7:00's Report

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

July 10th, 2014

SX7P: The European banking index is down well over 5% since the start of July and it'll need to stabilize before this sell off is over.

Pre 7:00 Look

- Futures are sharply lower this morning, dragged down by European markets and general geo-political concerns.
- Europe is very weak this morning as DNB Bank, Norway's largest bank, posted disappointing results.
- Economically, Chinese trade balance was slightly disappointing (exports and imports missed), while Japanese Machine orders plunged unexpectedly. Finally, Italian and French industrial production also unexpectedly declined.
- Econ Today: Weekly Jobless Claims (E: 315K). Fed Speak: George (1:15 PM), Fischer (4:30 PM).

Market	Level	Change	% Change
S&P 500 Futures	1949.75	-17.75	-0.90%
U.S. Dollar (DXY)	80.14	.098	0.12%
Gold	1343.80	19.50	1.47%
WTI	101.71	-.58	-0.57%
10 Year	2.547	-.018	-0.70%

Equities

European Banking Concerns Are the Reason We're Lower This Morning

Futures are sharply lower this morning and there are several reasons being kicked about in the media, but the core reasons for the declines is more negative European bank news.

Yesterday, Portugal's Banco Espirito de Santo (Portugal's largest bank by assets) fell nearly 10% in trading after one of its Luxembourg based subsidiaries asked for an extension on a debt payment and proposed a potential debt for equity swap.

Apparently funding concerns for BES have been percolating for a while, and the news yesterday is being extrapolated out to a potential funding crisis at one of Portugal's biggest banks.

Portuguese bonds declined yesterday on the news (so a bit of a flash back to the Euro Zone crisis there), although the declines weren't all that bad. As you'd expect, the Portuguese government has said BES is insulated from the money troubles of its subsidiary, but obviously doubts remain.

Then this morning, Norway's largest bank, DNB, missed earnings and reported generally poor results.

So, this adds to the string of bad European bank news we've gotten since last Friday: Profit warning by Erste Bank (Friday), a 9 billion dollar find for BNP Paribas (Monday), a potential similar fine for Comerzbank (Tuesday), the Banco Espirito Santo news yesterday, and the DNB earnings miss this morning.

Market	Level	Change	% Change
Dow	16985.61	78.99	-0.47%
TSX	15215.19	78.01	0.52%
Brazil	53634.69	-167.14	-0.31%
FTSE	6667.06	-50.99	-0.76%
Nikkei	15216.47	-86.18	-0.56%
Hang Seng	23238.99	62.92	0.27%
ASX	5464.45	11.96	0.22%
Prices taken at previous day market close.			

Media headlines will point to rising tensions in Gaza and concern about the end of QE as other reasons stocks are lower, but at its core the sell off this week is about Europe and specifically European banks.

Market	Level	Change	% Change
DBC	25.96	-.16	-0.63%
Gold	1330.80	14.30	1.09%
Silver	21.22	.207	0.99%
Copper	3.2520	-.005	-0.15%
WTI	102.26	-1.14	-1.10%
Brent	108.37	-.57	-0.52%
Nat Gas	4.168	-.036	-0.86%
RBOB	2.9415	-.0314	-1.06%
DBA (Grains)	26.85	-.28	-1.05%
Prices taken at previous day market close.			

So, it's a throwback Thursday, as we now need to again watch the SX7P, the European banking index (this was one of the best indicators of the severity of the Euro Zone sovereign debt crisis a few years ago). As you can see from the chart, it's gotten hit hard recently – and that is now our leading indicator to watch. That will need to stabilize before this latest sell off is over.

Market Recap

Stocks bounced yesterday, helped initially by an earnings beat by AA and positive guidance from AAR, and then by "dovish" Fed minutes from the June meeting. The S&P 500 rose +0.46%.

Stocks were slightly higher pre-open thanks again mainly to short-term sellers' exhaustion. But the AA earnings after Tuesday's close provided a positive data point, and AAR's positive business update (margins were good) also helped shake what had become very short-term-negative sentiment.

Stocks rallied steadily throughout the day, but caught a late-day boost after the FOMC minutes were released. It wasn't so much that the minutes were dovish, but they weren't as "hawkish" as the market feared. This helped goose the S&P 500 about 3 points higher, and we closed near the highs of the day. The S&P 500 closed less than 1% below the all-time highs, although its obviously lower this morning.

Trading Color

Yesterday was your typical "oversold bounce," as we saw the most beaten-up sectors of the last 48 hours recover. Airlines (helped by AAR), biotechs (NBI) and Internet stocks (QNET) all rallied more than 1%, bouncing back from the early week beating.

Looking at the indices, the Nasdaq bounced back courtesy of the rebound in the Internet stocks and was the best-performing major index, while the Russell 2000 continued to trade sluggishly, rising just +0.14%. (The Russell weakness is one of the most consistent "warnings signs" people keep pointing out to me, and yesterday's performance won't make that go away.)

Two things of note yesterday: First, despite the dire warnings about retail from TCS, the consumer discretionary ETF (XLY) was the best-performing S&P 500 subsector (up +1.2%).

Second, resource and materials stocks continued to trade very well, and have been a nice play to "hide" in during this sell-off (and they traded well last week, too). Gold miners broke out yesterday and are just off highs for the year (GDX up +2.9% yesterday), while obviously the AA earnings beat helped the industrial miners (PICK rose +0.8% yesterday and it's up on the week).

Point being, take a look at the resource/materials names, as this environment of a broad global recovery and buoyant commodity prices is beneficial for that space (this trend is continuing this morning as gold is 1.5% higher this morning).

On the charts the S&P 500 is set to open well below initial support at 1965, so the next level to look for is a support band between 1948 and 1952.

Bottom Line

It would have been premature to say "the sell off is over" after yesterday's pretty text book bounce because stocks rallied more because sellers moved to the sidelines for the day, rather than buyers stepping up. And, that is proving to be true this morning.

Some more consolidating or a further pullback is needed in the near term, and with the market devoid of a major catalyst until next week (earnings season kicking off and the Yellen testimony are the next big events), that's likely what we'll get.

Economics

FOMC Minutes

These minutes of the June FOMC meeting were released yesterday, and they elicited a "dovish" response from markets as gold, Treasuries and equities rallied, while the dollar sold off. But the minutes were only "dovish" insomuch as they didn't meet likely unrealistic "hawkish" expectations. Point being, this release was an actual non-event from a policy outlook standpoint.

If I were forced to cite one "reason" the minutes were "dovish," it would be the Fed's apparent lack of concern regarding inflation. When Fed Chair Yellen referred to the recent uptick in inflation as "noise" at the press conference, that was taken by many market participants as too dismissive of the increase (it added to the "Fed is behind the curve" worries). It was thought that Yellen was just being an uber-dove, but the minutes imply she represents the consensus of the Fed, as they do not see inflation as a concern at the moment.

From a headline standpoint, the "QE will end in October" was the big one. Some tried to spin it as "hawkish" initially, but everyone already knows QE will likely end in October/December, and it's not like cutting $15 billion vs. $10 billion will make much of a difference.

There was some discussion about potential complacency in the markets regarding volatility and risk (remember Yellen remarked on this in her comments last week). It seems the Fed is getting a touch concerned that they are communicating so well—and the expected path of rates is so well-known—that this may be starting to cause some excessive complacency in the markets. This doesn't mean much now, but if it continues, the Fed may try and surprise markets just to shake some complacency out of them (the Jackson Hole conference in August may be a venue for that).

I won't bore you with the minutiae regarding how the Fed plans to remove stimulus and reduce its balance sheet because 1) I don't want to put you to sleep and 2) the Fed doesn't know how it's going to do it yet. There will be plenty of time to cover IOERs, reverse repos, their spreads, and the like.

Market	Level	Change	% Change
Dollar Index	80.07	-.151	-0.19%
EUR/USD	1.3641	.003	0.22%
GBP/USD	1.7152	.0022	0.13%
USD/JPY	101.60	.03	0.03%
USD/CAD	1.066	-.0016	-0.15%
AUD/USD	.9413	.0015	0.16%
USD/BRL	2.212	.00	0.00%
10 Year Yield	2.547	-.018	-0.70%
30 Year Yield	3.360	-.020	-0.59%
Prices taken at previous day market close.			

Bottom line is the outlook for the Fed remains unchanged from yesterday's minutes (first rate increase still mid-2015).

Commodities

Commodities were mostly lower yesterday as the energy sector led the way down yet again. The recent trend continued, though, with the sole outliers being both gold and silver—they traded higher ahead of, and following, the release of the FOMC minutes. DBC, the benchmark commodity tracking index ETF, was down for the 9th straight session, falling -0.65% despite a universally weaker dollar.

Beginning with the metals, both gold and silver were in the green to start the day yesterday as a result of trader positioning ahead of the FOMC minutes (2:00 PM). Gold and silver finished the day up +1.1% and +1%, respectively. And, although some of the talking heads cited the violence on the Gaza Strip as influencing a safe haven bid, the impact of the conflict was limited.

Precious metals have been trading very well lately as both the technicals and fundamentals continue to favor the bulls. And, following the release of the FOMC minutes, there was a delayed surge in gold prices of nearly $10. This came despite the fact that there wasn't really anything unexpected in the release. So, the market reaction was rather bullish because it is a sign that investor sentiment toward gold is neutral to bearish.

On the charts the uptrend remains healthy and we continue to recommend buying dips or holding existing longs with a stop on a close below the trendline, currently in the $1,323 area with an initial profit target of between $1,355 and $1,360.

Shifting to the energy space, crude oil futures were down -1.2% yesterday, for the 7th drop in the last 8 sessions. The bears regained the momentum early as a weak morning rally stopped short and reversed at the 50-day moving average ($103.52; previous support) and the selling pressure continued for the remainder of the day.

In the afternoon, futures broke through and closed the primary session below the 100-day moving average ($102.32), which we were looking to as the next level of support, and then closed the electronic session (the time frame used by most chartists) well below at $101.94.

Going forward, we could see the shorts try to break the price down further and the next level of support is a technical uptrend at $101.25. Bottom line is WTI futures have gotten absolutely crushed in recent weeks after jumping to highs of the year thanks to the sudden escalation of violence in Iraq. So, there are without a doubt a lot of greedy shorts in the market looking to book some profits, and as soon as that begins, a sharp rally can be expected. And, the fundamentals (our growing economy leading to higher demand) continue to point to higher oil prices, so getting long crude oil here in medium-term trading accounts isn't a bad play.

We continue to have our eye on natural gas, which fell another -0.8% yesterday, but we have seen some shorts take profits and futures are beginning to digest the recent and substantial sell-off. We continue to recommend taking a shot on the long side on dips toward $4.10 with a stop just below the $4.00 mark.

Currencies & Bonds

Yesterday's trading in currency markets was dominated by the dovish Fed minutes, as the Dollar Index sold off following the release at 2:00 PM EST to finish down -0.2%.

Conversely, every other major currency rallied after 2 PM as the dollar slid. The euro and pound rallied an equal and opposite 0.2% each, while the yen erased earlier losses vs. the dollar to close flat.

After trading higher for a few days, the dovish outlook from the Fed has again arrested the rally, and the dollar continues to hover around the 80 level, as dovish guidance and commentary offsets continually improving economic fundamentals. And, that's a trend we should continue to expect from the dollar as we approach this transition period for the Fed .

Broadly, we all know that the Fed is on the way to tightening, eventually, so that does put some general support under the dollar. But, the time of that tightening is such an unknown, and its effect is significantly diminished, and we're seeing the dollar rally or fall in measured amounts based on shifting expectations. Case in point, following the strong PMIs and jobs report last week, the dollar rallied as expectations of Fed rate hikes were pulled forward. But, the "dovish" minutes yesterday served to remind everyone the Fed remains torn, but Yellen is the deciding vote (literally and figuratively), and as a result the Fed is sticking to the dovish rhetoric (so the dollar trades lower).

Bottom line, there's so much uncertainty with regard to the specifics of future Fed and ECB policy, we'll continue to see a lot of choppy trading. But it will likely be in a tight range of 79 and 81, until some of the details of those specifics (from either central bank) are revealed.

Longer term, the trend in the dollar is higher, but it's going to take a while for that to materialize, so I'd be a casual buyer of the dollar sub-80 during these short-term dovish sell-offs, but again that's a longer-term position.

Bonds, given the dovish minutes, finished slightly higher (up +0.1%) as the FOMC helped the bond market shrug off a pretty sloppy 10-year Treasury auction.

The bid to cover was low, at 2.597 (second lowest of the year), while the actual yield on the debt was 1 basis point higher than the "when issued" (which reflects a lack of aggressive bidding for the paper).

This markets the second-straight soft Treasury auction this week (the 3-year Tuesday wasn't all that great) so there will be extra focus on the 30-year today.

Speaking of which, the 30-year bond is now sitting against the downtrend line that's been in place since early June, so if this bond market is going to roll over, it should roll over here.

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
6/30/14	GLD SLV	127.30 20.15	None	*Long Precious Metals: This is mostly a technical trade, as both gold and silver have seen a positive cross of the 23 & 30 day EMA's rising above the 50. But, fundamentals aren't negative, as inflation is bottoming. Original Issue*
6/11/14	EIRL	37.42	35.41	*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	21.55	21.13	*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 positive for years 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.			

Asset Class Dashboard

(Updated 7.7.14)

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 hit another new high last week thanks to strong economic data (PMIs and jobs report). Despite being short term overbought, the outlook for stocks remains favorable as the global economy is accelerating while central banks remain very accommodative. Focus now shifts to earnings, but the path of least resistance remains higher.*

Best Idea: Long Europe (VGK/EIRL/EWP/EWI)

Best Contrarian Idea: Buy Retailers (XRT)

Commodities	**Neutral**	**Neutral**	*Commodities came under some pressure last week as the Iraq geo-political premium came out of the energy markets while gold digested recent gains. Near term the outlook is neutral, but longer term with the global recovery accelerating and recent inflation readings moving higher, the outlook for commodities is improving.*

Best Idea: Long Oil (USO)

Best Contrarian Idea: Buy Grains (DBA)

U.S. Dollar	**Neutral**	**Bullish**	*The Dollar Index rallied last week and broke a three week downtrend thanks to the strong economic data. Given the data and recent sluggish economic readings out of Europe, I expect the dollar to trade with a slight upward bias going forward.*

Best Idea: Buy the Pound (FXB)

Best Contrarian Idea: Long Canadian Dollar (FXC)

Treasuries	**Neutral**	**Bearish**	*Treasuries sold off hard last week on the strong economic data, and the 30 year bond broke the 2014 uptrend, likely signaling this 2014 rally has ended. I don't expect a sharp drop in bonds, but I believe this 2014 rally is over.*

Best Idea: Short long bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)