7:00's Report

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

May 27th, 2014

Pre 7:00 Look

- Futures are higher this morning after the long weekend, playing catch up to international markets, which rallied Monday off of good geo-political news.
- Petro Poroshenko won elections in Ukraine, as expected, and it is being viewed as a positive. In Europe, anti-EU parties made gains in elections, but more importantly in Italy and Greece support grew for the existing governments, which is a positive.
- Economically it was quiet, as UK Distributive Trades and EU Economic sentiment beat expectations.
- Econ Today: Durable Goods Orders (E: -0.8%), Case-Shiller HPI (E: 0.7%), Service PMI Flash (E: 55.4) Fed Speak: Lockhart (8:10 PM).

Market	Level	Change	% Change
S&P 500 Futures	1905.00	8.00	0.42%
U.S. Dollar (DXY)	80.34	-.11	-0.14%
Gold	1283.50	-8.20	-0.63%
WTI	104.03	-.32	-0.31%
10 Year	2.536	-.019	-0.74%

Equities

Market Recap

Stocks staged a broad rally last week on the back of stronger-than-expected economic data, apparent stabilization in the housing recovery, and a quiet rebound in the "momentum" sectors. The S&P 500 rallied 1.2% and is up 2.8% year-to-date.

Stocks started last week see-sawing back and forth Monday through Wednesday, largely trading on changes in sentiment. The Russell 2000 and "momentum" sectors acted as leading indicators (strength in the Russell led to a rally Monday and Wednesday while weakness led to the sell-off Tuesday).

Things changed Thursday though as the market actually traded off of fundamentals. Global flash PMIs generally beat expectations while existing home sales showed the first monthly increase this year. Stocks rallied nicely Thursday, and the rally extended into Friday as new home sales also beat and we saw some short-covering going into the long weekend ahead of the Ukrainian elections (which were viewed as a potential positive).

Trading Color

Positive economic data helped to spark last week's rally, but it was the quiet rebound in the Russell and "momentum" sectors of NBI and QNET that really helped push stocks to new all-time closing highs.

The Russell rallied 2% last week, importantly outperforming the S&P 500. Meanwhile NBI and QNET (and a lot of the true "momentum" names in the Internet, cloud computing and biotech spaces) traded with some resiliency for the first time since the sell-off began in earnest back in April. (Case in point, a bad earnings report by CRM midweek didn't spread to other Internet stocks, which was not the case over the past month and a half.)

The one asterisk to overall positive performance last week was extremely low trading volume. Last week saw two of the lowest-volume days of the year, and "real" money largely remains on the sidelines, so it's a fair criticism to say last week's gains came with little or no conviction. Better volumes and more conviction would be a nice positive surprise for this market.

On the charts, the S&P 500 is now sitting right against resistance at the all time highs of 1,902, while support remains in the low 1,880s to high 1,870s.

Market	Level	Change	% Change
Dow	16,606.27	63.19	0.38%
TSX	14,726.16	18.06	0.12%
Brazil	52,932.91	306.50	0.58%
FTSE	6,851.37	35.62	0.52%
Nikkei	14,636.52	34.00	0.23%
Hang Seng	22,944.30	-18.88	-0.08%
ASX	5,511.70	-1.13	-0.02%
Prices taken at previous day market close.			

This Week

The Ukrainian elections were the big news event of the long weekend. Petro Poroshenko (the "Chocolate King") importantly won the Ukrainian presidency and, in a key positive development, he apparently got more than 50% of the vote. This means there won't be a run-off election (so this went as well as possible).

Market	Level	Change	% Change
DBC	26.43	.06	0.23%
Gold	1293.00	1.30	0.10%
Silver	19.44	.022	0.11%
Copper	3.188	.0205	0.65%
WTI	104.15	-.20	-0.19%
Brent	110.24	-.30	-0.27%
Nat Gas	4.394	-.011	-0.25%
RBOB	3.0118	-.0117	-0.39%
DBA (Grains)	28.12	-.09	-0.32%
Prices taken at previous day market close.			

This will be viewed as a positive by the market, although the violence will continue and no one should expect the situation to improve materially anytime soon. But, it further reduces the risk of a Russian invasion, and this issue will remain largely in the background for stocks.

The other news this weekend came from the European Central Bank, which is holding a conference in Portugal. There were many comments yesterday, including from Mario Draghi, but nothing new was revealed. Expectations for action from the ECB are at an all-time high, and it just remains a question of "what" the ECB does next Thursday (and whether it satisfies the market).

For the rest of the week things are pretty quiet, as the focus will be on economic data. (On the earnings front, TOL is the only really notable report, as it'll give further insight into housing.)

Bottom Line

This market remains somewhat stalemated between negative "signals" and generally supportive fundamentals. But the balance shifted a bit to the fundamentals last week. Small caps and "momentum" sectors stabilized, removing part of the ominous "signals" the market has been sending (which is broadly positive for stocks). Bottom line: The "frustratingly flat" action hasn't been resolved, but last week was a good one for the bulls.

Fundamentally, the backdrop remains positive for stocks in an absolute sense: Global economic growth is generally accelerating, global central banks remain extraordinarily accommodative, and valuations for the market remain "reasonable" at 15.8X a \$120 '14 EPS and 14.6X a \$130 '15 EPS.

Bond yields remain the missing piece to this market being able to break out materially, but we did see a slight sell-off there last week and sentiment toward bonds appears very complacent at this moment (a lot of people are calling for sub-3% 10-year yields by year-end).

Given this setup, the question I'm asking is whether there's an opportunity in some of these beaten-down "momentum" sectors — and while it's too early to definitively say "yes," they will play catch-up in a big way if stocks can break out.

Banks, though, do seem particularly attractive at this point and the BKX traded well last week. From a broad strategy standpoint, this remains a sector-picker's market, and sectors linked to the "global inflation trade" remain attractive from a valuation and sentiment perspective.

Economics

Last Week

Last week was a good one for economic data, as global flash PMIs confirmed current market expectations (Chinese growth stabilizing, EU recovering slowly, U.S. recovery accelerating), and we got some welcome good news on domestic housing.

The global flash PMIs were the highlight of the week, and although there was some disappointment in European manufacturing data, largely the reports were better than expected. Importantly, they helped reinforce that the pace of Chinese economic growth is stabilizing, Europe is seeing a slow recovery and growth in the U.S. is slowly accelerating.

Chinese flash manufacturing PMIs hit a five-month high at 49.7, just below the important 50 mark, and a lot of the details of the report were strong. U.S. flash PMIs came in at 56.2 vs. expectations of 55.9, again implying that we are seeing a continued recovery form now that we're past the winter-weather-imposed economic dip.

The one "miss" in these numbers was in Europe, where

French PMIs disappointed, while German and EU manufacturing PMIs declined from April (and missed estimates).

On the headline that looks bad, but it's really not. First, everyone's focus is on what the ECB will do a week from Thursday. So, in some respects, the slightly disappointing data are putting more pressure on the ECB to act (so, mildly bad news is good). Second, in aggregate the PMIs for Germany and the EMU were "OK" (still comfortably above the 50 level), so importantly these weak numbers aren't going to result in anyone changing their growth estimates for the EMU (which means the numbers aren't really that bad for European stocks).

China and Europe remain two major areas of concern in the global economy, but the data last week further confirmed that we're seeing positive incremental progress in both regions, which is a positive for global equities.

The other important data released last week were the existing home sales Thursday and new home sales Friday. As you know, housing remains an area of concern for analysts and the Fed, as it hasn't "bounced" from the winter dip like the rest of the economy.

Well, data last week implied that we may finally be seeing some sort of a "bounce" in housing, as April existing home sales rose month-over-month for the first time this year, while new home sales increased as well.

Those positive surprises helped stocks rally late in the week, because if we can get the housing recovery to start moving forward again, that will be an unanticipated tailwind on the U.S. economy (and a positive for equities).

Two reports won't remove concern about housing, especially in this generally pessimistic environment, but these reports did help sentiment last week.

Finally, there were a bunch of Fed speakers last week and the release of the Fed minutes last Wednesday, but the bottom line is the outlook for Fed policy didn't change at all (tapering ending in October/December, and first rate increases mid-2015).

Perhaps the most important Fed-related item from last week was Vice Chair William Dudley's commentary about a Fed exit strategy. But there will be plenty of time to dissect that, as we're still a ways off from the Fed even starting to exit all these programs. But, as tapering and eventual rate increases draw near, expect the focus of the Fed analysis to shift to the exit strategy. For now, though, everything remains status quo.

This Week

There are several notable economic releases this week, but the truth is that, barring any major surprises, the market will be looking ahead to next week (ECB decision and May jobs report). So, nothing this week should materially change the market's outlook for the U.S. or global economy, again unless there's a big surprise.

Revised Q1 GDP Thursday will likely be the most-watched number this week, as it's likely we'll see growth for Q1 revised into negative territory. But, while that will be a much-publicized headline, again remember the market is much more focused on the *pace* of growth now than it was eight weeks ago.

April durable goods is released later this morning, while we get jobless claims and pending home sales Thursday. Claims ticked up a bit last week so the market will be looking for a resumption of that downtrend, while pending home sales will be closely watched (and that's probably the most important number this week, given the housing data last week).

It's the same story in Europe, as there are several releases, but everyone is looking ahead to the ECB on June 5. Japan is the one expectation, as there are multiple releases Thursday night.

This could move markets, as everyone is still trying to figure out how much the Japanese economy has slowed now that the sales tax increase has been in place for over a month. That, obviously, will have a impact on when (and if) the Bank of Japan eases further.

Market	Level	Change	% Change
Dollar Index	80.33	.025	0.03%
EUR/USD	1.3645	.0012	0.09%
GBP/USD	1.6842	.0012	0.07%
USD/JPY	101.89	-.07	-0.07%
USD/CAD	1.0854	-.0007	-0.06%
AUD/USD	.9248	.0022	0.24%
USD/BRL	2.2159	-.0067	-0.30%
10 Year Yield	2.536	-.019	-0.74%
30 Year Yield	3.398	-.031	-0.90%
Prices taken at previous day market close.			

Commodities

Commodities traded mostly higher last week as crude oil futures approached the 2014 highs of $105 a barrel on supply concerns, while copper hit a 13-week high in electronic trading yesterday. The benchmark commodity tracking index ETF, DBC, added 0.34% on the week.

Copper was again one of the better-performing commodities last week, as the support band at $3.10-$3.12 held and futures gained 0.7% on the week. Copper remains in a well-defined uptrend that has been in place since hitting a multi-year low in the high $2.80s back in March. As we have noted in previous weeks, copper remains one of the best ways to get long the global economy, and more specifically the Chinese economy. And as long as China continues to be "landing softly," buying dips remains a fundamentally sound trade.

The bulls remain in control of the oil market as we are seeing demand rise faster and sooner than most analysts had expected for this time of year, which is now weighing on inventories. The EIA reported a substantial draw of 7.2M barrels last Wednesday for the week prior against expectations that called for a build of 700K barrels. So, that bullish supply news — combined with the unexpected, early rise in gasoline demand — were the two primary reasons behind the 2.67% rally in WTI futures last week. Shorts closing out ahead of the long holiday weekend also helped support the price.

Looking ahead, we are currently testing the 2014 highs at the $105 level. If we see a breakout (which is more likely than not), we will see shorts get squeezed out. The next stop on the charts will be the $108-$110 resistance band. Looking below, there is support at $102.50.

It was more of the same in the gold market last week as futures were once again little-changed. Gold actually closed exactly where it opened the week at an even $1,293. The precious metals market has become flat-out boring as the trendless, sideways trading continues. The only development worth mentioning is that the trading range has compressed from roughly $1,270-$1,330, to $1,280-$1,305, which can be a precursor to a material breakout (in either direction).

However, such a move will require a shift in market dynamics (i.e., a correction in the stock market, or a series of unexpectedly bad economic reports, or even a drop in physical demand).

Currencies & Bonds

Economic data helped drive the currency markets last week, as the Dollar index rallied small (0.3%) to close at a six-week high above 80, thanks to the good data. The euro closed at a three-month low, courtesy of the weak manufacturing PMIs. Yesterday we saw those moves reverse a bit (the euro rallied after the ECB members failed to say anything more-dovish than before).

This week, we should continue to see the Dollar Index and euro driven by data and expectations of what the ECB will do a week from Thursday.

The yen was perhaps the most-interesting currency last week, as the yen/dollar hit a multi-month low below 101 yen/dollar, before reversing off critical support at the 200-day moving average and actually finishing the week higher at 101.95 (so the yen weakened vs. the dollar after showing initial strength). The yen continues to trade off BOJ expectations, which remain very much in flux. But, the charts and trading last week implied the yen bears remain in control (incidentally the Nikkei quietly rallied 2.5% last week, so the "short yen/long DXJ" trade is hanging in there).

Shifting to bonds, Treasuries quietly sold off last week in (appropriate) reaction to the good economic data, although there was a decent bounce yesterday on low volume. Treasuries remain the biggest ominous "signal" out there, and they need to decline for equities to break out.

A move below 136'00 (last week's low) in the Treasury market would be a positive for us bond bears, but until 133'50-ish is broken, the near-term trend remains higher.

Shifting to the 10-year, a yield of 2.65% or higher would help remove the ominous signal, but it's got to start moving toward 2.80% before we can say bonds are "confirming" the strength in the equity market and resolving the "bond conundrum."

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, 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 1900-1840.*

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've added IYZ (Telecom ETF) to this "market losers" basket, 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 remains 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 two weeks ago 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. **The Yen rallied to start the week last week but sharply reversed off of the 200 day moving average mid week (while the Nikkei quietly rallied 2.5%) suggesting the short yen/long DXJ trade is hanging in there. But, 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**

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).**