7:00's Report

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

June 19th, 2014

FDX: Strong earnings were overshadowed by the Fed, but FDX posted good numbers and was upbeat regarding the global economy, which is a positive shift in tone.

Pre 7:00 Look

- Futures are flat this morning as they digest yesterday's post FOMC rally, while international markets are almost universally higher as global stocks rose off the FOMC.
- Economically o/n it was quiet, as the only releases were UK Retail Sales, which met expectations, and Great Britain Industrial trends, which beat estimates.
- The Dollar Index and Treasuries are modestly weaker this morning on a delayed "Dovish" reaction to the FOMC.
- Econ Today: Weekly Jobless Claims (E: 313K), Philly Fed Survey (E: 13.0)

Market	Level	Change	% Change
S&P 500 Futures	1948.25	-0.75	-0.04%
U.S. Dollar (DXY)	80.32	-.35	-1.43%
Gold	1281.80	9.10	0.72%
WTI	106.03	.45	0.43%
10 Year	2.613	-.042	-1.58%

Equities

Market Recap

Stocks were flat Wednesday until 2 p.m. but then moved decisively higher during the last two hours of trading as a more "dovish" than expected Fed sent stocks to new all-time highs. The S&P 500 closed up 0.77%.

The day really started after 2 o'clock yesterday, as markets were flat into the Fed, and ignored strong earnings reports from FDX and ADBE. (Incidentally there is a quietly growing list of positive pre-announcements and mid-month earnings results as we move closer to Q2 earnings season.)

But, yesterday was all about the Fed decision and it was more dovish than expected and Yellen made sure there were no repeats of the "six months" slip up at the press conference. The dovish announcement and Yellen comments resulted in a squeeze higher as shorts rushed to cover and under-allocated managers added exposure. Stocks rallied throughout the final two hours of trading to close at the highs of the day.

Trading Color

Yesterday's rally was very broad and virtually every corner of the market participated, but it wasn't an enthusiastic rally. As mentioned, it felt like a squeeze higher more than anything else based on the simply reaction that if the Fed is dovish, then you buy stocks. That simply logic combine with the fact that many investors (including me) were looking for more of a consolidation in the market, so the rally pulled managers in who weren't long enough.

Internally yesterday's rally wasn't particularly strong, as

Market	Level	Change	% Change
Dow	16906.62	98.13	0.58%
TSX	15109.25	53.36	0.35%
Brazil	55202.54	902.59	1.66%
FTSE	6832.49	53.93	0.80%
Nikkei	15361.16	245.36	1.62%
Hang Seng	23167.73	-13.99	-0.06%
ASX	5468.20	85.48	1.59%

Prices taken at previous day market close.

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the S&P 500 and Dow outperformed the Russell and Nasdaq. And, while every S&P 500 sub-sector traded higher, the gains were led by a huge rally in utilities (up over 2%!) while consumer staples and healthcare also outperformed. More cyclical sectors like financials and industrials lagged.

Volumes ticked up a bit thanks to the last hour of trading yesterday, although again there weren't at levels where you would say there was a lot of conviction in the market.

Market	Level	Change	% Change
DBC	26.63	.13	0.49%
Gold	1273.90	1.90	0.15%
Silver	19.835	.103	0.52%
Copper	3.0655	.0045	0.15%
WTI	105.77	-.10	-0.09%
Brent	114.23	.78	0.69%
Nat Gas	4.663	-.046	-0.98%
RBOB	3.0996	.0085	0.27%
DBA (Grains)	27.395	-.035	-0.13%
Prices taken at previous day market close.			

On the charts the S&P 500 has now traded to a new all time high, which support lies down around the 1928 level.

Bottom Line

Yesterday's rally to new highs was more of a squeeze and driven by programs, algos and fast money funds, but at the same time the market made new highs. At some point the Fed being dovish won't elicit this type of automatic stock rally, but that's in the future.

So, for now the beat goes on. You don't discount stocks making new highs regardless of the quality of the reason why, so clearly it looks at though the most recent consolidation has ended, and we can expect the market to grind slowly higher assuming there are no "left field" shocks (Iraq remains a risk to monitor, obviously).

As far as what will outperform, it's going to be interesting to see over the next few days if this market reverts to the outperformance of defensives and bonds, or if the outperformance continues to shift towards more cyclical names, as it has done over the past two weeks. I think that shift towards cyclical outperformance will continue even if we get a resumption of the bond rally, as we now have a "forever" easy Fed combined with an economy that's as foundationally strong as it's been since the Fed started QE (which is again why people expected at least a hint of hawkishness yesterday).

The Fed's surprising dovishness increases my anxiety that we're brewing one heck of an inflation/asset bubble problem down the road, but for now the beat goes on and stocks continue to have a strong Fed tailwind, and the outlook remains overwhelmingly bullish.

Economics

FOMC Rate Decision

- FOMC made no change to interest rate policy and continued to taper QE by an additional 10 billion dollars (as expected).

Takeaway

The market was looking for the Fed to very slightly imply it was at least starting to consider a plan for policy normalization (and in doing so be slightly hawkish) but that didn't happen, as Yellen and Co. look to keep the easy money accelerator on the floor.

In yesterday's Report, we looked at the potential outcomes for the Fed meeting. We noted that the "hawkish" outcome would be if the average forecasted Fed Funds rates rose more than 25 basis points—so, above 1.4% in '15 and 2.7% in '16.

Result: The average Fed Funds rate projection for '14 and '15 was increased only slightly, to 1.20% for '15 and 2.5% for '16 – so, not enough of an increase over the March estimates to be considered "hawkish."

We also noted yesterday that if the expected unemployment rate dropped below 6% for 2014 or below 5% for 2015, we said to expect a "hawkish" reaction from markets. Result: Expected unemployment rate reduced slightly to 6.0%-6.1% for '14, 5.4%-5.7% for '15, but not enough to be considered "hawkish."

Additionally, FOMC participants drastically reduced their expected GDP growth for 2014, down to 2.1%-2.3% from 2.8%-3.0% in March. However, that is a bit misleading, because the reason for that steep downgrade was the surprisingly harsh winter, which severely depressed Q1 GDP. (So the full year '14 GDP has to dig out of a much deeper hole than thought back in March.) In fact, the commentary about the current state of the economy was more upbeat in the FOMC statement, where the committee referred to the economy as having "rebounded" in recent months vs. "picked up" in March

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(so, a slight upgrade).

Bottom line, as you saw from the market reaction, was that while the FOMC largely met market consensus, there was an expectation for an incrementally more hawkish tone, and that simply did not come yesterday. And, as a result we saw markets react dovishly (stocks up, bond and the dollar down).

Clearly the Fed is following the lead of the BOE which, until last Friday, has stood resolutely behind the "low for long" mantra—despite growing evidence that the economy is indeed seeing growth accelerate and inflation is bottoming. And, for now, the dovish Fed-speak will continue to help stock prices and support bond prices.

Commodities

Commodities traded mostly higher yesterday, albeit only slightly. The refined products outperformed for the third day in a row (despite mostly bearish inventory data) while natural gas was the worst performer ahead of its own inventory report due out later this morning (10:30). The PowerShares DB Commodity Tracking Index ETF, DBC, rallied +0.45%.

Beginning with energy, yesterday was inventory day for crude oil and the refined products and the data were universally bearish. WTI futures gave back morning gains to finish little-changed. However, both RBOB gasoline and heating oil (diesel) futures managed to finish higher, up +0.28% and +0.8%, respectively.

The EIA reported a smaller than expected draw in crude oil supplies, a drop of -600K vs. (E) -1.1M barrels while supplies at Cushing, Okla., actually rose +200K barrels to 21.4M from 21.2M barrels. Remember that somewhere around the 20M-barrel mark is the critical minimum level for safe storage at the nation's delivery point for Nymex crude oil futures (Cushing). And, since the rise was only marginal, traders will continue to focus on that number in the weekly report until it is substantially higher, and no longer a threat to the storage operations there.

Market	Level	Change	% Change
Dollar Index	80.525	-.191	-0.24%
EUR/USD	1.3583	.0038	0.28%
GBP/USD	1.6987	.0024	0.14%
USD/JPY	101.93	-.21	-0.21%
USD/CAD	1.0847	-.0011	-0.10%
AUD/USD	.9392	.0059	0.63%
USD/BRL	2.2298	-.0319	-1.41%
10 Year Yield	2.613	-.042	-1.58%
30 Year Yield	3.418	-.028	-0.81%
Prices taken at previous day market close.			

Moving to the products, RBOB gasoline stockpiles rose +800K vs. (E) +200K, a surprisingly bearish build during the summer driving months. Distillate supplies grew exactly in-line with analyst expectations of +400K barrels.

So, after the recent breakout above the $105 resistance level in WTI futures, we are seeing some moderation in domestic crude oil prices; however, the "fear premium" remains strong in Brent futures. But, as the situation in Iraq seems to be leveling off and supply data favored the bears yesterday, some profit-taking was to be expected. On the charts we are currently looking at support at the $105 mark (former resistance) while the first level of resistance is above at $108.

Elsewhere in energy, natural gas was the worst performer yesterday, falling -0.98% on the day as traders positioned ahead of this morning's EIA inventory report and weather forecasts were again adjusted to show more moderate weather over the coming weeks.

Analysts are calling for a 113 Bcf build in crude, and the drill remains the same: A material miss either way could spur a large move in the market.

From a technical standpoint, natural gas futures remain in a broad up-trend channel with support at $4.45 and resistance above at $4.95. For short-term traders, buying dips toward the $4.50 level with a stop 5 to 10 cents below could offer returns of 40 to 50 cents in coming weeks.

Over the longer term, both fundamentals and technicals suggest that natural gas prices are poised to move higher, and buying dips in the ETFs FCG and XOP remains one of the best ways to get exposure to the trade.

Moving to the metals, there really wasn't much to talk about yesterday. Gold traded in a very tight range between $1,267 and $1,275, closing higher by +0.2% in what turned out to be a very uneventful session. The reason for the afternoon rally was largely short-covering as the "risk" in the market yesterday was for a hawkish reaction (bearish gold) to the FOMC

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announcement. The Fed was surprisingly slightly dovish, which led a lot of disappointed shorts to close their positions. For the near term, gold has started to establish a new trading range with support at $1,240, while resistance is forming at $1,280.

Currencies & Bonds

Currency markets were surprisingly quiet yesterday despite it being a Fed day with an apparently "dovish" result. The Dollar Index was mildly weaker throughout the day "pre-Fed," down about -0.17%. After spiking lower initially, it actually mildly rallied into the close of trading, going out down -0.1%, which in a small way undermines the "dovish" interpretation.

The euro was +0.25% higher vs. the dollar on general U.S. dollar weakness heading into the Fed, but sold off modestly post-FOMC and closed up +0.2% vs. the dollar.

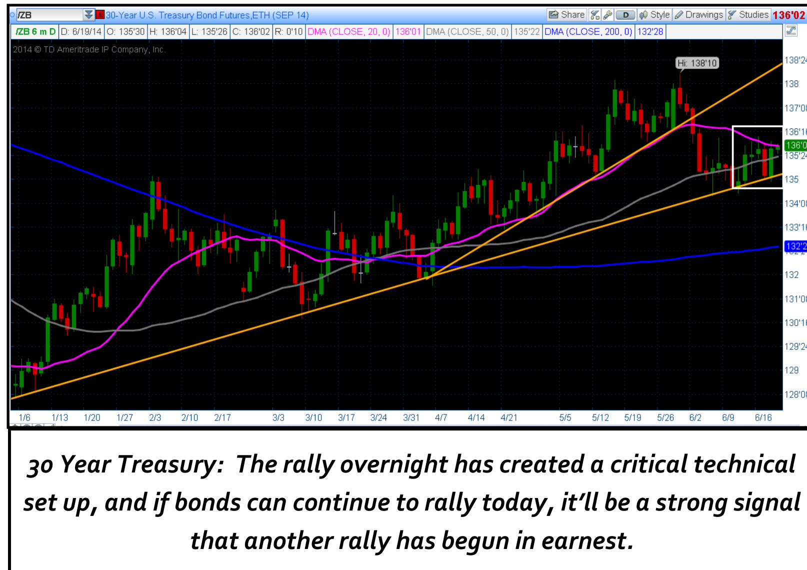
Elsewhere currencies were little-changed pre-FOMC, and they remains so post-FOMC: The pound, yen and "Loonie" were all basically flat vs. the greenback.

The Aussie was the only currency to really move yesterday, as it rallied +0.44% and largely ignored the FOMC, but keep in mind that the rally was just a bounce from Tuesday's beating (which came after the RBA minutes were dovish).

But, while yesterday's post FOMC reaction in currency markets was surprisingly tame, we're seeing much more of a reaction this morning. The Dollar Index is down .45% and looks to be rolling over, while the every major currency s. the dollar is higher be a minimum of .3%.

Turning to bonds, they did react "dovishly" following the statement, economic projections and press conference. The 30-year was modestly higher heading into the meeting, up +0.35%, and rallied post-FOMC to close up +0.5%. So, in an absolute sense bonds did benefit from a "dovish" Fed, but I was very surprised to see that the 30-year only rallied marginally from pre-FOMC levels, and more importantly couldn't trade above the highs from Monday or Tuesday.

But, like the Dollar Index, overnight the bond rally continued and the thirty year traded through the Tuesday's highs and is up .3% as of this writing.



30 Year Treasury: The rally overnight has created a critical technical set up, and if bonds can continue to rally today, it'll be a strong signal that another rally has begun in earnest.

My initial reaction to the lack luster post FOMC bond rally yesterday was to read it as another sign that the uptrend was continuing to get weaker, but the strength overnight somewhat invalidates that observation.

Today will be a very important day for the bond market, because if this overnight strength gains momentum throughout the trading session, and the 30 year can close meaningfully above 136'11, that will be a strong signal that bonds are indeed heading higher again, courtesy of the Fed.

Have a good 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	60.58 42.22 35.41 16.89	*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	30.32 31.97	*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	21.13 17.13	*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	59.53 36.83 22.33	*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	28.32	*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 broad 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 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 spositive for yeasr to come.*
Strategy Update (6/4/14): Focus on this trade has shifted to Abe's "3rd Arrow" of fiscal reforms, and if enacted, it 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 begins 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 6.16.14)

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 slightly Overbought**	**Bullish**	*After rallying hard since mid-May, markets are now taking a healthy pause. The "reasons" for the dip last week were politics (Eric Cantor loss) and geo-politics (Iraq), but more importantly the larger backdrop for stocks remains positive: Central banks accommodative, global economic recovery, skepticism towards the rally, decent valuations.*

Best Idea: Long Europe (VGK/EIRL/EWP/EWI)

Best Contrarian Idea: Buy Retailers (XRT)

	Near Term Trend	Long Term Trend	Market Intelligence
Commodities	**Neutral**	**Neutral**	*Geo-politics dominated commodities last week as violence in Iraq sent WTI and Brent crude to new highs for the year, while gold also rallied to multi-week highs. Beyond short term geo-politics, though, the outlook for commodities remains mixed and it'll take the situation getting much worse in Iraq to push commodities materially higher from here.*

Best Idea: Long Oil (USO)

Best Contrarian Idea: Buy Gold (GLD)

	Near Term Trend	Long Term Trend	Market Intelligence
U.S. Dollar	**Higher but Overbought**	**Bullish**	*The Dollar Index rose last week to a multi-month closing high thanks to continued weakness in the euro. The dollar is short term overbought, but the trend higher should reassert itself after a short period of consolidation.*

Best Idea: Buy the Pound (FXB).

Best Contrarian Idea: Long Canadian Dollar (FXC)

	Near Term Trend	Long Term Trend	Market Intelligence
Treasuries	**Neutral**	**Bearish**	*Treasuries have traded heavier since the ECB decision two weeks ago, and there are signs that the influx of foreign capital is ending, which should be bond bearish. But, the uptrend in place since January again held last week, so until 134'28 is broken in the 30 year, the shorter term trend remains higher.*

Best Idea: Short long bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)

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