7:00's Report

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

May 11th, 2014

Pre 7:00 Look

- Futures and most international markets are higher this morning after a mostly quiet weekend outside of Ukraine. There was no economic data o/n.
- In Ukraine, two eastern provinces held votes on independence, but the "official" result is unknown.
- The key with these votes is if they lead to a lot more violence (meaning more Ukrainian military action) and more sanctions from the West, it'll be a negative. For now, though, Ukraine remains on the back burner.
- Econ Today: No reports. Fed Speak: Plosser (12:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1880.00	6.75	.36%
U.S. Dollar (DXY)	79.905	-.056	-.07%
Gold	1294.80	7.00	.54%
WTI	100.49	.50	.50%
10 Year	2.622	.020	0.77%

Equities

Market Recap

The S&P 500 largely ran in place last week, as there was decent intra-week volatility, but the S&P 500 ended the week down just 0.2% and is now up 1.63% year-to-date.

The S&P 500 started last week decidedly lower on geopolitical concerns regarding Ukraine, but a strong ISM non-manufacturing report last Monday morning helped the S&P 500 reverse the declines and end trading with a small gain.

The strength didn't last, though, as Tuesday saw the biggest drop in the S&P 500 since early April (down just under 1%), as renewed weakness in the "momentum" stocks dragged the entire market lower.

The S&P 500 rebounded Wednesday, however, thanks mainly to comments from Vladimir Putin regarding a desire to de-escalate the crisis. Also cited for the lift in stocks was the benign testimony from Fed Chair Janet Yellen. She again reiterated that the economy is recovering and the Fed will remain accommodative even after QE. (It was nothing new but helped nonetheless.)

The S&P 500 was basically flat Thursday/Friday in quiet trading as investors digested the week's events and there were few catalysts to trade off of (the ECB meeting was a big event for the currency markets, not the stock market).

Trading Color

You'll notice in the above section that I didn't say what "markets" did last week, and instead only what the "S&P 500 did." That's because the real story last week was the divergence of the major indices.

The Dow Industrials actually posted a small gain last week, but the Nasdaq and Russell 2000 were down 1.3% and 2.1%, respectively, as the "momentum" sectors got hammered yet again.

The "reasons" for the renewed pressure on the biotechs and Internet stocks last week can generally be summed up by "soft earnings" and TWTR's plunge following the expiration of the lockup, but there's obviously more going on here than that. QNET made a new multi-month low, and NBI rolled over midweek and is now sitting near critical support at 2,300.

Sector-wise, it was a similar picture to the index trading,

Market	Level	Change	% Change
Dow	16,588.34	32.37	0.20%
TSX	14,534.06	-11.97	-0.08%
Brazil	53100.34	-322.03	-.60%
FTSE	6829.71	15.14	.22%
Nikkei	14149.52	-50.07	-.35%
Hang Seng	22261.61	398.62	1.82%
ASX	5448.44	-12.40	-.23%

Prices taken at previous day market close.

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as "safety" broadly outperformed "cyclicals." The tech sector and healthcare were both soft for obvious reasons (weakness in Internet stocks and biotechs), but banks also traded lower last week thanks to a flat yield curve and growing concerns about trading revenues. (JPM and Barclays have made cautious comments about trading revenues for the current quarter).

Market	Level	Change	% Change
DBC	26.09	-.14	-0.53%
Gold	1287.50	-.20	-0.02%
Silver	19.077	-.017	-0.09%
Copper	3.085	.0225	0.73%
WTI	100.01	-.25	-0.25%
Brent	107.89	-.15	-0.14%
Nat Gas	4.526	-.046	-1.01%
RBOB	2.8952	-.0098	-0.34%
DBA (Grains)	28.47	-.40	-1.39%
Prices taken at previous day market close.			

As far as what worked last week, consumer staples hit a new 52-week high while telecom also traded well. Industrials also remain just below their 52-week high as well.

Volumes and activity levels were low last week and the tone of the market remains cautious (the bond conundrum seems to be paralyzing investors to a point), while on the charts the S&P 500 is still trapped in the 1,880-1,840 trading range.

This Week

The Ukraine situation will obviously be in focus this week, but again unless there is a Russian invasion or we see major sanctions imposed that increase the risk of Russia retaliating, this will remain on the back burner for markets.

Other than economic data, the April quarter-end earnings begin this week and will be in focus. The highlight will be CSCO results Wednesday, and as always comments by CEO John Chambers will be closely watched. A few key retailers also report (M on Wednesday, and KSS and WMT on Thursday).

Bottom Line

This market is currently torn between generally constructive fundamentals and potentially ominous signals.

Fundamentally, the equity outlook remains constructive: The economic recovery (per the data) is continuing, valuations for most of the market remain reasonable at current levels and the macro-horizon remains pretty clear with the one exception being Ukraine.

Additionally, the recovery in Europe is starting to accelerate, economic data implies that Chinese growth is stabilizing, and global central banks remain very, very accommodative.

On paper, that's all positive for stocks. But, the inexplicable strength in the bond market—combined with the relentless weakness in the "momentum" sectors (and Nasdaq and Russell 2000)—is being taken as a signal that something big and bad is coming down the road and it will hit stocks hard.

So, that leaves us with a "frustratingly flat" market, which is exactly what we've had all year.

And, until one or the other "gives," meaning either the fundamentals start to break down or the "signals" go away (meaning bonds sell off and momentum stabilizes), we're likely to remain in a "frustratingly flat" market.

And, at the risk of sounding like a broken record, the way to outperform will continue to be finding the right sectors/names and buying "value" or a sector with positively turning fundamentals.

Unfortunately we've had to work for our money this year compared to the last two, and that's likely to continue. I still like industrials, telecom and "Europe" with a focus on PIIGS. And, depending on the Chinese data this week, I may initiate positions in sectors tied to the "global reflation trade" (shippers, tankers, multi-national industrials, China exposure), although I want to get a bit more data first.

Broader-market-wise, until we see bond yields moving higher, I'd be shocked if the S&P 500 gets above 1,900. And, the longer the "bond conundrum" exists, the more of a headwind it'll become.

Economics

Last Week

With the exception of the ECB, it was more of the same last week as economic data from the U.S., the EU and China confirmed what the market currently assumes and has priced in. Those assumptions are that: U.S. growth is recovering from the temporary winter drop, and 3%

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annual GDP growth is consensus. The EU economy is seeing the recovery accelerate slowly (but overall economic growth remains weak). Economic growth in China is showing signs of stabilizing (so 7.0%-7.5% GDP growth is still to be expected).

Looking at last week's data, reports were light in the U.S., but as mentioned, the reports we did get were good.

ISM non-manufacturing PMI was 55.2, the best reading since August, and that strong data helped reverse a big decline (over 100 points) last Monday in the Dow.

Additionally, weekly jobless claims declined to 319K, and appear to have resumed the downtrend we were seeing prior to the Easter/Spring Break "noise" in the number. And, if that trend of lower claims continues, it'll continue to imply we're seeing incremental improvement in the labor market (obviously a positive for the economy).

The Yellen testimony in front of Congress was in focus last week. But while some in the media were trying to spin her comments as a slight downgrade on the outlook for the economy, they really weren't. Her comments didn't give anyone any reason to change their outlook for Fed policy (tapering ending October/December, with the first interest rate hike coming in mid-2015).

In China, composite PMIs were in-line (importantly the service sector PMI stayed above 50 at 51.4). Meanwhile, the April trade balance was the positive surprise of the week, as both exports and imports increased small vs. expectations of a 3% monthly drop for both.

We get more Chinese data this week, but if it can confirm what we saw last week, it would make a very good case that the Chinese economic growth pace is stabilizing. (This is important because we may be able to get long "China" and also because it'll remove the macro risk of a Chinese "hard landing.")

The "biggest" event of the week was the ECB meeting last Thursday. As expected, there was no change to policy, but ECB President Mario Draghi's comments during the Q-and-A (he stated that the Committee was "comfortable acting next time") commanded the market's attention.

Market	Level	Change	% Change
Dollar Index	79.945	.543	0.68%
EUR/USD	1.3749	-.0091	-0.66%
GBP/USD	1.6842	-.0089	-0.53%
USD/JPY	101.76	.11	0.11%
USD/CAD	1.09	.007	0.65%
AUD/USD	.9351	-.0017	-0.18%
USD/BRL	2.2184	.0044	0.20%
10-Year Yield	2.622	.020	0.77%
30-Year Yield	3.466	.051	1.49%
Prices taken at previous day market close.			

We knew Draghi would again try to rhetorically ease policy, but no one expected this amount of specificity. And, it worked. The euro collapsed late last week, and everyone is penciling in either a rate cut in June, or the introduction of negative deposit rates. (QE, however, remains well off in the future.)

This Week

This is a busy week of data on the calendar, but I don't expect any of it to materially change the market's economic assumptions about the U.S., EU or China, unless the numbers are simply horrid.

In the U.S., retail sales tomorrow is the highlight, followed by industrial production Thursday. Although economic data have been strong, the inexplicable strength in the bond market and U.S. dollar weakness are keeping concerns alive about growth going forward. So, to a point, the market has a confidence problem, and each number that comes in better than expected (especially in April) helps to re-affirm that the economy is indeed seeing the recovery accelerate. So, retail sales and IP are important from a confidence standpoint.

We also get the first look at economic activity in May, via the Empire State and Philly Fed reports (both Thursday). These two first looks have lost some significance now that flash PMIs are released for the U.S. (they come next Thursday), but still they are watched because it's the first data for the current month. Philly has been the better predictor of national manufacturing activity lately, so pay more attention to that one.

Internationally, China releases April retail sales and industrial production tonight, and again the market is looking for further signs of stabilization. In Europe there are several pieces of data, but again unless the news is horrid, it won't really change anything as the entire focus of Europe is on what the ECB will do at the June meeting.

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Commodities

Commodities were mixed last week as gold declined slightly, crude oil futures were little-changed, and copper rallied. The PowerShares DB Commodity Tracking Index ETF (DBC) fell 0.5% for the week. The general theme in the commodity space over the past two months has been that of a broad, trendless and range-bound market and that continued last week.

Beginning in energy, crude oil futures gained a whopping 7 cents last week (+0.07%) to close at $100.03. The price of crude oil has been stuck in a range between the upper -$90s and the $105 area since the first week of February as the "supply bears" and "demand bulls" continue to push and pull the market within the aforementioned range, but neither has been successful in initiating a breakout one way or the other.

There are however, some key things to watch in the crude oil market. First, although national stockpiles are near all-time highs (most of the builds have been in storage facilities on the Gulf), inventories at Cushing, Okla., the delivery point for Nymex crude oil futures, are approaching the minimum required levels for "safe" storage. If that continues, there will need to be some adjustments made to ensure inventories remain above the required levels. Those "adjustments" would, in theory, be bullish for crude futures. Lastly, and on a fundamental note, crude oil futures remain in "backwardation," which suggests demand is historically high and that is also supportive of prices.

Moving to the metals market, gold fell 0.85% last week but remains comfortably above support in the $1270 region. Gold remains a decent hedge to the stock market, as the bond conundrum (and the expectation that harbors something negative in the future) is boosting demand for gold as a potential deflation or chaos hedge, and buying gold near these levels on dips as protection does make some sense, as long as that $1270 level continues to hold.

Copper was one of the best-performing commodities last week as futures added 0.4%, but importantly closed 2.4% off the lows. We mentioned last week that copper has again piqued our interest as the metal continues to trade "better." Copper futures have been able to hold support at $3.00 now for over a month and continue to trend higher. If we continue to see Chinese data stabilize or improve, copper could be a value at these levels (part of that "global reflation trade" I want to potentially put on).

Currencies & Bonds

Last week was a volatile one in the currency markets as the Dollar Index broke to new 52 week lows mid-week, before reversing hard Thursday and Friday courtesy of a plunging euro. Most of the early week losses in the Dollar Index were due to strength in other currencies (most international economic data was good last week). But, Draghi's "comfortable acting in next time" comment caused a big reversal as the euro collapsed and the Dollar Index rallied Thursday and Friday to finish the week just under the 80 level.

The euro, meanwhile, hit a new 52 week high just under 1.40 (1.3993) Thursday morning before falling hard Thursday and Friday (the euro finished the week at a one month low below 1.38 vs. the dollar). For all the volatility, though, the story with the dollar/euro remains the same: largely a range bound trade. Yes the ECB was rhetorically more "dovish" than expected, but their actions at the June meeting will likely by small and token, and last week was not a watershed moment to all of a sudden become very euro bearish/Dollar Index bullish. It'll take better economic growth data and actual forceful action by the ECB for that to happen.

Turning to the Treasury market, the 30 year actually closed down very slightly last week, as a very poor 30 year auction weighed the long bond Thursday afternoon and Friday. The yield curve steepened very slightly, while the yield on the ten year Treasury crept back above 2.6%. But, those small moves aside, the Treasury market remains inexplicably buoyant, and although there are some signs of "cracks" forming in this multi-week short squeeze, until Treasuries begin to decline in earnest, they will continue to be a growing headwind on the equity markets (2.80% in the ten year is generally considered the level where Treasuries would "confirm" the strength in equities, so that's the level to watch). Have a good week—Tom.

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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, the strength in bonds and flattening yield curve is starting to weigh on stocks in the near term and any move beyond 1900 is likely capped until bonds start to sell off.* *The S&P 500 remains largely in a trading range between 1890-1840.*

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) 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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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 two weeks ago with a stop at $1277 in futures or $123.11 in GLD.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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."**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	Bearish	Bearish	Bearish	*Bonds remain shockingly 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).**

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