7:00's Report

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

May 29th, 2014

Pre 7:00 Look

- Futures are flat after another quiet night, as markets continue to drift near all time highs. The bond rally remains the story, as the 30 year Treasury hit a new multi-month high overnight.
- Economically there was just one report o/n. Japanese April retail sales missed estimates (-4.4% vs. (E) -3.3%). But, that decline followed a huge jump in March, so it's not the negative it appears to be, and the yen is higher this morning.
- Econ Today: Revised Q1 GDP (E: -0.5%), Jobless Claims (E: 317k), Pending Home Sales (E: 1.0%). Fed Speak: Mester & Pianalto (8:30 AM EST), George (E: 9:30 PM EST).

Market	Level	Change	% Change
S&P 500 Futures	1910.00	1.25	.05%
U.S. Dollar (DXY)	80.46	-.16	-.20%
Gold	1254.30	-5.40	-.43%
WTI	10300	.29	.27%
10 Year	2.438	-0.08	-3.18%

Equities

Market Recap

Stocks traded flat Wednesday in what might have been the most-boring/quietest day of the year in the equity market. The S&P 500 fell 0.11%.

Stocks opened Wednesday flat and stayed there the entire day, as yesterday was devoid of any economic news or Fed-speak. TOL earnings would probably be the "highlight" yesterday, if I had to name one, as the commentary from the company on the housing market was upbeat.

Most everyone's focus was on the bond market yesterday (more on that later), and stocks traded in a 6-point range, hitting a low of 1,908 in the morning and a high of 1,914 in the afternoon, before selling off during the last 30 minutes of trading to end the day down fractionally.

Trading Color

The Russell 2000 and "momentum" sectors lagged yesterday, but only marginally (Russell down 0.4%). I'd call it more "taking a breather after a decent rally" than truly "lagging" the tape.

As you can tell by the flat performance by most of the averages, there wasn't a lot to glean from market internals yesterday.

Generally, there was outperformance in the "bond proxy" sectors as utilities and telecom were the two big outperformers (up 0.5% and 0.4%, respectively). Meanwhile energy, industrials and semiconductors also traded slightly higher.

Banks and homebuilders (both of which have seen nice rallies over the past few days) gave a little back, but overall there simply wasn't much to write home about in the equity market yesterday.

Volumes and activity remain very, very muted, and that trend got worse yesterday.

On the charts the S&P 500 hit a new intraday high, although broadly the S&P 500 remains range-bound (between 1,900-ish and 1,860-ish).

Bottom Line

Stocks have seen a nice move higher over the past few days and yesterday was a "pause" more than anything else (the strength in bonds held buyers back). But, broadly things remain the same.

Market	Level	Change	% Change
Dow	16633.18	-42.32	-0.25%
TSX	14610.96	-47.06	-0.32%
Brazil	52639.75	465.77	0.89%
FTSE	3240.10	-6.14	-0.19%
Nikkei	14681.72	10.77	0.07%
Hang Seng	23010.14	-69.89	-0.30%
ASX	5519.47	-7.71	-0.14%
Prices taken at previous day market close.			

Given the backdrop and the calendar (end of the month), the near-term benefit of the doubt remains with the bulls. However, I don't think we're about to see some material breakout from this 50-point trading range we've been in all year.

Market	Level	Change	% Change
DBC	26.22	.01	0.04%
Gold	1259.30	-6.50	-0.51%
Silver	19.07	-.01	-0.01%
Copper	3.1725	-.01	-0.16%
WTI	102.74	-1.36	-1.33%
Brent	109.78	-.24	-0.22%
Nat Gas	4.61	.10	2.17%
RBOB	3.01	.01	0.34%
DBA (Grains)	27.75	-.01	-0.04%
Prices taken at previous day market close.			

Economics

No economic reports yesterday.

Commodities

Commodities were broadly weaker again Wednesday, as a stronger dollar weighed on the metals while supply concerns pushed WTI crude lower. The commodity ETF DBC was flat on the day.

WTI crude was actually the worst-performing commodity on the screen yesterday, dropping below $103/bbl as traders hedged ahead of the weekly inventory report released this morning (delayed one day because of the holiday).

Gold: Not even the gold bugs can deny this is a very ugly chart, and other than as a hedge to equities, there aren't a ton of reasons to own gold at these levels, as we'll almost certainly be able to buy it cheaper.

Analysts are predicting a build in absolute oil supplies (500K increase is the consensus), but also a potential increase in stockpiles at Cushing, Okla., the delivery point for the NYMEX-settled contract. The first factor (overall supply) has been a headwind on prices, while the second (low inventories in Cushing) has been supportive. If both rise, then we could see WTI give back some more ground in the near term. With these supply levels as high as they are, we need to see demand and stronger economic growth materialize to justify prices north of $100/bbl (which, incidentally, we think they will; it'll just take some time). In the very near term the range in WTI Crude remains support around $102.30, with stiff resistance at $104.50.

Brent crude stayed relatively flat yesterday as the closure of a recently opened Libyan port offset continued progress between the Ukrainian government and Russia. Brent remained flat at just under $110/bbl.

Staying in energy, natural gas was the best-performing commodity yesterday, rallying 2.28% on forecasts predicting hotter than expected weather this June.

Additionally, some major banks made bullish calls on natural gas over the past few days, with Barclays stating it didn't think summer production will be enough to replenish supplies by next fall. And, Bank of America called $4.00/MMcf the "floor" in natural gas prices because the newly minted natural gas deal between Russia and China was done at $11/MMcf. And, according to them, transportation costs to China for LNG are about $7/MMcf, so anytime natural gas dips below $4, we should see Chinese buyers come in going forward.

Next up in the gas market is the weekly inventory data, and the Street is expecting a build of 109 MMcf. So, like last week, if we get a few MMcf above that number, expect a tumble in natural gas. But, that won't change the fact that as temperatures rise, the outlook for natural gas gets more fundamentally bullish.

Finally, turning to the metals, gold sold off modestly (down 0.6%) mostly on mild follow-through selling from Tuesday's drop, although the stronger U.S. dollar and weakening Chinese yuan (gold becomes more expensive in China, the world's largest gold consumer, as the yuan drops) could support higher prices.

Again, going forward, I think there are enough hints of inflation to help prevent a gold rout. There should be buyers on dips, but the chart is ugly, and I'd look to be a buyer (outside of a hedge position) in the lower $1,200s.

Currencies & Bonds

Bonds were the big story yesterday, again. The 10- and 30-year surged higher by 0.5% and 0.9%, respectively, despite the lack of any obviously positive catalysts from the U.S. And, the yield on the 10-year sank to a 10+ month low, now comfortably below 2.5% (2.43%, to be exact). And, that strength is continuing this morning, as the thirty year bond made a slight new multi-month high overnight.

The only truly fundamental occurrences in the bond market yesterday were neutral, as the Fed bought $1 billion worth of 30-year Treasury bonds while a 5-year Treasury note auction saw just average demand (a bid to cover of 2.73, the second lowest of the year) while the actual yield was basically in-line with the "when issued." Bonds dipped just a bit on the results, but recovered those gains by mid-afternoon.

As far as "why" bonds were so strong, the actual answer is short-covering, as we're entering the end of the month and seeing a short-squeeze (again). The catalyst for the squeeze was the surprisingly disappointing German employment data, which saw the number of people out of work rise by more than 23K vs. (E) of a 15K drop.

That, obviously, isn't what you want to see if you are looking for a continued recovery in Europe, and it clearly puts even more pressure on the ECB to act decisively a week from this morning. That's because, if Germany's economy begins to slow, you can say "Auf Wiedersehen" to the fledgling EU recovery. So, based on the news and the market reaction, clearly the case can be made for a continued European influence in this major bond rally.

With regard to the strength in bonds, it's worth noting that some of my friends on desks said they thought the rally (which again is continuing this morning) in bonds was more due to a lack of liquidity there as well. Volumes everywhere have dried up, so small amounts of money (like buying or covering into the month-end) can produce outsized results.

Market	Level	Change	% Change
Dollar Index	80.63	.225	0.28%
EUR/USD	1.3593	-.0041	-0.30%
GBP/USD	1.6705	-.102	-0.61%
USD/JPY	101.87	-.09	-0.10%
USD/CAD	.9185	-.002	-0.22%
AUD/USD	.9213	-.0034	-0.37%
USD/BRL	2.2320	-.0057	-0.25%
10 Year Yield	2.438	-0.08	-3.18%
30 Year Yield	3.288	-.079	-2.35%
Prices taken at previous day market close.			

Finally, the strength in bonds recently has been a worldwide phenomenon, as we saw bonds rally yesterday in peripheral Europe (the PIIGS) as well as Asia. So, we had all better hope this global bond strength is the byproduct of a very successful ECB-led effort to "talk rates down" that's spilling over across the globe—because if it isn't, the global bond markets are sending a very scary signal.

Regardless, for now the trend in bonds remains clearly higher, and that will likely remain the case for the next week, into the ECB meeting and US jobs Report.

Turning to currencies, the Dollar Index rallied to nearly a two-month high yesterday—not because anything really "dollar-positive" happened, but instead because the euro declined moderately. The Dollar Index finished the day up 0.27% and comfortably above 80.50 for the first time early April.

The euro dropped mainly because of the aforementioned German unemployment data, and also because the ECB verbal carpet-bombing continued. Yesterday it was ECB member Yves Mersch, who said yesterday morning that the coming ECB meeting could yield "a combination of policies."

The euro closed below 1.36 vs. the dollar for the first time since Feb. 12, and I'm surprised just how effective this ECB "carpet bombing" of dovish rhetoric has been (although data has been soft as well over the past two weeks).

But, with euro below 1.36, it's fair to say that there is now a large expectation that the ECB will do something decisive at next week's meeting, as they have very deliberately raised expectations. And, I hope they don't disappoint the market, because if they do the euro will be rammed higher.

The last time there was this much anticipation for an ECB meeting was August of two years ago, when the ECB announced measures to end the EU sovereign-debt crisis. That time, the ECB raised expectations and delivered. Let's hope they do it again.

Interestingly, despite the soft economic data and the dovish comments from Mersch, the euro was the second -worst-performing European currency yesterday vs. the dollar. Meanwhile the pound traded down sharply, dropping 0.6% following a shockingly bad distributive trades number (think retail sales).

Distributive trades isn't normally a market-mover, and it wasn't solely responsible for the decline in the pound yesterday, as most of the selling was technical in nature. The pound broke support at 1.6727, and the 50-day moving average.

Fundamentally the pound remains the strongest major developed currency, as the BOE will almost certainly be the first major central bank to hike rates later this year or early next, so I'd look to buy this dip in the pound on that basis via FXB. But, the pound has rallied methodically for the last year, and is in need of some sort of a correction. So, I would look to be a buyer on a little bit more weakness, as long as the fundamentals hold.

Turning to Asia, the Aussie dollar continued to sell off on general China concerns (the yuan hit a 19-month low yesterday vs. the dollar) while the yen rallied small vs. the dollar on mild short-covering ahead (and is extending those gains this morning) of the retail sales data out overnight (it looked like a big headline miss but it really wasn't as sales were front loaded in March due to the sales tax increase, so some dip was expected). Focus in the yen will now turn to several pieces of data that comes out tonight (manufacturing index, CPI, Industrial Production).

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.**

	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 exited my long GLD position yesterday on the clear break of $1277, as there's no reason to be long gold other than as an equity hedge at these levels.**

	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. **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."**

	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).**