7:00's Report

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

July 23rd, 2014

Pre 7:00 Look

- Futures are drifting slightly higher while foreign markets rallied following the gains in the US yesterday.
- News wise it was another quiet night as there were no developments in Russia/Ukraine or Gaza and concern towards both situations continues to gradually recede.
- Economically, Australian CPI was higher than expected which has resulted in a big rally in Aussie (up 60 bps) but outside of that it was quiet. There are no reports scheduled for today.
- Earnings: BA (2.02), PEP (1.23), T (0.63), FB (0.32).

Market	Level	Change	% Change
S&P 500 Futures	1978.75	3.75	0.19%
U.S. Dollar (DXY)	80.83	-.035	-0.04%
Gold	1308.30	2.00	0.15%
WTI	102.41	.02	0.02%
10 Year	2.466	-.008	-0.32%

Equities

Market Recap

Stocks rallied yesterday on a combination of better than expected economic data and stagnant geopolitics. The S&P 500 added +0.5% on the day.

Stocks traded sharply higher out of the gate yesterday, hitting fresh all-time highs by midmorning before trading sideways for the remainder of the session and closing just off the highs. Stocks rallied thanks to several encouraging economic reports: CPI was not too "hot" like many investors had feared, while housing data were better than expected.

Russell 2000: It's worth pointing out that the Russell 2000 appears to have completed a text book Fibonacci retracement of the May to July rally.

Additionally, the lack of any material developments in either the Ukraine/Russia or Gaza/Israel situations reduced a bit of the recent geopolitical headwind that has been hindering equity markets (confirmed by the weakness in commodities yesterday, which have been supported by geopolitics in recent sessions).

There was a mini-dip in the market around 2:45 that coincided with a headline that the FAA was halting flights into Tel Aviv after reported rocket attacks near the airport, but the dip was temporary and stocks recovered shortly thereafter. Stocks hit fresh highs late morning, but investor conviction was absent, leaving the S&P to drift sideways into the close.

Trading Color

Encouragingly, cyclicals outperformed yesterday as the Russell 2000 traded +0.8% higher and the Nasdaq was +0.7% higher, both decently outperforming the S&P 500

Market	Level	Change	% Change
Dow	17,113.54	61.81	0.36%
TSX	1,5315.13	65.14	0.43%
Brazil	57,983.32	349.40	0.61%
FTSE	6,820.15	24.81	0.37%
Nikkei	15,328.56	-14.72	-0.10%
Hang Seng	23,971.87	189.76	0.80%
ASX	5,576.75	33.45	0.60%
Prices taken at previous day market close.			

(although while the SPX hit a new 52-week high yesterday, the Russell remains well off the highs).

The cyclical outperformance yesterday extended into sector trading as tech was the leader (up +0.84% ahead of AAPL and MSFT earnings, which were mostly in-line).

Industrial miners and those sectors linked to the global recovery also continued to outperform, with PICK rallying +1.25% after hitting a new 52-week high yesterday.

Market	Level	Change	% Change
DBC	25.57	-.09	-0.35%
Gold	1306.70	-7.20	-0.55%
Silver	21.005	-.007	-0.03%
Copper	3.207	.008	0.25%
WTI	102.38	-.48	-0.47%
Brent	107.36	-.32	-0.30%
Nat Gas	3.778	-.071	-1.84%
RBOB	2.8802	-.0112	-0.39%
DBA (Grains)	26.34	-.06	-0.23%

Prices taken at previous day market close.

Defensive sectors lagged again as consumer staples again traded poorly (mostly thanks to lackluster earnings). Meanwhile utilities, despite the fact that bond yields are basically at the lows of the year, continue to lag—which is not what you would expect in this environment.

Finally, regional banks continued to get beaten due to this rotation into the investment banks. But at this point, KRE is off more than 10% from the March highs and approaching multi-year support around $38 (this trendline dates back to Oct '11), and has to be worth a look on the long side if you're a macro bull.

"Left Field"

Part of our job is to make sure nothing comes out of "left field' and blind sides us - so we have a white board in the office called left field where we put potentially disruptive events that are low probability.

"Argentine default" has been up there for a while, and after yesterday's non-decision by a New York court to allow Argentina to pay other bond holders before the hold outs from MNL Capital and others.

The likely outcome is there will be some sort of an agreement to extend the negotiations, but the official deadline for Argentina to pay other bond holders is a week from today July 30th, so we are getting down to crunch time. Again, this will all probably work out, but we're getting close, and this situation needs to be watched, because another Argentina default is currently not priced into risk assets.

Bottom Line

Yesterday was a nice rally but the S&P 500 failed to materially break through 1,985. This sort of reminds me of what we saw earlier in the year in the March-May period where 1,885 proved resistance and the market basically treaded water for two months. I'm not saying that's going to happen again this time, but it feels similar.

Earnings season rolls on, but I get the feeling it's ready to be chalked up as "better than expected," although it'll be important to see continued revenue strength. Today should be quiet as the next big data point is the flash PMIs out tomorrow.

Economics

CPI

- CPI rose 0.3% m/m in June vs. (E) 0.3%.
- Core CPI rose 0.01% vs. (E) 0.2%.

Takeaway

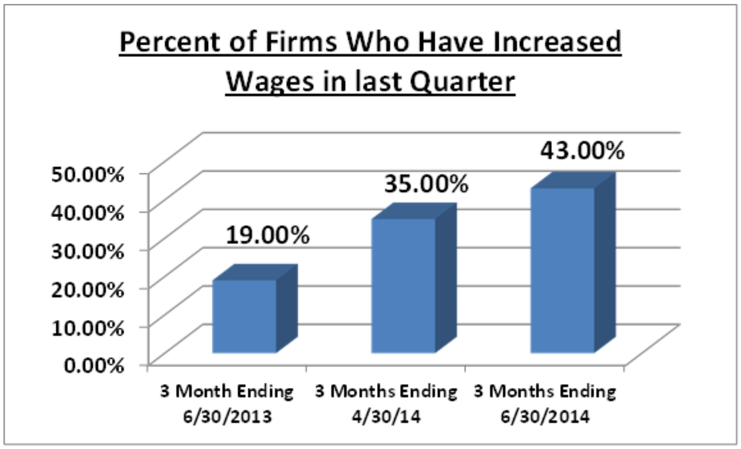
June CPI was in line, with both the monthly and year-over-year readings meeting expectations (importantly, core CPI maintained the 1.9% yoy increase seen in May, which will give the Fed some breathing room).

While clearly the pace of inflation remains elevated compared to a year ago, the recent acceleration from March-May seems to have moderated (as expected, because it was pretty unsustainable). Nonetheless, this most recent CPI reading furthers the point that we are seeing inflation bottom, although we aren't in a material acceleration phase.

But, there's more to inflation than just price inflation. As I alluded to yesterday, there is evidence that wage inflation is starting to bottom along with price inflation – and that's something for the Fed to watch closely.

More Signs of Growing Wage Pressures

While the world yesterday was focused on price inflation (which is what CPI measures), there have been some interesting developments lately with regard to wage inflation. Stagnant wages remain one of the core reasons QE hasn't resulted in higher general inflation. But there are some signs that wages may finally be rising, and along with them wage inflation.



In its quarterly survey, the National Association for Business Economics (NABE) reported that nearly 50% of companies reporting had increased wages during Q2 2014, which is up from 35% in Q1 and most importantly 19% in Q2 2013.

Taken in the context of the whole "Fed is behind the curve" opinion, if this trend continues and turns into legitimate wage inflation, then the outlook for inflation will take a material jump to the upside. This matters because if that happens, then the Fed will be perceived as "*way* behind the curve" and they'll have to react.

The Fed has been able to dismiss general price inflation (Yellen called it "noise") because, so far, price inflation has been limited mostly to commodities—which is viewed as transitory. But, wage inflation is another issue entirely, and it's one that's not so easily dismissed by the Fed.

Bottom line is despite the relentless rally in bonds, evidence is building that the Fed is going to have to adjust when it expects to begin to tighten. If these trends continue, that adjustment remains one of the biggest threats to this rally. Again, we're not there yet, but the case is slowly but surely building.

Market	Level	Change	% Change
Dollar Index	80.865	.238	0.30%
EUR/USD	1.3467	-.0056	-0.41%
GBP/USD	1.7062	-.0012	-0.07%
USD/JPY	101.45	.06	0.06%
USD/CAD	1.0733	-.0001	-0.01%
AUD/USD	.9389	.0017	0.18%
USD/BRL	2.2107	-.0083	-0.37%
10 Year Yield	2.466	-.008	-0.32%
30 Year Yield	3.252	-.012	-0.37%
Prices taken at previous day market close.			

Commodities

Commodities traded mostly lower yesterday as the multiple geopolitical disturbances eased (or at least did not escalate) and economic data largely met or beat expectations. Natural gas was again the worst performer as prices remain in "free-fall," while copper continued to trade well and was the sole outperformer on the day. DBC (the benchmark commodity index) fell -0.35%.

Beginning with the sole outperformer, copper was up well over +1% yesterday morning, but much of those gains were lost as short-term longs took profits and traders positioned ahead of Chinese economic data due out later tonight. Regardless, copper futures still encouragingly finished the day up +0.25%.

Going forward, we continue to like owning copper as one way to gain exposure to the ongoing global reflation trade. The charts, however, are relatively neutral on the low time frame as investors await the closely watched global flash PMI reports, namely the Chinese figure. But, an important support level to watch is the 200-day moving average at $3.18, as a close below it would shift the technicals in favor of the bears.

Elsewhere in metals, gold fell -0.55% yesterday thanks to the in-line CPI report as well as the better than expected housing data in Existing Home Sales. The CPI report was the real focus of the metals markets, though, as many investors continue to fear that the Fed may be "behind the curve" and a rate hike could come sooner than is currently priced into the market.

And, for that very reason, we remain cautiously bullish on gold as any mention of that possible "sooner than later" rate hike would likely cause a sharp rally as part of a greater "inflation trade" (which would include a sell-off in both the stock market and bonds, and a dollar rally).

Moving to the energy space, WTI crude oil futures fell -0.47% yesterday as energy traders positioned ahead of the weekly EIA inventory report due out this morning (10:30). Analysts are forecasting a draw of 2.5 million barrels in crude oil, a build of 900k in RBOB gasoline, and a build of 1.9 million in distillate supplies.

Looking at the technicals in WTI, yesterday sent mixed signals as futures failed to close above the $103 mark, which has proven to be stubborn resistance this week, but encouragingly held the 100-day moving average. Going forward, the story remains the same: As long as the economy continues to grow, specifically the labor market, so too will demand for crude oil and refined products. This means prices should remain comfortably above the $100 mark.

Natural gas continues to be under heavy selling pressure as the bears clearly maintain momentum for the time being. Futures fell another -2% yesterday and are down over -10% since this time last week. Sooner or later, natural gas is going to reverse, and likely sharply. But, until we get a disruption in production, or a spike in demand because of warmer weather, the path of least resistance remains lower.

Currencies & Bonds

The euro was the big mover in the currency markets yesterday as it fell to a new low for the year after violating major support at the 1.35 level. There wasn't any specific reason for the declines other than that technical break – and rather than having any specific catalyst, the euro has sold off this month on general realization that the paths of interest rate policy between the EU and the U.S. are diverging (EU easier, U.S. tighter). Also pushing the euro lower yesterday was selling ahead of the flash manufacturing PMIs out tomorrow morning, as investors are assuming we're going to get another soft number.

Despite other major currencies trading flat vs. the dollar (the pound, yen, Loonie and Aussie were all basically unchanged), the Dollar Index still managed to rally +0.28% almost entirely on euro weakness (the dollar largely ignored the in-line CPI and Existing Home Sales data). Now, on the eve of the July flash PMIs, the Dollar Index sits at resistance at 81 while the euro is teetering on the lows.

At this point the euro is short-term oversold, and disappointing PMI is at least partially priced in. But even if there is a bounce, it appears that downward pressure on the euro is building, which would be a positive for the EU economy and EU stocks (remember, a weaker euro means the ECB policies are "working" and that will help stoke inflation and equity prices). The weaker euro may be a potential signal to get back "in" to our euro longs, and this bears watching.

Turning to bonds, they went up again yesterday despite the in-line inflation data and stronger than expected Existing Home Sales report. Initially, bonds declined on the CPI and EHS print, but there were buyers on the dip as clearly the trend remains higher. Bonds now are sitting just off the highs ahead of the July flash PMIs tomorrow morning, and if recent past is prologue, then regardless of whether there's a beat (which would be bond-bearish) or a miss (which would be bond-bullish), bonds will rally.

As I said yesterday, this market is totally detached from (apparent) economic reality at the moment, but clearly the trend remains higher for now, so more patience is required.

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
7/21/14	JJC	39.17	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 7.22.14)

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 derail 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)