7:00's Report

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

June 20th, 2014

30-Year Treasury: The long bond continues to test the 2014 uptrend line.

Pre 7:00 Look

- Futures are flat this morning after another quiet night, as markets continue to digest the FOMC.
- From a market standpoint, the situation in Iraq got slightly better yesterday on news the US is sending Kerry and 300 special forces to assist the Iraqi government.
- Economically it was quiet o/n, as Great Britain PPI and public sector borrowing were the only releases and both met expectations.
- Econ Today: No economic reports today.

Market	Level	Change	% Change
S&P 500 Futures	1951.00	.75	0.04%
U.S. Dollar (DXY)	80.425	.029	0.04%
Gold	1311.30	2.70	0.21%
WTI	106.02	-.03	-0.03%
10 Year	2.622	.009	0.34%

Equities

Market Recap

Stocks traded flat Thursday as investors digested the FOMC decision and ignored more strong economic data. The S&P 500 rose +0.13%.

Markets were flat pre-open Thursday as they digested the FOMC. But, an in-line jobless claims report helped stocks rally immediately following the open before they rolled over (despite the strong Philly Fed manufacturing index) mostly as short-term traders booked profits from Wednesday's rally.

Stocks basically treaded water for the remainder of the day before hitting their lows right before President Obama spoke regarding Iraq.

His comments, specifically that he's sending Kerry and a couple hundred special forces there, marked the low of the day. Stocks rallied from 1:30 till the close to finish the day slightly positive.

Trading Color

The major averages were all more or less unchanged yesterday, so there's not a lot to read into there. But from a sector standpoint, we did see defensives and value sectors outperform cyclicals (following Wednesday's trend).

Utilities once again were the best-performing S&P 500 sub-sector, rallying +0.82% after Wednesday's +2% rise, and XLU moved to yet another 52-week high. Utilities are now up over +14% year-to-date, and are the best-performing S&P 500 sub-sector.

But, the strength in defensives extended beyond utilities as consumer staples also rallied, as did REITs (VNQ). Meanwhile banks, financials, basic materials and con-

Market	Level	Change	% Change
Dow	16921.46	14.84	0.09%
TSX	15112.22	2.97	0.02%
Brazil	55202.54	902.59	1.66%
FTSE	6829.03	20.92	0.31%
Nikkei	15349.42	-11.74	-0.08%
Hang Seng	23194.06	26.33	0.11%
ASX	5419.48	-48.73	-0.89%
Prices taken at previous day market close.			

sumer discretionary lagged and all finished mildly negative.

So, despite the fact that bonds rolled over yesterday, there was a clear "low rate" bid in the equity market. It'll be interesting to see if that divergence continues (I don't believe it will, but that's just an opinion).

Volumes were at the highest levels of the week yesterday, but that likely was due to some trading ahead of the "quad-witch" option expiration today, which certainly will see volumes spike higher. Despite the higher volumes, though, there remains little to no conviction in this market.

Market	Level	Change	% Change
DBC	26.87	.26	0.98%
Gold	1318.70	46.00	3.61%
Silver	20.85	1.072	5.42%
Copper	3.0765	.0165	0.54%
WTI	105.97	.38	0.36%
Brent	114.87	.61	0.53%
Nat Gas	4.588	-.071	-1.52%
RBOB	3.1224	.0242	0.78%
DBA (Grains)	27.73	.29	1.06%
Prices taken at previous day market close.			

Bottom Line

Yesterday was a day of consolidation and digestion, and little more. Generally the outlook for stocks remains very favorable. And, while short-term extended, stocks aren't expensive and there's plenty of room for this market to grind slowly higher, especially when you consider the calendar.

Minus some economic data (flash PMIs Monday, July jobs report, etc.) and excluding any potential geopolitical disruptions (Iraq), the next "major" event for markets could very well be the Jackson Hole central bankers meeting.

Markets will be looking toward Wyoming for an update on the outlook for Fed policy, as it's widely expected that economic data will continue to trend better between now and then.

So, a slow grind higher over the next several weeks certainly wouldn't be surprising. I continue to think cyclicals will continue to play catch-up, and **I'll be adding the other half of my "post-ECB portfolio" throughout trading today.**

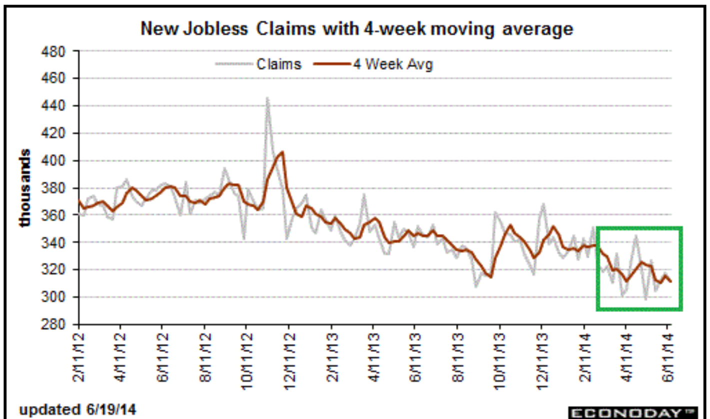
Economics

Weekly Jobless Claims

- Weekly Claims Fell to 312K vs. (E) 313K last week
- The 4-Week Moving Average dropped 3.75K to 311.75K

Takeaway

Weekly claims were mostly in-line with expectations last week, falling -6K to 312K vs. (E) of 313K. The data from the week prior were revised slightly higher from 317K to 318K. Positively, the 4-week moving average declined last week, falling -311.75K, just above a multi-year low.



Jobless claims continue test multi-year lows, signaling continued incremental progress in the labor market.

Bottom line, weekly jobless claims have to a degree stalled in the low-300Ks, so incremental progress in the jobs market appears to have stalled a bit. But, it's important to note that the 4-week average is about 30K less than it was at the beginning of the year, so clearly we've seen material improvement in the jobs market so far this year, which is obviously a positive.

Philly Fed Survey

- General Business Conditions Index for June jumped to 17.8 vs. (E) 13.0
- New Orders surged +6.1 points to 16.8

Takeaway

The Philadelphia Fed Survey came in much better than expected with the General Business Conditions Index rising +2.4 points to 17.8 in the month of June, beating estimates of 13.0 and hitting the highest level since September.

Also positively, the leading indicator within the report, New Orders, surged +6.1 points from May to 16.8 in

June. Other details within the report indicate that inventories are falling as demand is increasing.

Bottom line, yesterday's Philly Fed survey was very strong, matching Tuesday's Empire State survey. While neither are directly predictive of the national PMIs (we get the June flash PMI Monday), the data points this week certainly imply we're seeing the manufacturing recovery accelerating.

Commodities

Commodities were mostly higher yesterday in a very active session. Precious metals led the way higher, rallying sharply as part of a broad, multiple-asset-class "inflation" trade. The sole underperformer was natural gas, which sold off in the afternoon after the market digested the EIA report that showed a supply build that was in-line with analyst expectations. The benchmark commodity tracking index ETF (DBC) broke out to a fresh high for the year as it rallied +1% on the day.

Beginning with the best performers, gold and silver rallied +3.21% and +4.91% respectively yesterday as weak shorts got squeezed from the market.

We first mentioned that there was a threat for a short-squeeze last Wednesday when the CFTC's Commitments of Traders report showed short interest in gold had doubled over the previous 4 weeks. And, once the newfound resistance level at $1,280 (the top end of the short-lived trading range) was broken overnight, a short-squeeze ensued and gold futures rallied more than $40 to a two-month high just shy of $1,320.

The primary reason for yesterday's surge in gold was a delayed reaction to the surprise "dovishness" by Chair Yellen and the Fed on Wednesday. In being more dovish than expected, despite recent data suggesting that the economy is not only recovering but actually accelerating, Yellen sparked fears of inflation. This is what many gold bugs have been waiting for. Combine that with overweight shorts in the market, and you get a classic "melt-up short-squeeze."

Market	Level	Change	% Change
Dollar Index	80.405	-.265	-0.33%
EUR/USD	1.3603	.0008	0.06%
GBP/USD	1.7036	.0044	0.26%
USD/JPY	101.95	.04	0.04%
USD/CAD	1.0821	-.0015	-0.14%
AUD/USD	.9397	-.0008	-0.09%
USD/BRL	2.222	-.005	-0.22%
10 Year Yield	2.622	.009	0.34%
30 Year Yield	3.459	.041	1.20%
Prices taken at previous day market close.			

From here the charts are a bit of a mess, however. Initial resistance is above at $1,325 while former support at $1,280 is back in focus.

Moving to energy, crude oil futures bounced off support between $105 and $105.25 (which was formerly resistance) and finished the day higher, up +0.55%. WTI futures fell back earlier in the week as the situation in Iraq is "on pause" for lack of a better term, and domestic supply data favored the bears.

But, Iraq is still very much in traders' focus, and any escalation—specifically a push by ISIL to gain more ground to the south—will bring back the fear bids in force and in turn send futures toward resistance at $108. Meanwhile the former 2014 highs remain pretty solid support between $104 and $105.

Elsewhere in energy, natural gas futures sold off mid afternoon, closing down -1.5% in a delayed reaction to the mostly in-line inventory report released by the EIA at 10:30. The EIA reported a build in supplies of 113 Bcf which matched most analysts' expectations, although the consensus was apparently a touch lower, at 110 Bcf.

Because the report was mostly in-line, traders seemed to look back to weather reports. Because the forecasts are calling for moderate temperatures in the near futures, futures came for sale as traders expect near-term cooling demand to be low. Bottom line, natural gas futures continue to trade with some intraday volatility, but are in a well-established, but broad, uptrend channel with support at $4.45 and resistance above at $4.98.

Currencies & Bonds

By far the most interesting trading yesterday occurred in bonds, as the 30-year Treasury reversed midday and actually closed lower by 0.3%, after being up as much as 0.6% early in the session.

There wasn't any specific catalyst that caused bonds to roll over, as Treasuries largely ignored the good economic data Thursday morning. Instead, the reversal came via a slow, methodical decline that seemed to gain momentum throughout trading yesterday. As we watched bonds slowly get heavier throughout the day, I couldn't help but think the price action would make me very nervous if I were materially long bonds, because there was no follow-through to the early strength.

The 30-year again violated the 2014 uptrend on an intraday basis, closing right on support for the third time in three weeks.

As far as "why" bonds rolled over yesterday, the answer is inflation (or fears thereof). Economic growth is accelerating, and the Fed apparently seems determined to keep policy as easy as it was when growth was stagnant. And, although inflation currently is only bottoming, I believe the bond market yesterday started to price in the fact that the Fed is trying to manufacture inflation and there are signs that they are starting to actually succeed.

More broadly, it's important to recognize that there was a clear "Inflation Trade" in the markets yesterday: Gold was sharply higher (rising inflation expectations causing a short-squeeze), Treasuries declined, and the dollar declined (this one doesn't make sense immediately, but if the Fed has promised to keep rates low even after inflation appears, then expected inflation isn't as dollar-bullish as it normally would be because rates won't rise regardless).

But, inflation is bad for bonds and makes them less-attractive (hence why they would decline).

I'm not declaring the bond rally dead yet, as that trendline has again held on a closing basis, but yesterday was not a good day for the bond bulls. I'm growing cautiously more confident that my call that June 5 was the "top" in the '14 bond rally may yet turn out to be right.

Turning then to the rest of the currency markets, there was universal strength vs. the dollar, as the FOMC meeting again weighed heavily on the currency. As explained, it didn't benefit from that "inflation trade" in markets yesterday. The Dollar Index was down by 0.35% and lower against every major trading partner.

The euro rallied an equal 0.35%, while the pound rallied 0.5% on a combination of dollar weakness and after decent economic data (retail sales and Industrial Trends Survey). The pound traded to a new high for the year vs. the dollar (which makes it a new multi-year high) and it remains the fundamentally strongest major currency vs. the greenback (and it'll continue to rally).

In Asia the yen was the relative underperformer vs. the dollar as it only rallied +0.15%, which reflects weakness in the yen more than anything else, while the commodity currencies drifted higher courtesy of general dollar weakness (down -0.45% each).

With regard to the dollar, if the market is going to start to discount coming inflation, the dollar might not rally like you'd expect, as long as the Fed remains committed to not raising rates even as inflation accelerates. I for one think the Fed ultimately will "blink" if inflation rears up, but that's still well in the future. So, the outlook for the dollar in the near term just got a lot less bullish, likely until the Jackson Hole conference in August, which will be the next major Fed policy update.

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	60.58 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*
12/13/13	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.*			

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 re-assert 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)