7:00's Report

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

May 1st, 2014

Pre 7:00 Look

- Futures are slightly higher this morning after the official Chinese manufacturing report met expectations at 50.4.
- Outside of China, the other economic data came from the UK, where it was universally better than estimates (Home Price Index and manufacturing PMI).
- Econ Today: Weekly Jobless Claims (E: 320K), Personal Income and Outlays (E: 0.4%), ISM Manufacturing Index (E: 54.3)
- Fed Speak: Yellen (8:30 AM).

Market	Level	Change	% Change
S&P 500 Futures	879.75	1.75	.09%
U.S. Dollar (DXY)	79.525	-.007	-.01%
Gold	1285.80	-10.30	-.80%
WTI	99.24	-.50	-.50%
10-year	2.648	-.047	-1.74%

Equities

Market Recap

Stocks were higher again Wednesday as the market shrugged off a weak Q1 GDP report thanks to more M&A news and resiliency in the "momentum" sectors. The S&P 500 closed up 0.30%.

Stocks were higher pre-market yesterday thanks to ADP (220K vs. (E) 210K jobs added) and more M&A chatter. (EXC bought POM and there appears to be a potential bidding war for Alstom.) But the weak Q1 GDP report took the wind out of the bulls' sails and acted like an anchor, keeping stocks flat ahead of the FOMC statement. Markets drifted slightly higher into the announcement, which met expectations and contained no surprises. Following the release, markets drifted gradually higher during the last 90 minutes of trading to finish just off the highs of the day.

Trading Color

Make it two in a row for the "momentum" sectors. NBI and QNET both finished positive yesterday (although barely so), but importantly they held Wednesday's gains. QNET was able to rally out of a more-than-1% TWTR induced hole early in the day (TWTR closed down 9%). And, that resiliency from "momentum" helped push markets higher throughout the afternoon.

More broadly, the Russell 2000 and Nasdaq also saw nice moves in the afternoon session (both were negative at midday), and the Russell ended up outperforming the S&P 500 while the Nasdaq was in-line. So, again there was some impressive resiliency from the cyclical parts of the market.

Sector-wise it was the same theme—resiliency and a late-day push by the cyclicals. Early Wednesday, the "defensive" sectors were outperforming (consumer staples, utilities, REITs), but at the end of the day all 10 S&P 500 sub-sectors were higher. Semiconductors, consumer discretionary, banks and industrials were the outperformers. And, in a turn of luck, telecom (IYZ) was the best-performing S&P 500 sub-sector, rallying 1.5% as buying accelerated in the space into the close.

On the charts the S&P 500 was able to close above 1,880 for the first time since early April, although I'd stop short of calling yesterday a definitive "breakout."

Bottom Line

Market	Level	Change	% Change
Dow	16580.84	45.47	.27%
TSX	14662.01	78.90	.54%
Brazil	51524.10	-314.51	-.61%
FTSE	6797.01	16.98	.25%
Nikkei	14485.13	181.02	1.27%
Hang Seng	23003.65	-183.32	-.79%
ASX	5448.76	-40.31	-.73%
Prices taken at previous day market close.			

All the important "macro" events largely met expectations yesterday and this morning (Chinese official manufacturing PMI) so the overall market dynamic remains unchanged. Chinese growth appears to be stabilizing, the recovery in Europe in accelerating and the ECB will do "more" at some point but QE is not on the table, and the US recovery is progressing despite horrid winter weather that caused a temporary economic dip.

Market	Level	Change	% Change
DBC	26.42	-.12	-0.47
Gold	1291.70	-4.60	-0.35%
Silver	19.085	-.403	-2.07%
Copper	3.026	-.047	-1.53%
WTI	99.77	-1.51	-1.49%
Brent	108.15	-.83	-0.76%
Nat Gas	4.799	-.032	-0.66%
RBOB	3.0077	-.0557	-1.82%
DBA (Grains)	29.28	-.10	-0.34%
Prices taken at previous day market close.			

Regarding the market, we're technically through the 1880 level in the S&P 500 but remember the recent all time high is 1897, so this isn't the definitive "breakout" the bulls want, although given the way the market is trading I wouldn't be shocked to see us test that level over the next few days baring a soft jobs report.

Bottom line is sector positioning remains key (look for value in recently beat up sectors as well as those with positive turning fundamentals). IYZ had a nice day yesterday, although there are rumors this morning that T may bid for DTV, so that could cause a dip in IYZ, which I would view as a buying opportunity.

Economics

Jobs Report Preview

As usual, I'm providing the "Goldilocks" jobs report preview a day early, as I know not everyone gets to the Report by 8:30 a.m. EST. Overall expectations are for 205K jobs added, with a "whisper" number a touch higher (say 210K-215K) thanks to declining jobless claims and the ADP number.

The "Too Hot" Scenario: > than 250k: A number above 250K would likely result in an acceleration of the Fed tapering QE and/or increasing interest rates sooner than expected. So, in this instance you would expect stocks to dip initially but then recover (because "good" data is "good," as economic growth is more important than Fed accommodation at this point in the cycle). The Dollar Index would rally, and bonds and gold would fall (likely hard).

The "Just Right" Scenario: 250K-150K: Anything in here likely doesn't result in any change in the future path of Fed policy (tapering of $10 billion per meeting and rate increases in mid-2015). Depending on which end of the range the number falls, you could see stocks and bonds move a bit. But a number in this range isn't really going to change anyone's outlook for economic growth or Fed policy.

The "Too Cold" Scenario: < than 150K: This is the scenario to be wary of (and given the recent data, it's a very remote possibility this will happen). As stated, growth is much more important than Fed accommodation, so a "bad" number here isn't "good." And, taken in the context of yesterday's poor GDP number, if April job adds are weak, it'll re-ignite concern about the pace of growth. In this instance, the reaction would be "dovish" as bonds and gold would rally hard, while stocks and the dollar would drop sharply.

FOMC Rate Decision

- The FOMC tapered another $10 billion of QE, reducing purchases to $45 billion per month, as expected.
- There was no change to interest rate policy.

Takeaway

This statement was pretty much as expected. The commentary on the outlook for the economy was upgraded slightly, while also mentioning that the economy "slowed sharply" in Q1 due to winter weather (apropos, given the Q1 GDP report).

Commentary on inflation and housing was largely unchanged, and there was nothing in this statement to imply the Fed is going to alter the course of policy anytime soon. Of note, it was a unanimous vote (last month Minneapolis Fed president Kocherlakota dissented but did not this month).

So, bottom line is the outlook for Fed policy remains very stable.

Q1 GDP

- Q1 GDP increased by 0.1% (saar) vs. (E) 1.1% (saar).

Takeaway

The first look at economic activity in Q1 (keep in mind this will be revised twice) was soft, and there aren't a lot of positives in this number. Personal Consumption Expenditures (PCE, or consumer spending) rose at a 3% annual rate, but over half the increase came from healthcare spending (up 9.9% in Q1) as the citizenry had to comply with the "Affordable Care Act" and purchase insurance.

Final sales of domestic product (which is GDP excluding inventories and a better measure of the economy compared to headline GDP), rose at a 0.7% annual rate in Q1, while inflation remained subdued (core PCE price index rose 1.3% annually in Q1, the same rate as Q4 2013).

So, both the headline and the details of this report were disappointing.

Stocks sold off initially on the headline, but the weak report didn't end up being a major negative for stocks. That's because the report was already expected to be weak, and it wasn't substantially worse than feared. Additionally, the winter weather provides a convenient excuse. Finally, the fact that economic activity in April seems much-improved also helped investors look beyond the soft reading.

Bottom line is while Q1 GDP was disappointing, the economy appears to have recovered from the winter dip. Most importantly, nothing in the Q1 GDP report materially changed economists' 3% GDP growth target for 2014, so it's not a major influence on the markets.

Commodities

Commodities were mostly lower yesterday as the EIA inventory report and more economic reports were the focus of the markets. The benchmark commodity tracking index ETF, DBC, fell 0.55%

Market	Level	Change	% Change
Dollar Index	79.545	-.366	-0.42%
EUR/USD	1.3869	.0058	0.42%
GBP/USD	1.6877	.0052	0.31%
USD/JPY	102.17	-.44	-0.43%
USD/CAD	1.0949	.0008	0.07%
AUD/USD	.9289	.0021	0.23%
USD/BRL	2.2325	-.0031	-0.14%
10-year Yield	2.648	-.047	-1.74%
30-year Yield	3.458	-.033	-0.95%
Prices taken at previous day market close.			

WTI crude oil was one of the biggest losers yesterday as the EIA reported that stockpiles grew to a fresh record high. Futures fell 1.5% to close below $100/barrel for the first time in a month.

The EIA's weekly inventory report showed that national crude oil supplies grew by 1.7M barrels (vs. (E) 2.2M) to 399.4 mln bbls. And, although the build was lower than expected (usually bullish), the fact that supplies hit a new record high was enough for the supply bears to keep the pressure on WTI. As we mentioned yesterday, Cushing, Okla., inventories were also in focus and supply levels there fell 612K barrels. But, it wasn't enough to overcome the surging national supply.

The second thing we noted that traders would be watching closely was the gasoline data, as this summer's demand outlook has been helping to support the entire energy space as of recent. But, the EIA data on gasoline was bearish. Gasoline stockpiles reportedly grew by 1.6M barrels vs. (E) of a 400K-barrel draw. The explanation for this was that the surprise build was a result of extended (and some unexpected) refinery maintenance, so gasoline data will certainly remain in focus going forward.

Bottom line in the energy space is that the "supply bears" remain in control of the market. On the charts, the first level of support is at the 100-day moving average at $99.20. But that is not far below yesterday's lows, and if that support is broken (WTI is sitting on it now) we could easily see a move down toward the March lows of $97.50 in the coming weeks.

Natural gas was lower by 0.66% yesterday, mostly falling in sympathy with the rest of the energy space. However, there was also some positioning ahead of this morning's EIA inventory report. Analysts are calling for a build of 79 Bcf, and again a surprise either way has the potential to materially move the market.

Gold futures were again rather volatile yesterday, but closed little-changed, down just 0.3% in electronic trading. Gold was materially lower early yesterday morning, hitting the lows of the day shortly after the better-than-expected ADP employment report, but then rallied over $12 on the very disappointing GDP report at 8:30 a.m. Futures continued to fluctuate throughout the middle of the day and then dropped from the highs on the FOMC announcement at 2 p.m.

On the charts, the technicals are continuing to favor the bears as resistance has moved down to $1,295 while the first line of support lies below at the 100-day moving average ($1,281.70).

Gold is trading heavy again this morning (down $10.00 as of this writing) ahead of tomorrow's jobs report. The #1270 region remains key support today and tomorrow. If that can't hold, then a move into the mid-low $1200's isn't out of the question (although I think that's be a buying opportunity long term).

Currencies & Bonds

The dollar was universally weaker against major currencies yesterday as the soft GDP report weighed on the greenback, while "in-line" economic reports from Europe and Japan helped support those currencies.

The dollar started Wednesday slightly lower thanks to strength in the euro and yen. The euro rallied on the April HICP, increasing to a 0.7% increase yoy (which missed estimates but was viewed positively because it bounced from the March low of 0.5%). The yen rallied small off the BOJ meeting mostly meeting expectations.

But, when Q1 GDP was released the Dollar Index took another leg lower, as strength in the euro and yen was now combined with outright U.S. dollar selling. So, think of yesterday's 0.4% drop in the dollar as half due to euro and yen strength, and half due to outright U.S. dollar weakness. The Dollar Index closed basically at a three-week low, and with the jobs report looming 48 hours away, 79.37 is the level to watch (it's the low for the Dollar Index this year). If that level is "given" then a run to 79 isn't out of the question.

Turning back to the euro and yen, I covered in yesterday's Report what happened with regard to EU HICP and the BOJ economic and growth outlook, and neither event really just reinforced the status quo. In Europe, dis-inflation remains a problem and we will likely see the ECB do "something" to help growth over the next two or three months. But that "something" won't be QE, as QE in the EU remains a possible but far-off event. In Japan, the BOJ remains optimistic that the recovery is on track and they will achieve their goal of 2% inflation by 2016, but the major wildcard is what the increase in the national sales tax will do to the economy. Consensus remains for the BOJ to do "more" later this year, but it keeps getting pushed out (now July seems to be the most popular expectation).

With regard to the yen short and DXJ long, I continue to like both trades, for the simple fact that if there is inflation and economic growth (as the BOJ wants) then the yen will fall and DXJ will rise. And, if there isn't, the BOJ will unleash more stimulus, which should be yen-positive/DXJ-negative. Bottom line is as long as 100.78 in the dollar/yen and $44.75 in DXJ aren't violated, then I will continue to hold both positions.

Turning to Treasuries, they traded off the GDP and PCE price index number yesterday. Bonds were lower to start trading Wednesday but reversed sharply on the GDP release and hit their highs of the day not long after the 8:30 report. Bonds drifted slightly lower throughout the remainder of the day and didn't really react to the FOMC meeting, and closed trading with solid gains (0.3%).

The 30-year remains stubbornly buoyant, but has stalled a bit at this 135'00 level with the jobs report looming. If we are going to see this counter-trend rally start to break, it'll take some major catalyst like a strong jobs number.

Finally, as a follow-up to my comments yesterday about investors starting to throw in the towel on the "higher yields" mantra and the bond bulls puffing their chests out a bit, a customer (thank you, Charlie) sent me a note yesterday that Wells Fargo lowered its interest rate targets on the 10- and 30-year Tuesday. Hopefully this trend is picking up steam.

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	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). I'm added IYZ (Telecom ETF) to this "market losers" basket this week, as its trading at a valuation discount and has underperformed other defensive sectors recently.**

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.**