7:00's Report

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

May 2nd, 2014

The Bond Conundrum Continues: The thirty year Treasury hit a new 6 month high yesterday on short covering ahead of the jobs report.

Pre 7:00 Look

- Futures and most international markets are drifting slightly higher as everyone looks ahead to the jobs report, while economic data o/n met expectations.
- EU economic data was in line. EU April Manufacturing PMI was 53.4 vs (E) 53.3, while the unemployment rate was 11.8% vs. (E) 11.9%.
- Ukraine headlines continue to get uglier (separatists shot down a Ukrainian helicopter) but unless there's an invasion, it'll remain on the back burner.
- Econ Today: Employment Situation (E: 215K).

Market	Level	Change	% Change
S&P 500 Futures	1878.75	1.00	.05%
U.S. Dollar (DXY)	79.635	.056	.07%
Gold	1286.70	3.30	.26%
WTI	99.84	.42	.42%
10-year	3.405	-.053	-1.53%

Equities

Market Recap

Stocks traded flat Thursday as markets digested more economic data and M&A chatter, while looking ahead to today's jobs report. The S&P 500 closed down 0.01%.

Economic data was the main catalyst for trading yesterday. Stocks opened flat but traded lower almost immediately following conflicting economic data. (Personal Income/Spending beat as did ISM Manufacturing PMI, while construction spending, auto sales and jobless claims missed.) Also, there was more M&A chatter yesterday that helped the bulls as T is considering a bid for DTV and S is expected to bid for TMUS later this summer.

The S&P 500 briefly broke through support at 1,880 an hour after the open, but buyers were there on the dips and stocks rallied hard to hit their highs right before lunchtime, just below 1,890. Things slowed considerably in the afternoon. Stocks couldn't hold their gains as investors positioned ahead of the jobs report, and the markets finished the day almost perfectly flat.

Trading Color

"Momentum" sectors made it three in a row yesterday as both QNET and NBI rallied more than 1%, handily outperforming the markets and further implying that the Friday/Monday sell-off was more about month-end positioning than it was renewed de-risking in the space (which is an overall positive for the market).

Specifically, YELP was able to rally nearly 10% yesterday on "ok" earnings Wednesday night, and that's in stark contrast to what happened to the Internet names last

Market	Level	Change	% Change
Dow	16558.87	-21.97	-.13%
TSX	14664.07	12.20	.08%
Brazil	51626.69	-211.92	-.41%
FTSE	6814.54	5.67	.08%
Nikkei	14457.51	-27.62	-.19%
Hang Seng	22260.67	126.70	.57%
ASX	5458.06	9.29	.17%
Prices taken at previous day market close.			

week (they got dumped Thursday/Friday regardless of the quality of their earnings).

This continued resiliency in momentum is encouraging, and people I talked to on desks yesterday said that, for the first time in a while, they saw “real” money nibbling on the long side. (So, it wasn’t just short-covering or fast money trying to catch a bounce.) If that can continue, it’s a positive for the market.

Market	Level	Change	% Change
DBC	26.22	-.19	-0.72%
Gold	1285.00	-10.90	-0.84%
Silver	19.055	-.064	-0.33%
Copper	3.025	-.0025	-0.08%
WTI	99.47	-.27	-0.27%
Brent	107.83	-.24	-0.22%
Nat Gas	4.711	-.104	-2.16%
RBOB	3.0077	-.0557	-1.82%
DBA (Grains)	29.10	-.17	-0.58%
Prices taken at previous day market close.			

Reflecting the strength in the Internet names, the Nasdaq was the only major index to trade higher yesterday, while the Russell, Dow Industrials and S&P all finished fractionally lower.

Sector-wise it was a mixed bag yesterday. Telecom was again the best-performing S&P 500 sub-sector (IYZ rose 0.9% … sometimes it pays to be more lucky than good) off the T/DTV and S/TMUS merger chatter. Healthcare, financials, homebuilders and consumer discretionary also traded marginally higher, while consumer staples, banks and semiconductors were off small. But, most of the sector moves yesterday were the results of earnings as opposed to any great movement in positioning by investors.

Volumes and activity were busy in the morning (thanks to the data and earnings), but things slowed materially in the afternoon (May Day had something to do with it as well).

On the charts, the S&P 500 held support at 1,880, and unless the jobs report is a big miss, a run to 1,900 isn’t out of the question over the coming days if “momentum” holds up and Russia doesn’t invade Ukraine (the former being much more likely than the latter).

Economics

Weekly Jobless Claims

- Initial Jobless claims were 344K vs. (E) 320K
- The 4 Week Moving Average increased by 3K to 319.75K

Takeaway

Weekly jobless claims jumped for the third week in a row last week. Initial claims increased by 14K to a 9-week high of 344K. The week prior was revised slightly higher from 329K to 330K. The smoother look at the data, the 4-week moving average, also increased—up 3K to 319.75K, a 6-week high.

Stock futures sold off and gold jumped on the data release. However, the moves were temporary, knee-jerk reactions and both markets returned to essentially where they were pre-data. The weekly claims number is continuing to be skewed by the Easter holiday (i.e., temps being relieved of work), which was the original reason they dipped so much (i.e., temps being hired to satisfy heightened holiday demand). So, the report is largely being ignored, and we can expect to get a “cleaner” number in next week’s report. Also, because of the “skew,” yesterday’s report did not materially affect the “whisper number” for the official jobs report.

ISM Manufacturing PMI

- April PMI 54.9 vs. (E) 54.3.
- New Orders Index unchanged at 55.1

Takeaway

This was a good manufacturing report as the headline beat estimates, while the details were also good. New orders were flat month-over-month, and production dipped slightly (55.7 vs. 55.9 in March), but more importantly the employment sub-index rose to 54.7 from 51.1 in March, again implying we’re seeing incremental improvement in the labor market.

Markets didn’t really react to the release, though, as a good number was expected. Regardless, though, it is nice to see a strong ISM Manufacturing PMI immediately following the soft Q1 GDP report, as it further solidifies that the slowdown in Q1 was indeed temporary.

Personal Income and Expenditures

- March Consumer Spending rose 0.9% vs. (E) 0.6%.
- Core PCE Price Index rose 1.2% yoy, up from 1.1%.

Takeaway

This was a bit of a misleading report, as most financial websites cited the fact that consumer spending was strong in March. It was, but not really for the best reasons. The jump in consumer spending was due to a big increase in services (i.e., utilities courtesy of the frigid winter and healthcare spending courtesy of the Obamacare deadline). Good spending (buying discretionary stuff) was muted in Q1, as other data implied. So, this report served more to confirm the weak consumer spending in Q1, not contradict it (although obviously things are a bit better now).

Also of note in this report, the core PCE Price Index ticked a touch higher, rising to 1,2% yoy vs. 1.1% in February. Remember the core PCE Price Index is the Fed's preferred measure of inflation. So, while still low vs. the 2.0% target, it did bump up a bit (which to a point negates the "low inflation caused the bond rally yesterday" thesis. Inflation has been low for a long time and didn't get any lower yesterday).

Commodities

The selling continued in the commodity space yesterday as crude oil and gold futures extended weekly losses. The PowerShares DB Commodity Tracking Index ETF (DBC) fell 0.76% on the day.

Natural gas was one of the worst-performing commodities yesterday, falling 2.16% following a government inventory report. According to the EIA, national supply levels grew by 82 Bcf, which was largely in-line with analyst estimates of 79 Bcf. But, as has been the trend in recent weeks, futures slumped on the data as disappointed (bullish) speculative traders unwound positions.

On the charts, the technicals are shifting from bullish to neutral for the near term. Going forward we are looking for support at $4.64 while resistance lies above $4.80. Despite the shift in technicals, the fundamental situation remains largely the same as inventories are still near 11-year lows. And, with prices remaining relatively elevated (up 11% YTD), the bullish argument for nat gas E&P ETFs FCG and XOP remains intact.

Elsewhere in energy, Nymex crude oil futures continued to break down yesterday, although WTI did close well off the lows of the day ($98.74) at $99.41. The pop was mostly short-covering as front-month futures dipped toward the 100-day moving average at $99.22. Futures briefly turned positive but gave back the gains to close down 0.3% on the day and 1.05% for the week.

Moving to the metals market, gold also continued to break down yesterday, falling 0.84% to close at $1,284.40. Futures did post a sharp rally to test the $1,290 resistance level upon release of the weaker-than-expected weekly jobless claims data, but the spike was short-lived and the selling continued. Fundamentally gold remains in a "no man's land" as events in Ukraine aren't really effecting gold, while inflation remains muted (although again there are signs of a slight uptick). On the charts gold remains in a well-defined, technical downtrend with resistance at $1,290 while the first level of support is below at $1,280, and major support in the $1,270 level, which will likely be tested if the jobs report is strong. If that is broken, a move to the mid $1200's is likely.

Currencies & Bonds

Bonds surged higher yesterday despite economic data being bond-bearish (bonds haven't been trading off economic data for weeks, and this trend accelerated yesterday). Despite the manufacturing PMI beating estimates and the personal consumption and expenditures report also posting headline beats, the 30-year note traded to a new high for the year and finished the day up 0.65% (the yield broke below 3.40% while the yield on the 10-year fell below 2.6% for the second time in three weeks).

Market	Level	Change	% Change
Dollar Index	79.585	.053	.007%
EUR/USD	1.3864	-.0002	-0.01%
GBP/USD	1.6888	.0018	0.11%
USD/JPY	102.30	.06	0.06%
USD/CAD	1.0961	.0003	0.03%
AUD/USD	.9272	-.0011	-0.12%
USD/BRL	2.233	.001	0.04%
10-year Yield	2.606	-.042	-1.59%
30-year Yield	3.405	-.053	-1.53%
Prices taken at previous day market close.			

There was a lot of coverage of "why" bonds were so strong, and we've been addressing that for some time here – but yesterday specifically, bonds were higher because we saw a big short-squeeze ahead of the jobs report this morning. That short-squeeze was exacerbated by the fact that yesterday was "May Day" and much of Europe and Asia was closed, making the market more thin than usual.

The question now is where do we go from here. Clearly the detachment of bonds from economic reality (or at least, what we think is economic reality) has reached a new high. At this point, I think it's safe to say we're either seeing a "blow off" top in this bond rally as the pain for the bond shorts (me included) is becoming excruciating, and this bond rally is about to reverse and reverse very hard, or the economic data is going to start to turn worse and confirm this bond rally. Either way, the dichotomy in the bond/equity market can't continue, unless this really is all foreign buying of Treasuries (which I cover below).

Regardless, if this morning's jobs number is a big miss (which no one is expecting at all) then folks over at the SEC better get off their duffs and start looking around, because someone will have known something.

For what it's worth (perhaps I'm a glutton for punishment), I bought TBT calls yesterday into the close, as the magnitude of yesterday's the short covering rally made absolutely no sense to me. Unless the jobs number is anything other than horrid, we should see some sort of a dip in these bonds today.

In the currency markets, things were much more quiet thanks in part to May Day but also as currency markets digested the big moves Wednesday and looked ahead to the jobs report this morning. The Dollar Index was flat as a move higher in claims offset the strong ISM manufacturing PMI report, while the euro and pound were flat (despite economic data in the UK being better-than-expected). But, the looming jobs report stunted any moves of the major western currencies yesterday.

Commodity currencies saw small declines thanks to the weakness in the commodity complex and the in-line (but absolute low) level of the April Chinese manufacturing PMI. (It basically met what was priced into the Aussie dollar.) Finally, in Japan, the yen was down small, giving back some of Wednesday's gains, and the yen continues to tread water around the 102 yen/dollar level.

Could This All Be Because of Europe?

One of the theories I keep hearing (which I covered previously here) is that this strength in bonds is the result of a rotation of money out of Europe (where yields are heading lower) and into Treasuries. And, as I've said before, this is feasible, because compared to the ECB and BOJ, the Fed is incrementally more "hawkish."

This is important to consider because if this is the reason, then it's possible we could see both bonds and stocks rally together for an extended period, like we saw in '11 and '12 (that would obviously invalidate my "bond bear" thesis).

I saw during the euro-zone crisis how turmoil in that area resulted in money flowing into Treasuries, so it certainly is possible that money flows out of Europe into the U.S. are supporting Treasuries. And, although I'm a bond bear and painfully short bonds, I also own stocks. So, I'd much rather have "European money flows" be the reason for bond strength, compared to some forecasting of an economic slowdown/deflation.

But, I have a hard time reconciling that European investors are relentlessly buying Treasuries, and have been doing so all year. And, while I'd like to point to the money flows as the reason, it just doesn't make sense to me that it could account for the inordinate strength in bonds in the face of improving economic data and a no longer incrementally more dovish Fed.

So, disregarding my short opinion (because I'd rather make money than be right), this rally in bonds continues to trouble me, and while I'd like to explain it away with money flows, it just doesn't seem right to me. Even if I weren't short bonds, I'd be a lot happier if bonds start falling and "confirm" the strength in equities.

Have a good weekend,

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.**