7:00's Report

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

June 27th, 2014

Pre 7:00 Look

- Futures are slightly weaker as the market continues to digest the recent rally. There were no real negative catalyst o/n.
- Japan was the laggard o/n (down 1%) after economic data showed the rate of inflation slowing. The yen is stronger this morning and is close to breaking major resistance.
- Economically there were numerous reports o/n, but nothing deviated too far from expectations. German CPI is in focus, as regional reports released earlier imply a slight uptick in inflation, which is a positive for Europe and the reason those markets are slightly higher.
- Econ Today: Consumer Sentiment (E: 81.9).

Market	Level	Change	% Change
S&P 500 Futures	1943.50	-5.25	-0.27%
U.S. Dollar (DXY)	80.25	-.029	-0.04%
Gold	1316.60	-.40	-0.03%
WTI	105.88	.04	0.04%
10 Year	2.53	-.03	-1.33%

Equities

Market Recap

Stocks were basically flat again Thursday as the markets rebounded from early morning weakness and drifted higher throughout a quiet trading session. The S&P 500 fell -0.12%.

Economic data (soft consumer spending from the Personal Income & Outlays Report), several lackluster earnings results and "hawkish" comments by St. Louis Fed President James Bullard saw stocks open solidly in the red yesterday and basically gap lower immediately following the open. But, for the second straight day, the lows for the day were in before 10 a.m., and stocks began a methodical climb higher that lasted pretty much the entire day.

Bullard's comments received the majority of the "blame" for lower stock prices yesterday, but in truth he didn't say anything new. (He's been leaning more hawkishly for some time now.) Frankly, he doesn't really carry a lot of weight on the FOMC. As evidence, bonds rallied and dollar was flat.

Trading Color

With markets broadly flat for the second straight day, there wasn't a lot to read into the sector trading yesterday. The major indices all finished slightly lower, while sector trading was mixed.

Utilities were the best-performing S&P 500 sub-sector, and there was a hint of demand for "bond proxy" stocks as rates continued to fall.

But there was no definitive outperformance by defensives. And energy bounced back to close up small, while consumer discretionary also closed in the green.

Specifically in energy, refiners caught a nice bounce yesterday after the "exporting oil" beat-down from Wednesday.

This remains a sector of interest that I'd look to buy on a further dip, as again the trend toward eventual crude oil exports is a long-term negative for refiners. But it's not happening anytime soon, and their margins will remain healthy for some time.

Banks got hit on several factors (more on that below), although those were centered on the investment banks. More conventional and regional banks held up OK, as bank angst is centered primarily on trading revenues,

Market	Level	Change	% Change
Dow	16846.13	-21.38	-0.13%
TSX	15030.74	56.09	0.37%
Brazil	53506.75	81.01	0.15%
FTSE	6743.93	8.81	0.13%
Nikkei	15095.00	-213.49	-1.39%
Hang Seng	23221.52	23.69	0.10%
ASX	5445.06	-19.26	-0.35%
Prices taken at previous day market close.			

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which apparently are pretty bad this quarter.

Volumes remain anemic and you could have been forgiven for thinking the market was closed once the soccer game started. On the charts the S&P 500 remains just under the all-time highs of 1,968.

Market	Level	Change	% Change
DBC	26.79	-.06	-0.22%
Gold	1315.90	-1.10	-0.08%
Silver	21.11	-.06	-0.27%
Copper	3.18	.009	.028%
WTI	105.81	-.03	-0.03%
Brent	113.34	.13	0.11%
Nat Gas	4.46	.02	0.45%
RBOB	3.07	.01	0.33%
DBA (Grains)	28.05	.11	0.39%
Prices taken at previous day market close.			

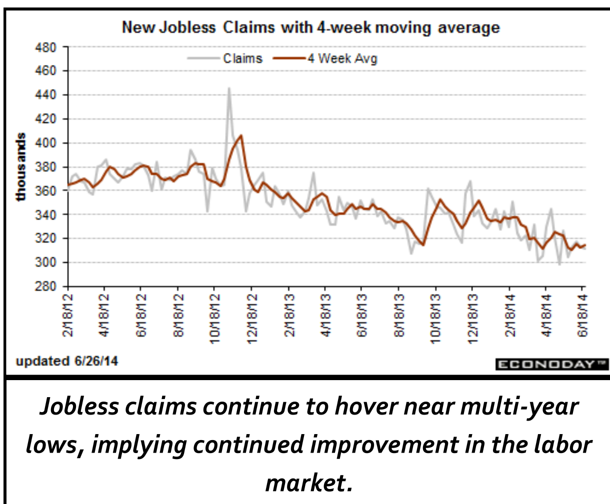
Bottom Line

The real story of this market remains the lack of activity. Stocks do act tired and while they could hold up thanks to end-of-month window-dressing, a consolidation is needed and healthy.

Looking at Wednesday and yesterday morning, the gaps lower in the averages are a result of a lack of liquidity more than anything else. It's just very easy to get markets to gap lower on low volumes, but it's not aggressive selling and that's why the market drifts back.

And, given it's a holiday week next week, that's a trend that's likely to continue.

In the meantime, market fundamentals remain supportive of stocks, and I continue to like cyclicals and European exposure over the U.S. as a destination for incremental capital at these levels.



Jobless claims continue to hover near multi-year lows, implying continued improvement in the labor market.

Enough With Bank Lawsuits, Please.

Banks traded poorly again yesterday on follow-through selling from Wednesday (stemming from Barclays getting hit with a lawsuit over the marketing of its dark pool) and after a profit warning by Standard Chartered Bank, which became the latest bank to say trading revenues have fallen sharply.

I'm no cheerleader for the banks, generally speaking, but after hearing several lawyers on CNBC yesterday decreeing wide spread "fraud" by banks and bringing up the financial crisis, I can't help but think enough is enough.

Can we all please be honest and just admit that the endless parade of lawsuits and fines against the banks is nothing other than a money grab—plain and simple?

Yes, banks had their part in the financial crisis, but they didn't cause it by themselves nor did they bring us to the brink of collapse by themselves. To be honest, JPMorgan buying Bear Stearns, Bank of America buying Merrill, and Wachovia buying Washington Mutual helped stop the hemorrhaging. (Keep in mind those banks were told to do so by regulators.)

Five years hence, the banks remain the easiest target for Attorneys General to score points with the public during an election year (everyone likes the AG who is "tough on the banks"), and the easiest large corporations for lawyers to make money off of (both defending and suing).

But, here's the thing the lawyers and politicians don't get (or maybe they do and just don't care). First, when you slap banks with seemingly endless lawsuits and fines, it depresses their share price (like right now). And, seeing as pretty much everyone with a 401(k) probably owns bank shares, you're harming a lot more people than just the bank's executives.

Second, banking is a pretty inelastic service, and the banks know it. So, banks don't really "eat" increased fees. Remember free checking? Remember free checks? They went away as fines and consumer protection measures have gone up over the past several years.

Third, banks are massive employers in this country. I know the image of bank "fat cats" has been beaten into the psyche of the public for the last 6 years, but this relentless cloud of uncertainty hurts the "rank and file" bank employees via lack of wage increases and employ-

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ment opportunities just as much, if not more, than it does the CEO.

I was told once when I started on the floor that as the banks go, so goes the economy. And, again, while I'm not a cheerleader for banks and certainly they needed to share in the cost of the financial crisis (and have), enough is enough. It's time for the government (state and local) and lawyers to stop using lawsuits on banks as an ATM (pardon the pun) every time they need some fine money or free publicity.

With regards to this latest suit that Barclay's improperly marketed its dark pool, I'm sure the participants in Barclays' dark pool (which would have been made up almost entirely of institutional trading desks, hedge funds and high-frequency traders) really were significantly harmed by the misleading marketing materials of a non-transparent, private trading pool, which exists solely as a workaround of normal market transparency. Thank goodness New York AG Eric Schneiderman is there to protect them, as I'm sure this is a greater priority than fixing the myriad of legitimate problems we currently have in New York state. What a disgrace.

Economics

Personal Incomes and Outlays

- Personal Income increased 0.4% in May, matching expectations.
- Consumer Spending increased 0.2% vs. (E) 0.4%

Takeaway

Personal Income increased +0.4%, meeting expectations, while consumer spending cooled slightly, missing expectations of +0.4% and coming in at +0.2%. The key component of the report that every trader and analyst on Wall Street was focused on yesterday was the Core PCE Price Index, which exactly matched expectations of +0.2%. This caused a lot of disappointment out of the inflation bugs, although year-over-year there was a slight increase to 1.5%. That isn't exactly a jump—but the Core PCE Price Index is inching toward the 2% "target" of the Fed.

Overall the Personal Income report reflected a somewhat weaker than expected consumer (which is why we saw some 1Q GDP revisions yesterday), although it didn't materially change anyone's outlook on the economy or for inflation.

Commodities

Commodities traded mostly lower yesterday, led down by natural gas which at the lows fell as much as -3.5% on inventory data while the grains and copper futures managed small gains. The commodity ETF DBC fell -0.33%.

Natural gas futures suffered their biggest one-day drop in seven weeks after the EIA released its supply figures from last week and the data were bearish. Stockpiles reportedly grew by 110 Bcf vs. the consensus analyst estimate calling for 102 Bcf. The report sent futures plummeting 12 cents to test support at the lower end of the longstanding trend channel. But futures were able to recover the losses to close down just -2.9% on the week but have importantly held onto support at the lower end of the up-trend channel.

Crude oil fell as much as -1.25% yesterday and tested support at $105. But there were plenty of traders who missed the initial leg higher due to the developments in Iraq who were eager to get in. So, futures reversed off the lows and rallied back toward the $106 mark. $105-$108 continues to corral futures prices, and that is set to continue over the near term as recent gains are consolidated.

Market	Level	Change	% Change
Dollar Index	80.25	-.029	-0.04%
EUR/USD	1.3617	.0006	.0.04%
GBP/USD	1.7012	-.0002	-0.01%
USD/JPY	101.41	-.28	-0.28%
USD/CAD	.9337	-.0003	-.03%
AUD/USD	.9369	.0013	0.14%
USD/BRL	2.1964	.00	0.00
10 Year Yield	2.53	-.03	-1.33%
30 Year Yield	3.34	-.04	-1.09%
Prices taken at previous day market close.			

Gold steadily sold off overnight on Wednesday. But following the uneventful economic data released yesterday morning, futures held support at $1,310 and rallied back to finish the day with only modest losses, down -0.45%. The Core PCE data that every precious metals trader was watching yesterday morning came in exactly in-line with estimates, leaving gold futures comfortably within the recently established range

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between $1,310 and $1,330.

Currencies & Bonds

The dollar was flat yesterday as the disappointing consumer spending data and relatively benign Core PCE price index increase of +1.5% (both dollar-negative) were offset by Bullard's comments.

Despite the dollar being a touch flat, the euro declined -0.15%. The euro didn't fall because of economic data (there weren't any reports), but instead it declined as traders positioned ahead of the German CPI, which was out o/n.

German CPI was slightly higher than estimates, and given Germany's huge influence on EMU statistics, that's raising hopes that Monday's HICP will tick a bit higher and imply the risk of deflation in Europe has receded slightly (which would be a positive for the region).

In Asia, the yen continued to quietly rally vs. the dollar, up +0.15% yesterday. This came despite the lack of any really positive news from Japan (there was no data or hawkish Fed-speak). Instead, the market seems to be drifting higher on a general sense of disappointment regarding the lack of critical details in Shinzo Abe's "3rd Arrow" announcement earlier this week.

Clearly, there is political wrangling still to be done to get the changes Abe wants through, and it'll be into the fall before we know whether he was successful. So, in that environment, given how "short" people are in the yen, the natural inclination is to drift higher.

But, dollar/yen is now at an absolutely critical juncture. It's sitting on the 200-day moving average, which is support that has held multiple times throughout the year. To be honest, I don't like the way dollar/yen is trading, but keep in mind the BOJ has pledged not to allow the yen to appreciate and jeopardize the economic gains that have been made. Central bankers aren't traders, but I would guarantee someone at the BOJ is watching the yen, and it wouldn't shock me to hear some "dovish" comments over the next day or so to get the yen trading lower again.

Bonds continued to slowly grind higher and clearly traded through the highs of last week as the bond market focused more on the slightly soft economic data of the past two days (Durable Goods and Personal Income and Outlays) than it did the inflation data or Bullard's "hawkish" comments. Although, the "real" reason for the rally in bonds yesterday was mostly short covering, as bond shorts closed positions as the thirty year clearly looks to be heading higher after successfully holding multiple tests of the 2014 uptrend.

The European inflation data is weighing a bit on Treasuries this morning (European bonds are down in sympathy and yields are up, so that makes them incrementally more attractive vs. Treasuries) but the next big catalyst for the bond market is Monday's EMU HICP release. So, I'd expect quiet trading today.

Going forward, if bonds continue to rally we'll be back to the question of how can bonds and stocks rally simultaneously, and is that a negative omen for stocks? The general consensus is it wasn't earlier this year because deflation fears sent EU money into bonds short term. But, now that the ECB is actively trying to push EU sovereign debt lower/yields higher via their policies, that excuse doesn't work so well. If both stocks and bonds continue to rally it'll be a problem at some point, but for now the trend in bonds is your friend, and that trend remains higher.

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.			

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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)			

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