7:00's Report

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

July 18th, 2014

Pre 7:00 Look

- Futures are little changed this morning while global markets are mostly lower as investors digest the geo-political events that took place yesterday.
- There were no new developments in the MH 17 tragedy o/n as Russian and Ukrainian authorities continues to accuse each other of involvement. In Gaza, Israel has launched a ground operation, but this was largely expected.
- Economically, there were no reports o/n and no reports scheduled today.
- Earnings Today: HON (E: $1.36).

Market	Level	Change	% Change
S&P 500 Futures	1955.25	1.75	0.09%
U.S. Dollar (DXY)	80.60	.03	0.04%
Gold	1311.00	-5.90	-0.45%
WTI	102.57	.37	0.36%
10 Year	2.475	-.063	-2.48%

Equities

Market Recap

Stocks suffered their biggest declines since early April Thursday after the downing of a Malaysian airliner over Ukraine and a ground invasion into Gaza by Israel overshadowed more good earnings. The S&P 500 fell -1.18%.

Stocks were lower Thursday morning after the U.S. and EU announced additional sanctions on Russia Wednesday night, and after June New Home Sales posted a big miss. But, a strong Philly Fed report and good earnings from MS helped stocks recover by mid-morning.

EUM: The inverse emerging market ETF reversed yesterday, breaking a multi-month downtrend, and could be a good hedge against continued geo-political and central bank uncertainty.

The news of a Malaysian jetliner being shot down over Ukraine broke shortly after 11 a.m., and that news dominated the rest of the trading day. Stocks initially sold off in a defensive move as people looked for clarity on the situation, but the S&P 500 initially held support at 1,965 into the early afternoon.

But then, more "hawkish" comments by a Fed governor (Bullard), confirmation that the plane had been shot down, news that Israel was launching a ground invasion of Gaza and reports the White House was on lockdown all weighed on stocks as they sold off hard during the last two hours of trading.

Geo-Political Update (Ukraine and Gaza)

The downing of Flight MH17 is obviously a human tragedy and underscores how dangerous eastern Ukraine is at the moment. But the tragedy, as it's currently known, isn't really a market-defining event and not a material negative (by itself), although it does dampen sentiment.

As far as "why" stocks sold off yesterday on the news, it was more about being defensive given the lack of details more than it was a reaction to the actual event itself.

Market	Level	Change	% Change
Dow	16,976.81	-161.39	-0.94%
TSX	15,188.21	-38.13	-0.25%
Brazil	55,637.51	-79.85	-0.14%
FTSE	6,699.21	-39.11	-0.58%
Nikkei	15,215.71	-154.55	-1.01%
Hang Seng	23,454.79	-66.08	-0.28%
ASX	5,531.66	9.23	0.17%
Prices taken at previous day market close.			

Bottom line with the situation remains that unless Russia full-on invades eastern Ukraine, which is still a small-probability event, it is not a "bearish game-changer." Yes the headlines weighed on stocks yesterday. But beyond Russia-linked stocks and commodities (wheat in particular moved substantially yesterday) the impact likely won't be felt going forward. And, yesterday the headlines more provided an excuse for a market that acted like it wanted to trade lower all morning. This is not, in its current state, a major negative geopolitical event, despite efforts in the media to spin it that way.

Market	Level	Change	% Change
DBC	25.72	.07	0.28%
Gold	1317.10	17.30	1.33%
Silver	21.175	.40	1.93%
Copper	3.2195	.005	0.16%
WTI	103.09	1.89	1.87%
Brent	105.55	-.30	-0.28%
Nat Gas	3.97	-.149	-3.62%
RBOB	2.8767	-.0058	-0.20%
DBA (Grains)	26.29	.04	0.15%

Prices taken at previous day market close.

Moving on to Gaza, again it's a similar situation. And, I'm not trying to be dismissive of the events because they are certainly serious. But unless the issues in Gaza, Iraq, Syria, etc. devolve into a total regional holy war (Sunnis vs. Shiites vs. Israelis) then the current situation isn't a bearish game-changer by itself.

Bottom Line

The bottom line is stocks have been consolidating/ correcting since July 3, and despite the terrible headlines, this remains part of that process. The negative headlines are weighing on near-term sentiment, but as of yet neither event should cause one to significantly reduce exposure.

Support at 1,965 in the S&P 500 was "given" yesterday, so 1,951-1,953 is now the next area to watch. If that's broken, we're looking at almost a straight line to 1,934 (the 50-day moving average). If we get to that point, that's when things get more interesting.

A Hedge Against More Geopolitical Volatility

If you are looking for some sort of a geopolitical hedge—other than gold, which can have its issues as a geo-pol hedge—consider EUM, the inverse MSCI Emerging Markets ETF. It's not really a Russia play (Russia only makes up about 7% of EUM) and it is heavy in Asia (China, Korea and Taiwan make up over half the index). But, if we are going to see geopolitical upheaval continue, then the emerging markets, which have had a huge run since late January, are going to have to come back down to earth.

I have to admit the chart on this thing looks bad at first glance (it seems to only go down) – but it does work as a hedge against EM volatility. From Oct. 22, 2013, till Feb. 2, 2014, the respective highs and lows for that move, it returned over 15%. And yesterday EUM broke a two-month downtrend and appears to be trying to bottom near the $24 level.

The other immediate way to hedge (other than just getting short) is via gold, but that's going to be volatile. While gold has traded as a decent hedge against the equity markets this year, gold is also trading violently in reaction to inflation numbers (CPI is looming next week) and the Fed outlook. So, there are some cross-currents that make me want to spread a hedge out a bit (hence looking to emerging markets).

Finally, if we do see some unexpected "hawkishness" from the Fed over the coming weeks—or the market begins to adopt the belief that the Fed is indeed behind the curve—then emerging markets will get hit, and hit very hard. So, to a point, this is a geopolitical and Fed hedge with a relatively low-risk entry point.

Economics

Housing Starts

- New Housing Starts were 893K SAAR vs. (E) 1.026M in June

Takeaway

Yesterday's new housing starts report for June was disappointing on the headline as starts fell -9.3% to 893K SAAR, badly missing estimates for 1.026M. This report follows a nearly equally disappointing May report that showed a drop of -7.3% in starts. Looking to the details of the report, the weakness was universal as the multi-family component saw losses of -9.9% (after falling -14.7% in May) while the more closely watched, single-family component fell an even -9% (after a drop of -2.6% in May).

But, there were some silver linings that were missed by the media. First, almost all of the declines in starts came from the South (so it was localized instead of national), and more importantly, single family building permits, which are a leading indicator of housing starts, rose 2.6% after rising 3.0% in May. So, while clearly not a great number, housing starts wasn't as bad as it looked and doesn't materially derail the "Housing Recovery is accelerating" thesis.

Philly Fed Survey

- General Business Conditions Index was at 23.9 vs. (E) 16.9 in July

Takeaway

Yesterday's Philly Fed survey joined Tuesday's Empire State manufacturing survey as both handily beat analyst estimates and rose to multi-year highs. The index for Philly Fed rose to the highest reading since March 2011, and the details of the report were also very strong as the leading indicator, New Orders, surged 17.4 points to 34.2 in July. Other components of the report such as shipments and unfilled orders were also very strong. Employment growth, however, was a bit light at just 12.2, but slightly higher than the 11.9 reading in June. Stocks traded to session highs following the release of the report.

Bottom line, both the Empire State and Philly Fed surveys released this week suggest there has been a material uptick in the manufacturing sector in July, which overshadows the lagging industrial production report for June that disappointed on Wednesday. Looking ahead, the reports will be taken with a grain of salt because of both the geographic limitations and subjective nature of the surveys. However, the data were encouraging and will likely influence an uptick in estimates for both the July industrial production and durable goods reports.

Market	Level	Change	% Change
Dollar Index	80.57	-.055	-0.07%
EUR/USD	1.3524	-.0001	-0.01%
GBP/USD	1.7113	-.0023	-0.13%
USD/JPY	101.27	-.40	-0.39%
USD/CAD	1.0746	.0006	0.06%
AUD/USD	.9373	.0006	0.06%
USD/BRL	2.2457	.0221	0.99%
10 Year Yield	2.475	-.063	-2.48%
30 Year Yield	3.29	-.058	-1.73%
Prices taken at previous day market close.			

Commodities

Like everything else yesterday, commodities were heavily influenced by the news of MH 17 and were mostly higher yesterday thanks to fear bids in the gold, oil and even grain markets. Meanwhile natural gas futures plummeted more than -4% on bearish inventory data. The benchmark commodity tracking index ETF, DBC, added +0.2%.

Beginning with the gold, it was already higher (above $1300) Thursday morning following the announcement of new sanctions on Russia, but the rally accelerated after the MH 17 headlines hit and gold rallied as high as $1,325 immediately following the headlines before selling off a bit during the afternoon to close 1.5% higher.

Gold is down a few dollars this as details emerge regarding the tragedy, but as I said earlier unless we have a significant escalation in the Ukraine/Russia situation, the tragedy won't be a lasting bullish force on gold. Instead the bigger issue remains the bottoming of inflation and the perception that the Fed is "behind the curve." If that idea continues to gain traction, it will be a significant bullish force on gold, but it's early yet. On the charts, $1,310 is again initial support (it's being tested as I write) while $1,300 is also strong support, and $1293 (the low from this week and 50 day moving average) is the "line in the sand" for the bulls.

WTI crude oil futures also caught a fear bid from the headlines out of the Ukraine, but were already up well over 1% at the Nymex open yesterday thanks to the new sanctions being imposed on Russia by the United States and Europe. Technically, Wednesday's electronic close was also bullish as futures finished the day above the steep downtrend line that has been in place since the frothy highs of mid-June (due to Iraq).

So, the geopolitical fear bid was an additional boost to WTI, and futures hit fresh 8-day highs above $103 by early afternoon and closed at $103.94.

Looking ahead, we remain fundamentally bullish as domestic economic data continue to improve, especially the employment situation, as we are now averaging well over 200K new jobs per/month (and most of them need to drive to work which, in turn, increases gasoline demand). On the charts, there is support near $101.50 while the level to beat is yesterday's high of $103.94 (note we have moved ahead to the September contract).

Natural gas was by far the worst performer yesterday as futures fell a staggering -4.15% on the session. Traders were eyeing support in the $4.10 area earlier in the week, and although that level was violated, a smaller than expected build would have been capable of sparking a material short-covering rally. But, that was not the case as the EIA reported a weekly injection of 107 Bcf — 10 Bcf higher than the consensus analyst estimate of 97 Bcf. Given that information, it should be no surprise that natural gas instantly fell more than 10 cents. Natural gas future are now below $4.00/BCF for the first time since December of last year, and given that inventories are still 25% below the 5 year average, are getting fundamentally "cheap." But, the downside momentum at the moment is strong, so we'll wait for some sort of a bottom to form before getting long the futures again.

Currencies & Bonds

The yen spiked with gold and bond prices while Aussie (a [proxy for "risk" in the global currency markets) sold off sharply once word got out that MH17 was shot down yesterday morning and then, later, that the Israelis initiated a ground invasion in Gaza. The dollar oscillated back and forth in reaction to the headlines and several economic reports, but closed the day little-changed, down just -0.07%.

The yen was the big mover yesterday, rallying +0.42% on the news headlines out of the Ukraine, which influenced the flight to safety across asset classes. Earlier in the session, the yen was trading slightly higher but reversed to flat thanks to the mostly better than expected U.S. economic data (Philly Fed and weekly claims beat while housing starts missed). But looking at the bigger picture, the story is largely the same as the yen is tightly range-bound between 101 and 102, but continues to trade with a "heavy tone." So, the level to watch remains the 2014 low of 100.74.

Elsewhere in Asia, the Aussie was up +0.15% in mostly technical trading after bouncing off of the 50-day moving average, but sharply reversed to retest that level ($0.9353) when more negative geopolitical news of an Israeli ground invasion of Gaza hit the newswires toward the equity close. If the 50-day is forfeited, there is another line of support below at $0.9325, while resistance is above at $0.9400. But, like the yen, the Aussie is largely range-bound for the time being.

In Europe, the euro was essentially flat on the day as it bounced off support toward 1.35. If that support can hold, we will have a double-bottom forming on the charts and a retest of the downtrend at 1.36 will be in focus. And, that will present a possible opportunity for short-term traders to make some fast money on a short position, but we advise longer-term investors to stay away for the time being.

Bonds surged higher yesterday on geopolitical fears (Ukraine and then the Gaza ground invasion) yesterday as the 30-year traded to a new high for the year, and the yield on the 10-year fell below 2.5%. It was very clearly a "risk off" move in the markets yesterday though as junk bonds didn't benefit (JNK fell -0.75%) because there was a rush to the safety of Treasuries.

At this point bonds are on the rise and clearly the trend remains higher, as money flows and "risk off" sentiment continue to push this market higher in spite of further deteriorating bond fundamentals (bottoming inflation, accelerating economy).

While more of the coverage yesterday was appropriately on the Ukraine, Fed Governor Bullard joined in the recent trend of being "hawkish," cautioning that the economy is close to back to where the Fed wants it, and that rate hikes could come sooner than the market expects or has priced in. As has been the case, though, the warnings fell on deaf ears.

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
6/30/14	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	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	63.41 38.32	59.53* 36.83*	*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.			

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Asset Class Dashboard

(Updated 7.14.14)

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	**Neutral**	**Bullish**	*The S&P 500 fell from record highs last week as global economic data disappointed and a drop in European banks dragged global markets lower. Last week's dip appears to be a consolidation/correction that's needed after the rally since May, as the fundamentals for this market remain broadly bullish.*
Best Idea: Long Europe (VGK/EIRL/EWP/EWI) **Best Contrarian Idea:** Buy Retailers (XRT)			
Commodities	**Neutral**	**Neutral**	*We saw continued bifurcation in the commodity markets last week as energy continued to decline on expectations of an increase in output and reduction in geo-political tensions, while metals continued to rally. Broadly, though, the outlook for commodities is improving as global inflation bottoms and the global economic recovery continues.*
Best Idea: Long Oil (USO) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Neutral**	**Bullish**	*The Dollar Index was flat last week as "dovish" FOMC Minutes countered a late week "Risk off" bid. Going forward the dollar should remain range bound given uncertainty over Fed and ECB policy specifics.*
Best Idea: Buy the Pound (FXB) **Best Contrarian Idea:** Long Canadian Dollar (FXC)			
Treasuries	**Neutral**	**Bearish**	*Treasuries rallied big last week, driven by European buying and short covering, and are now just off highs for the year. Despite the direction of future Fed policy clearly being "hawkish," money flows into Treasuries are continuing to support bonds.*
Best Idea: Short long bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			