7:00's Report

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

July 11th, 2014

Pre 7:00 Look

- Futures are very slightly higher as markets bounce from yesterday's sell off. It was a quiet night news-wise.
- Europe stabilized o/n as there was no incrementally negative bank news, although again this is little more than an oversold bounce as we end a rough week.
- Economically it was quiet, as the final reading in June German CPI was the only report and it met expectations.
- Econ Today: No economic reports today. Fed Speak: Plosser (11:15 AM), Evans (2:00 PM) .
- Earnings Today: WFC (E: $1.01).

Market	Level	Change	% Change
S&P 500 Futures	1961.25	3.50	0.18%
U.S. Dollar (DXY)	80.14	-.03	-0.04%
Gold	1337.00	-2.20	-0.16%
WTI	102.49	-.44	-0.43%
10 Year	2.532	-.015	-0.59%

Equities

Market Recap

Stocks closed in the red again Thursday on more European bank concern, but stocks were able to cut the losses nearly in half by the close. The S&P 500 closed down -0.41%.

It was an ugly start to trading Thursday as more negative news from European banks combined with generally disappointing global economic data. (The Chinese trade balance missed, as did Japanese machine orders and Italian and French industrial production.)

Gold traded to a new multi-month high yesterday in reaction to the stock market sell off. But, gold has been rallying for more than a month on rising inflation expectations and declining real interest rates, and those trends will continue.

But, a good weekly jobless claims report helped turn sentiment a bit. After hitting their lows almost immediately after the open in heavy selling, stocks began to gradually lift and the S&P 500 nearly got back to flat by 1:30, before giving some of those gains back during the final two hours of trading.

News-wise, the middle of the trading day was pretty quiet, as comments by Kansas City Fed President Esther George were the only real news event (and she did not say anything new). After giving some of the midday rally back, stocks managed to bounce into the close to cut the day's losses in half.

After the close yesterday newly appointed Fed Vice Chairman Stanley Fischer spoke, but his comments focused on financial regulation and he didn't reveal anything about monetary policy.

Trading Color

The Russell 2000 continued to trade poorly yesterday (down -1%) but outside of that, the internals weren't that bad. The Nasdaq traded in line with the S&P 500

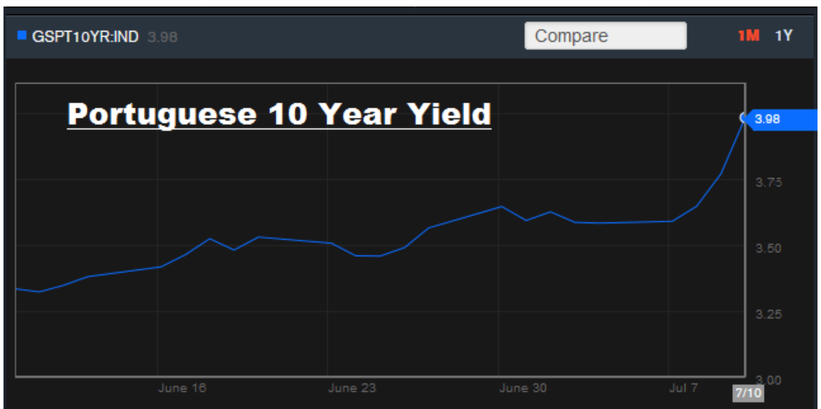
Market	Level	Change	% Change
Dow	16915.07	-70.54	-0.42%
TSX	15114.48	-100.71	-0.66%
Brazil	54592.75	958.06	1.79%
FTSE	6686.78	14.41	0.22%
Nikkei	15164.04	-52.43	-0.34%
Hang Seng	23233.45	-5.54	-0.02%
ASX	5486.79	22.35	0.41%
Prices taken at previous day market close.			

(down -0.5%) and while “momentum” sectors were negative, they had a nice bounce off the lows (NBI and QNET fell -0.35% and -0.7%, respectively).

Market	Level	Change	% Change
DBC	25.98	.04	0.15%
Gold	1336.70	12.40	0.94%
Silver	21.45	.382	1.81%
Copper	3.27	.022	0.68%
WTI	102.84	.55	0.54%
Brent	108.67	.39	0.36%
Nat Gas	4.118	-.052	-1.25%
RBOB	2.958	.0203	0.69%
DBA (Grains)	26.31	-.55	-2.05%
Prices taken at previous day market close.			

Sector-wise, defensives outperformed (XLU was the only S&P 500 sub-sector in the green) but there wasn't material underperformance by cyclical sectors (SPHB, banks, industrials and basic materials were down just -0.6%, in line with the S&P 500). So, we didn't see the carnage in cyclical or high-beta sectors you would have expected given the way the market opened yesterday.

More broadly, while the open was ugly yesterday, similar to Wednesday we didn't see any material follow-through from sellers. Stocks lifted more due to a drying up of that selling than buyers stepping in to aggressively buy the dip. Point being, much of these declines have been the result of fast-money funds and day traders pushing index futures and ETFs lower, **not aggressive de-risking from real money.** So, when the fast money stops selling, then the market naturally lifts.



Portuguese 10 year yields have risen sharply this week, but that's as much a factor of a lack of liquidity in those bonds as it is legitimate market concern regarding Banco Espirito de Santo.

That's what happened shortly after the open yesterday. Now, does that mean the selling is done? No, but it does mean we're not seeing real money selling yet (if that starts, it'll be a new negative force on the market).

On the charts we're still sitting on support in the 1,962-1,964 level (we closed above it yesterday) and below that, the 1,950-1,952 is the next level the bulls want to hold.

Is Portugal a Problem?

The yield on Portuguese 10-year bonds has risen to 3.99% as of yesterday, the highest level since March, on concerns that financial difficulties at Banco Espirito Santo will result in a flare-up of the sovereign-debt crisis.

I don't know a ton about the subsidiary of BES that's cash-strapped, or if there are major solvency/funding issues at the larger parent bank (as the bears portend). But, I do feel that extrapolating this out as some revival of the European sovereign-debt crisis is an exaggeration of the highest order.

After surviving bailouts of four separate countries and the Spanish banking sector, common sense tells us that—even if there are major problems at Banco Espirito Santo—Portuguese and European officials aren't going to let it have a major negative influence on the European economy or funding markets, which after 4 years of malaise are just now starting to show signs of life.

If we want to talk about real risks to Europe, much more important than BES is the recent softening of economic data in Europe. Bottom line is the European economy remains the key beyond the very short term. Because of that, I don't think this BES drama or the backup in Portuguese 10-year yields materially changes the outlook for the euro-zone markets.

So again, when we can get the SX7P to bottom, I'll look to be a buyer of Europe (again) on that dip.

Bottom Line

Europe is something to watch but not a bearish game-changer at this point, and this still feels more like part of a consolidation/correction the market has needed since late June.

The S&P 500 is still just 20 points (so just over 1%) off the highs. And while the Russell's weakness is something to watch, nothing here tells me that we're heading toward some sort of a material correction, at this point.

European banks remain the "cause" of the weakness, so SX7P remains the indicator to watch. When it bottoms, so too will the broader averages (assuming nothing else bad happens between now and then). I continue to view this as a dip to buy.

Economics

Weekly Jobless Claims

- Weekly Claims dropped to 304K vs. (E) 315K
- The 4 Week Moving Average fell 3.5K to 311.25K

Takeaway

Weekly jobless claims fell 11K last week to 304K from an unrevised 315K the week prior. The smoother look at the data also showed a favorable move lower, down 3.5K to 311.25K, the lowest level in 5 weeks. Yet, the market showed little interest in the report as S&P futures were already down more than 15 points at the time of the release thanks to the negative European bank news.

Bottom line, we saw a bit of an encouraging drop in the headline jobless claims number (304K is the lowest since late May), but whether or not the downtrend in claims we saw over Q2 is set to resume remains to be seen.

Commodities

The commodity space finally caught a bounce yesterday as the benchmark commodity tracking index ETF, DBC, rallied for the first time in 10 sessions, finishing the day up +0.27%. The rally was fairly broad as both industrial and precious metals, along with oil and the refined products, posted solid rallies for the day. There were exceptions, however. Natural gas fell -1.2% as futures continue to feel for support, while the grains remain under pressure.

Market	Level	Change	% Change
Dollar Index	80.175	.133	0.17%
EUR/USD	1.3607	-.0037	-.027%
GBP/USD	1.7133	-.0023	-0.13%
USD/JPY	101.32	-.30	-0.30%
USD/CAD	1.0645	-.0005	-0.05%
AUD/USD	.9392	-.0016	-0.17%
USD/BRL	2.2214	.0094	0.42%
10 Year Yield	2.532	-.015	-0.59%
30 Year Yield	3.364	.004	0.12%
Prices taken at previous day market close.			

Beginning with the precious metals, gold and silver finished the day higher by +1.1% and +1.85% respectively. The continuation of the rally, in which futures traded to near 4-month highs early yesterday morning, was largely fueled by the negative headlines surrounding European banks, which brought a "safe haven" bid into the gold market as stocks sold off. However, the underlying "inflation bid" is also still present in gold and a strong uptrend remains intact on the charts, with the first level of resistance at yesterday's highs in the mid-$1,340s, but the ultimate target remain $1,355-$1,360.

Copper also rallied yesterday, adding +0.8% on the day partially thanks to speculation of further economic stimulus measures by the Chinese government. But, copper was not able to break back above the trending support that was broken on Wednesday, and we continue to be in "wait and see" mode on copper. Until futures pull back toward the $3.20 level, we will remain sidelined.

Energy was mixed yesterday as natural gas continued lower in search of support, while a short-squeeze sent crude oil futures up +0.65%.

Nat gas futures fell -1.2% yesterday for the 5th straight daily drop. The lows of the day were hit shortly after the EIA released the weekly inventory report that showed stockpiles grew by 93 Bcf vs. (E) 92 Bcf. Yesterday's EIA report was the first in nearly 2 months that was less than 100 Bcf, a report you would think would cause a bullish reaction. But, with the average weekly build for this time of year at just 72 Bcf, it is not a surprise that we saw the selling pressure continue.

Natural gas closed down near the lows of the day, which is bearish technically. However, futures are quickly approaching longstanding technical support at $4.10 which we have been watching since prices started to accelerate downward. And, we remain cautiously bullish from that level as long as we don't see a close below it. But, most natural gas traders will tell you that you shouldn't fight the direction of momentum in the market, and the sellers continue to have momentum on their side at the moment.

So, bottom line, we are essentially trying to catch a falling knife here, but the risk/reward remains favorable, risking about 10 cents for a potential return of 40 cents-plus. Proceed with caution.

In WTI crude oil, futures hit two-month lows in pre-market trading, but the sellers ran out of steam at the $101.55 mark and the short squeeze began. The rally started quietly, but accelerated as the day went on until futures closed the day within reach of the high ticks at $103. But, $103 is the technical level futures needed to close above in order to break the steep downtrend that has formed as a result of the heavy sell-off that began in late June. Today, closing resistance moved down to $102.50 while support is below at $101.25, and we recommend buying a dip toward support or a close above that $102.50 level.

Currencies & Bonds

It was an old-fashioned "risk off" day in the currency markets (and the first one in some time) Thursday, as the dollar was higher against every currency except the yen (the dollar and yen being the "risk off" currencies of choice).

The euro was the worst performer vs. the dollar yesterday, which isn't surprising given all the negative European news and the move higher in Portuguese yields. The euro fell -0.3% yesterday and is once again sitting on support at the 1.36 level.

The Aussie was the next biggest decliner vs. the dollar, dropping -0.27% despite the fact that economic data from 'Oz was better than estimates. The June Labour Force Survey (their jobs report) showed an increase in employment of 15,900 vs. (E) 12,000, but that was overshadowed by general risk aversion (the Aussie is still somewhat of a global proxy for risk sentiment, so when the Dow is down 200 points pre-market, the Aussie will usually be lower) and the disappointing Chinese import numbers.

There will be good money to be made shorting the Aussie at some point in the future, but for now it remains range-bound between $0.92 and $0.94, so I'd look to be a seller if the Aussie can rally further toward the upper end of that months-long trading range.

Looking at Treasuries, it surprisingly wasn't the best day for bonds. The long bond did close positive (up +0.07%) and the yield on the 10-year crept closer to 2.50%. But bonds didn't trade all that well yesterday, as they hit their highs of the day before the U.S. equity market open, and drifted lower throughout the day. Even when stocks were on their lows yesterday morning, the 30-year was up less than +0.5%, and given the quasi-hysteria in the market yesterday, I would have thought it would have been higher.

Helping Treasuries trade a touch heavy yesterday was a lackluster 30-year Treasury auction. The government auctioned $13 billion worth of 30-year Treasuries yesterday, and the results made it a trifecta of disappointing auctions this week (3-year Tuesday, 10-year Wednesday).

The bid to cover on the auction yesterday was 2.4, near the lower end of this year's auctions, while bidding was less than aggressive as the actual yield was ½ basis point higher than the "when issued" yield at 3.369%.

Interestingly, though, there was a silver lining to this auction. Indirect bidders, which are often used as a proxy for foreign bidders, took down more than 53% of this auction, and that's the largest percentage since 2008. I'm not an expert in the intricacies of bond auctions, but we know one of the reasons Treasuries remain buoyant is because of foreign (mainly European) demand. This high indirect bidder number implies that Treasuries are still attractive to foreign investors, which will help support the long bond.

Bottom line is the bond market appears to have thrown yet another enormous head fake with the drop of last week. The highs for the year at 138'10 remain resistance, but given the momentum in this market, I'd not be surprised if that's challenged, despite strong economic data and bottoming inflation. Despite the surge in bond-negative fundamentals, this bond rally of 2014 isn't going to end without a fight.

Have a good day - Tom

7:00's REPORT

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

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 (We were stopped out of EIRL yesterday).*
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.			

7:00's REPORT

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

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)