7:00's Report

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

June 11th, 2014

Long Bond: The 30 year Treasury is now sitting on the uptrend in place since the 1st of the year.

Pre 7:00 Look

- Futures are modestly lower after another uneventful night as markets further digest the recent rally.
- Internationally there was broad weakness o/n although again that's a function of markets taking a breather, rather than anything "negative" occurring.
- Economically the only release was the UK Labour Market Report, which was better than expected (the unemployment rate fell to 6.6% vs. 6.7% in April). But, the pause in global markets is offsetting the good data.
- Econ Today: No economic reports today.

Market	Level	Change	% Change
S&P 500 Futures	1943.25	-7.50	-0.38%
U.S. Dollar (DXY)	80.92	-.02	-0.02%
Gold	1262.50	2.40	0.19%
WTI	104.50	.15	0.14%
10 Year	2.635	.022	0.84%

Equities

Market Recap

It was a return to boring trading yesterday as the S&P 500 closed almost perfectly flat during a quiet day. The S&P 500 declined -0.02%.

It was a very slow news day, and stocks were lower premarket despite the fact that the JOLTS survey (which measures job openings) was better than expected and the NFIB Small Business Optimism Index hit a new high.

But, stocks continued to feel "tired" and drifted lower after the open and were modestly weaker by midmorning.

But, with things so quiet and no conviction to the selling, the market bottomed. It rallied throughout the afternoon, turning positive late in the trading session, as stocks literally ran in place pretty much the entire day. Stocks closed quietly with the S&P 500 fractionally weaker.

Trading Color

Small caps mildly underperformed yesterday (Russell 2000 down 0.23%) but both it and the Nasdaq finished well off their worst levels of the day (so it wasn't a "bad" day internally).

Sector-wise, most sectors traded lower (healthcare, semiconductors, basic materials and tech were the only sectors in the green), but the moves were pretty small (no sector moved anywhere near 1%).

Of note, though, homebuilders and REITs were the laggards yesterday, and utilities and consumer staples were also lower, so we are continuing to see a small revival of the selling of "bond proxy" sectors as yields rise.

Market	Level	Change	% Change
Dow	16945.92	2.82	0.02%
TSX	14904.38	33.17	0.22%
Brazil	54604.34	331.18	0.61%
FTSE	6839.19	-34.36	-0.50%
Nikkei	15069.48	74.68	0.50%
Hang Seng	23257.29	-58.45	-0.25%
ASX	5453.99	-15.66	-0.29%

Prices taken at previous day market close.

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Volumes once again challenged for the lowest day of the year, and it feels very much like the market is in digestion mode. On the charts the S&P 500 remains just below its all-time intraday high, while support lies lower at 1,930-ish and 1,907.

Market	Level	Change	% Change
DBC	26.09	-.07	-0.29%
Gold	1261.50	7.60	0.61%
Silver	19.215	.149	0.78%
Copper	3.058	.0145	0.48%
WTI	104.49	.08	0.08%
Brent	109.63	-.36	-0.33%
Nat Gas	4.538	-.107	-2.30%
RBOB	2.9775	-.0073	-0.24%
DBA (Grains)	27.47	-.05	-0.18%
Prices taken at previous day market close.			

Bottom Line

Stocks are digesting the recent gains and given how short-term overbought the S&P 500 got, that's about as good a scenario as the bulls could hope for. The calendar remains quiet for the rest of the week, and things should slow even further once the World Cup starts Thursday (games are played starting around noon EST). But a grind sideways or mild correction (which again could come in the form of a sideways grind) would be healthy and needed for a move higher in the coming weeks.

The Post-ECB Decision Portfolio

I said last week that if indeed the ECB measures do signal an end to this bond rally, then it could signal a reversal in what's "worked" so far this year from a sector standpoint. So, to that end, I wanted to construct a "post-ECB" portfolio of ETFs that should outperform if we see bonds roll over and economic growth stay consistent with recent levels.

So, basically I'm demonstrating a way you can put the observations from our board (which I included in Friday's Report) into concrete action:

Long Europe: 50% VGK (pan-European ETF), 50% PIIGS ETFs: EWP (Spain ETF), EIRL (Ireland ETF), EWI (Italy ETF). The PIIGS will benefit the most if the ECB is successful in stimulating the economy and manufacturing inflation. (Because the marginal benefit will be felt the most in those stagnant economies, the weaker euro will help their largely service- and tourism-based economies, and inflation will alleviate their debt loads.)

Long Cyclical Sectors over Defensives: 50% SPHB, 50% KBE. If rates start to rise and economic data remain firm, we should see cyclical and high-growth sectors handily outperform defensives going forward, a complete reversal of what's happened YTD. SPHB is heavily weighted in consumer discretionary, financials, IT and industrials, and they should be able to play catch-up in this market and outperform defensive sectors. Banks, meanwhile, should also play catch-up as the higher loan demand and increased NIM (net interest margin) story regains traction.

Dollar-Bullish/Euro-Bearish: 50% UUP/50% EUO. This one is pretty obvious. The euro should gradually weaken over time as the ECB remains "easy" while the U.S. and UK begin to gradually tighten policy.

Bearish Bonds: 50% TBT, 25% STPP, 25% REK: Again, another mostly obviously one here. As bonds resume their decline TBT should rally, the yield curve should steepen (STPP) and in general, real-estate-related stocks (REITs and homebuilders) should decline. A word of caution, though: STPP and REK are very low-volume issues (they are just the best ETFs for the exposure).

I'm going to allocate equal parts to each strategy, so of my overall allocation to this portfolio, it'll be split evenly among Long Europe, Long Cyclicals, Long Dollar and Bearish Bonds, and then each position will be the stated proportion of each section. So, to keep numbers simple, if you were going to invest $1,000 in the overall strategy, each portion would get $250 and the individual ETF allocations would be made from there. And, obviously each of the trades are fine on their own too.

As far as stops, the levels seen immediately prior to the ECB meeting (so 6/4) of each position should suffice, and if/when each is hit, I'll exit that position, making any losses pretty reasonable with significant upside potential.

Finally, from an execution standpoint, given I'm a bit cautious on the market here in the immediate term (but also acknowledge that it's been absurdly strong), I'm going to allocate half of the total to the strategy today, and half once this market has worked off some of the "froth."

Economics

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There were no economic reports yesterday.

Commodities

Commodities were again rather quiet yesterday with the exception of natural gas, which was down 2.5%. The PowerShares DB Commodity Index Tracking ETF, DBC, fell 0.46% on the day.

Beginning with the notable mover, natural gas futures fell 2.45% on the day yesterday for a couple of reasons. First, the EIA cut natural gas "use growth," saying competition from other energy sources such as coal and new "renewable energy" technologies, paired with historically elevated nat gas prices, will cause less demand than initially expected over the course of the next 5 years.

But, the revisions were not substantial and the fact that natural gas is being used for more and more things every day, notably transportation, helped prevent a more material sell-off.

Second, weather forecasts were revised to be more mild than initially reported. The cooler than expected weather, along with the EIA report, proved to be reason enough for many short-term traders to take profits after nat gas futures saw nice gains last week. Also, because weather has been fairly moderate, traders are looking ahead to tomorrow's EIA report, expecting another sizeable build.

As long as the weather remains mild, natural gas futures will likely remain in the lower end of the trading channel ($4.43-$4.93) as demand for electricity generated from natural gas to power air conditioners will remain subdued.

Bottom line, natural gas continues to trade in the aforementioned broad up-trend channel, and short-term swings are a result of the pace of weekly supply builds and weather forecasts as well as headlines from the EIA such as the one released earlier this week.

Market	Level	Change	% Change
Dollar Index	80.92	.143	0.18%
EUR/USD	1.3547	-.0045	-0.33%
GBP/USD	1.6756	-.0044	-0.26%
USD/JPY	102.32	-.20	-0.20%
USD/CAD	1.0901	-.0001	-0.01%
AUD/USD	.9372	.0017	0.18%
USD/BRL	2.2262	-.0008	-0.04%
10 Year Yield	2.635	.022	0.84%
30 Year Yield	3.466	.015	0.43%
Prices taken at previous day market close.			

Sticking with the energy sector, WTI crude oil futures gave back the morning's gains after testing resistance at the $105 level, closing little-changed, down 0.02%. Futures rallied up to $105.06, just 16 ticks away from the 2014 high established back on March 3rd of this year. On the charts, the failed breakout attempt resembles the second failed attempt back in mid-April. But, the pullbacks from the $105 level are getting shorter, leading to a series of "higher lows" on the daily chart, a bullish technical indicator. There is without a doubt some room for WTI prices to fall back in the very near term, but support is trending higher, now in the $102 area.

So, we continue to recommend buying dips in crude oil futures (or the ETF USO, even though the correlation with actual WTI prices is rather loose) toward the $100-$102 level based on the thesis that the expanding economy is leading to higher gasoline demand than initial expectations called for (simply put: more people are driving to work), in turn increasing demand for crude oil.

Gold futures saw nice gains yesterday, adding 0.54%, trading up to the highest intraday level since May 28th. There was no real reason cited for the pop in gold, but the entire move came at the open yesterday, which could have been a result of a large fund opening a new long position or covering a short.

The gold market is essentially the same as it was for most of the first half of Q2, just $50 lower. Gold futures seem to be falling into a new range between $1,240 and $1,270, with the reason for the drop of course being the recent leg higher in the stock market combined with an easing geopolitical situation.

Just a reminder, though. The recent Commitments of Traders reports indicate that there is a growing risk for a short-squeeze in the market, as the number of shorts in the market has nearly tripled in the past four weeks. If initiated, a short-squeeze could easily break the new resistance level at the $1,270 mark.

Currencies & Bonds

Treasuries were once again the story yesterday as the bond market again came under pressure, and the 30-year Treasury is now sitting on key

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support after declining 0.35% yesterday. A positive JOLTS report and NFIB survey were again anecdotally positive for the economy, but it's obvious the main driver of this Treasury dip has been the action taken by the ECB. With the 30-year sitting on that trendline that been in place since January, we are now at a key tipping point for this bond rally. If that trendline breaks, expect some acceleration in the selling.

Currencies were mixed yesterday as the dollar was stronger against most European pairs, but weaker against Asian currencies. Thanks to the heavy weight of the euro in the "basket," the Dollar Index added 0.18% on the day. The euro weakness continued yesterday, falling 0.3% on technical selling as markets further digested the ECB policies and Benoit Coeure's statements regarding the fact that interest rates in the EU will diverge from those in the U.S. and UK.

But, nothing new happened that was "euro-negative" and in fact the economic data yesterday were positive (good industrial production numbers from France, UK and Italy; and some bright spots in the Italian GDP report). But, the euro isn't trading off fundamentals at the moment, and it broke down further yesterday. Although it's oversold and due for a bounce, I expect it's a matter of time until the low for the year at 1.3476 is tested.

The pound was also weaker yesterday, again despite the better than expected April Industrial Production data, but the declines felt more like sympathy selling with the euro ahead of last night's Labour Market report, which was slightly better than expectations and we're seeing a mild bounce vs. the dollar this morning.

In Asia, the yen and Aussie rallied vs. the dollar, although mostly it was just random trading "noise" ahead of a key Australian job market indicator out tonight and the BOJ meeting tomorrow. Both currencies continue to largely drift, as they have been doing for the last week or so, and that will continue today as well.

Have a good day,

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)

	Fundamental Outlook	Technical Outlook	Overall	Comments
Stocks	Bullish	Neutral	Bullish	*Market fundamentals have been quietly improving for the past few weeks with both domestic and global economic data coming in better than expected, central banks continuing to be very accommodative, and valuations remaining reasonable. And, sentiment toward the market remains skeptical, keeping the pain trade higher. However, the S&P 500 is overbought and in need of a sell-off to restore some short term health.* *The trading range in the S&P 500 has bumped up, to 1920-1950ish.*

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'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 one 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.**

	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 saw a strong rally in late May, but sharply reversed off of the 200 day moving average (while at the same time, 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).**

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