7:00's Report

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

July 21st, 2014

Pre 7:00 Look

- Futures are slightly weaker this morning and most foreign markets are lower on general geo-political concerns.
- Over the weekend the Ukraine/Russia situation was static, but there was an escalation in violence in Gaza as the Israeli operation continues. That situation seems to be weighing on markets this morning.
- There were no material economic reports out o/n and no releases are scheduled today.
- Earnings Today: BBT (E: 0.75), HAL (E: $0.92), NFLX (E: 1.14), TXN (E: 0.59).

Market	Level	Change	% Change
S&P 500 Futures	1697.25	-4.25	-0.22%
U.S. Dollar (DXY)	80.62	.025	0.03%
Gold	1315.50	6.10	0.47%
WTI	101.88	-.07	-0.07%
10 Year	2.485	.010	0.40%

Equities

Market Recap

Stocks managed to close modestly higher last week despite a lot of news and volatility, as good earnings and economic data (domestically and from China) countered negative geopolitical news. The S&P 500 rose +0.5% on the week and is up +7.03% year-to-date.

The S&P 500 was little-changed through Wednesday of last week despite a decent intraday sell-off Tuesday. Good earnings, stabilization in European financials and the potential mega-merger of TWC/NWS helped offset an intraday sell-off Tuesday. The S&P 500 dipped to support at 1,965 intraday Tuesday thanks mainly to a sharp drop in biotechs and social media stocks after they were singled out by the Fed as being potential overvalued. But, there was no real conviction to the selling, and markets rebounded by the close Tuesday to finish very slightly lower.

Stocks rallied Wednesday thanks to earnings, strong Chinese economic data and the news of the potential NWS/TWC merger, and the S&P 500 closed just off the all-time highs.

Thursday, however, saw the biggest one-day decline in the S&P 500 since early April, as a "triple whammy" of geopolitical events caused stocks to sell off hard during the last hour of trading Thursday. New sanctions on Russia and news that Israel was launching a ground operation in Gaza weighed on stocks. But the real negative catalyst was the downing of Malaysia Airlines Flight MH17, which caused a "sell first, ask questions later" response as rumors flew around the Street.

But, the market was able to recoup almost all of Thursday's losses on Friday, as markets calmed down and (correctly) viewed the incident as an awful human tragedy, but not something that would cause the Ukraine/Russia situation to become more than a local issue, which it is. Dip-buyers stepped in Friday morning and the more stocks lifted, the more the markets pulled in buyers and caused weak-handed shorts to cover. Stocks closed the week basically at the highs of the day.

Trading Color

There was no real definitive trend within markets last week, as cyclicals and defensives performed basically the same (SPHB and SPLV were down fractionally on the week). The Russell 2000 and "momentum" sectors

Market	Level	Change	% Change
Dow	17,100.18	123.37	0.73%
TSX	15,266.57	62.09	0.41%
Brazil	57,012.90	1,375.39	2.47%
FTSE	6731.12	-18.33	-0.27%
Nikkei	15215.71	-154.55	-1.01%
Hang Seng	23387.14	-67.65	-0.29%
ASX	5539.94	8.28	0.15%
Prices taken at previous day market close.			

(biotechs and Internet stocks) got hit hard last week and were among the worst performers. But that was due more to the Fed's comments about those sectors than it was any general rotation.

Market	Level	Change	% Change
DBC	25.54	-.17	-0.64%
Gold	1310.20	-6.70	-0.51%
Silver	20.89	-.244	-1.15%
Copper	3.1855	-.035	-1.09%
WTI	103.27	.08	0.08%
Brent	107.35	-.54	-0.50%
Nat Gas	3.95	-.004	-0.10%
RBOB	2.8649	-.0168	-0.58%
DBA (Grains)	26.37	.10	0.40%
Prices taken at previous day market close.			

With earnings season getting into full swing, we saw tech trade well (despite the weakness in Internet stocks) as large-cap tech companies posted good earnings results, and XLK (tech sector SPDR) hit a new 52-week high.

Financials also traded well last week. Large bank earnings are coming in better than feared, although we are witnessing an interesting rotation. Regional banks are seeing money rotate out into the large multi-nationals, as earnings from the latter aren't as bad as feared. Given that, they may offer some value over the regionals.

Materials stocks and specifically the global industrial miners continue to trade very well, and this remains one of the best-performing sectors throughout this recent market consolidation. PICK surged Friday to close at a new 52-week high on a combination of good earnings (RIO and others) and improving prospects in China. Materials/industrial miners remain an attractive sector going forward from a fundamental (leveraged to the global recovery) and valuation standpoint.

Finally, utilities lagged last week, which is surprising given the decline in yields. And, despite bonds hitting new highs for the year, utilities remain well off recent highs, which is a surprisingly bearish sign.

On the charts the S&P 500 appears to have successfully held support at 1,965, and that remains a key level to watch this week. Resistance sits at the old highs (1,985).

Bottom Line

A lot happened last week news-wise, but stepping back, none of it materially changed the outlook for stocks. The market continues to simply consolidate the rally since mid-May, which is what's been going on since July 3rd.

Geopolitical events last week were notable, but MH17, Gaza, Banco Espirito Santo and other events aren't enough to cause a reversal in this rally, although I'm not trying to downplay the potential for them to become more serious.

Instead, the main reason stocks remain buoyant (Fed accommodation and a recovering economy) remained very much in place last week, as Yellen was not hawkish and the economic data were good.

Additionally, while it's still early in earnings season, results are good (borderline very good). According to Bloomberg, 80 S&P 500 companies have reported results, with 77% beating on EPS. More importantly, 70% topped revenue estimates, which if it holds will be a significant uptick from the recent 50-ish percent from recent quarters.

Sales growth has been missing in this economic recovery and previous earnings season beats were the result mostly of cost cutting and buy backs, not increased sales. So, if these revenue "beats" continue, that's an unexpected tailwind on stocks because It would not just confirm $130 EPS for 2015 in the S&P 500, but strong revenues may also up that number, and then valuation becomes solidly in the bulls' favor.

While geopolitics will continue to make headlines, the real risk to this rally remains a jarring shift in perception of Fed policy (i.e., the market all of a sudden realizes the Fed is going to get "tight" sooner than is currently expected).

But, for now, that remains just a risk to monitor. While the period of consolidation may continue for a while, the benefit of the doubt remains with the bulls and I would not be reducing exposure at these levels.

Economics

Last Week

Last week economic data points were good, and although to a point this was ignored amid the geopolitical news, the data points last week are going to further increase worries that the Fed is "behind the curve," because the data from last week showed economic growth is accelerating.

The blowout numbers were the Empire State and Philly Fed manufacturing indices, which both handily beat expectations (25.6 & 23.9 vs. (E) 17.8 & (E) 16.9 respectively) and made new multi-year highs. Granted, they are just regional surveys, but they are the first data points from July, and will clearly increase expectations for the flash manufacturing PMI that comes Thursday.

There were a few headline "misses" from other numbers last week, but the headlines were somewhat deceiving. June retail sales missed estimates, rising +0.2% vs. (E) +0.6%. But importantly, there were positive revisions to the April and May data, and the "control" group (retail sales less autos, gasoline and building materials, which is a better measure of true consumer spending than the headline) rose +0.6% in June. So, that report helped calm some nerves about a consumer spending decline.

Housing starts was the big miss of the week, as June starts were 893K (seasonally adjusted annual rate) vs. (E) 1.026 million. But, while a pretty bad number on the headline, almost all of the declines in starts came from the South. More importantly, single-family building permits (which are a leading indicator of housing starts) rose +2.6% in June, implying future gains. So, the data point isn't enough to throw the re-acceleration of the housing recovery into doubt.

Industrial production was the only truly disappointing number last week, but it was only mildly so. Industrial production in June rose +0.2% vs. +0.4% and the manufacturing component rose just +0.1%. But it is still growth (albeit slow growth) and that's not materially changing anyone's outlook on the economy by itself.

Looking at the Fed, last week's focus was on Chair Yellen's "Humphrey-Hawkins" testimony to Congress. While it was spun slightly "hawkish" it really wasn't. As far as Yellen is concerned, Fed policy remains "steady as she goes" and the testimony was a relative non-event. We did hear from some other Fed presidents, though, and generally speaking there was a "hawkish" tone from Richard Fisher and James Bullard, although it was largely ignored by markets. But, the "hawks" are getting a bit more vocal, despite Yellen remaining unmoved. The hawkish tone is adding to the idea that the Fed may be starting to get "behind the curve."

Market	Level	Change	% Change
Dollar Index	80.605	.035	0.04%
EUR/USD	1.3527	.0001	0.01%
GBP/USD	1.7089	-.0009	-0.05%
USD/JPY	101.36	.21	0.21%
USD/CAD	1.0728	-.0033	-0.31%
AUD/USD	.9394	.0043	0.46%
USD/BRL	2.2281	-.0294	-1.30%
10 Year Yield	2.485	.010	0.40%
30 Year Yield	3.294	.04	0.12%
Prices taken at previous day market close.			

Bottom line last week was economic data continued to show the domestic recovery is accelerating. While the economy isn't going "gangbusters," things are improving. That's important because it'll continue to put some pressure on the Fed to potentially change tone on when rates may start to rise.

<u>This Week</u>

Given the good economic numbers from last week, and taken in the context of growing sentiment that the Fed may be "behind the curve," the CPI reading Tuesday is the most important number this week.

If inflation runs hot again (and market expectations are for slight moderation from the current pace in inflation), that will further the argument that the Fed is "behind the curve," and the market could react negatively.

After CPI we get the global "flash" manufacturing PMIs for July starting with China Wednesday night and the EU and U.S. Thursday morning. The market will be looking for continuation of the recent trend: PMIs that show the Chinese economy is stable, the EU recovery is ongoing (even at a very slow pace) and the U.S. recovery is accelerating. The EU and German manufacturing PMIs will be particularly in focus, and if the numbers are weak on Thursday, that could weigh on markets.

There's also more housing data this week, and it's a bit more important given the big headline miss in housing starts last week. Existing home sales hits tomorrow and new home sales hits Friday. If both those numbers echo the weakness in the housing starts headline, then we could see some doubts spring up about the recent acceleration of the housing market recovery. Finally the week wraps up with durable goods Friday.

Commodities

Commodities continued to trade heavy last week, with the metals and natural gas among the worst performers. The notable exception was crude oil, which held support at $100/barrel and reversed mid-week on short-covering. The benchmark commodity tracking index ETF, DBC, was down for the 4th week in a row, falling -0.82%.

Natural gas futures broke through support and traded below the $4 mark for the first time this year upon release of the weekly EIA supply data, which reflected a larger injection than analysts had forecasted (107 Bcf vs. (E) 97 Bcf). Natural gas futures fell -4.9% on the week. Going forward, the path of least resistance is lower as the weekly supply builds continue to be larger than the seasonal average, although given supply is still more than 25% below 5 year averages, we're getting close to "value" levels for natural gas longer term.

Elsewhere in energy, crude oil futures found support at $99 and the momentum shifted to favor the bulls mid-week. WTI finished the week higher by +1.2% largely thanks a surprisingly large draw in supplies announced by the EIA on Wednesday (-7.5M bbls vs. (E) -2.6M bbls). The report helped futures reverse and close above technical resistance at the sharp downtrend line that has been in place since prices peaked in mid-June due to the situation in Iraq. Looking ahead, we remain fundamentally bullish based on the argument that the economy is continuing to grow, which is supportive of prices (higher demand). The near-term technical situation, however, is a little less clear, but we feel good about buying dips toward $100 with a stop below last week's lows.

Moving to the metals, copper futures sold off much as we have been expecting, but they encouragingly held support at the 200-day moving average. Copper finished the week lower by 2.5% mostly thanks to some lackluster economic data out of China as well as new shorts coming into the market. Looking ahead, the bullish fundamental argument based on the improving global economic situation remains intact, and buying copper here is a well-supported and low-risk trade opportunity, using stops beneath last week's lows ($3.16) and having an initial target of around $3.30.

Gold futures fell -2.1% last week for no real reason other than buyer exhaustion and long-side profit-taking. Gold encouragingly held the 50-day moving average close to $1,294 and was able to recover the $1,300 level later in the week. So, going forward we remain cautiously bullish on gold over the medium term, especially with the major underlying theme in the market of the threat of inflation and the unclear future of Fed policy.

Currencies & Bonds

The Dollar Index traded to a one-month high last week as strong economic data and general "risk off" sentiment following the MH17 news helped push it higher.

Conversely, the euro dropped to an intraday 5-month low (it was the worst-performing major currency vs. the dollar last week, dropping -0.6%). It closed just above support at 1.35 thanks to more dovish commentary from Draghi and other ECB members. (Draghi said bond purchases (QE) were "squarely within" the scope of the ECB.) The flash PMIs will be key for the euro this week as to whether it can hold key support at 1.35.

Turing to Asia, the yen grinded steadily higher, closing at a multi-month high after the Bank of Japan left their forecasts for inflation unchanged at a meeting last week, and the yen benefited from a "risk off" bid following the geopolitical news last Thursday.

The yen is challenging support at 101 vs. the dollar, but the major "line in the sand" in the short yen trade remains the high for the year at 100.74.

Looking at the bond market, the 30-year surged higher last week despite good economic data and "hawkish" commentary from multiple Fed presidents (although Yellen wasn't hawkish in her testimony).

Bonds benefited from a flight to safety Thursday following the geopolitical news, as the 30-year traded higher by nearly +1%. Bonds are now at the highs of the year, and despite negative fundamentals gathering steam, money flows continue to trump fundamental reality.

Bonds remain susceptible to a washout if the idea that the Fed is "behind the curve" gains more traction. CPI will be important for bonds today, but the fact remains that bonds are still in a decided uptrend for now.

Have a good week—Tom.

Position Sheet

Tactical Trading/Investment Account (Time frame of a few weeks to months).

Date	Position	Open Price	Stop	Strategy
7/21/14	JCC	Buy on open	None	*Copper has benefitted from the rebound in the global economy and now there is an attractive entry point given last week's correction. We will initiate a small position today and look to add to it on further weakness.*
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*
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 (7/21/14): Geo-political concerns and foreign money flows sent bonds to new highs for the year last week, and the gap between deteriorating fundamentals and price action is widening. For now, though, the trend is higher and more patience is required in this long term trade.			

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Asset Class Dashboard

(Updated 7.21.14)

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 finished last week mildly positive although there was significant volatility. Geo-political events continue to grab headlines but MH 17/Gaza aren't enough to de-rail the rally, and generally the market continues the consolidation that has occurred since the July 3rd highs. The benefit of the doubt remains squarely with the bulls.*

Best Idea: Buy global industrial miners (PICK, FCX, RIO, etc.)

Best Contrarian Idea: Buy Retailers (XRT)

Commodities	**Neutral**	**Bullish**	*Commodities broadly continued to correct last week as DBC ended lower for the 4th straight week, weighed down by natural gas and gold. WTI Crude managed to hold support at $100/bbl on geo-political fears while copper traded back towards support as well.*

Best Idea: Long Oil (USO)

Best Contrarian Idea: Buy Grains (DBA)

U.S. Dollar	**Neutral**	**Bullish**	*The Dollar Index traded modestly higher last week on a combination of good economic data, a "Risk off" trade given geo-political headlines, and euro weakness. The Dollar Index is near the upper end of it's 79-81 trading range and unless CPI is high, I don't expect the Dollar Index to break out.*

Best Idea: Buy the Pound (FXB)

Best Contrarian Idea: Long Canadian Dollar (FXC)

Treasuries	**Bullish**	**Bearish**	*Treasuries rallied big last week, driven higher by geo-politics and a "Risk Off" bid Thursday. Bonds are now at new highs for the year despite further deteriorating fundamentals.*

Best Idea: Short long bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)