7:00's Report

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

June 5th, 2014

Pre 7:00 Look

- Markets are unchanged globally ahead of the ECB, despite another relatively busy night of data.
- In Europe, economic data was decidedly positive for the first time in a week. EU retail sales, German Manufacturers Orders, and UK Halifax Home Price Index all handily beat estimates, but they won't effect the ECB this morning.
- Chinese data was mixed as May composite PMIs rose to 50.2, but service PMIs fell to 50.7 vs. 51.4 last month.
- Econ Today: Weekly Jobless Claims (E: 310K). Fed Speak: Kocherlakota (1:30 PM).

Market	Level	Change	% Change
S&P 500 Futures	1925.25	-.50	-0.03%
U.S. Dollar (DXY)	80.62	-.086	-0.11%
Gold	1244.70	.40	0.03%
WTI	102.34	-.30	-0.29%
10 Year	2.604	.013	0.50%

Equities

Market Recap

Stocks drifted mildly higher Wednesday thanks to more decent economic data, during another extremely quiet session as everyone looked ahead to the ECB. The S&P 500 rose 0.19% to set another new intraday all-time high.

Stocks opened lower Wednesday in sympathy with international markets and after a mildly disappointing ADP jobs report. But, the selling didn't last long as stocks rallied into the release of the ISM non-manufacturing

Shipping ETF: It's due for a pullback, but shipping and tanker stocks have rallied hard this year, and that's anecdotally a good sign for the "global reflation trade."

PMI at 10 a.m. After that report beat expectations, markets continued to rally throughout the morning and hit their highs shortly after lunchtime.

Entering the afternoon session, trading quieted (as has been the pattern). The only news item during the afternoon was the Fed Beige Book, which didn't contain any surprises (it implied the recovery is accelerating, as expected). Stocks drifted off the highs before bouncing into the close on a large "buy" market-on-close imbalance.

Trading Color

Encouragingly, the Russell 2000 and Nasdaq outperformed yesterday (up 0.4% each) as several biotech and Internet names rallied, so there were some positive market internals (although volumes are so low it's difficult to read too much into it).

Sector-wise, it was again a mixed bag with no clear trend. Semiconductors hit another new high and continue to be one of the recent market leaders. Tech, banks and basic materials also rallied, but no sub-sector moved

Market	Level	Change	% Change
Dow	16,737.53	15.19	0.09%
TSX	14,796.79	62.10	0.42%
Brazil	51,832.98	-199.40	-0.38%
FTSE	6,800.88	-17.75	-0.26%
Nikkei	15,079.37	11.41	0.08%
Hang Seng	23,109.66	-42.05	-0.18%
ASX	5,436.88	-7.95	-0.15%

Prices taken at previous day market close.

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more than 0.5% yesterday.

"Defensive" sectors mildly underperformed, but again that was mostly just trading noise. Bond yields continued to rise and we saw some mild profit-taking in those "bond proxy" sectors (which have outperformed YTD) going into the ECB later this morning.

Market	Level	Change	% Change
DBC	25.88	-.10	-0.38%
Gold	1244.20	-.30	-0.02%
Silver	18.785	.022	0.12%
Copper	3.0945	-.0425	-1.35%
WTI	102.52	-.14	-0.14%
Brent	108.33	-.49	-0.45%
Nat Gas	4.641	.012	0.26%
RBOB	2.9359	-.0128	-0.43%
DBA (Grains)	27.39	-.08	-0.28%
Prices taken at previous day market close.			

Sector trading aside, the real story in the market remains the lack of volumes, activity and volatility. "Boring" would be the best way to characterize trading so far this week (and really for the last 2 weeks). Volumes and activity remain at very low levels, and there is simply no conviction in this market (although it's possible that might be about to change).

On the charts, the S&P 500 continued to grind to new highs, while support lies much lower toward 1,900.

Bottom line is market has been drifting into the ECB and jobs number and feels a bit "tired" in the short term, so there is the chance for a dip if either disappoints. But, while the market has been drifting, fundamentals continue to quietly improve (and that's continued this week), and with sentiment still skeptical/nervous and everyone looking for a correction, the benefit of the doubt, beyond the very short term, remains firmly with the bulls.

Jobs Market Preview

Focus is on the ECB this morning. But tomorrow's jobs report, while not as important as previous reports this year, still has the potential to move markets. Here's the Goldilocks preview:

- **The "Too Hot" Scenario: > 250K**. Anything substantially over 250K will bring about the possibility of an acceleration of Fed tapering of QE and potentially hiking rates sooner-than-expected. *Market Reaction*: Bonds fall (sharply), gold falls, stocks fall (likely modestly) and the dollar rallies.

- **The "Just Right" Scenario: 170K—250K.** This is the market's sweet spot, as it implies the labor market is improving but not enough for the Fed to alter policy. *Market Reaction*: Bonds fall slightly; gold and stocks and the Dollar Index likely don't move much on the news as this is what's largely expected and priced in.

- **The "Too Cold" Scenario: < 170K.** Any substantial print below 170K would revive fears that the economy isn't as strong as the recent data suggest. Keep in mind "bad" economic data is not "good" for the market anymore, as it's much more important for the economy to continue to rebound than it is for the Fed to keep doing QE. *Market Reaction*: Bonds up (potentially sharply), gold up (potentially sharply), and stocks and the dollar down (modestly).

Finally, with this report there will be more of a focus on the details, specifically on wages and the labor participation rate.

The last two jobs reports have had strong headline numbers, but analysts have taken issue with stagnant wage growth and the low participation rate. A participation rate higher than last month's 62.8% will be a positive, as will a greater-than-1.9% wage increase (as both will signal increasing labor market tightness and the beginnings of wage inflation, both of which would further confirm the economy is seeing the rebound accelerate).

Economics

ADP Employment Report

- May Private Payrolls grew by 179K vs. (E) 210K

Takeaway

Yesterday's ADP employment report was the first of the three "jobs week" numbers and the results were disappointing. The headline showed that private payrolls grew by 179K vs. (E) 210K. The market reacted as expected to such a miss, with gold and bonds trading up to session highs while stock futures did the opposite, falling back to new lows. However, no technical levels were violated as the move was algo-driven and lacked any real conviction.

While a "miss," though, this number isn't too far from

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expectations. As we started mentioning two weeks ago, “whisper numbers” for this month’s jobs report were quietly being reduced as there was a spike in weekly claims during the “survey week” for the government jobs report. Plus, the May employment component of the manufacturing PMI declined from April. So, the takeaway here is that, while mildly disappointing, it didn’t change anyone’s outlook on the economy,

ISM Non-Manufacturing Index

- May ISM Service PMI was 56.3 vs. (E) 55.3.

Takeaway

The ISM non-manufacturing index reading for May beat expectations yesterday morning and was the number the market focused on yesterday (much more so than the slight ADP miss).

The details of the report were strong, with new orders rising to 60.5 from 58.2 in April while business activity, the non-manufacturing equivalent to the “Production Index” in the ISM manufacturing PMI, was also comfortably above the 60 mark at 62.1, up from 60.8 in April.

Copper fell back to the uptrend yesterday and normally we’d be a buyer here. But I’d prefer to get more information on the stock pile probe before risking capital.

Stocks recovered morning losses upon the release and the S&P turned positive shortly after. The report confirms that the service sector (the largest component of the U.S. economy) continued to expand in May, and provided another shot of confidence for the market.

Commodities

Commodities were mixed yesterday during another relatively quiet session, as only copper moved more than 1% in trading. The PowerShares DB Commodity Index Tracking ETF (DBC) fell 0.37%.

Market	Level	Change	% Change
Dollar Index	80.705	.112	0.14%
EUR/USD	1.3598	-.0029	-0.21%
GBP/USD	1.6744	-.0005	-0.03%
USD/JPY	102.69	.21	0.20%
USD/CAD	1.0934	.0029	0.27%
AUD/USD	.9273	.0012	0.13%
USD/BRL	2.2805	.001	0.04%
10 Year Yield	2.604	.013	0.50%
30 Year Yield	3.442	.009	0.26%
Prices taken at previous day market close.			

Copper broke through initial support at $3.12 in early trading yesterday and closed down 1.35% at $3.095. The reason for the decline is linked to the common practice of using copper as collateral for business loans in China (longtime subscribers will remember this from earlier in the year).

Apparently there was a revelation yesterday at the port of Qingdao that there isn’t quite as much physical copper being stored there as inventory receipts seem to indicate. (Shockingly, it would appear business pledged the same copper to multiple banks to acquire funding.)

It’s unclear exactly how big a problem this is, but it exerted pressure on copper yesterday. Nervous creditors sold their physical copper into the market and unwound their hedges against that copper, causing a sharp decline.

Whether this presents a major headwind for copper is unclear at the moment, but it’s fair to say that this likely won’t be the last issue we have with copper (and other base metals) being used to back loans in China.

On the charts, copper did close the session yesterday right at the critical, technical uptrend line that has been in place since prices bottomed at multi-year lows back in March. Normally, I’d be a buyer here, but this sort of physical tomfoolery spooks me in commodity markets, as I’m not in the physical business. So, I’ll watch copper here for the moment until there’s a bit more clarity on just how deep this over-pledged copper rabbit hole goes.

Turning to energy, yesterday was inventory day for crude oil and the refined products and the results were slightly bullish; however, the market largely ignored the data. The EIA reported that crude oil stocks fell -3.43M barrels vs. (E) -100K, and inventories at Cushing, Okla., the delivery point for WTI, inched lower toward that critical 20M level—down to 21.4M barrels

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from 21.7M last week. But, while WTI jumped on the initial headline release, it failed to hold the gains and finished down 0.22%, as a late-morning gap lower turned the market.

The reason for yesterday's late-morning drop of more than 50 cents was almost entirely technical. Once futures failed to break back toward/above the $104 level, algos and day traders took control and filled a "gap" on the daily chart between yesterday's open at $103.18 and Tuesday's close of $102.69. There was no follow-through lower once the gap was filled, which suggests the move was primarily technical.

Bottom line, the crude oil market remains range-bound between $100 and the 2014 highs at $105. However, over the medium term, the technicals do favor the bulls.

Elsewhere in energy, natural gas futures were little-changed, up 0.4% to $4.65 yesterday ahead of the weekly EIA inventory report due out this morning. Analysts are expecting a build of 117 Bcf, and we can expect some volatility around that level (especially if it's a few Bcf higher than estimates). Resistance sits at 4.75, while initial support sits at 4.49.

Currencies & Bonds

Economic data yesterday were largely dollar-positive (ISM non-manufacturing) and slightly euro-negative (slight miss on May composite PMIs) but the moves in both currencies were muted ahead of the ECB this morning. The Dollar Index finished up 0.14% while the euro fell 0.18%. Obviously both currencies were largely paralyzed ahead of the ECB.

Asian currencies did move a bit yesterday, though, as the yen continued its slow bleed lower vs. the dollar, finishing the day basically on the lows at 102.71 yen/dollar, and threatening to break down.

This three-day drop in the yen is based almost entirely on market expectations of PM Shinzo Abe's "Third Arrow," so it's important to note that nothing has actually changed, and to a point the yen may be ahead of itself in the short term (there is the chance Abe disappoints, after all). But, regardless, the yen is now sitting at major support at 102.70. If that support is materially broken over the next few days, a quick run to 104 yen/dollar isn't out of the question (which would obviously be positive for YCS and DXJ).

But, again, this is all on speculation of what Abe will do, so there remains a risk to adding to positions at these levels. I'd prefer to wait until Abe's announcement, or until support at 102.70 is decisively broken, before adding to my YCS or DXJ positions.

Staying in Asia, the Aussie saw an oversold bounce Wednesday (up 0.22%) thanks to Q1 GDP coming in slightly better than expectations (up 1.1% in Q1 and 3.5% yoy vs. (E) 1.0% in Q1 and 3.3% yoy). So, it was a slight beat, but it doesn't change the outlook for the Aussie economy, which is mixed at best. Really, yesterday's rally was more an oversold bounce than anything else.

Fundamentally, the outlook for the Aussie remains bearish, given a mixed domestic economy and a central bank that wants a cheaper Aussie (and will act to devalue the currency if it gets too high). It's a matter of time until the downtrend resumes. $0.92 remains the level to watch, as I would look to sell a violation of that support (by selling futures or buying CROC) as that likely would signal a resumption of the downtrend in the Aussie.

Speaking of downtrends, bonds closed slightly lower for a 4th straight day yesterday, despite the Fed buying $1 billion worth of long bonds, as the 30-year declined 0.12% while the 10-year yield rose above 2.60% for the first time in nearly a month. Obviously the reason was continued profit-taking from bond longs ahead of the ECB.

As we've covered, there's the possibility of fireworks in the bond market today depending on what the ECB does. On the downside, watch 134'ish in the 30-year. That's the support level from the uptrend that's been in place literally from the first of the year, and if that's broken, the declines will accelerate. Conversely, if Draghi disappoints, watch 136'00 as resistance. If the strength in the bond market is starting to fade, even in the face of a potential ECB disappointment, resistance at 136'00 will likely hold. If that's broken, then a run at the old highs at 138'00 isn't out of the question (and this bond rally won't be over). Have a good day—Tom.

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The 7:00's Report Asset Class Dashboard

(Outlook on the primary trend for major asset classes over the next month)

	Fundamental Outlook	Technical Outlook	Overall	Comments
Stocks	Bullish	Neutral	Bullish	*Gradual economic improvement domestically and globally is a tailwind on stocks, and as earnings season has largely com in "ok," the path of least resistance remains broadly higher. But, the strength in bonds and flattening yield curve is starting to weigh on stocks in the near term and any material move beyond 1900 is likely capped until bonds start to sell off.* *The trading range in the S&P 500 has bumped up, to 1910ish—1860ish.*

Trade Ideas

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. It has worked with utilities and most recently the retailers and banks. I'd also look to allocate to deep cyclicals like industrials (DIA), basic materials (IYM) and global industrial miners (PICK). I've added IYZ (Telecom ETF) to this "market losers" basket, as its trading at a valuation discount and has underperformed other defensive sectors recently.**

Long Japan: **"Hawkish" comments by BOJ Governor Kuroda sent the yen spiking higher vs. the dollar and DXJ near the lows for the year. I remain a fundamental bull on Japan, but a decisive break of 44.66 in DXJ will see me exit this trade, despite the fundamentals.**

Long Natural Gas E&Ps: **Term structure in the natural gas markets remains bullish, as its in backwardation out nearly a year, implying a structural increase in demand. But, natural gas equities remain under pressure, and could potentially offer some value in the market over the medium/longer term. FCG and XOP are the two "pure play" ETFs in the natural gas E&P space.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Commodities	Bullish	Neutral	Neutral	*The outlook for commodities remains mixed, as the global economy remains mired in stagnant growth. Given the severe underperformance of commodities last year, though, the asset class remains on of the last corners of value in the market, if the global recovery can accelerate.*

Trade Ideas

Gold: **The outlook for gold remains unclear, but, gold has acted as a decent equity hedge all of 2014, so if you're nervous about the stock market here, buying gold isn't the worst idea.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index remains largely range bound, as a stronger euro will hamper any ability for the US Dollar Index to rally, despite continued tapering of QE.*

Trade Ideas

Short: Japanese Yen. **The Yen rallied to start the week last week but sharply reversed off of the 200 day moving average mid week (while the Nikkei quietly rallied 2.5%) suggesting the short yen/long DXJ trade is hanging in there. But, if the yen were to trade below the low for the year, 100.26 yen/dollar, I would exit this trade as the trend will have clearly changed.**

Short: Aussie Dollar. **Aussie saw a big short covering rally last week on better than expected data, but with risks to Chinese growth skewed to the downside and the Reserve Bank of Australia wanting a weaker Aussie, the longer term trend remains lower. For those non-futures traders, shorting FXA or buying CROC is the easiest way to put this trade "on."**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	Bearish	Bearish	Bearish	*Bonds remain shockingly buoyant despite economic data confirming the winter slowdown in the economy was temporary, while the Fed has confirmed it intends to continue tapering. The longer term trend remains lower, but the counter trend rally in bonds is continuing in the short/medium term.*

Trade Ideas

Buy: **TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury).**

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