7:00's Report

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

June 13th, 2014

Pre 7:00 Look

- Futures are drifting mildly lower after a relatively quiet night. The biggest "news" o/n was that BOE Governor Marc Carney hinted at sooner than expected rate hikes, which sent the pound higher and FTSE down by 1%.
- Geo-politically, the situation in Iraq remains largely the same, but Iraq is now fighting back and the US is contemplating airstrikes (so a mild positive).
- Economically, Chinese Industrial Production & Retail Sales were in-line, and EU trade balance also met expectations.
- Econ Today: PPI-FD (E: 0.1%).

Market	Level	Change	% Change
S&P 500 Futures	1921	-2.25	-0.12%
U.S. Dollar (DXY)	80.63	-.05	-0.06%
Gold	1273.40	-0.60	-0.05%
WTI	107.12	.59	0.54%
10 Year	2.586	-.54	-2.05%

Equities

Market Recap

Stocks traded decidedly lower Thursday as geopolitics and some mildly disappointing economic data weighed on sentiment. The S&P 500 fell 0.71%.

Stocks opened slightly lower after retail sales and jobless claims both missed expectations, while the situation in Iraq and Washington (the Eric Cantor defeat) cast a generally somber shadow over the morning (reminding everyone just how calm the macro environment has been lately, and that the potential is there for it to change going forward).

Transports: Airlines took a big hit yesterday and the Transportation Index looks to be correcting. This year, previous corrections have stopped at the 100 day moving average, or about 5% from here.

Also weighing on sentiment yesterday was some potential political trouble in Italy. (PM Matteo Renzi is seeing some party revolt, but European politics just aren't as important as they used to be given the low sovereign bond yields.)

Markets drifted marginally lower pretty much the entire morning and early afternoon, although House Speaker John Boehner's comments, President Obama's "all options are open" remark and reports that Iran was sending troops to aid the Iraqi government weighed on stocks generally. Markets took a leg lower in the mid-afternoon and hit their lows of the day during the last hour of trading before bouncing a bit into the close thanks to some buy imbalances on the market on close orders.

Trading Color

Encouragingly, once again the Russell 2000 and Nasdaq performed in-line with the broader market (Russell down -0.63% and -0.8% for the Nasdaq), so once again

Market	Level	Change	% Change
Dow	16734.19	-109.69	-0.65%
TSX	14909.63	17.50	0.12%
Brazil	55102.44	498.10	0.91%
FTSE	6781.54	-61.57	-0.90%
Nikkei	15097.84	124.31	0.83%
Hang Seng	23319.17	144.15	0.62%
ASX	5405.05	-23.75	-0.44%
Prices taken at previous day market close.			

the more cyclical indices are holding up much better than over the previous two months, which is encouraging.

Market	Level	Change	% Change
DBC	26.39	.37	1.42%
Gold	1273.20	12.00	0.95%
Silver	19.52	.35	1.82%
Copper	3.01	-.03	-.90%
WTI	106.33	1.93	1.85%
Brent	112.89	2.94	2.67%
Nat Gas	4.738	.23	5.10%
RBOB	3.08	.08	2.57%
DBA (Grains)	27.48	.03	.11%
Prices taken at previous day market close.			

Sector-wise it was about how you'd expect, given that the broader market was down roughly 1%. Cyclicals underperformed, led on the downside by transports (down 2.7%) as airlines declined around 5% each. Meanwhile basic materials, industrials (down on Iraq-inspired global macro angst) and consumer discretionary (LULU imploded yesterday) all traded down more than 1%.

Conversely, utilities bounced thanks to the decline in bond yields while energy was the only other S&P 500 sub-sector to finish positive (for obvious reasons).

Volumes remained subdued yesterday, and again there was no aggressive selling to account for the declines—this was mild profit-taking combined with a lack of bids. Activity and volumes, generally, remain very, very low.

The S&P 500 has now backed away from the 1,950 highs and is nearing first support at 1,914 (the 20-day moving average).

Bottom Line

The market needed a pause, and now it's getting it. The situations in Iraq and Washington (fallout from the Cantor loss) do bear watching, but they aren't quite as bad in the near term as the headlines would lead you to believe. And, while retail sales and claims were mildly disappointing, overall the macro and fundamental backdrop remains largely unchanged (and globally equity-market-positive).

Risks, as always, remain—including if Iraq violence grows and oil rallies materially higher, or if economic data slows (which has always been a risk). But for now this should be viewed as little more than the market taking a breather after an unexpected and uninterrupted rally from mid-May.

Going forward, sentiment seemed to turn more bullish at the start of the week. I'm not hearing the chorus of "This is it" regarding the ultimate correction, so I imagine there's probably more to go on the downside before this is done. But, as long as the economic data stays firm and the Islamic State of Iraq and Syria (ISIS) doesn't move into Southern Iraq, this is a dip I'm looking to buy, and will likely add to the other half of my "post ECB" portfolio on further weakness.

Economics

Economic data yesterday were mildly disappointing, and they added to overall somber mood of markets given events in Iraq and Washington.

Retail Sales

- May Retail Sales rose .03% vs. (E) 0.6%.

Takeaway

Retail sales wasn't great but it wasn't horrible either. The headline missed expectations, but that was offset by a large revision to April (up to 0.5% from 0.1%).

The more important "control" group, which excludes cars, gasoline and building materials, was basically flat in May. Revisions weren't material, so bottom line is there was a little softness to consumer spending in May.

Bigger picture: This is slightly disappointing from an economic growth standpoint, but this won't materially alter anyone's outlook for the U.S. economy by itself.

Jobless Claims

- Weekly Jobless Claims rose to 317K vs. (E) 313K.
- Four Week Moving Average rose to 315K.

Takeaway

There was a slight uptick in jobless claims this week, up to 317K, but the trend in claims still remains lower. Generally speaking, we are continuing to see slow but steady improvement in the jobs market.

The 4-week moving average, which is the better metric to watch, took a slight uptick higher to 315K, but remains near multi-year lows, which were set last week.

Bottom line is there was nothing really new here. The job market continues to get incrementally better and nothing in the weekly claims data implies that this is changing.

Commodities

Commodities were higher yesterday in volatile trading as geopolitics and supply/demand data drove significant moves in most commodities.

Starting with energy, obviously the situation in Iraq is top of mind. Brent rallied 2% and WTI crude 1.5% on escalating geopolitical risk, and both hit new highs for the year.

With regard to the outlook for oil prices, headlines have gotten a touch hysterical. But while there are significant potential long-term implications of what's happening in Iraq and Syria, in the immediate term there isn't the potential for a huge impact on the global oil market **unless the ISIS can move south of Baghdad**. If that happens, then this goes from mostly an emotional market reaction to an actual production problem, and the effect on oil prices would be potentially significant.

More broadly, though, the success of ISIS (or ISIL, depending on which site you were reading—they are the same) just escalates a long-running (and decades-old) conflict between Sunnis and Shiites. ISIS and Iraq are pawns in a larger proxy war between the Saudis, Iranians, Egyptians, etc. Bottom line is this escalates the mess that is the Middle East, which could be a longer-term problem. But, again, in the immediate term, unless ISIS gets south of Baghdad, don't expect the oil markets to continue streaking materially higher from here (meaning near $120/bbl. or so). I would continue to look to buy a dip in oil if/when the ISIS advance is halted.

Despite the geopolitical news, oil wasn't even the best performer in the energy space yesterday. Natural gas rallied 5% after weekly injections missed expectations by 3 Bcf (107 vs. (E) 110). 3 Bcf isn't a lot, but it does reflect just how nervous the natural gas market remains. Inventories are still 31% below last year and 35% below the five-year average, and I've head from a couple places that weekly injections need to be 20-35 Bcf higher than estimates per week for the next couple of months to replenish inventories. So, point being, the supply/demand situation in natural gas remains precarious, and bullish.

Turning to the metals, gold rallied 1% yesterday and silver 1.7% on an initial "chaos" bid due to events in Iraq resulting in a small short-squeeze that carried gold back above $1,270 for the first time in nearly three weeks. The short-squeeze could continue over the coming days depending on the Iraq headlines, but unless gold can trade through $1,286-ish (the 50-day moving average), I don't think this is a catalyst for a material rally.

Finally, grains took another leg lower after the release of the June World Agricultural Supply/Demand Estimates yesterday, which were generally bearish on the grains. Without getting too much in the weeds (forgive the pun), the weather is just about perfect for crops this year. Crop conditions for corn are the best they've been in four years, and the weather outlook for the summer is on the cool side—which, if it sticks, should result in multi-year highs for crop yields. So, better yields per acre equals greater supply, and that is pressuring grain prices. So, unless we get a (hotter) turn in the weather, it looks like at least corn, wheat and soybeans won't be increasing in price at the grocery store anytime soon.

Currencies & Bonds

The Dollar Index declined for the second-straight day Thursday, falling 0.28% thanks mostly to short-term profit-taking, although the slightly disappointing economic data (retail sales and jobless claims) also weighed on the dollar.

Market	Level	Change	% Change
Dollar Index	80.69	-.213	-0.26%
EUR/USD	1.3566	.0036	0.27%
GBP/USD	1.6823	.0042	0.25%
USD/JPY	101.69	-.35	-0.35%
USD/CAD	.9191	.0013	0.14%
AUD/USD	.9363	.0041	.44%
USD/BRL			%
10 Year Yield	2.586	-.54	-2.05%
30 Year Yield	3.41	-.59	-1.70%
Prices taken at previous day market close.			

Conversely, the euro rallied 0.3% and rose for the first time in a week courtesy of dollar weakness and a much better than expected April industrial production number (up 0.8% vs 0.04%).

Again, economic data mattered yesterday in the dollar decline/euro rally, but really all we saw was a bit of an overbought correction/oversold bounce. Both currencies have seen extreme moves over the past week, and that's something that easily could continue for the next few days, before the bigger trends of dollar strength and euro weakness re-asset themselves.

In Asia the yen rallied another 0.3% vs. the dollar as Machinery Orders beat expectations, but it was short-covering ahead of the BOJ decision overnight that was the real driver of yen strength this week.

Interestingly, the biggest "news" of the past 24 hours in the currency markets happened overnight, as Bank of England Governor Marc Carney hinted at what we (and others) have been saying for some time: That markets may be underestimating when the BOE will have to start to tighten policy, specifically that it might be later this year (vs. expectations of Q1 '15). The pound traded .75% higher vs. the dollar and is just off 52 week highs, while the FTSE is down 1% on the news as of this writing.

Again, the BOE is a "ahead" of the Fed on the policy curve, so it's important to watch how the currency and markets react to these types of "surprises," because they are almost certainly coming here as well.

Treasuries moved sharply higher yesterday as a "perfect storm" of positive factors helped bonds yesterday. First, there was a mild geopolitical bid early in the morning off the Iraq news, but that got a boost when a report hit the wires late Thursday that Iran was sending troops to help the Iraqi Shiite government (which potentially complicates things).

Second, economic data missed expectations, as both retail sales and jobless claims were slight disappointments.

Third, and this was the most powerful bullish force, a $13 billion 30-year bond auction went very, very well. The bid to cover, a measure of demand, was 2.69, the highest since February 2013. Additionally, the actual yield of 3.444% was 2 basis points under the "when issued" yield, reflecting aggressive bidding. Finally, "indirect bidders," which include foreign buyers, took down 51.8% of the issue, up from 43.1% last month. So, based on these auction results, clearly the higher yields for Treasuries brought out more buyers.

The 30-year bounced nicely off the uptrend that's been in place since January, and for now it remains in place. With geopolitics clouding the issue, this rally could run a bit further (and I'll be looking to sell that rally if it materializes).

Have a good weekend,

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.*			

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Asset Class Dashboard

(Updated 6.9.14)

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)			