7:00's Report

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

June 26th, 2014

Valero (VLO): Refiners were sharply lower yesterday as investors feared that the era of high margins is over now that the US is moving towards exporting crude.

Pre 7:00 Look

- Futures are flat after an extremely quiet night, while most international markets rallied following the bounce back in the US yesterday.
- There was no economic data o/n.
- Iraq remains static and the apparent strategy is focused on forming a new inclusive Iraqi government while ISIS continues to gain ground laterally, but not toward Baghdad.
- Econ Today: Weekly Jobless Claims (E: 310K), Personal Incomes and Outlays (E: 0.4%)
- Fed Speak: Lacker (E: 8:30 AM), Bullard (1:05 PM).

Market	Level	Change	% Change
S&P 500 Futures	1948.75	-.75	-0.04%
U.S. Dollar (DXY)	80.27	.005	0.01%
Gold	1311.60	-11.00	-0.83%
WTI	106.42	-.08	-0.08%
10 Year	2.559	-.027	-1.04%

Equities

Market Recap

Stocks bounced Wednesday and recouped most of Tuesday's losses as the market shrugged off a weak Q1 GDP report. The S&P 500 rose +0.49%.

Economic data had stocks mildly lower at the open yesterday, as shockingly bad headline numbers from GDP and plain bad headline numbers from April durable goods weighed on stocks.

But, the open was the low tick of the day, and stocks almost immediately started to drift higher for a multitude of reasons. First, the headline economic data were bad. But once that sticker shock wore off, markets realized that Q1 was nearly 3 months ago and current data have been much better. And the details of the durable goods report, while not super-strong, weren't really that bad. Additionally, the "flash" June service sector PMI rose above 60 and beat expectations, again reinforcing that the economy is better now than it was in Q1. Finally, there was definitely a bit of dip-buying especially given the calendar. Once again, we are nearing the end of the month, and managers are putting more money to work as monthly performance anxiety sets in.

Outside of the obligatory 11:30 a.m. (European close) dip, stocks drifted higher throughout the day in quiet, low-volume trading, and closed just a few ticks off the highs.

Trading Color

Yesterday was almost the exact opposite of Tuesday, as we saw a general rally in stocks on low volume that was

Market	Level	Change	% Change
Dow	16867.51	49.38	0.29%
TSX	14974.65	12.28	0.08%
Brazil	53425.74	-855.04	-1.58%
FTSE	6736.59	2.97	0.04%
Nikkei	15308.49	41.88	0.27%
Hang Seng	23197.83	331.13	1.45%
ASX	5465.32	62.31	1.15%

Prices taken at previous day market close.

more the result of a lack of sellers than it was aggressive buyers.

The Russell 2000 outperformed, rallying +0.8% as did the Nasdaq (+0.68%). Sector-wise, 9 out of 10 of the S&P 500 sub-sectors were higher (consumer staples lagged), but generally cyclicals outperformed defensives (so again undoing what happened Tuesday).

Market	Level	Change	% Change
DBC	26.89	.03	0.11%
Gold	1321.3	00	0.00%
Silver	21.055	.012	0.06%
Copper	3.163	.012	0.38%
WTI	106.52	.49	0.46%
Brent	114.09	-.37	-0.32%
Nat Gas	4.566	.031	0.68%
RBOB	3.0948	-.031	-0.99%
DBA (Grains)	27.94	.16	0.58%
Prices taken at previous day market close.			

The only corner of the market where there was real action yesterday was in energy. E&Ps surged higher, recouping some of Tuesday's losses. Conversely, refiners got hammered yesterday (VLO down -8%, as an example) and the entire trade in energy was based on the Commerce Department's decision to let EPD and PXD export lightly refined oil. Of note, yesterday's drubbing of the refineries may be a bit overdone (their margins aren't going to go away anytime soon), and I'd look to be a buyer on further weakness.

Volumes, as you can guess, remain abysmally low, as does conviction, and I can only imagine what next week (a holiday week) will look like. There remains no conviction to this market.

Bottom line is if you exclude the Pavlovian Wednesday rally post FOMC, this market has been quietly drifting for over a week, and that's something I expect to continue, although with the month end approaching, the drift should continue higher.

Economics

Final Revisions to Q1 GDP

- Final Q1 GDP was revised sharply lower to -2.9% vs. (E) -1.8%

Takeaway

Yesterday's final look at Q1 GDP was without a doubt a shocker as the headline number was revised down from -1.0% to -2.9% vs. (E) of -1.8%. But, as usual the headline was rather deceiving as the report wasn't quiet as bad as it seemed, as most of the drop was related to non-core economic issues.

"Obamacare" continues to play havoc with statistics, as nearly 2/3rds of the downward revision to GDP was because of a drop in PCE (personal consumption expenditures or consumer spending). Normally that would be a terrible sign about the economy, but the reduction in PCE from 3.1% to 1.0%, was because of a huge drop in the healthcare services component, which fell from +9.1% to -1.4%. That drop was the result of the Bureau of Economic Analysis miss-judging how much healthcare spending increased due to the implementation of the ACA. So, PCE fell not because the consumer collapsed in Q1, but because the statisticians overestimated the economic impact of the ACA.

Stock futures immediately sold off to session lows upon the weaker than expected release. But once the dust settled and the market opened, equities recovered their losses and turned positive as investors brushed off the lagging report.

Bottom line, yesterday's GDP report was rather ugly, but most investors and analysts are looking past it as economic data in Q2 have been much more upbeat. Many indicators are hitting multi-year bests, and expectations for Q2 GDP growth remain around 3.0%.

Durable Goods Orders

- May Durable Goods Orders fell -1.0% vs. (E) 0.4%

Takeaway

The durable goods report for May disappointed on the headline yesterday with new orders falling -1.0% vs. (E) 0.4%. But, the details of the report were stronger than the headline showed.

The key number to look at in the report, new orders for Non-Defense Capital Goods Ex-Aircraft (NDCGXA), increased +0.7% and the rolling 3 month average increased by +1.35%.

Capital investment by businesses, like real estate, hasn't rebounded the way other sectors of the economy have since winter, and yesterday's Durable Goods, while not as bad as the headline, confirm that we're still seeing caution by businesses and consumer with regards to large capital investments (like new machinery, etc.). The housing market is showing clear signs of improvement, but capital spending activity has to improve before we can say the economy is firing on all cylinders.

Commodities

Commodities were mixed yesterday but the bias was to the upside as WTI (+0.4%) narrowed the spread with Brent (-0.4%). The products underperformed, while copper tested June highs. The benchmark commodity tracking index ETF added +0.11% on the day.

The big story in the commodities space yesterday was the decision by officials at the U.S. commerce department to loosen restrictions on crude oil exports for the first time in four decades, leading WTI to rally +0.4% on the session while Brent fell -0.4%. But, many of the headlines regarding the issue were misleading.

First of all, the commerce department did not outright drop the ban on crude oil exports. They permitted two specific companies (PXD and EPD) to export "condensate," which is a slightly processed form of very light sweet crude oil that can obviously be refined into gasoline, distillates and jet fuel. But, bottom line, the exports are going to be very small to begin with and will not materially affect supply.

However, this is a bit of a "game changer" for the energy industry, as it opens the door for more restrictions to be lifted in the future—with the possibility of a high percentage of the current 8.4M boe/d production being exported. So basically over the longer term, the decision to begin easing/lifting regulations on exporting crude oil is obviously going to have a bullish effect on WTI prices.

Market	Level	Change	% Change
Dollar Index	80.26	-.133	-0.17%
EUR/USD	1.3629	.0024	0.18%
GBP/USD	1.6977	-.0007	-0.04%
USD/JPY	101.84	-.13	-0.13%
USD/CAD	1.072	-.0023	-0.21%
AUD/USD	.9399	.0037	0.40%
USD/BRL	2.2038	-.0204	-0.92%
10 Year Yield	2.559	-.027	-1.04%
30 Year Yield	3.381	-.025	-0.73%
Prices taken at previous day market close.			

Yesterday was also inventory day for crude oil and the products, and the data were mixed. The EIA reported that crude stockpiles increased +1.7% vs. (E) -1.2M, while RBOB gasoline supplies rose +710K vs. (E) +1.2M, and distillate inventories rose +1.2M vs. (E) +800K.

The surprise build in total crude supplies, paired with an increase of 400K in supplies at Cushing, Okla., caused a knee-jerk sell-off to session lows. But with all of the hype surrounding the new export ruling, there were plenty of buyers waiting for an entry. And, futures reversed off the lows, traded back into positive territory, and drifted higher for the remainder of the day.

Elsewhere in energy, natural gas futures were up +0.64% yesterday as traders positioned ahead of this morning's EIA report (10:30 a.m.). Natural gas started the week by testing longstanding technical support at the base of the "uptrend channel" that has been in place since February, and support at $4.45 held strong. The reason for the weakness earlier in the week was again supply- and weather-related (the two primary drivers of the market during the build season).

Supply-wise, the 6 most recent inventory builds have been of 100 Bcf of more, which many analysts view as sufficient to replenish national stockpiles to levels needed to enter the winter draw season. But, it is worth pointing out that this hypothesis is only valid if you make multiple assumptions, namely that weather will remain mild-to-moderate for the rest of the summer. Otherwise, a spike in temperatures would spur energy demand to satisfy cooling needs, in turn restricting weekly inventory builds.

Looking ahead, the story remains the same: Traders will continue to look at current inventory levels compared to the historical averages, pace of weekly supply injections and extended weather forecasts. Today the EIA will release inventory data from last week and a panel of WSJ analysts are predicting a build of 102 Bcf, and you know the drill, a surprise either way could spur a material move in the futures price. On the charts, the longstanding uptrend channel is intact with support edging up to $4.46 while resistance is well above at $4.97.

Moving over to precious metals, gold was little-changed yesterday as traders positioned ahead of this morning's

Personal Incomes and Outlays report (8:30 a.m.). As we have been saying since after the FOMC meeting last week (which, as a reminder, triggered a dovish/inflation-driven short-squeeze on Thursday), any surprises in the core PCE number—which is the Fed's preferred measure of inflation—could cause another leg higher in gold futures, with a target near the $1,350 area. For now though, support lies below at $1,310 while $1,330 is initial resistance.

Silver: The 23 & 30 day exponential moving averages crossed the 50 day to the upside, indicating the trend in silver is turning higher.

Also in precious metals, there was a bullish crossover in the moving averages in silver futures earlier this week, as the 23 and 30 day exponential moving averages crossed the 50 day to the upside. Historically, the indicator is very accurate gauge of a trend change for commodities, so after months of a downtrend, things appear to be looking up for silver. At this time, silver futures are rather overextended, up +16% this month, so we are going to wait for a better entry point to get some long exposure (and silver futures are down this morning, so we'll buy this dip via SLV if it extends a bit further).

However, there is a 3-tiered argument for silver over the medium term. First as a precious metal, silver will benefit and appreciate from an uptick in inflation. Second, silver has industrial uses and will rally as demand for raw materials increases. The global economy, namely China, is continuing to improve. This has in turn spurred demand speculation and helped copper futures roar back to the highs of the month. Third, the aforementioned technical indicators are supportive of there being plenty of upside potential in silver prices.

Currencies & Bonds

The dollar traded universally lower against its major trading partners yesterday courtesy of the disappointing economic data, and the Dollar Index hit a 1-month low after the weaker than expected GDP and durable goods reports were released. The dollar recovered some losses throughout trading yesterday but still closed the day down -0.17% The US economic data was the main driver of currency markets yesterday.

The euro traded higher primarily as a result of the weaker dollar, closing the day up +0.18%. The continuing effect of the Fed's surprisingly dovish commentary last week is also causing some euro strength and dollar weakness, and the two currencies continue to generally drift against each other ahead of critical inflation data starting today with the Personal Income and Outlays Report, and followed tomorrow by German CPI and Monday by the EMU Flash HICP for June Those reports will determine whether the recent trend of dollar strength and euro weakness, which has been on "pause" since shortly after the ECB meeting, resumes. Elsewhere in Europe the pound was little-changed despite the weaker dollar, suggesting the rally is taking a healthy breather from the recent outperformance.

Bonds rallied, as you would expect, yesterday morning following the disappointing U.S. economic data, but steadily drifted lower over the course of the trading day. The 10 year gained +0.18% while the 30 year rallied +0.32%.

Fundamentally, there was a 5-year note auction yesterday and again the results were mixed at best, following a poor 2 year auction Tuesday. The bid to cover (a measure of demand) was 2.74 which was below the rolling 4-month average of 2.87. This suggests interest in the notes has slipped this month, despite the high yield of 1.67% (so again the higher yield failed to spur demand). The auction was only modestly disappointing, though, and had little effect on the Treasury market. Bottom line is bonds are threatening to break out to the upside again, and unless we get a "hot" inflation reading in the Personal Income and Expenditures report later this morning which would put pressure on bonds, it looks like the uptrend is again accelerating.

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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)

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)

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)

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)