7:00's Report

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

May 28th, 2014

Pre 7:00 Look

- Futures are slightly higher after an uneventful night that saw follow through buying globally from yesterday's rally.
- Economically it was another quiet night, although there was a negative surprise in Great Britain, as Distributive Trades (retail sales) badly missed expectations (16 vs. (E) 35). The pound is modestly weaker as a result.
- The only other notable moves came in the Chinese yuan, which declined and is near 18 month lows on general concern about the Chinese economy (there was no new news).
- Econ Today: No economic reports today.

Market	Level	Change	% Change
S&P 500 Futures	1913.25	4.00	.21%
U.S. Dollar (DXY)	80.485	.08	.10%
Gold	1265.70	0.00	0.0%
WTI	104.34	.23	.22%
10 Year	2.516	-.02	-0.79%

Equities

Stocks quietly, but steadily, rallied yesterday and the S&P 500 traded to fresh all-time highs on better than expected economic data and more M&A activity. The S&P 500 gained 0.66%.

Stocks opened higher out of the gate yesterday morning thanks to the durable goods headline beating analysts' expectations pre-market. That report was followed by two home price indicators, both of which showed an uptick in housing prices, which the market also liked. Lastly, the service PMI flash increased more than expected, which sent stocks to session highs.

S&P 500 Stocks moved decisively to new all time highs yesterday, and the first rule of trading is you "buy what's making new highs."

After sprinting to new high immediately following the open, stocks spent most of the day treading water between 1910 and 1908 as things got very quiet from a news and activity standpoint. Stocks lifted a bit into the close thanks to large "buy" market on close orders to hit a new high at 1912, shortly before the closing bell.

Trading Color

The internals (excluding volumes) continued to get more positive yesterday as not only did the Russell 2000 and the Nasdaq outperform the S&P, but the two momentum sectors that have been in the spotlight recently, QNET and NBI, were among the best performers, up 1.33% and 2.54% respectively.

Sector-wise, however, it was a bit of a wash, as there was no clear trend other than that of some select beat up sectors continuing to outperform.

Financials and tech were among the best performers but oddly utilities were a close third and also outperformed the S&P. Meanwhile healthcare, industrials and consumer discretionary were in-line while materials, consumer

Market	Level	Change	% Change
Dow	16675.50	69.23	.42%
TSX	14658.02	-57.67	-.39%
Brazil	52172.36	-760.55	-1.44%
FTSE	6848.61	3.67	.05%
Nikkei	14670.95	34.43	.24%
Hang Seng	23080.03	135.73	.59%
ASX	5527.18	15.48	.28%
Prices taken at previous day market close.			

staples and energy underperformed.

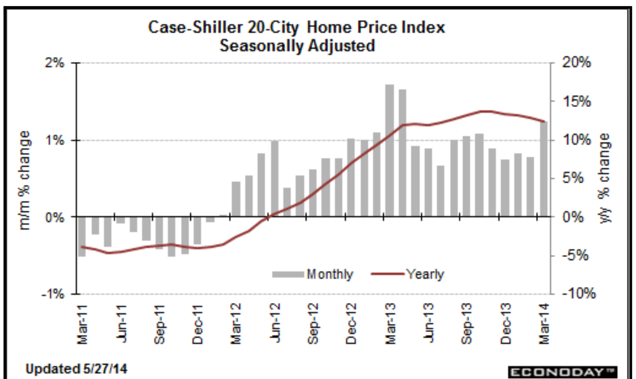
Volumes remain an issue as they were very low (not surprising coming out of a holiday) and activity was again muted.

On the charts the S&P 500 surged to a new all time high at 1912, and that level is resistance, while support lies lower around 1900.

Bottom Line

Did we just break out of this months long 1880-1840ish range (finally)? Yes, probably, but I think this will reflect a move higher in a the trading range (say 1910-1860) rather than a forceful break out in stocks that we need to pile into.

As far as "why" stocks rallied yesterday and have broken out, there wasn't any specific catalyst, but instead just the general backdrop is getting more positive: Economic data is continuing to show improvement domestically and globally, geo-political tensions are falling, valuations aren't stretched and central banks remain extremely accommodative. And, one of the two "ominous" signals in the market is going away (small caps and momentum are rebounding).



Case-Shiller HPI: After several months of no gains, the Case-Shiller HPI saw a nice uptick in home prices in March, giving the market another much needed positive data point in housing.

All that said, though, we have to keep in mind that this is month end, so we're probably seeing some short covering/dip buying into the end of the calendar, especially in small caps and "momentum" names, and bonds still aren't cooperating—so it's not like we've got an "all clear" on the market either.

Given we're close to month end and the calendar is quiet, I'd expect near term to see the path of least resistance marginally higher, but I'd want to see follow through in early June before getting too bulled up on this market and piling into high beta names.

Economics

Market	Level	Change	% Change
DBC	26.24	-.19	-0.72%
Gold	1267.20	-24.50	-1.90%
Silver	19.10	-.318	-1.64%
Copper	3.1735	.006	0.19%
WTI	104.22	-.13	-0.12%
Brent	110.09	-.223	-0.21%
Nat Gas	4.494	.089	2.02%
RBOB	2.9976	-.0259	-0.86%
DBA (Grains)	27.78	-.34	-1.20%

Prices taken at previous day market close.

Durable Goods Orders

- April Durable Goods Orders increased by 0.8% vs. (E) -0.8%
- Non-Defense Capital Goods Ex-Aircraft (NDCGXA) fell 1.2% in April after rising 4.7% in March

Takeaway

Yesterday's durable goods report was initially seen as a good report, as the headline handily beat expectations and the March print was revised higher by a full percentage point. New orders for April actually grew 0.8% against analysts' expectations of a 0.8% drop, while the data from March were revised from a positive 2.6% to +3.6%.

However, the details of the report were decent as well, as the key number to watch, Non-Defense Capital Goods Ex-Aircraft (NDCGXA) fell 1.2% in April, although that drop was more than offset by a large revision to NDCGXA for March, which was adjusted higher by 2.7%.

The markets initially responded to the report favorably (bonds and gold hit morning lows while stock futures and the dollar bounced), but later recovered back to pre-report levels.

Bottom line is the durables report helps reinforce that while we saw a large "bounce back" effect in March from winter economic weakness, activity moderated a bit in April. But, all in all this is another sign that the economy is recovering from the winter induced weakness, which is the most important point.

Service PMI Flash

- The Service Flash PMI for May was 58.4 vs (E) 55.4

Takeaway

Growth in the service sector is accelerating faster than analysts expected this month, as the service PMI flash rose to 58.4 vs (E) 55.4. Unlike the durable goods report, the service PMI flash is very straightforward and the headline results indicate that the service sector remains very strong.

Commodities

Commodities began the shortened trading week with a thud yesterday after the space saw general strength last week. Precious metals were among the worst performers while copper actually continued to trade well. Copper was one of only two commodities to rally yesterday, with the other being natural gas. The benchmark commodity tracking index ETF closed down 0.75%.

Gold was the big story in the commodity space yesterday. Futures broke down through support of the recent, very tight trading range that has been in place for months now around the $1,300 level. Gold prices fell more than $25 to a low tick of $1,264.30 and closed the day down 2% at a 15-week low.

As we mentioned in yesterday's Report, the compression of the trading range (rising support, and falling resistance levels) often precedes a material breakout move on the charts. Yesterday, we saw that move occur to the downside in gold, as stocks traded to new highs following better than expected economic reports (at least on the headlines), and geopolitical tensions dropped to the lowest in months as Ukrainian elections went smoothly and the expectations are that things will continue to improve there going forward.

Going forward, gold generally rallies on geo-political tensions or inflation expectations, and with the Ukraine situation settling a bit, focus will turn to inflation. And, while there are "green shoots" of inflation domestically, there simply isn't enough to overcome the short term selling in gold.

I don't expect a total wash out here, but it's tough to see a near term positive catalyst for gold. So, I'd look to be a buyer of a further dip for longer term accounts. That said, though, the inverse relationship between stocks and gold futures remains intact, and although stocks are trading well at the moment, gold remains a good hedge to equity positions for those looking for some protection.

Elsewhere in the metals, copper continues to trade very well. As mentioned, it was one of only two of the commonly monitored commodities to rally yesterday. Copper added 0.25% to close at $3.175 yesterday, which is a fresh 11-week high. This industrial metal continued higher as traders remain optimistic that the Chinese economy is avoiding a "hard landing" and government stimulus will help boost demand. Copper also benefited from the better than expected durable goods headline here in the U.S.

On the charts, copper futures remain in a well-defined uptrend, with support moving up from the $3.10-$3.12 band to the 100-day moving average at $3.14.

Moving to energy, natural gas was the only other commodity to rally yesterday, strongly outperforming the space to close higher by 2.25%. Natural gas continues to be supported by the historically low national inventories, but prices have recently come under pressure as a result of several larger than expected builds in a row.

Going forward, weekly supply builds (recently bearish effect), weather (hot-bullish, mild-bearish), and the overall national stockpiles (recently bullish effect) will be the primary influences on the market.

Elsewhere in energy, crude oil futures were little-changed yesterday, down 0.17% to $104.15. WTI continues to trade in the top of the range that has been in place since February between the upper-$90s and $105.

On the charts, a rough, bullish "flag" pattern is developing on the daily chart, which oftentimes precedes a breakout to the upside, through longstanding resistance levels.

In this case, the fundamentals are mostly in agreement. We saw a material draw in inventories last week (-7.2M barrels) along with increasing gasoline demand coming earlier in the calendar year than normal.

Market	Level	Change	% Change
Dollar Index	80.40	-.05	-0.06%
EUR/USD	1.3635	-.001	-0.07%
GBP/USD	1.681	-.003	-0.18%
USD/JPY	101.96	.02	0.02%
USD/CAD	1.0858	.0001	0.01%
AUD/USD	.9258	.0022	0.24%
USD/BRL	2.2393	.0157	0.71%
10 Year Yield	2.516	-.02	-0.79%
30 Year Yield	3.363	-.035	-1.03%

Prices taken at previous day market close.

So, bottom line is, although it may not happen this week, or even in the next month, the trend favors the bulls. A breakout toward resistance between $108 and $110 is the path of least resistance.

Currencies & Bonds

Currency markets were relatively quiet yesterday as the news wires were slow and the only real market-moving economic reports were here in the U.S. The dollar rallied yesterday morning after the release of several better than expected economic reports; however, it failed to hold the gains and finished the day down 0.07%.

The dollar drifted higher ahead of the economic data, accelerating upon release of the better than expected durable goods print. Then, the S&P Case-Shiller Home Price Index and FHFA House Price Index were released. Both indicated that home prices increased in March, signaling that demand for housing remains strong and helping the dollar to extend its gains. Lastly, the service PMI flash for May was released, and also came in higher than expectations and helped to boost the dollar to a fresh intra-day seven-week high.

In Europe the euro was slightly higher, up 0.07%, but importantly closed above the 200-day moving average. The euro gained thanks to the easing geopolitical tensions between the Ukraine and Russia as well as the favorable election outcomes in Italy and Greece. However, trading in the euro remains on standby as traders are already looking ahead to the June 5 ECB announcement, when officials will reveal what kind of stimulus they will choose to ease policy. The 200-day moving average at 1.36 remains a key level in the euro/dollar pair, as there has already been one close slightly below (Friday).

Elsewhere in Europe, the pound was lower for both economic and political reasons. Economically, a report released by the British Bankers' Association showed U.K. mortgage approvals fell in April, which weighed on the currency. Politically, the U.K. Independence Party, a group with anti-European Union views, was largely successful in the elections. This also dragged the currency lower.

In Asia, the yen spent most of the day lower yesterday, and even traded through the 102 mark for the first time in two weeks, but closed off by only 0.02%. The general risk-on feel to the market (ex-bonds) had a negative influence on the yen, but it was comments from Bank of Japan Governor Kuroda that were citied for causing the Japanese currency to weaken. Kuroda said in a WSJ interview that "investors should not expect a further increase in the yen."

Bonds rallied yesterday, with the 30-year Treasury up 0.34% and the 10-year note up 0.09%. There was no real reason for the strength, specifically at the long end of the curve, as you would have expected the generally "good" economic data to influence some selling.

There was a 2-year note auction yesterday and the results showed high demand for the short end of the curve continues. The bid to cover, a measure of demand, was 3.52, well above both the April and March bid to cover readings of 3.35 and 3.20 respectively.

Bottom line, the bond conundrum is continuing and investors are growing more and more uncomfortable wondering what it is the bond market knows that everyone else seems to be overlooking. And, if we don't see a breakdown soon (and subsequent rise in yields), the strength in Treasuries will continue to be a headwind for stocks, limiting this most recent breakout to current levels.

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 material move beyond 1900 is likely capped until bonds start to sell off.* *The trading range in the S&P 500 has bumped up, to 1910ish—1860ish.*

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 FXA or buying CROC is the easiest way to put this trade "on."**

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).**