7:00's Report

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

July 28th, 2014

Pre 7:00 Look

- Futures are flat this morning while international markets are higher led by strength in Asia, following a quiet weekend. There were no economic reports o/n and focus remains on geo-politics.
- Ukraine made important military gains Friday against rebels and the EU is expected to announce tougher sanctions on Russia, but broadly the situation remains static.
- In Gaza, fighting continued over the weekend despite growing international calls for a case-fire.
- Econ Today: Pending Home Sales (E: 0.3%).

Market	Level	Change	% Change
S&P 500 Futures	1971.50	.00	0.00%
U.S. Dollar (DXY)	81.10	-.025	-0.03%
Gold	1303.80	.50	0.04%
WTI	101.46	-.63	-0.62%
10 Year	2.469	-.040	-1.59%

Equities

Last Week

The S&P 500 rallied to new highs last week on good earnings and status-quo geopolitics. But stocks couldn't decisively break out and the S&P ended the week virtually unchanged on the week, up +7.03% year-to-date.

Last week trading was mainly driven by earnings and economics. And while geopolitics generated a lot of headlines, it wasn't a factor in trading.

Stocks declined modestly Monday during a slow day of digestion, but rallied Tuesday on a benign CPI report and good earnings. On Wednesday and Thursday, the S&P 500 made new all-time highs on the back of good earnings (especially from large-cap tech names like AAPL and MSFT) and good global economic data (July flash PMIs). But, despite trading to 1,991 intraday Thursday, the market felt "tired" and stocks declined Friday as investors booked profits ahead of the weekend.

Trading Color

The S&P 500 made new highs last week, but there were more signs of "caution" from various sectors and asset classes to note.

First, small caps continue to badly lag, as the Russell 2000 underperformed again and declined -0.6% on the week. The Russell is now down -1.5% year-to-date, underperforming the SPX by nearly 8%.

Perhaps more importantly, though, junk bonds remain under pressure—something we pointed out in Tuesday and Wednesday of last week (beating the FT and WSJ, which wrote about it Friday morning). The breakdown in junk is yet another potential "divergence" to monitor, especially if JNK rolls over from current levels.

I'll be joining host Stuart Varney today at Noon EST to discuss the what's ahead for markets this week.

Despite yet another potential "warning sign," cyclicals and high-beta names did manage to outperform defensives as SPHB (S&P 500 High-Beta ETF) rose +0.24% while SPLV (S&P 500 Low-Volatility ETF) declined -0.62%.

Earnings Season Update

Broadly, this has been a good earnings season. As of the end of last week (per Bloomberg), 78% of S&P 500 companies that have reported beat earnings. More im-

Market	Level	Change	% Change
Dow	16,960.57	-123.23	-0.72%
TSX	15,455.04	60.59	0.39%
Brazil	57,821.08	-156.48	-0.27%
FTSE	6,797.95	6.40	0.09%
Nikkei	15,529.40	71.53	0.46%
Hang Seng	24,428.63	212.62	0.88%
ASX	5,577.39	-6.12	-0.11%

Prices taken at previous day market close.

portantly, 66% of those companies are beating on revenues, which is a material uptick from recent earnings seasons. And, management commentary on conference calls has been more bullish and upbeat.

Market	Level	Change	% Change
DBC	25.69	.10	0.39%
Gold	1308.50	17.70	1.37%
Silver	20.795	.38	1.86%
Copper	3.248	-.0185	-0.57%
WTI	101.89	-.18	-0.18%
Brent	108.25	1.18	1.10%
Nat Gas	3.783	-.064	-1.66%
RBOB	2.8668	.03	1.06%
DBA (Grains)	26.72	.07	0.26%
Prices taken at previous day market close.			

Looking at some individual results, large-cap (i.e., "boring") tech has done well, with big names like AAPL, MSFT, IBM, EMC and INTC issuing pretty good reports. And, while the underperformance of social media has dominated the conversation in tech, "boring" tech seems to be doing just fine.

Regional banks stabilized at the end of last week. I've noted previously how regionals have gotten beaten up the past 2+ weeks not because of bad earnings, but instead because the multi-national investment banks have done better. We've seen a rotation out of the regionals into the IBs on a valuation basis. Regionals aren't "expensive" but IBs appeared "cheaper" post-earnings. But, regionals have found support and are worth a look on the long side (especially with an SPX hedge if you're worried about the broader market).

Finally, China killed it last week. FXI rallied +5% last week alone and China was the best-performing major stock market following the flash July PMIs. And, China-related plays also did well as PICK (the global industrial miner ETF) moved to another 52-week high. The "global reflation trade" idea has worked well, and while it's short-term overbought, opportunities remain in international industrials and miners.

Geopolitical Update: Argentina, Ukraine & Gaza

Although the latter two are generating the most headlines, the biggest "geo-pol" risk this week stems from Argentina, as the 30-day grace period from a missed June debt payment ends Tuesday. If there is no extension of the negotiating period between Argentina and the holdout creditors, Argentina will be in default. If that happens, we could see ripples across emerging markets (and global equities).

With regard to Ukraine and Gaza, both situations, while serious, continue to be viewed as regional issues. Although both bear watching, neither at the moment are going to have any material effect on markets beyond a day or so.

Bottom Line

Stocks are acting tired in the very short term, and I said last week we may be embarking on something similar to what we saw in March-May, where the S&P 500 was largely range-bound between 1,855-1,885.

But, beyond this period of consolidation, the 4 pillars of the rally remain intact: Central banks remain "easy," the global recovery is ongoing, the macro horizon remains clear (Ukraine/Gaza notwithstanding), and valuations are reasonable.

Right now the Fed outlook (and the perception of the Fed being behind the curve) remains the biggest material risk to the rally, and this week brings a lot of incremental data in that regard.

Bottom line: If I had to put incremental capital to work this week, I'd look to Europe or Asia over the U.S. And, going forward we need to watch JNK (junk bond ETF). There have been a lot of false divergences over this year (small caps/Treasuries), but if JNK breaks down from here, I have a hard time believing equities don't follow in the short term.

Economics

Last Week

The two most important things that happened last week were that: The Fed got a bit of a reprieve from the growing "behind the curve" concern given a June CPI reading that met estimates. Global "flash" PMIs broadly met expectations and confirmed current market expectations of a stabilizing economy in China, slow but continuing recovery in Europe, and accelerating recovery in the U.S.

June CPI met expectations with a +0.3% monthly increase and +1.9% "core" CPI year-over-year increase. So, the acceleration of inflation pressures we saw from March-May abated somewhat, as was expected. And, this "in line" reading gives the Fed some more breathing room with regard to policy.

Globally, the most important numbers last week were the Chinese manufacturing PMIs (which hit a multi-month high of 52) and the German manufacturing PMIs (which were 52.9 vs. 52.8). Generally speaking, economically last week was a good week of data and helped push prices higher, as inflation "paused" and the global recovery appears to be ongoing.

Normally I'd spend more time reviewing what happened last week, but this week is busy and important, so our time is better spent covering what's coming, as it is more significant than last week's data.

This Week

The most-pressing question facing the market right now remains "Is the Fed behind the curve?" with regard to monetary policy and the current pace of growth and inflation. Put in plain English, there is the growing concern that the Fed is too "easy" from a policy standpoint, and if so, it will likely react by pulling forward the time frame when it will "normalize" policy and raise rates.

The reason that's the most-important "theme" to monitor in markets right now is because if the market thinks the Fed will "pull forward" normalization of policy, that will be a potentially disruptive event to an equity market that's grown accustomed to "perma-accommodation."

To that end, figuring out whether the market views the Fed as "behind the curve" is important from an allocation standpoint. This week will offer a lot of insight into that question.

The "headline" event is an FOMC meeting. But despite it being the week's "most important" occurrence, it will likely be a non-event. That said, the risk is the Fed makes a slightly "hawkish" language shift regarding when policy will begin to "normalize." Or else some FOMC members could dissent about the continued $10B taper. But, the consensus expectation will be for this meeting to contain no surprises.

Market	Level	Change	% Change
Dollar Index	81.16	.198	0.24%
EUR/USD	1.343	-.0003	-0.02%
GBP/USD	1.697	.0001	0.01%
USD/JPY	101.77	.03	0.03%
USD/CAD	1.081	-.007	-0.04%
AUD/USD	.9365	.0002	0.02%
USD/BRL	2.2295	.001	0.04%
10 Year Yield	2.469	-.040	-1.59%
30 Year Yield	3.244	-.056	-1.70%
Prices taken at previous day market close.			

Now, turning to the data, the advanced look at Q2 GDP prints Wednesday morning. Despite the recent uptick in economic data, the Fed isn't widely perceived as "behind the curve" from an economic-growth standpoint. That's partially because Q1 GDP was so weak (so, we have a hole to climb out of). But, if Q2 GDP comes in stronger than expected, that will largely negate the disappointing Q1 GDP and make people more confident about growth going forward.

In addition to advanced Q2 GDP, it's also jobs week. We get ADP Wednesday, claims Thursday and the government report Friday. Improvement in the labor market has outpaced actual economic growth so far this year, but another strong jobs number will further imply that the Fed is underestimating the economy, which would further the "behind the curve" thinking.

Turning to inflation, as mentioned the Fed got a break last week with a benign CPI reading (which was expected by most following it). But, there are several inflation indicators embedded in the economic reports this week that will be important. First, the PCE deflator in Q2 GDP will be watched closely to see if there was a notable uptick. Second, the wage data in the June jobs report Friday will be closely watched to see if we are finally starting to see wage increases. Finally, also on Friday we get the Personal Income and Outlays report for June, and the Fed's preferred measure of inflation, the PCE Price Index, will be released.

So, with regard to inflation this week, the devil is in the details, as the sub-components of those reports will be almost as important as the headline.

Speaking of inflation, we also get the July flash HICP reading from the EU on Thursday, and this is important with regard to the "long Europe" investment thesis. An uptick in HICP, if it comes, will be positive for European equities (we may see a slight dip based on the idea the EU may do less policy accommodation in the near term, but that would be a dip to buy).

Again, this week is critical not in an absolute sense (we know the economy got better in Q2, and the labor market is improving) but more in regard to the opinion of the Fed. If the data further imply the Fed is behind the curve with respect to growth and inflation, then things could get a little bumpy in the equity market.

Commodities

Commodities traded well last week with DBC, the benchmark commodity tracking index ETF, rallying +0.5% despite the strength in the dollar, which gained +0.72% on the week. Copper was the best performer in the space, jumping on better than expected Chinese economic data. Meanwhile precious metals and crude oil were little-changed to close the week, but natural gas remains an outlier, as futures continued to trend lower.

Beginning with the best performer, copper futures surged overnight Wednesday upon release of the Chinese flash manufacturing PMIs, which beat expectations (52.0 vs. E: 51.2) and finished the week higher by +1.9%. The fundamental story supporting our bullish call on copper (outperformance due to global economic growth) remains intact. And, the technicals suggest there is plenty of upside left in the trade going forward. The first level of resistance is above toward $3.30 while we fall back on trend support at $3.22.

Elsewhere in metals, gold held support (albeit barely) last week at the 50-day moving average ($1,294.50) to finish the week essentially unchanged. We remain cautiously bullish on gold over the medium term, as indicators continue to suggest the bottom is in for inflation while the geopolitical backdrop is keeping the fear bids in the market. The 50-day moving average is the line in the sand, and if it is violated on a closing basis, we will be forced to reconsider our position.

Crude oil is continuing to consolidate in a range between roughly $101 and $104 per barrel after the sharp sell-off we saw between mid-June and mid-July. But, over the longer term, demand should continue to steadily rise with the growing global economy and in turn continue to support higher oil prices.

Natural gas remains in a sharp downtrend; however, there are some signs that the sellers are beginning to get exhausted. We are not yet bullish enough to initiate long positions at this time, though, as the bears do still have momentum on their side.

Currencies & Bonds

The Dollar Index rally continued last week as it rose +0.21% and closed above the 81 level for the first time since February.

The dollar traded higher thanks to good domestic economic data but also thanks to explicit weakness in other currencies. The euro fell -0.27% against the greenback, and closed materially below the 1.35 level for the first time since November 2013. The euro ignored the good manufacturing PMIs and instead continued to focus on the widening policy gap between the ECB (more accommodation) and Fed (less accommodation). The pound also declined to a one-month low vs. the dollar after UK retail sales disappointed.

Turning to Asia, the yen also declined small vs. the dollar but is now sitting on support for the uptrend in place since March, after Japanese export data missed expectations.

Bottom line in currencies is the major story is that of dollar strength. This week will be key (GDP, jobs report, Fed and EU HICP) as to whether that trend continues. Many currencies have (for years) enjoyed a generally weak dollar, and while that isn't definitively changing, we could be nearing a tipping point where the dollar begins to be bought ahead of policy tightening, and not because other central banks are easing. That's a potential trend to monitor.

Treasuries surged to new closing highs for the year thanks to a strong Friday rally. Although fundamentals continue to deteriorate, money continues to flow into Treasuries and the trend, for now, is higher. Obviously the Fed and jobs report are the key releases affecting the bond market this week, while there are multiple Treasury auctions this week: 2-year today, 5-year Tuesday and 7-year Wednesday.

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
7/28/14	DBC	Buy Open	None	*We are going to look to initiate long positions in DBC here as a low risk-high reward opportunity has presented itself. In DBC, support has formed at $25.50 while potential target to the upside is close to the $27 mark. So, you will be risking about 20 cents for a potential return of $2*
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 have initiated a position and look to add to it on further weakness. Original Issue*
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 7.28.14)

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 traded to new intra-day highs last week, although stocks couldn't hold their gains and finished flat. In the very near term stocks feel a bit "tired" and this period of consolidation/correction should last a bit longer. More broadly, though, fundamentals remains bullish and the path of least resistance higher.*

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

Best Contrarian Idea: **Buy Retailers (XRT)**

Commodities	**Neutral**	**Bullish**	*Commodities in aggregate appear to be trying to bottom, and while that process will take some more time, the outlook for commodities is improving as the global recovery is continuing while inflation (globally) appears to be bottoming.*

Best Idea: **Long Oil (USO)**

Best Contrarian Idea: **Buy Grains (DBA)**

U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index broke out to a multi-month high last week, trading through 81 on a combination of good economic data and weakness in other currencies. Broadly the dollar appears to be gaining some momentum as currency traders are starting to price in the potential for the Fed to finally normalize policy.*

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

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

Treasuries	**Bullish**	**Bearish**	*Treasuries rallied again last week, driven higher by geo-politics and a "Risk Off" bid. 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)**