and closed well below the closely watched 80 level yesterday.

The yen was the strongest currency against the dollar yesterday, gaining 1.5%, off the aforementioned Kuroda comments. The yen is seeing a small dip this morning, but major resistance levels at 101.26 and 100.74 vs. the dollar are now in view. If both are violated, that will further confirm the trend has changed in Japan and the yen.

The euro rallied 0.4% against the dollar yesterday thanks to more comments from ECB policymakers that seemed to pour more cold water on the "ECB will do QE" euphoria of last week.

But, movement in the euro this week is largely just noise, as ECB comments continue to be digested and the market continues to challenge Draghi's "verbal accommodation."

Bottom line is the ECB is evolving in the sense that they now accept that some form of QE or unconventional measures may be needed in the EU. But they will more than likely wait as long as possible before using any unconventional measures to combat deflation. So, the euro and the dollar will more than likely remain range-bound for the foreseeable future.

Elsewhere in Europe, the pound was also stronger against the dollar because of some better-than-expected economic data. The pound gained 0.77% following a report that showed British Industrial Production handily beat expectations. The euro also rallied on the data release.

In Asia, the Aussie gained 0.8% against the dollar due to a combination of a good day in Chinese equity markets as well as more short-covering ahead of the Chinese economic data due out both tonight and tomorrow night. If the Chinese data is strong tonight and tomorrow, the Aussie could easily take another leg higher, but we are now getting into the mid .90's vs. the dollar, and that's an area I'd expect the RBA to begin to defend, and would expect some "dovish" rhetoric should Aussie move closer to .95.

Bond markets remained buoyant yesterday, rallying small despite the higher stock market. If I had to point to something I'd say geo-politics put a small bid in Treasuries, but bigger picture I'll feel a lot better about this market when Treasuries resume their declines. 135'00 in the thirty year remains my line in the sand with regards to my short Treasury position.

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: **"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, 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. **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**	*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.**