7:00's Report

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

May 8th, 2014

Pre 7:00 Look

- Futures are flat but most international markets are slightly higher thanks to the strong close in the US and decent April Chinese trade data. Chinese trade balance for April saw exports and imports increase more than expected.
- In Ukraine, despite Putin's comments yesterday, the situation remains the same, as many eastern provinces will go forward with votes on independence Sunday.
- Econ Today: BOE Meeting (7 AM), ECB Meeting (Announcement 7:45, Press Conference 8:30). Weekly Jobless Claims (E: 330K).
- Fed Speak: Plosser (8:00 AM), Tarullo (8:30 AM), Yellen (9:30 AM), Bullard (2:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1874.75	.50	.03%
U.S. Dollar (DXY)	79.13	-.113	-.14%
Gold	1292.20	3.30	.26%
WTI	100.50	-.27	-.27%
10-year	2.59	-.005	-0.19%

Equities

Market Recap

Stocks rebounded Wednesday and were able to trade slightly higher thanks to comments made by Russian President Putin apparently aimed at de-escalating the Ukraine crisis and commentary on the economy by Fed Chair Yellen. The S&P 500 closed up 0.56%.

There were a lot of different catalysts cited for the movement in stocks yesterday. Futures were slightly lower pre-open thanks a hangover from Tuesday's decline. But things turned for the better about an hour before the open, when headlines hit that Putin wants to discuss ways to de-escalate the situation in eastern Ukraine. He also said eastern regions should postpone their May 11 referendum on independence, and that he's pulling troops back from the border. Whether any of the comments were sincere remains to be seen (and we have good reason to be skeptical), but the headlines were positive and risk assets rallied on the news.

Also helping to support stocks was commentary by Fed Chair Yellen. She sounded confident that the economic weakness in Q1 was temporary and largely weather-related, and she followed up by saying stocks aren't in a bubble. (The comments don't really change anything, but in a market looking for some confidence, it helped arrest the early selling yesterday.)

Countering those bullish "catalysts" was further selling in the "momentum" sectors, which were down big early yesterday but rebounded. This is reminding everyone that, while Yellen is confident there's no bubble in the broader stock market, pockets of dubious valuations and potentially excessive price levels remain. The difference maker yesterday amidst the push and pull was those "momentum" stocks, which bottomed at mid day and rallied throughout the afternoon. Stocks grinded steadily higher throughout the last hour of trading (helped by market-on-close imbalances), and actually closed on the highs of the day.

For all the "catalysts" referenced by the press to explain the intraday trading, though, the truth is that bonds are still "driving the bus" in the equity market. The 30-year note closed the day down small (that's why stocks were able to rally), but we're not going to see any decent strength in the equity market until bonds start to sell off and the yield curve begins to steepen.

Market	Level	Change	% Change
Dow	16518.54	117.52	.72%
TSX	14656.40	44.11	.30%
Brazil	54052.74	273.00	.51%
FTSE	6823.35	26.91	.40%
Nikkei	14163.78	130.33	.93%
Hang Seng	21837.12	90.86	.42%
ASX	5476.77	.41.00	.75%

Prices taken at previous day market close.

Trading Color

The Russell 2000 and Nasdaq again underperformed, although both indices did show some nice resiliency, as they dropped more than 1% at the lows of the day but managed to close well off the lows (up 0.05% and down 0.32%, respectively). So, while not a "great" day from an internals standpoint, it could have been a lot worse.

Market	Level	Change	% Change
DBC	26.32	.08	0.30%
Gold	1290.50	-18.10	-1.38%
Silver	19.298	-.30	-1.53%
Copper	3.0365	-.0205	-0.67%
WTI	100.73	1.23	1.24%
Brent	108.19	1.13	1.06%
Nat Gas	4.743	-.056	-1.17%
RBOB	2.9242	.0384	1.33%
DBA (Grains)	29.03	-.10	-0.34%
Prices taken at previous day market close.			

Sector-wise, yesterday's trading was pretty reflective of the sector performance this year. Safety sectors led the markets (utilities bounced back, rallying 1.7%), while REITs and consumer staples also rallied more than 1%. Energy and basic materials stocks again traded higher (up just under 1%), as did industrials, and those sectors continue to hold up well. Finally, financials and banks caught a bit of a bid yesterday (remember they've been hammered so far this quarter), as KBE rallied 0.1%. On the downside, tech was down thanks to the weakness in the energy names, and consumer discretionary again badly underperformed.

Bottom line is there wasn't too much to read into yesterday other than what was working (long defensives and value cyclicals, and short high-beta tech and consumer discretionary) is continuing to work well.

On the charts the S&P 500 closed just under 1,880 again thanks to a late rally into the close, but still remains largely in that 1,880-1,840 range.

Bottom Line

The "frustratingly flat" grind continues. "Momentum" again had the focus of the market yesterday but its important to note that we're seeing some decent bifurcation amidst momentum stocks. Bio-tech have traded much better than internet stocks lately, and while risks still remain, a "momentum" sell off isn't going to be the major negative catalyst that it was a month ago, because we're seeing more selective, and less wholesale, selling amidst high flying sectors.

The story largely remains the same. Until bond "confirm" the equity markets and the data, stocks will have a hard time breaking out of the current 1885ish—1845ish range. But, correlations continue to receded and we are continuing to see significant outperformance from the right sectors in the market, and that remains to way to outperform.

Economics

There were no economic reports yesterday, but I did want to review the Yellen testimony and refute the notion that it was somehow cautious on the economy, and also preview the ECB.

Yellen Testimony

Overall this was mostly a non-event, although on an otherwise-slow news day, the press did try to spin some of her comments as mildly cautious on the economy. (However, the market didn't really see it that way, evidenced by a stronger stock market and dollar, and weaker bonds and gold.).

In particular, Chair Yellen referred to GDP growth as being "somewhat" higher in '14 than '13, and it was the "somewhat" comment that commentators keyed off of, as it was viewed as a slight downgrade.

Additionally, although she said she did not think the stock market was in a bubble, she did cite overvaluation in some small caps. Finally, she did reference some caution on the housing market, that the recovery might not resume as quickly as anticipated given rising prices.

But, extrapolating those comments out to be cautious on the economy—one week after the FOMC statement was upbeat on the economy—is a stretch. The bottom line with Chair Yellen's testimony is that the outlook for Fed policy and the economy remains unchanged (continued QE tapering that ends in October/December of this year, first rate hike mid-2015, and 3% annual GDP growth, respectively).

ECB Meeting Preview

There is certainly justification and a fair bit of pressure for the ECB to do "more" at today's ECB meeting, given the stubbornly low inflation rate (April HICP was just 0.6% yoy) and the strong euro. Despite that, the overwhelming likelihood is that the ECB still will not change any policy and will instead again opt to try to "rhetorically ease" at the press conference. It will likely speak very dovishly and reiterate that QE is indeed on the table, should conditions worsen. But, other than a temporary benefit, that rhetorical easing hasn't really worked over the past two meetings (the euro is at a multi-month high).

So, I'd expect the same result out of this meeting. The market is determined to push the ECB toward QE, and it'll continue to do so for the foreseeable future.

Commodities

Commodities were mixed in active trading yesterday as energy caught a bid on inventory data and gold dropped for a multitude of reasons, including Yellen's comments on the economy. The benchmark commodity tracking index ETF, DBC, added 0.3% yesterday.

Gold was the most-notable mover in the commodity space Wednesday as futures fell 1.5%. Gold initially began selling off early yesterday morning amidst news that tensions were easing in the Ukraine. This led to an unwind of the geopolitical fear bid that has been helping to support the precious metals market since the conflict erupted over two months ago.

A short time later, gold futures accelerated lower and broke through the $1,300 level upon release of Chair Yellen's prepared testimony. It was not that the chairwoman's testimony was "hawkish" but rather that it was not as dovish as some traders were expecting. As a result we saw more longs unwind positions.

Market	Level	Change	% Change
Dollar Index	79.255	.129	0.16%
EUR/USD	1.3912	-.0015	-0.11%
GBP/USD	1.6953	-.0023	-0.14%
USD/JPY	101.79	.12	0.12%
USD/CAD	1.0895	.0004	0.04%
AUD/USD	.9334	-.0013	-0.14%
USD/BRL	2.2195	-.0094	-0.42%
10-year Yield	2.59	-.005	-0.19%
30-year Yield	3.403	.022	0.65%
Prices taken at previous day market close.			

The next leg lower in gold was a result of the stock market reversing off morning lows and rallying back to positive territory. Gold responded to the stock market strength with another leg lower toward $1,290/oz. So, gold continues to trade as a decent equity hedge (as stocks extended their rally, gold fell). Bottom line is that the near-term technical and fundamental situation remains neutral and $1,300 will continue to be in focus as futures largely drift around that level.

On the charts the first level of support lies at the 100-day moving average at $1,285, while $1,295 is the first resistance level. If you do not already own gold as an equity hedge, buying some at these levels remains one of the better hedges to the stock market at this time.

Moving to energy, yesterday was inventory day for crude oil and the refined products and the results were slightly bullish. Crude oil stocks unexpectedly fell by 1.8M barrels vs. (E) of a 1.2M barrel build. Gasoline stocks increased by 1.6M barrels vs. (E) +100K barrels and distillates fell by 400K barrels vs. (E) +1.2M barrels.

Crude oil caught a bid initially on the algos buying up futures on the surprise drop in the headline. But prices continued higher when the details of the report showed yet another draw in Cushing, Okla., inventories, which were down 1.4M to 24M barrels even. The dip draws Cushing stockpiles closer to the required supply levels that are in place to ensure safety and prevent fires or explosions from occurring. This has brought in a bit of a "supply bid" to the market, something we haven't seen since the heating oil supply concerns earlier this year.

Bottom line though in crude oil is that the market remains range-bound and largely a trader's market driven by day traders and algos. The bulls and bears are at a stalemate as overall supply levels are up near record highs (bearish), while Cushing inventories remain under pressure and expectations for summer gasoline demand continues to be in focus for analysts.

On the charts there is support around $99.75 while the first level of resistance is above at the 50-day moving average at $101.06.

Copper futures were under pressure with the rest of the metals yesterday, finishing the day down 0.67%. We discussed copper a lot over the past couple of months and I wanted to offer an update.

Copper futures did indeed find a bottom down near $2.90 in mid-March; however the rally off of those lows seems to have stalled. But, given the recent disappointing economic data in China, it is not surprising and the next leg higher in copper prices will follow an improvement in Chinese economic data. On the charts copper futures are stuck between $3.00 and $3.10, and we expect that range to hold until something materially changes in the market.

Natural gas futures traded lower yesterday, falling 1.17% as traders positioned ahead of this morning's EIA inventory report. Analysts are calling for a build of 69 Bcf in supply levels following last week's build of 82Bcf. And the story remains the same: Any material surprise in the report will cause a big reaction in futures, as this market remains very sensitive to the critical supply levels.

Currencies & Bonds

Treasuries were little-changed yesterday, trading basically flat throughout the day and largely ignoring the various headlines.

Looking at some market fundamentals, the Treasury auctioned off $24 billion worth of 10-year Treasury notes, and the results were pretty good—especially considering they were auctioned at the lowest yield (2.612%) since last June. Positively, the yield was a full basis point lower than the "when-issued" yield, which speaks to strong demand for the paper from those who were bidding.

The bid to cover wasn't all that great, though. At 2.63, it was the second-lowest bid to cover of the year and below the 2013 average of 2.71. This implies that there wasn't above-average demand for the offering (perhaps because of the presumed low yield).

The 10-year was higher throughout the day yesterday, and while it did hit the intraday highs following the auction, it was due to a continuation of the existing rally rather than an auction-induced spike higher. Frankly, the 10-year didn't really react all that much to the auction.

Bonds remain disconcertingly strong, but nearly a week into it, the 30-year seems to be having trouble holding that 136'00 level. And, perhaps we are seeing a bit of exhaustion in the shorts (most of whom will hopefully have now covered.) Specifically, there was fodder for the bond bulls to push the long end higher. (The Yellen "somewhat" comments and cautious tone on housing would be more than enough to ignite a bond rally in this environment.) But, the long end didn't rally, and if we consider that the long end has been stuck at 136'00 for a week now, perhaps we are finally seeing exhaustion in the short-covering that's helped propel this market higher. To that end, I had two wise and experienced subscribers (thank you Ritt and Tom) whom I respect very much contact me separately noting the same observation, so perhaps we're almost done with the painful short covering rally..

The Dollar Index bounced back a bit yesterday and was marginally higher vs. every major currency thanks to some short-covering. Fundamentally there wasn't much news to trade off of in the U.S. yesterday (Yellen was the main catalyst, and although the press tried to spin her as slightly cautious on the economy, that wasn't the case). Instead we just saw a general oversold bounce in the greenback.

The euro and pound were off small into their respective central bank meetings (no policy changes expected from either), while the yen dipped 0.2% vs. the dollar, giving up some of the recent gains following some surprisingly soft composite PMI readings. In particular, the weak PMI helped rekindle fears of the economic drag on the Japanese economy from the new sales tax. Data over the coming weeks will be critical with regard to future BOJ policy (mainly whether they will ease further in the next 2-3 months).

Overall it was a quiet day in the currency space, as the Dollar Index is bouncing off the recent lows. Into the ECB decision, watch 79.06. That 52-week low in the Dollar Index remains critical support.

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 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.**

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. **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 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).**