7:00's Report

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

June 25th, 2014

S&P 500: Yesterday was a text book bearish "outside reversal" in the S&P 500, and it's making the chartists cautious this morning.

Pre 7:00 Look

- Futures are very slightly higher while most international markets declined in reaction to yesterday's losses.
- The big news o/n was the announcement that the Commerce Department took a first step to allow oil to be exported from the US, reversing a 40 year ban.
- The situation in Iraq remains largely static as fighting continues, but no material further gains are being made by ISIS at the moment.
- Econ Today: Durable Goods Orders (E: 0.4%), Final Q1 GDP (E: -1.8%).

Market	Level	Change	% Change
S&P 500 Futures	1945.00	1.75	0.09%
U.S. Dollar (DXY)	80.405	.012	.01%
Gold	1313.70	-7.60	-0.58%
WTI	106.58	.55	.52%
10 Year	2.588	-.035	-1.33%

Equities

Market Recap

Stocks rallied to new all-time highs yesterday morning on strong economic data, but then reversed at mid-day on geo-political concerns and profit taking. The S&P 500 closed lower by -0.64%.

The S&P 500 opened flat but then quickly rallied to new all-time highs following "OK" earnings (CCL and WAG) and the strong new home sales data (504K vs. E 441K).

The S&P 500 hit its high of the day right at 11 a.m., and spent most of the next 2 hours drifting just off those highs.

Then right before 1 o'clock, stocks reversed and basically hit a vacuum of no bids, and the declines fed on themselves as fast-money funds booked profits. The "reason" most cited for the reversal was a headline that Syrian war planes had shot missiles into Iraq (which is true but they were shooting at ISIS, not invading Iraq, and if anything that's a mild positive).

Regardless, the sell off accelerated during the last two hours of trading as profit-taking continued, although stocks managed to bounce a bit right into the close to finish off their worst levels of the day.

Trading Color

Yesterday's drop was much more about profit-taking than it was anything else, despite the mini-hysteria the 100 point Dow decline elicited from the financial media (when we do actually have a meaningful correction, which we will, I can only imagine what the response will be).

Market	Level	Change	% Change
Dow	16818.13	-119.13	-0.70%
TSX	14962.37	-143.26	-0.95%
Brazil	54280.78	70.73	0.13%
FTSE	6737.73	-49.34	-0.73%
Nikkei	15266.61	-109.63	-0.71%
Hang Seng	22866.70	-13.94	-0.06%
ASX	5402.01	-30.78	-0.57%
Prices taken at previous day market close.			

Despite the declines, stocks didn't actually trade that badly. Higher-beta and growth-oriented sectors did underperform, but not horribly so. (The Russell 2000 was down just -1% while the Nasdaq only declined -0.47%.) So, we didn't see any "puking" of momentum or growth sectors—just some general profit-taking, which makes sense after a run like we've had in those markets.

Market	Level	Change	% Change
DBC	26.86	.04	0.16%
Gold	1321.60	3.20	0.24%
Silver	21.01	.094	0.45%
Copper	3.1485	-.001	-0.03%
WTI	105.94	-.23	-0.22%
Brent	114.36	.24	0.21%
Nat Gas	4.532	.086	1.93%
RBOB	3.122	.0144	0.46%
DBA (Grains)	27.76	-.04	-0.12%

Prices taken at previous day market close.

Sector-wise, defensives outperformed as utilities and healthcare were the only S&P 500 sub-sectors to finish positive. But, the sector trading more confirmed my "profit-taking" point than anything else.

Financials, tech and consumer discretionary all traded in line with the S&P 500, while the worst performing sector of the market was energy, as the XLE dropped -2%. Keep in mind energy has seen a huge rally, so there was definitely profit-taking in that space yesterday. Basic materials, which is another sector that's seen a nice rally lately, also fell -1%.

Encouragingly, the declines came on low volumes and with little participation, and the drop from 1:00-3:45 yesterday was due more to a lack of bids than it was aggressive selling.

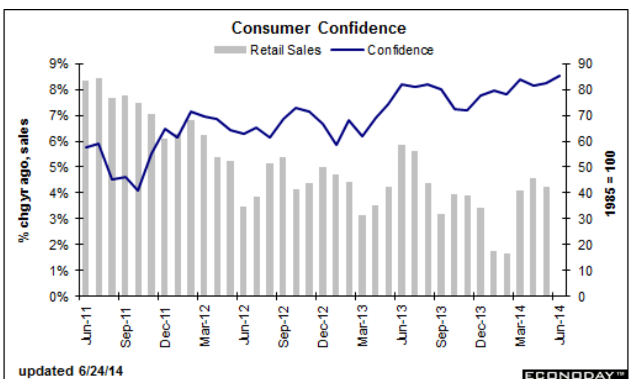
While I am downplaying the declines, I do want to acknowledge the "bearish outside reversal" on the daily chart of the S&P 500. As most of you know, an outside reversal is one of the oldest and most widely followed technical indicators in the book. And, as a result, you'll hear some technicians saying we're in for a correction. I don't think that's the case, but I do want to acknowledge the negative chart pattern.

Bottom Line

Stocks can't go up every single day. In a market that is this slow and with such low volumes, drops like yesterday are going to happen. But, while I do acknowledge the bearish outside reversal, I'm not viewing the declines yesterday as anything other than part of the digestion of this month-long rally.

As far "why" stocks declined, there were several reasons listed, but none really were confirmed by the price action: Violence in Iraq (but oil prices fell), Argentine default fears (but Argentine bonds trading higher yesterday), and N.Y. Fed President William Dudley's comments that interest rate hikes by mid-'15 is "reasonable" (but bonds rallied). Bottom line is yesterday appears to be just a dip in a short term over extended market, nothing more.

As I said in Monday's Report, the consensus expectation for a continued rally in stocks was getting pretty universal, so we should expect a bit of a shakeout at some point. Yesterday may have been the start of it, although again I think it should best be viewed as "digestion" and likely a dip to buy, unless something materially changes. (Meaning central banks get "hawkish," economic data turn for the worse, and/or oil prices spike and a Shiite vs. Sunni regional conflict erupts, all of which are low probability.)



Consumer confidence surged to a new multi-year high yesterday.

Economics

There were three pieces of housing data yesterday but the most important one, new home sales, was a blowout number and further reinforced that the housing recovery is accelerating.

<u>New Home Sales</u>

- New Home Sales in May rose to 504K (SAAR) vs. (E) of 441K (SAAR).

Takeaway

This was a huge headline beat as new home sales rose +18.6% from April (which was revised lower) and hit their highest level since 2008. Sale prices also rose

+4.6% in May (so the increase in sales didn't come at the expense of cost-cutting). The West and South led the gains (up +34% and +14.2% from April), but all four regions showed gains.

New home sales is a volatile number and this huge spike will probably be revised lower next month. But even so, this is another sign that the housing market is finally playing "catch-up" with other sectors of the economy. This, as we've been saying, is a broad positive for the economy and stocks.

The other two housing releases yesterday, Case-Shiller CPI and the FHFA Home Price Index, both slightly missed expectations, rising 0.2% and 0.0% respectively. But that data came from April, which was before the housing market started to get moving again (it's the May data that have been good).

Besides, we don't need to see prices rise materially from current levels for housing to continue to be a tailwind for the economy – we just have to have a normal, healthy market (which can be debated given low mortgage rates, but for now that is certainly helping).

Commodities

Commodities were mostly higher yesterday, led by natural gas which encouragingly reversed sharply off of technical support while the grains underperformed. DBC, the benchmark commodity ETF we use to gauge the health of the space, added +0.16% yesterday while the agriculture ETF fell -0.12%.

Starting with the best performer in the space, natural gas futures began the week by testing longstanding technical support at the base of the "uptrend channel" that has been in place since February. Yesterday, support held at the $4.45 level and futures rallied more than 2% on the session as dip-buyers swooped in and shorts covered. But, this week's EIA inventory report on Thursday (10:30 a.m.) will be very important because a larger than expected build could potentially be a catalyst that sends futures down through support.

Market	Level	Change	% Change
Dollar Index	80.39	.052	0.06%
EUR/USD	1.3603	.00	0.00%
GBP/USD	1.6983	-.0042	-0.25%
USD/JPY	101.99	.06	0.06%
USD/CAD	1.074	.0013	0.12%
AUD/USD	.9373	-.0046	-0.49%
USD/BRL	2.2227	.0052	0.23%
10 Year Yield	2.588	-.035	-1.33%
30 Year Yield	3.406	-.043	-1.25%
Prices taken at previous day market close.			

Looking to crude oil futures, WTI fell -0.2% as traders positioned ahead of this morning's EIA report while Brent rallied +0.2% as the "Iraqi fear bid" continues to float international prices. Over the near term, geopolitics will continue to support Brent, and WTI should remain elevated in sympathy (to a degree).

But, the longer-term story in WTI remains bullish because, at the end of the day, the U.S. economy is growing. This means more people in the workforce (+2.6M non-farm jobs were created in the past 12 months) and therefore more people on the road (higher demand for gasoline). On the charts, $105-$105.25 remains solid support while some resistance is above at $108.

WTI futures are higher this morning after the U.S. loosened a four decade ban on crude oil exports yesterday evening. The U.S. Bureau of Industry and Security at the Commerce Department, who oversees the export guidelines, confirmed that it is within the regulations to export "lightly processed" crude because it is by definition a "refined product."

So, bottom line, the U.S. is poised to begin exporting very light sweet crude after minimal processing which will begin to weigh on domestic inventories once the shipments get rolling. But, does this mean we are about to become a net exporter of crude? No. Not even close. Initial estimates indicate that exports will be between 50K and 100K barrels a day initially which is a fraction of our overall production. But, this important part here is this has started the process towards becoming, eventually, a meaningful exporter of oil, which is a definite game changer in the global oil markets.

Price action in gold was again quiet yesterday with futures up just +0.25% as traders remain sidelined ahead of the Personal Incomes and Outlays report on Thursday (8:30 AM). Until then, trading should continue to be quiet with $1,330 acting as initial resistance while the first level of support is around $1,310.

Currencies & Bonds

It was a relatively quiet day in the currency markets yesterday, despite the volatility in stocks. The dollar finished the day slightly higher thanks to the better than expected housing report (up .06%) and the Dudley comments regarding a mid-2015 rate hike being "reasonable."

The euro traded flat yesterday and shrugged off the soft German IFO survey and is flat again this morning as it's ignoring the secondary economic data out overnight from France and Italy (which was mixed).

As we said Monday, the euro and dollar should continue to drift against each other until we get better readings on inflation in both regions (so the Core PCE tomorrow will be important as will the EU flash HICP Monday).

Moving to Asia, the big mover yesterday was the Aussie dollar, which fell -0.45% after approaching highs of the year on Monday. But it failed to hold the gains, which caused shorter-term longs to close positions. Over the longer term, the upside potential in the Aussie is relatively "capped" by the Reserve Bank of Australia and its pledge to combat any material appreciation in the AUD, which has resulted in a traders' market. Technically, the Aussie is range-bound between roughly $0.9400 and $0.9200. That will likely continue until there is a fundamental catalyst, such as a material economic change of pace or a policy change by the RBA. And, for those looking to trade that channel, selling Aussie here makes sense with an initial target of .92.

In Japan, it was a very anti-climactic day as the yen dropped -0.3% due to the mild strength in the dollar. The anti-climactic part comes from the fact that PM Shinzo Abe formally announced his "3rd Arrow" of fiscal regulatory reform, but the official release contained virtually nothing new, and the major "unknowns" about how much the corporate tax rate will be cut and how much pension funds will have to invest in Japanese and foreign stocks won't be known for another few months.

So, this is now a market without an immediate catalyst, other than economic data. That doesn't mean the trade can't keep working as despite the yen trading flat the last few weeks, DXJ is up over 10% since mid-May and just off highs of the year. So, while disappointing, nothing about the anti-climactic release makes me think the "long DXJ/short yen" trade still isn't going to work going forward.

The pound traded lower yesterday, down -0.24% in response to BoE Governor Mark Carney's statement before Parliament's Treasury Committee that included "developments on the wage front suggest that there has been more spare capacity in the labor market than we had thought." But, the pound remains very strong, trading just below the $1.70 mark, and continued strength in the currency going forward remains the consensus. There is support at $1.675.

The bond market was remarkably strong yesterday (10-year and 30-year Treasuries rallied +0.26% and +0.55% respectively) despite two bond bearish events. First, there was the strong New Home Sales report, and then there was a less than stellar 2 year Treasury auction. The bid to cover was 3.23 vs. the recent average of 3.46 despite a yield of .511, the highest level of the year. Also, bond dealers were responsible for purchasing 54% of the auction, which implies less than stellar demand from general investors.

Regardless, bond futures surged to close at the highest level since June 2 yesterday as the stubborn, supporting uptrend line proved to be solid once again, and the uptrend remains intact. Today economic data will be in focus (bonds have ignored strong data so far this week, as will a 5 year note action). Bonds are now testing the upper end of the recent trading range, and if they can break out today, expect short covering to resume and the uptrend to accelerate, much to my short term dismay.

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*
12/13/13	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.			

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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**	*The S&P 500 traded to new highs again last week after a "dovish" Fed ignited a broad rally. Generally the outlook for stocks remains positive, as global central banks remain accommodative, valuations are stretched but not expensive, and the global recovery is ongoing. Sentiment is getting a touch too bullish, but beyond the very short term things look good for stocks.*

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**	*Gold jumped back above $1300 on rising inflation expectations and a dovish Fed, while Iraq uncertainty kept a bid under WTI Crude. Commodities generally benefitted from a shift in focus from economic growth to inflation, and if that continues, it could be a positive for the entire commodity complex.*

Best Idea: Long Oil (USO)

Best Contrarian Idea: Buy Gold (GLD)

	Near Term Trend	Long Term Trend	Market Intelligence
U.S. Dollar	**Neutral**	**Bullish**	*The Dollar Index declined last week thanks to the dovish FOMC, and given their apparent increased tolerance for higher interest rates, the outlook for the dollar has become more neutral in the short term.*

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 135'07 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)