7:00's Report

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

July 2nd, 2014

Pre 7:00 Look

- Futures are flat this morning after a pretty uneventful night but It's green across the screen as global markets continued the rally started in the US yesterday.
- Economically it was mostly quiet. UK economic data continues to impress as the Home Price Index and Construction PMI beat estimates, while the final reading of Q1 EU GDP was in line.
- Econ Today: ADP Employment Report (E: 213K), Factory Orders (E: -0.3%)
- Fed Speak: Yellen (11:00 AM).

Market	Level	Change	% Change
S&P 500 Futures	1966.50	0.50	0.03%
U.S. Dollar (DXY)	79.875	.03	.04%
Gold	1328.30	1.70	0.13%
WTI	104.99	-.35	-0.33%
10 Year	2.563	.047	1.87%

Equities

Market Recap

The S&P 500 surged to new highs yesterday thanks to strong economic data and start of quarter buying. The S&P 500 rose .67%.

The real "catalyst" for the global rally yesterday was the June manufacturing PMIs, and while there was some give and take in Europe (Spain was strong but Germany was slightly disappointing), the major takeaway was that the data confirmed the global recovery (especially in the US and China) was continuing, and that, more than any-

Canada: Yesterday was "Canada Day" and while we celebrated new highs in the S&P, the Canadian market did the same, as is now up over 12% year to date!

thing, was the "reason" stocks rallied. Also contributing were the strong auto sales of 16.6 million saar vs. (E) 16.3 million (again further implying the recovery is healthy and on going).

Finally, much like the start of June, I think most traders expected a bit of a "start of month" dip after the June rally, but when that didn't come yesterday morning we saw some buyers chasing stocks around mid-day (when the S&P 500 hit its high).

Activity and news slowed into the afternoon as focused turned to the soccer game. Concerns about Iraq (more on that below) weighed a bit on stocks into the close and market finished off the highs, but it was still a very good day.

Trading Color

The rally was broad and strong yesterday as the Dow Industrials, S&P 500 and Russell 2000 hit new all time highs together, while the Nasdaq hit a new multi-year high. Markets were led higher by cyclical sectors. SPHB rallied 1.35%, while banks (KBE up .87%), consumer dis-

Market	Level	Change	% Change
Dow	16956.07	129.47	0.77%
TSX	15146.01	51.76	0.34%
Brazil	53171.49	3.27	0.01%
FTSE	6826.25	23.33	0.34%
Nikkei	15369.97	43.77	0.29%
Hang Seng	23549.62	358.90	1.55%
ASX	5455.40	79.50	1.48%
Prices taken at previous day market close.			

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cretionary (XLY up 1.06%) and tech (up 1%) all handily outperformed. Utilities were the only S&P 500 subsector to finish negative (down .9%) as defensive sectors broadly underperformed (interest rates were higher but we didn't see any sort of rotation out of higher yielding stocks, just some general "risk on" underperformance).

Market	Level	Change	% Change
DBC	26.51	-.07	-0.26%
Gold	1328.20	6.20	0.47%
Silver	21.150	.094	0.45%
Copper	3.2020	-.0015	-0.05%
WTI	105.28	-.09	-0.09%
Brent	112.25	-.11	-0.10%
Nat Gas	4.454	-.007	-0.16%
RBOB	3.0351	-.0082	-0.27%
DBA (Grains)	27.31	-.15	-0.55%
Prices taken at previous day market close.			

Volumes were a touch heavier yesterday morning as there seemed to be a bit more conviction behind the rally then we've seen in some time, but certainly part of that was new money being put to work for the new quarter.

On the charts the S&P 500 is at new all time highs, while resistance sits well below current levels at 1950 (the 20 day moving average).

Iraq Update

Iraq has deteriorated a bit this week and the inability of the Iraqi Parliament to choose a new PM weighed a bit on stocks late yesterday. Before reading the particulars, keep in mind there are two negative scenarios in Iraq for the markets. The first is that ISIS gets south of Baghdad and gains control of major oil export terminals in Basra in southern Iraq. That would send oil materially higher. The second is this Iraq conflict sparks a Sunni/Shiite civil was that spreads across the Middle East and pulls in Iran, Saudi Arabia, etc. Obviously, that would send oil higher. Given the events of the last few days, the worry is for the later and the moment more so than the former, as ISIS remains well north of Baghdad.

Now, the reason things have deteriorated a bit this week are two fold. First, ISIS (which is comprised of Sunni Muslims) attached a Shite shrine in Samarra earlier this week. The last time that happened was '06, and it sparked a nasty mini-civil war in Iraq.

Second (and more importantly) it was expected that the Iraqi parliament would pick a new Shiite Prime Minister to replace current PM Nouri al-Maliki, who is accused of largely ignoring Sunnis. It was hoped that a new PM would be viewed as more inclusive, and ISIS would lose support among regular Iraqi Sunnis.

But, as Baghdad dithers, Iraq burns. And, while militarily it seems a bit of a stalemate at the moment, any real solution will only come from a more inclusive government that saps ISIS's ability to rally regular Sunnis. Then the government can beat them back militarily. But, the longer that doesn't happen, the more support ISIS can gather among regular Sunnis, increasing the probability of a broader civil war.

Oil is down this morning so clearly the market isn't worried about this yet. But, the situation has gotten a bit and I wanted to make you aware. A major positive in this scenario remains the appointment of a new Iraqi PM, while oil (specifically Brent Crude) remains the indicator to watch as to whether things are materially getting worse.

Economics

ISM Manufacturing Index

- June ISM Manufacturing Index slipped to 55.3 in June vs. (E) 55.6
- New Orders rose 2.0 to 58.9

Takeaway

Yesterday's ISM manufacturing index came in at 55.3 for June, just shy of analysts' expectations of 55.6 and a tick below the May reading of 55.4. However the details of the report were stronger than the narrow headline miss suggested. New orders, the leading indicator and most-watched component of the report, rose 2.0 points to a solid 58.9.

The stock market rallied upon release of the ISM report yesterday morning, sending the S&P up to fresh all-time highs. Bottom line: The headline was good, but the leading indicators within the report, namely new orders, were better. They continue to indicate strong and steady growth in the manufacturing sector going forward.

Commodities

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Commodities seemed to ignore the strong economic data yesterday as both industrial and energy futures underperformed while precious metals rallied. The benchmark commodity ETF, DBC, fell -0.21%

Gold and silver futures were among the best performers yesterday, rallying +0.46% and +0.45%, respectively. Overnight, gold futures spiked to a 14-week high of $1,334.90, which was more than likely an attempt at "running stops" and initiating another short-squeeze-style leg higher. And, although the apparent attempt failed, gold traded very well yesterday, finishing the day at the highest level since late March. On the charts, the first line of resistance at $1,330 remains intact while support remains well below at $1,310.

Looking to the energy markets, WTI, Brent, the products and natural gas futures all fell slightly yesterday in primarily technical trading as the newswires were mostly quiet. Day traders and algos got into the crude market early, selling heavily until eventually futures broke through Monday's lows. This in turn stopped out a lot of low-time-frame longs.

But, futures reversed sharply off of the supporting 2014 uptrend line and importantly closed well off the lows and comfortably above the $105 mark. Going forward, the trend remains higher, and it is important to note that a close below $105 this week would not be as bearish as many may think. The key is staying above the trendline, which is currently sitting at $104.70.

Grains Update

We mentioned in Tuesday's Report that the grains were in the process of getting crushed, and there was some follow-through to that trade yesterday as corn, soybean and wheat futures fell -0.53%, -0.93% and -0.78%, respectively. The reason for the high-volume sell-off was a bearish USDA acreage report.

Beginning with soybeans, the report indicated that soybean-planted area for 2014 is estimated at a record high of 84.8 million acres. That's an +11% increase year-over-year, and much higher than average estimates of 82.2 million acres. This is obviously supply-side bearish, and futures fell to the lowest level since December 2011.

Corn futures are down -6.6% so far this week thanks to the USDA reporting that stockpiles will be larger than forecast this year. Stockpiles reached 3.854 billion bushels vs. (E) 3.723 billion, which is up from 2.766 billion last year.

Bottom line is the grains, which were among the best-performing commodities to start the year, are now trending lower, and we will be keeping an eye on the individual trends and technical indicators as we look for any trade opportunities in Q3.

Currencies & Bonds

Most currencies were driven by economic data yesterday. The Dollar Index drifted slightly higher off the decent June ISM manufacturing PMI (up +0.06%) while the euro was slightly weaker (down -0.12%) after mixed manufacturing PMIs (they generally met expectations but the euro has seen a big rally lately).

The Aussie was the best performer vs. the dollar, rising +0.8%, breaking decisively through resistance at $0.94 and hitting a new high for the year. The strength in the Aussie was due to short-covering as the currency rallied through $0.94 (which had been the high for the year) thanks to the improvement in Chinese PMIs and the lack of any dovish comments from the RBA during their rate meeting yesterday.

Markets were looking for the RBA to make some mention of the recent strength in the Aussie and attempt to "talk it down" as they did last year, but that didn't happen. It's especially surprising given the fact that some bulk commodity prices (specifically iron ore) have collapsed 30% since April while the Aussie has rallied, causing a "double whammy" on the mining sector that continues to threaten the economy. But, the RBA refrained from any Aussie-related commentary and instead said they continue to expect a "period of stability"

Market	Level	Change	% Change
Dollar Index	79.855	.044	0.06%
EUR/USD	1.3678	-.0013	-0.09%
GBP/USD	1.715	.0047	0.27%
USD/JPY	101.54	.24	0.23%
USD/CAD	1.0635	-.0032	-0.30%
AUD/USD	.9494	.0064	0.68%
USD/BRL	2.203	-.0107	-0.48%
10 Year Yield	2.563	.047	1.87%
30 Year Yield	3.395	.057	1.71%
Prices taken at previous day market close.			

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in interest rates (meaning no more cuts).

Given the divergence in the Aussie vs. key commodity prices (high vs. low), a stabilizing but not accelerating Chinese economy, and the RBA's reluctance to ease further, the picture isn't very optimistic for the Aussie economy. Fundamentally, things are still bearish for the Aussie. But, clearly the trend is higher for now, and next resistance is $0.9518. And, until the RBA says something about the elevated Aussie, then this counter-trend rally will continue.

The pound continued its grind higher, hitting another multi-year high after the Great Britain June PMI beat estimates (57.5) Tuesday, and the trend remains clearly higher. (As long as the Fed is dovish and the UK economy continues to surge, the pound will continue to rally vs. the dollar. We've not seen the highs yet in this trade, I believe.)

The yen weakened a bit vs. the dollar yesterday (down -0.25%), but it bounced off the intraday lows and dollar/yen remains below the 200-day moving average – and it needs to get back above that support level today or tomorrow; otherwise the outlook for the yen will continue to get stronger.

Economic data lately out of Japan has been a bit tepid, and given the lack of specifics from Shinzo Abe's "3rd Arrow," it appears the market is starting to lose some confidence in the PM (that's why the yen is rallying – it's not because of economics per se). The Bank of Japan remains in the corner of the yen bears, and I believe they will act if the economy begins to falter – but that could be at a much lower level for dollar/yen.

Again this has been a trade that has worked for over 18 months, so I'm hesitant to abandon it now, but the dollar/yen needs to get back above the 200-day sooner than later.

Bonds were sharply weaker yesterday as the 30-year fell -0.65%, trading lower off of the global PMIs. This largely implied the global economic recovery is progressing (there was also a cautious article on junk bonds and credit spreads in the WSJ, **link here**, although that didn't really tell us anything new).

Bonds were weaker all day yesterday (the selling began overnight Tuesday once the Chinese PMIs hit), and the declines accelerated after the strong auto sales and ISM manufacturing PMI. The yield curve steepened yesterday as the "belly" of the curve declined only modestly (down -0.27%), helped by the Fed purchasing $2.9 billion worth of 7-year bonds.

Bonds gave back a lot of last week's rally yesterday, but still remain firmly in a solid uptrend until the 30-year breaks 135'18-ish, the uptrend will continue.

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	VGK EWP EIRL EWI	61.24 43.58 37.42 18.14	59.60 42.22 35.41 16.89	*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 spositive for yeasr 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 6.30.14)

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 in thin trading, but generally the outlook for stocks remains positive, as global central banks remain accommodative, valuations are stretched but not expensive, and the global recovery is ongoing. Sentiment is getting a touch too bullish, so a correction or churn sideways for a few weeks would be healthy, but beyond that the outlook remains favorable.*

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 Gold (GLD)**

U.S. Dollar	**Neutral**	**Bullish**	*The Dollar Index declined last week off slightly disappointing economic data (consumer spending/durable goods), but will remain largely range bound until we get more clarity on trends for inflation here and in the EU.*

Best Idea: **Buy the Pound (FXB).**

Best Contrarian Idea: **Long Canadian Dollar (FXC)**

Treasuries	**Neutral**	**Bearish**	*Treasuries rallied off the soft economic data and ignored the uptick in inflation last week. The uptrend in place since January again held a major test, so until 135'18 is broken in the 30 year, the shorter term trend remains higher.*

Best Idea: **Short long bonds (TBT)**

Best Contrarian Idea: **Short High Yield Bonds (SJB)**

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