7:00's Report

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

June 12th, 2014

Pre 7:00 Look

- Futures are flat as markets continue to digest the recent rally.
- Focus o/n was on Iraq, as insurgents have pushed south and Mosul and Kirkuk have been lost. Oil prices surged and are now at highs for the year.
- Economically data was good o/n, as Chinese money supply, Japan machinery orders and EMU Industrial Production all beat, but the market is largely ignoring the data.
- Econ Today: Jobless Claims: (E: 309k), Retail Sales (E: 0.6%).

Market	Level	Change	% Change
S&P 500 Futures	1944.75	.75	0.03%
U.S. Dollar (DXY)	80.89	-.013	-0.02%
Gold	1266.00	4.70	0.37%
WTI	105.95	1.55	1.48%
10 Year	2.64	.05	0.19%

Equities

Market Recap

Stocks actually declined yesterday as the market took a much-needed breather. The S&P 500 fell 0.35%.

Futures were lower Wednesday mostly in sympathy with international markets. Regarding the global weakness, there were many "reasons" cited for the declines (World Bank global growth reduction, Lufthansa negative update, escalating violence in Iraq). All were more incidental than causal, and really global markets just needed to take a break.

Domestically, the defeat of House Majority Leader Eric Cantor weighed a bit on sentiment, as it reminded everyone that Washington has (thankfully) not been a headwind since last fall. But that the potential is still very much alive, especially in an election year.

Like Europe, though, the Cantor news is legitimate—but it's more coincident with a market that needs to take a break than it is causal of a decline in stocks.

News flow was quiet in the afternoon (Cantor resigning as House Majority Leader was about the only material headline, and not unexpected after the news last night). Stocks hit their lows shortly after 2 p.m. with the Dow down more than 100 points and the S&P 500 down 10. But there were buyers on that dip and the markets rallied into the close to cut the declines in half.

Trading Color

Despite the declines yesterday market internals weren't really negative. Positively, we did not see material underperformance from the Russell or Nasdaq (so no wholesale selling of cyclicals or momentum stocks), while sector trading was largely driven by specific news.

Semiconductors, tech and energy were the outperformers while banks and utilities lagged. Airlines got hit hard yesterday on the Lufthansa news, and I expect they'll be lower again this morning (higher oil). Airlines has surged this year, and if we are seeing elevated oil prices and a "pause" in the markets, then there may be some room for a correction in that space, and I will do some work over the next few days into seeing if there are any short opportunities in that sector.

Volumes and activity were muted again yesterday and stocks fell as much for a lack of buy demand as they did from selling (so point being is there was no aggressive selling yesterday).

Market	Level	Change	% Change
Dow	16843.88	-102.04	-0.60%
TSX	14892.13	-12.25	-0.08%
Brazil	55102.44	498.10	0.91%
FTSE	6845.65	6.78	0.10%
Nikkei	14973.53	-95.95	-0.64%
Hang Seng	23175.02	-82.27	-0.35%
ASX	5428.80	-25.20	-0.46%

Prices taken at previous day market close.

On the charts the S&P is now backing away a bit from the all time high at 1950, while support remains decidedly lower in the low 1900's.

Market	Level	Change	% Change
DBC	26.03	-.06	-0.23%
Gold	1260.80	-.70	-0.06%
Silver	19.19	.02	0.09%
Copper	3.03	-.02	-0.62%
WTI	104.43	.08	.08%
Brent	110.00	.48	0.44%
Nat Gas	4.52	-.02	-0.33%
RBOB	3.00	.03	0.92%
DBA (Grains)	26.02	-.07	-0.27%
Prices taken at previous day market close.			

Bottom Line

Markets can't go up every day and yesterday looked like the beginning of a normal (and healthy) pause. The Washington news (Cantor's loss) was jarring and immediately brought back memories of debt ceiling showdowns, but there's a lot of time between now and the mid-terms.

Iraq is now the most prominent geo-political issue to watch, but generally it looks as though markets are beginning to take "pause" but I don't think a dip, if we even get much of one, will be anything substantial, and I'd be a buyer of cyclicals on that dip.

WTI Crude surged to a new high for the year o/n on increased Iraqi violence.

Economics

There were no economic reports yesterday.

Commodities

Commodities were mixed yesterday in relatively quiet trading, as continued weakness in the grains outweighed small rallies in oil and gold. DBC fell -0.23%.

Energy, ex-natural gas, traded higher yesterday as geo-politics and inventory data drove trading. WTI crude finished the day up small (+0.12%), while RBOB gasoline was the best performer, up 1%.

But, oil prices have surged overnight (both WTI and Brent up more than 1% and at new highs for the year) as violence has erupted in Iraq and the focus of the market shifts from Russia/Ukraine back to the Middle East.

Al-Qaeda rebels have seized the city of Mosul in the north, and overnight pushed south in a shockingly quick advance, as government troops appear to be abandoning their posts en masse. Additionally, semi-autonomous Kurds have now captured Kirkuk, throwing the whole northern region of the country into chaos.

From an actual oil shipment standpoint, this takeover doesn't really mean much (the pipeline in Northern Iraq that runs north to Turkey has been shut down for months, as it's been sabotaged by rebels nearly 50 times this year).

Additionally, from an actual production standpoint this doesn't mean much, either, as the producing fields in Southern Iraq are still safe. But, Iraq was largely viewed by the oil markets as a key swing producer this year—one that will be able to increase output over the coming months. A lot of that increased output was supposed to come from the north, and clearly that's in jeopardy now.

Finally, the taking of Mosul and the push south overnight shows the rebels are gaining strength, and it doesn't take much to envision a further move south and battle for Baghdad (some reports have rebels just 60 miles away as of this morning).

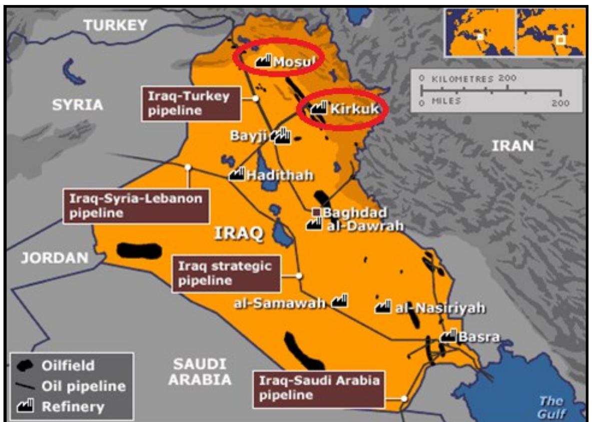
Bottom line is this re-introduces more geo-political risk into oil prices, and will be supportive until the Iraqi government forces begin to push back on the rebels.

Turning to fundamentals now, yesterday was inventory day, and the results were mixed. On the bulls' side, the headline inventory number showed a much-bigger draw than anticipated (2.6 million barrels vs. (E) 1.2 million). Meanwhile supplies at Cushing, Okla. (the delivery point for NYMEX oil futures) fell closer to that critical 20 million barrel level, dropping to 21.2M barrels from 21.4M the previous week.

Again, here's a reminder that commodities are a physical business: Even though U.S. oil supplies are near all-time highs, if inventories at Cushing drop below 20 million barrels, this will put upward pressure on oil prices. That's because the oil futures contract is based on delivery at Cushing (so if there's no oil there, people will pay up to get it there). Such are the intricacies of the commodity markets.

On the bearish side, though, gasoline inventories surged yesterday, rising 1.7 million barrels vs. expectations of a 500K draw. Much like heating oil in the winter, gasoline demand is one of the swing factors in the oil price this summer, and low inventories have helped support oil prices. If gasoline inventories continue to build, that will become a headwind on oil prices (although it's not there yet).

WTI surged to new highs for the year overnight on the news, and with geo-politics joining positive fundamentals, I'd be a buyer of USO or futures on any weakness (although not on this spike, as I hate trading geo-politics).



Iraq: Key oil infrastructure remains in the south towards Basra, but the southern push by rebels towards Baghdad is making markets nervous.

Metals markets were again quiet yesterday, with gold and silver trading flat. Gold has acted "better" since the ECB decision, and I think some of the gold buying is in part reaction to the drift higher in rates combined with some small buying on an inflation play. (Not that inflation is here yet, but if the economy continues to grow and rates rise, we'll see inflation sooner than is widely thought.)

That's not a catalyst that will propel gold higher in the immediate term, but the market is pretty short at the moment (based on the Commitments of Traders, as we said earlier in the week). So if gold can trade above $1,267-ish, we could see a bit of a squeeze materialize.

Currencies & Bonds

Market	Level	Change	% Change
Dollar Index	80.895	-.045	-0.06%
EUR/USD	1.3532	-.0013	-0.10%
GBP/USD	1.6783	.0041	0.24%
USD/JPY	102.02	-.32	-0.32%
USD/CAD	.9180	.0035	.38%
AUD/USD	.9322	.0014	0.15%
USD/BRL	2.2337	.0088	0.40%
10 Year Yield	2.64	.05	0.19%
30 Year Yield	3.47	.03	0.09%

Prices taken at previous day market close.

Currencies were mixed Wednesday as the Dollar Index finally took a breather, finishing off -0.05%, despite the fact that the euro traded to a new four-month low yesterday (down -0.1%). News flow for both currencies (the dollar and the euro) was slow Wednesday.

The reason for the Dollar Index weakness was the strength in the yen, which rallied 0.3%, mostly on short-covering ahead of the BOJ decision out today. The BOJ won't make any changes to policy, and on the commentary front it will almost certainty be slightly "hawkish" in that it won't allude to more stimulus.

But, this trade is shifting, and the focus on what the next catalyst for yen weakness will be is moving from BOJ policy to PM Shinzo Abe's "Third Arrow" and corporate tax reform and alteration of how the General Pension Investment Fund allocates money. Point being, the BOJ is less likely to stimulate the economy further (so, more QE) because its current policy is working—it's stimulating inflation (which is bad for the yen) and the economy (which is good for Japanese stocks).

Bottom line is we could see some yen strength out of this meeting as traders react to a "hawkish" BOJ governor (Haruhiko Kuroda). But I believe this would be a rally you sell, and I will do so if the yen trades into the mid-101 range.

Turning to bonds, Treasuries continued to ride that trendline in place since January 1st yesterday, as the 30-year was basically flat on the day. Interestingly, bonds couldn't rally when the stock market was on its lows and the Dow was down more than 100 points, which is a stark departure from how bonds traded earlier this year.

Fundamentally, we had a $21 billion auction of 10-year Treasuries, which was mixed. Positively, the bid to cover was the second highest of the year at 2.88, but the yield "tailed" on the auction as the "When Issued" yield was 1 basis point below the actual yield. This reflects the fact that bidders were not being aggressive.

Additionally, "indirect bidders"—which is a proxy for foreign buyers—saw demand fall to its lowest level in over a year, as "indirect bidders" bought just 36.1% of the offering compared to 49.6% last month. One auction doesn't make a trend, yet weak indirect bidding (and foreign demand) coming immediately following the ECB decision could anecdotally imply that European money has stopped flooding into Treasuries.

Given yesterday's auction, focus will be on the 30-year auction today—specifically on those indirect bidders, to see if there is a steep drop there as well.

Bottom line is the Treasury market continues to act different than it has all year, post-ECB. But, the uptrend remains in place, so for now the benefit of the doubt remains with the bulls, although signs of cracks continue to emerge.

Changes to the Report

We've made some improvements to the "Asset Class Dashboard" that changes are designed to aid in idea generation and provide more insight into how we are acting on the analysis contained in the report.

Updated Position Sheet

Market analysis is important, but at the end of the day this is a results business. So, we wanted to create an easier to follow sheet that shows what investments we are making for our proprietary accounts, all of which are based on the analysis we provide in The 7:00's Report.

The Position Sheet is broken down into two sections: a ***Tactical Trading and Investment Account***, and a ***Long-Term Macro-Trend Investment Account***.

The *Tactical Trading and Investment Account* is comprised of trades and investments that have an expected time horizon of weeks and months. The trades can be technically or fundamentally based (or both). We detail the date initiated, our open price, stop price, and give a description of the strategy along with a link to the original issue where we initiated the trade, making it easy to see our investment thesis.

The *Long-Term Macro Trend Account* is allocated to major macro trends we think can last for quarters and years (and produce sizeable returns over that period of time). We detail when we first identified the trend, which stocks and ETFs we are using to gain exposure to the trend, the original investment thesis, and periodic strategy updates. (For instance, if we are adding or reducing our positions based on near-term opportunities and risks.)

Asset Class Dashboard – Shortened and Sharpened So You Can Get More Insight in Less Time

The goal of the new Asset Class Dashboard is to make sure you have an immediate answer when a customer asks, or you wonder, "What do you think of commodities (or currencies, bonds, stocks, etc.) and what's your best idea there?"

Reconciling time horizons (so short-term objectives vs. long-term objectives) is one of the most-challenging issues investors and advisers face. To help more effectively differentiate the two, we are now including a "**Near-Term Trend**" that gives our opinion on the trend in each asset class over the coming weeks and months. We believe this will be most beneficial for tactical investment accounts.

We also have added a "**Long-Term Trend**" that reflects our view of the major macro direction of each asset class, regardless of the short-term outlook (so the goal is to keep focused on macro fundamentals, and see past shorter-term corrections and counter-trend rallies). This outlook is designed to provide longer-term guidance for more stationary accounts like retirement accounts and longer term asset allocation models.

Additionally, we have added a "Best Investment Idea" and "Best Contrarian Idea" to each asset class. The purpose of these is to provide two types of idea generation: Traditional ideas that are fundamentally or technically based, and Original, unique, "out of the box" investment ideas for clients wanting something different in that asset class.

Have a goo day,

Tom

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Position Sheet

Tactical Trading/Investment Account (Time frame of a few weeks to months).

Date	Position	Open Price	Stop	Strategy
6/11/14	VGK EWP EIRL EWI	61.24 43.58 37.42 18.14	60.59 42.23 36.78 17.54	*Long Europe. Part of the "Post-ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
6/11/14	SPHB KBE	32.73 33.40	17.14 32.23	*Long Domestic Cyclicals. Part of the "Post-ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
6/11/14	UUP EUO	21.55 17.46	21.14 17.14	*Long Dollar. Part of the "Post-ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
6/11/14	TBT STPP REK	63.41 38.32 23.00	59.54 36.84 22.34	*Short Bonds. Part of the "Post-ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
4/30/14	IYZ	28.99	28.88	*Telecom trading at a value to the market, has lagged other safety sectors. Original Issue*
3/3/14	XLI IYM PICK DIA	52.19 83.06 19.48 164.28	None	*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 broader market. Original Issue*
12/13/14	FCG XOP	18.97 65.62	None	*Natural Gas supplies low, increased demand, E&Ps at a value. Original Issue.*

Longer-Term Macro-Trend Investment Account (Long-term time frame of months/quarters)

Date Initiated	Strategy	Position (s)	Investment Thesis
November 2012	**Long Japan**	**DXJ/YCS**	*The election of Prime Minster Shinzo Abe in late 2012 resulted in massive monetary and fiscal stimulus designed to break Japan out of decades-long deflation and stagnation. The resulting efforts will be yen-negative/Japanese-stock-positive for years to come.*
Strategy Update (6/4/14): Focus on this trade has shifted to Abe's "3rd Arrow" of fiscal reforms that, if enacted, could lead to a material decline in the yen/rally in DXJ.			
April 2013	**Short Bonds**	**TBT/TBF/ STPP/KBE**	*The 30-year bull market in bonds is over as the Fed begins to gradually remove stimulus, the economy recovers and inflation slowly starts to increase.*
Strategy Update (6/5/14): The ECB decision to stimulate the EU economy should end the massive inflow of foreign money into Treasuries, which should result in a gradual resumption of the decline in bonds/rise in yields.			

Asset Class Dashboard

This page is meant to provide a general outlook for the path of each major asset class and is updated at the start of each week.

Near-Term Trends are provided primarily for tactical and trading accounts (Time Horizon of weeks and months).

Long-Term Trend is provided for longer-term asset allocation models/retirement accounts (Time Horizon of Months/Quarters).

The "Best Idea" represents our best idea at the moment. Not all best ideas are trades we make—they are provided for idea generation.

	Near Term Trend	Long Term Trend	Market Intelligence
Stocks	**Higher but Overbought**	**Bullish**	*The market has largely climbed the "Wall of Worry" in place since March, and has become very short-term overbought. A sideways drift or dip would be healthy, but beyond that the fundamentals remain very equity-positive. A grind higher following some sort of a pause or correction is likely.*
Best Idea: Long Europe (VGK/EIRL/EWP/EWI) **Best Contrarian Idea:** Buy Retailers (XRT)			
Commodities	**Mixed/ Down**	**Neutral**	*Commodities generally remain mixed, as the outlook is positive for oil and natural gas, but negative for grains and neutral for gold. There isn't any overarching positive influence for commodities at this time, though, as global growth remains subdued and inflation muted.*
Best Idea: Long Oil (USO) **Best Contrarian Idea:** Buy Gold (GLD)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index has traded higher post-ECB meeting, and that likely will continue over the coming weeks as pressure builds on the euro.*
Best Idea: Buy the Pound (FXB) **Best Contrarian Idea:** Long Canadian Dollar (FXC)			
Treasuries	**Neutral**	**Bearish**	*Treasuries have traded heavier since the ECB decision last week, and there are signs that the influx of foreign capital is ending, which should be bond-bearish. Until the uptrend at 134'22, the trend remains up.*
Best Idea: Short Longer-Term Bonds (TBT) **Best Contrarian Idea:** Short High-Yield Bonds (SJB)			