7:00's Report

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

June 9th, 2014

Pre 7:00 Look

- Futures are drifting slightly lower this morning while international markets are slightly higher as the weekend was quiet and markets are digesting last week's rally.
- Asia outperformed o/n as Chinese May trade data was mixed but generally positive (exports beat estimates but imports fell short).
- Q1 Japanese GDP was also revised higher to 6.7% from 5.6%, helping the Nikkei rally to a three month high.
- Econ Today: No reports today. Fed Speak: Bullard (9:10 AM), Tarullo (12:45 PM), Rosengren (1:30 PM).

Market	Level	Change	% Change
S&P 500 Futures	1947.25	-2.00	-0.10%
U.S. Dollar (DXY)	80.515	.088	0.11%
Gold	1256.00	3.50	0.28%
WTI	103.26	.60	0.58%
10 Year	2.597	.013	0.50%

Equities

Market Recap

The rally accelerated last week as good economic data and forceful action by the ECB led to broad gains in stocks. The S&P 500 rose 1.3% last week and is up 5.47% year-to-date.

Stocks were little-changed Monday-Wednesday, as the market drifted around on low volumes amidst little market-moving news. Generally, though, news was positive, as economic data (manufacturing PMIs) met or exceeded expectations.

But, the gains accelerated Thursday after the ECB largely met (and slightly exceeded) lofty expectations for their policy response to the growing dis-inflation threat. Stocks moved sharply higher and saw follow-through buying on Friday after a better than expected jobs report. Markets ended the week basically on the high ticks.

Trading Color

The important thing that happened internally last week was that, post-ECB decision (so, starting Thursday), cyclicals outperformed defensive sectors. The Russell 2000 rallied 2% on Thursday and banks also surged, while utilities, consumer staples, telecom and healthcare relatively underperformed. That's important because it may represent a shift in what's "worked" so far this year from a sector standpoint.

Year-to-date, defensive and "bond proxy" sectors have outperformed, while small caps, banks and other growth stocks have lagged. With the ECB decision known, and the potential for the bond rally to stall, we could be seeing a shift toward outperformance of those other sectors (it's obviously too early to definitively tell yet, but it's something to watch).

Despite the improvement in market internals, though, volumes and activity remain very subdued, and we only saw a modest bump following the ECB and jobs report.

On the charts, the S&P 500 hit another new high and is now overextended in the short term (it's only finished in the negative three times since May 15, and those drops were all less than 3 points. But, the trend remains clearly higher, with the first level of support at 1,920.

This Week

It's a pretty quiet week. Chinese economic data (CPI,

Market	Level	Change	% Change
Dow	16,924.28	88.17	0.52%
TSX	14,838.90	38.72	0.26%
Brazil	53,128.66	1569.87	3.04%
FTSE	6,875.66	17.45	0.25%
Nikkei	15,124.00	46.76	0.31%
Hang Seng	23,117.47	166.47	0.73%
ASX	5,464.03	27.15	0.50%
Prices taken at previous day market close.			

PPI, retail sales and industrial production) and U.S. retail sales will be in focus from a macro standpoint, while things are almost equally quiet from a "micro" standpoint.

One event to watch is the Morgan Stanley financial services conference (Tuesday/Wednesday). Multiple banks (GS, BAC, C, Barclays) have warned about low trading revenues in the current quarter, and a continuation of that trend could weigh on the sector.

Market	Level	Change	% Change
DBC	26.05	.11	0.42%
Gold	1252.40	-.90	-0.07%
Silver	19.00	-.083	-0.43%
Copper	3.0585	-.032	-1.04%
WTI	102.79	.31	0.30%
Brent	108.76	-.03	-0.03%
Nat Gas	4.715	.014	0.30%
RBOB	2.9474	-.0089	-0.30%
DBA (Grains)	27.65	.31	1.13%

Prices taken at previous day market close.

Bottom Line

Market fundamentals have been quietly improving for the past few weeks, and stocks are reacting accordingly. Last week, economic data continued to show a growing global recovery, and the ECB acted as forcefully as hoped to combat the growing dis-inflation threat and stimulate the EU economy.

So, we find ourselves in a stock-friendly environment:

- Economic data (domestically and globally) are gradually improving and confirm signs of accelerating recoveries.
- Central banks the world over remain very accommodative with no plans to tighten policy any time soon.
- Valuations remain reasonable (16.2X '14 $120 EPS, 15.0X '15 130 EPS).

Despite the favorable backdrop, however, sentiment toward the market and the rally remains skeptical and distrusting (keeping the "pain trade" higher).

The two ominous signals the market has been dealing with (small-cap underperformance and a strong bond market) aren't as formidable as they once were, as small caps appear to be trying to rebound, while the bond rally has stalled (although obviously it's early yet).

Markets can't go up forever and clearly the S&P 500 is short-term overbought and in need of a sell-off to restore some short-term health, but the backdrop for stocks remains positive.

Given the events of last week, I am investigating getting much more cyclical in my allocations. This includes small caps, financials and industrials, and sticking with the "global reflation trade"-linked sectors like industrials, metals & miners (PICK) and basic materials.

Risks to the rally remain (the economic recoveries remain fragile), and I'm not a market cheerleader. But backing up and looking at things honestly, the environment is pretty favorable for an extension of this rally after some sort of a correction that's needed to restore short-term technical health.

Finally, I want to make it clear that last week's ECB moves are a big tailwind for European stocks, which surprisingly didn't outperform on the news. "Europe" is basically trading in-line with the S&P 500 year-to-date (both up around 6%), but Europe trades at a much cheaper valuation (14X) and arguably has more room to "catch up." So, if you're underweight European stocks or have no exposure, consider looking at the PIIGS or a European ETF (EIRL, EWP, FEZ, VGK) as last week's ECB news was very euro-stock-positive.

Economics

Last Week

Last week was a good one for the global economy and risk assets. May economic data confirmed that we are seeing the pace of growth stabilize in China, and accelerate in the U.S. Plus, the ECB basically met very high expectations with regard to stimulating the EU economy and combating dis-inflation. From a stock market (and risk asset) standpoint, the macro-economic backdrop became more of a tailwind for stocks last week.

Starting with the ECB, by now you know the details of what they did, but more importantly, Mario Draghi and the ECB not only took steps to stimulate growth and inflation in the EU, but also left open the idea of doing more in the future (specifically ABS purchases and again hinted at potential outright QE).

Importantly, this came amid a mixed (at best) week of data for the EU, as manufacturing and composite PMIs missed, and May HICP declined further. Importantly, though, the ECB appears committed to doing what's necessary to support the EU recovery. That, over time, will remove the risk of "Japan style" deflation in Europe (assuming they follow through).

In the U.S., economic data were almost universally better than expected. May ISM manufacturing PMIs were in-line at 55.4 vs. (E) 55.5 (remember this was the release last Monday with the three revisions), while ISM non-manufacturing PMIs were 56.3, and the monthly employment report beat estimates at 217K vs. (E) 213K. Finally, the four-week moving average for jobless claims fell to its lowest level since June '07 at 310K.

So, the data were good, but not *too* good that they altered anyone's expectation of Fed policy—so for now tapering of $10 billion per meeting will continue, with rate increases coming next year.

Finally, Chinese data provided more evidence that the pace of growth is stabilizing between 7.0% and 7.5% annual GDP growth, which is what the market expected. And, while the housing market and "shadow banking system" are potential risks to monitor, for now the risk of a Chinese "hard landing" continues to recede.

Not that I'm a macroeconomic cheerleader, but last week was a good week, and certainly the improving macro outlook is helping stocks slowly rally, as last week:

1) Helped reduce the chances of European deflation, which is a big concern of markets (Tepper's comments), and
2) Showed the economy in the U.S. and China are meeting current expectations (which is positive for risk assets).

This Week

After a busy week last week, things slow materially this week (which is normally the case).

Domestically it's going to be quiet, with retail sales and jobless claims being the only notable releases. It's pretty much consensus that the economy rebounded strongly in March from the winter weather and then paused in April, so especially in consumer spending, markets will be looking for a resumption of gains.

Internationally, China will be in focus with CPI and PPI coming tonight (although these numbers aren't as important right now because inflation isn't an issue in China). May industrial production and retail sales (out Thursday) will be watched to make sure they confirm the strength we saw in the May PMIs. These are probably the biggest releases this week.

Finally in Europe, data are also pretty sparse this week, as the UK Labour Market Report (which could send the pound sharply higher if it's strong) is released Wednesday and the EMU industrial production comes Thursday. Given the moves by the ECB last week to stimulate growth, EU economic data (unless horrid) won't matter as much as they did previously, until we start to see the effects of the stimulus.

Commodities

Commodities were all over the place last week. Copper broke down on bearish physical news out of China, natural gas rallied in spite of in-line inventory data, and crude oil and gold futures ended the week little-changed. DBC finished the week slightly higher, up 0.27% .

Starting with the big movers, copper came crashing down through support last week on news that Chinese officials were launching a probe/investigation into the practice of using copper as collateral for business loans. Long story short, there was speculation that there were multiple loans outstanding on the same copper. Needless to say, those holding physical copper began selling in what was all but a panic which carried over into, and put pressure on, the futures market.

Bottom line is we are now in a "wait and see" mode as the investigation continues. And, until the authorities can shed some light on the situation, that will leave copper futures under pressure. On the charts,

Market	Level	Change	% Change
Dollar Index	80.44	.037	0.05%
EUR/USD	1.3639	-.0002	-0.01%
GBP/USD	1.6798	-.0002	-0.01%
USD/JPY	102.45	-.02	-0.02%
USD/CAD	1.0924	-.0008	-0.07%
AUD/USD	.9330	-.0002	-0.02%
USD/BRL	2.2445	-.002	-0.09%
10 Year Yield	2.597	.013	0.50%
30 Year Yield	3.437	.005	0.15%

Prices taken at previous day market close.

the $3.00 level is the line in the sand. However, if this whole debacle turns out to be a fluke and all loans are legitimately backed, the market will likely spring back and technicians will forgive the short-term violation of the longstanding, and dominant trend.

Natural gas was the other big mover in the space, rallying 3.6% on the week. Most of the gains came on the back of the EIA inventory report despite the fact that it was relatively in-line and actually mildly bearish (119 Bcf vs (E) 117 Bcf). Nat gas remains largely corralled in a broad uptrend-channel between $4.43 and $4.93 with short-term volatility being fueled by inventory data and weather reports.

Moving to the quieter commodities, both WTI crude oil an gold saw decent moves intra-week but finished little-changed. Gold started the week lower, rallied sharply during Mario Draghi's press conference (specifically at the mention of preparing ABS purchases), then fell back on the in-line jobs report and resulting rally in the stock market.

On the charts the $1,240 level, which we initially pointed out when gold first went into freefall on May 27, has proved solid support, so far. But, with global geopolitical tensions continuing to ease and stocks repeatedly making new highs, it would not be a surprise to see a breach of that level. Having said that, gold remains one of the best hedges against the rallying stock market, so buying dips to protect long stock exposure is a decent trade.

Crude oil also closed the trading week little-changed in what turned out to be a week primarily driven by technicals. The "evidence" was Wednesday's bullish EIA inventory release that failed to spur a re-test of the $104-$105 resistance band, which led to futures rolling over as traders filled a "gap" in the chart. Then support held (nearly to the tick) at the technical up-trend line that has been in place since the first week of the year. So, bottom line is it is more of the same in the crude oil market. Futures remain range-bound between $100 and $105/ barrel but the technicals continue to favor the bulls.

Currencies & Bonds

The Dollar Index closed higher last week but only very slightly so, as strength early in the week on anticipation of the ECB announcement was offset by a big "sell the news" decline on Thursday following the ECB announcement. It was the opposite for the euro, as you'd expect. The euro declined through Thursday of last week but then bounced hard in a "buy the news" reaction, before dipping a bit Friday to finish the week slightly lower.

Again, the reason for the seemingly illogical moves in the currency market was the fact that what the ECB did was (largely) priced into the Dollar Index and euro. But, beyond the short term, the ECB moves last week were euro-bearish and Dollar Index-bullish. And, while I don't think that results in a waterfall decline in the euro, the era of broad euro strength vs. the dollar should be coming to an end (I read several places the ECB would be "happy" with a 1.30 euro vs. the dollar).

The other currency movement worth highlighting last week was in the yen. The yen sold off last week and challenged support at 102.70 before rallying on dollar weakness Thursday. The yen weakness was the result of increasing anticipation of Prime Minster Abe releasing his "third arrow" of structural financial reforms later in June. That is expected to include a corporate tax cut and a directive for the Japanese General Pension Investment Fund to invest up to $200 billion in overseas stocks and bonds, which should weigh on the yen. Whether Abe delivers remains to be seen, but expectations are rising and if support at 102.70 yen/dollar is broken, look for the decline to accelerate to the 104 level pretty quickly.

Treasuries traded very similarly to the euro last week. The continued their correction through Thursday, spiked lower to support on the ECB announcement, then bounced very hard on a "buy the news" reaction and stayed buoyant Thursday. But, like the euro, the news out of the ECB last week should be Treasury-bearish over time, and while the market is still too oversold to likely break support in the next few days, if past is prologue, the market should begin to adopt that bearish Treasury view over the coming days/weeks as the ECB decision "sinks in." So, although a steep decline may not be in the near future, the top in this bond rally should be "in." If not, then Treasury strength has to be re-examined, and it'll re-emerge as a caution sign for stocks. Have a good week—Tom.

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	*Market fundamentals have been quietly improving for the past few weeks with both domestic and global economic data coming in better than expected, central banks continuing to be very accommodative, and valuations remaining reasonable. And, sentiment toward the market remains skeptical, keeping the pain trade higher. However, the S&P 500 is overbought and in need of a sell-off to restore some short term health.* *The trading range in the S&P 500 has bumped up, to 1920-1950ish.*

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.**

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 one 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.**

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 saw a strong rally in late May, but sharply reversed off of the 200 day moving average (while at the same time, 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**

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).**