7:00's Report

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

May 9th, 2014

Pre 7:00 Look

- Futures are slightly weaker this morning as international markets are mixed following a pretty quiet night.
- Economically, Chinese CPI and PPI were subdued (as expected) and that helped Asia rally as Chinese officials can stimulate further if they choose. Otherwise it was quiet.
- Geo-politically the situation remains the same, as eastern Ukrainian provinces will vote for independence Sunday despite Putin telling them not to.
- Econ Today: No economic reports today. Fed Speak: Kocherlakota, Fisher (Noon).

Market	Level	Change	% Change
S&P 500 Futures	1870.00	-2.25	-.12%
U.S. Dollar (DXY)	79.61	.21	.26%
Gold	1290.90	3.10	.24%
WTI	100.69	.43	.43%
10-year	2.602	.012	0.46%

Equities

Market Recap

Stocks finished slightly lower Thursday, as an early rally faded at midday and stocks drifted lower during a deceptively quiet trading session. The S&P 500 fell 0.14%.

Stocks started Thursday stronger mostly thanks to strength in foreign markets. And, while a series of "reasons" were given (i.e., improvement in Ukraine, "optimistic" Yellen, "dovish Draghi"), none really caused stocks to rally.

Markets drifted slightly higher throughout the morning session in quiet trading, but the recent market dynamic reasserted itself at lunchtime.

Stocks reversed at noon and the most-cited "reason" was a bill proposed by Senator Carl Levin (D-Mich.) that would halt corporate "inversions" (or domiciling off-shore to avoid taxation), although that's a stretch to say it caused the reversal.

Instead, stocks continued to take their cue from the Treasury market and now the Russell 2000. Treasuries were strong all morning (they hit a new high) and the Russell started to roll over at midday. This more than anything led to stocks coming off their highs.

Markets drifted lower throughout the afternoon and the Russell's declines accelerated (it closed down 1%). Stocks limped into the close, marginally in the red, on a day that was actually worse than the headlines seemed to convey.

Trading Color

The continued weakness in the Russell 2000 is now joining the rally in Treasuries (and to a lesser degree the weakness in the Dollar Index) as a "red flag" on the market. The Russell traded down 1% after spending the morning in the green, notched a multi-month closing low and is now just above the lows for the year at 1,082.72.

"Momentum" also came for sale yesterday. It's almost as if it read yesterday's Report, where I lauded biotechs as holding up well, because NBI played catch-up with the recent weakness in QNET and dumped 1.8%, making me look foolish yet again. Meanwhile, QNET made a new closing low for the year (after making a new intraday low Wednesday).

Looking at the rest of the market, the Dow outper-

Market	Level	Change	% Change
Dow	16550.97	32.43	.20%
TSX	14546.03	-110.37	-.75%
Brazil	53422.37	-630.37	-1.17%
FTSE	6814.82	-24.43	-.36%
Nikkei	14199.59	35.81	.25%
Hang Seng	21862.99	25.87	.12%
ASX	5460.84	-15.93	-.29%
Prices taken at previous day market close.			

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formed (up 0.2%), while the Nasdaq also lagged the S&P 500 (down 0.4%). So, despite the mild moves in the S&P 500, yesterday wasn't a very good day.

Market	Level	Change	% Change
DBC	26.21	-.10	-0.38%
Gold	1290.70	1.80	0.14%
Silver	19.105	-.193	-1.00%
Copper	3.061	.0285	0.94%
WTI	100.25	-.52	-0.52%
Brent	108.07	-.06	-0.06%
Nat Gas	4.58	-.16	-3.38%
RBOB	2.9051	-.0131	-0.45%
DBA (Grains)	28.89	-.14	-0.48%
Prices taken at previous day market close.			

Sector-wise it was a mixed bag. The standouts included energy (which got hit hard yesterday, falling 1.5% and breaking down badly one day after hitting a new 52-week high). Meanwhile, utilities (earnings) and basic materials also lagged.

Telecom (IYZ) was the best-performing sub-sector, thanks to DTV hiring an adviser to investigate a merger with T and also CTL earnings, rising 5% on the day. Semiconductors, retailers and consumer staples were the other S&P 500 sub-sectors that managed to close positive (mostly because of stock-specific or earnings-related news). Overall, from a sector standpoint it was a mixed bag, although that nasty breakdown in energy sure did get my attention (we may be seeing people ring the register on that space).

For the 3rd time in 35 years of history, the NYSE Composite Index hit a new all-time high, while the Russell 2000 broke below its 200-day moving average. The other two times this happened were in 1999 and 2007.

On the charts the 1,880-1,840 range remains intact, while volumes and participation were both subdued, as everyone seems to be in a wait and see mode.

Bottom Line

This market has been absurdly resilient over the past several years, so getting ahead of a potential decline and de-risking isn't what you do here. But, if I were on an island and hadn't watched the market for years, and someone said to me that 30-year Treasuries were inexplicably strong, the yield curve was flattening, and the Russell 2000 was on the verge of breaking down badly, I would tell them to get a plan to get defensive, because all those things are historically warning signs.

So, even though I'm not selling any long stock here, I am spending some time thinking about what I'd like to do if their market breaks down, as the number of "caution" flags is increasing.

Bottom line for now, though, is that the S&P 500 won't be able to get through this 1880ish resistance until bonds start to decline, and they were resilient again yesterday.

But, sector trading continues to yield results, as good sectors continue to outperform and produce nice returns in an otherwise -flat market. So, that remains the best strategy for the current environment.

For What It's Worth

A colleague sent me a note yesterday that I wanted to share, because something has (apparently) happened for just the third time in 35 years of market history, and the two previous times preceded peaks in the market.

The event I'm talking about is this: The NYSE Composite Index (Index symbol NYA) just surged to an all-time high, while at the same time the Russell 2000 broke below its 200-day moving average. The last two times this happened (again apparently) was 1999, and again in 2007.

Now, does this mean we're about to see a market correction? No, not by itself. But, in the face of the growing "bond conundrum" and other "caution" signs on the market, I think it's prudent to keep you up on these things, because it's crucial to have an action plan in place *before* any major market sell-off begins.

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Again, I'm a bull at heart (I have a 2-year-old son, so I have to be), but there are a lot of conflicting signs in the market right now, and it's my job to monitor and interpret them, and I wanted to make sure you were alerted to this little-followed indicator.

Economics

Weekly Jobless Claims

- Weekly Claims fell to 319K vs (E) 330K

Takeaway

Weekly Jobless claims dropped 26K to 319K last week vs. analyst expectations of 330K. Data from the week prior were revised slightly higher to 345K from 344K. The smoother look at the data, the 4 week moving average, ticked higher last week for the third time in a row, increasing 4.25K to 324.75K. The increase though, was largely expected as the Easter holiday skewed data higher as seasonal employees were released.

The markets showed little interest in the report, mostly because it overlapped with Mario Draghi's press conference and, at the time, that was the primary driver of the markets.

Bottom line, yesterday's weekly jobless claims report confirmed our expectations that seasonal hiring ahead of Easter, and the release of employees following the holiday-skewed data, was first for the better, and then for the worse.

However, the important thing is that with the holiday behind us, weekly claims seem to have resumed the spring trend lower. This suggests the labor market is continuing to improve, which we saw confirmed by the better than expected April Jobs Report. And, a better labor market is obviously a good thing for the economy and therefore risk assets going forward.

Market	Level	Change	% Change
Dollar Index	79.415	.172	0.22%
EUR/USD	1.3852	-.0058	-0.42%
GBP/USD	1.6939	-.0013	-0.08%
USD/JPY	101.54	-.36	-0.35%
USD/CAD	1.0823	-.0075	-0.69%
AUD/USD	.9377	.0051	0.55%
USD/BRL	2.209	-.007	-0.32%
10-year Yield	2.602	.012	0.46%
30-year Yield	3.415	.012	0.35%
Prices taken at previous day market close.			

Commodities

Commodities were mixed yesterday in quiet trading as only copper and natural gas futures moved more than 1%. The benchmark commodity tracking index ETF, DBC, fell 0.5%.

Natural gas was the worst performer in the commodity space yesterday as futures dropped 3.5% on supply data. The weekly EIA inventory report indicated that stockpiles grew 74 Bcf vs. (E) 69 Bcf. Futures sold off sharply upon the release of the report as disappointed spec longs immediately began to unwind positions.

Natural gas fell through the first line of support at $4.65, but were able to bottom out at the 50-day moving average at $4.56. The 50-day is now the first line of support while resistance has been moved down to $4.65. Stepping back, though, the historically low supply levels will remain the most important factor in the natural gas market, and as a result, hot weather could be a much bigger influence in natural gas prices, even in the summer. The bottom line is the market is expected a big "build" season to replenish supplies, and if signs appear that's not happening, then expect natural gas to remain elevated.

Crude oil traded slightly lower yesterday, falling 0.5% on the session as Wednesday's EIA inventory report continued to be digested by traders, and largely the oil markets remain range bound and in search of a catalyst to break the current stalemate between the demand bulls and supply bears.

On the charts, support has been adjusted higher to the $99.75 area while the 50-day moving average remains the level to beat at $101.01.

Moving to the metals, gold was little-changed yesterday, up just 0.14% in choppy trade as CB-speak was the primary driver of the market. Gold spiked lower as the dollar rallied against the euro after Mario Draghi's dovish remarks during the ECB conference yesterday (more on that later), but the move was short-lived as traders saw the dip as a buying opportunity.

On the charts, the technicals remain rather neutral with the price oscillating in a $30 range around the $1,300 mark with support at $1,285 while resistance is above at $1,315.

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Currencies & Bonds

Europe was in focus in the currency markets yesterday as the euro fell hard (down 0.54%) on dovish comments from ECB President Mario Draghi which, in turn, sent the dollar sharply higher, and away from fresh lows of the year. The Dollar Index closed higher by 0.23%.

The euro fell back from a 2.5-year high against the dollar yesterday amidst dovish comments from Mario Draghi. Draghi said that the ECB is **"comfortable with acting in June,"** and the market took him seriously (at least for yesterday) as euro futures fell from the highs of 1.399 to close down at 1.385, a substantial move in currency futures. That selling is continuing today, as markets anticipate what the ECB may do in June (likely a interest rate reduction or negative deposit rate, if they actually act).

The commodity currencies, the Aussie and the Loonie, rallied 0.55% and 0.69% respectively on stronger than expected economic headlines.

The Aussie was up thanks to a stronger than expected payroll report as well as the better than expected Chinese trade data. The payroll data is obviously bullish for the Aussie dollar as the uptick in payrolls suggests improvement in the economy. Meanwhile the details within the Chinese trade report indicated higher than expected demand for Australian commodities, which is also favorable for the Australian economy. The Loonie rallied as a result of a better than expected housing report as well as the strong Chinese data.

Both commodity currencies (much like the bond market) are continuing to benefit from a continued short-squeeze, as investors positioning offsets (at best) neutral fundamentals and dovish central banks. Fundamentally both currencies are "shorts" at these levels, but in the near term short-covering alone will be supportive.

It was a volatile day in the Treasury market yesterday, as an ECB-induced extension of the rally was offset by a poor 30-year Treasury bond auction.

The 30-year traded sharply higher early Thursday, rallying off the Draghi comments that the ECB is "comfortable acting in June." That sent European yields lower, and money clearly flowed from Europe into the Treasury market (more and more I'm hearing from friends on desks that "Europe" is the reason for the "bond conundrum," although I'm skeptical of that reasoning because the dollar has been weak. But, I hope they are right).

The 30-year Treasury actually hit a new intraday high (136'22), following the Draghi comments, and it looked as though we were going to see a repeat of last Thursday (where we saw a massive short-covering melt-up). But, then came the 30-year auction at 1 PM.

Yesterday's 30-year bond auction was shockingly bad. First, the yield on the debt at auction was 3.44%, which is a full 3 basis points above the "when issued" yield of 4.41% (3 basis points may not sound like a lot but in Treasury auction terms, that's a big sign of lack of demand by those bidding). Additionally, the bid to cover was just 2.09, the lowest since August of 2011! So, not only was there a lack of strong bidding for the debt, but the people who did bid weren't aggressive.

And, presumably, part of the reason for lackluster demand for the 30-year debt was that the yield was the lowest since June '13. So, despite the recent strength in the long end, it does appear at least those in the auction market are wary of buying long-dated Treasuries with such a low yield.

The 30-year gapped lower on the auction results, falling from the highs of the day and turning briefly negative. But, there are clearly still buyers on dips and shorts looking to cover, and the 30-year recouped those auction-induced losses and finished the day flat — well off the highs but still pretty resilient. Nonetheless, the soft auction will give hope to the bond bears that this short-covering rally/money rotation is getting closer to the end.

Have a good weekend and happy Mother's Day to all you moms.

Tom

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The 7:00's Report Asset Class Dashboard

(Outlook on the primary trend for major asset classes over the next month)

<table>
<tr><th></th><th>Fundamental Outlook</th><th>Technical Outlook</th><th>Overall</th><th>Comments</th></tr>
<tr><td>Stocks</td><td>Bullish</td><td>Neutral</td><td>Bullish</td><td>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.</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

<u>Long Market "Losers":</u> 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.

<u>Long Japan:</u> "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.

<u>Long Natural Gas E&Ps:</u> 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.</td></tr>
<tr><td>Commodities</td><td>Bullish</td><td>Neutral</td><td>Neutral</td><td>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.</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

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.</td></tr>
<tr><td>U.S. Dollar</td><td>Neutral</td><td>Neutral</td><td>Neutral</td><td>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.</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

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."</td></tr>
<tr><td>Treasuries</td><td>Bearish</td><td>Bearish</td><td>Bearish</td><td>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.</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

Buy: TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury).</td></tr>
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