7:00's Report

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

July 29th, 2014

Pre 7:00 Look

- Futures are flat again this morning after another quiet night while international markets are almost universally higher, again led by strong gains in China.
- Geo-politically, the US and EU appear ready to announce (significantly) increased sanctions on Russian industries, but this issue remains on the back burner for markets.
- Economically the only data was out of Japan and it was mildly disappointing: June retail sales & unemployment both missed expectations, but the yen is little changed.
- Econ Today: Case-Shiller HPI (E: 0.4%).

Market	Level	Change	% Change
S&P 500 Futures	1973.75	.75	0.04%
U.S. Dollar (DXY)	81.145	.0223	0.03%
Gold	1310.20	4.40	0.34%
WTI	101.44	-.23	-0.23%
10 Year	2.491	.022	0.89%

Equities

Market Recap

The S&P 500 recovered from a mid-morning sell-off Monday to finish unchanged during a very quiet session. The S&P 500 rose +0.03%.

Stocks declined immediately following the opening bell Monday, and although there were "reasons" assigned to the sell-off, the truth is that it was mostly fast money pushing the action in index futures and ETFs.

Looking at the actual news of the day, there were some

Junk Bonds (JNK): After bouncing from the initial declines, JNK now appears to be rolling over. Support at 41.00 is now key.

headlines but none of them moved the markets: There were two mergers announced yesterday (DLTR/FDO and Z/TRLA) although that wasn't enough to push stocks higher. And, there were several economic releases but they were ignored with the exception of pending home sales (July service PMI was in-line while the Dallas Fed report slightly missed estimates).

With regard to the early declines in the averages yesterday, there was no catalyst and there was never any conviction to the selling even after the disappointing pending home sales report. Stocks bottomed shortly after 10 once the sellers ran out of momentum after support again held in the mid-1,960s.

After bottoming shortly after 10 a.m., the S&P 500 began to climb out of its 10-point hole, and the SPX turned positive just after lunchtime. But, there was no follow through and the markets virtually flat lined into a quiet close.

Yesterday was so slow and uneventful I'm not going to waste your time dissecting the very small moves in the

Market	Level	Change	% Change
Dow	16982.59	22.02	0.13%
TSX	15445.22	-9.82	-0.06%
Brazil	57695.72	-125.36	-0.22%
FTSE	6803.31	15.24	0.22%
Nikkei	15618.07	88.67	0.57%
Hang Seng	24640.53	211.90	0.87%
ASX	5588.44	11.05	0.20%
Prices taken at previous day market close.			

various sectors. The bottom line is that we can chalk up yesterday's trading to being driven by day traders and algos, as most everyone else was on the sidelines ahead of a series of key events starting tomorrow. More broadly, the market continues to consolidate/correct, and yesterday remained part of that process.

Market	Level	Change	% Change
DBC	25.65	-.04	-0.16%
Gold	1304.50	1.20	0.09%
Silver	20.615	-.021	-0.10%
Copper	3.2455	.005	0.15%
WTI	101.68	-.41	-0.40%
Brent	107.56	-.83	-0.77%
Nat Gas	3.751	-.03	-0.79%
RBOB	2.8515	-.0138	-0.48%
DBA (Grains)	26.81	.09	0.34%
Prices taken at previous day market close.			

Potential Dissent on the FOMC?

Interestingly, the one really notable occurrence yesterday didn't really affect equity markets all that much.

CNBC's Steve Liesman said yesterday that he expected at least one dissenter to the FOMC statement this week (Richard Fisher from Dallas, who wrote an interesting Op-Ed in the Journal about the dangers of policy that's too easy, link here). But, Liesman also postulated that Charles Plosser may also dissent.

I mentioned in Monday's issue that we'd likely see a dissenter or two at the meeting tomorrow (if you're paying attention to that sort of thing, it's not a bold call). Having a few dissenters isn't a big deal. But taken in the "Is the Fed Behind the Curve?" context, it implies that some FOMC members think the Fed is behind the curve, and undoubtedly they will be voicing their opinions at the meeting.

A Good Way to Hedge Goldman's Caution on Stocks

You've probably heard by now that Goldman Sachs put equities to a "Hold" last week based on a fear that rising bond yields will cause a sell-off (this is based on the same "Fed is Behind the Curve" logic we've been talking about here since June, although obviously GS making the call carries a little more weight than when we do).

I certainly understand their reasoning, seeing as I've been saying all year that bonds are going to break (and been quite wrong about it). And, eventually bonds *will* break because fundamentals continue to deteriorate.

But, the Goldman call backs up the point I've been making for over 6 weeks: that the No. 1 risk to this rally is for perceptions regarding Fed policy to change, potentially radically, and for that to cause some sort of unruly sell-off in the bond market, which becomes a repeat of June of last year.

Assuming GS is right and we're about to see an alteration of perception of Fed policy, there are some ways to hedge other than just de-risking. The first obviously is to short bonds, which if you've been reading this note for a while, you know how to do: SJB (Short Junk Bond ETF), TBT or TBF, and STPP (yield curve steepener).

But, I've also been recently talking about how beaten-up regional banks have gotten, as they've seen money rotate into large investment banks on a valuation basis. But, if we're going to see a correction because of an uptick in rates, then bank stocks should relatively outperform (assuming we don't get a commensurate slowdown in the economy) as higher rates and a steepening yield curve are positive for bank margins.

So, another way to hedge against the Goldman "Hold" call on stocks is to get long regional banks and short the market, which is quite easy to do: Long KRE/Short SPY.

Finally, if an uptick in rates is going to cause U.S. equity markets to correct, then international markets—where policy remains very, very easy—should outperform, specifically China (FXI), Japan (DXJ) and Europe (VGK). So, a paired trade of long China, Japan or Europe (or all three) and short SPY would also likely be an effective hedge if Goldman is right and an uptick in rates causes a market sell-off.

Economics

Pending Home Sales

- The Pending Home Sales Index slipped -1.1% in June vs. (E) 0.3%

Takeaway

The pending home sales report for June missed expectations yesterday morning, falling -1.1% vs. (E) 0.3%. The index dipped down to 102.7 from a slight downwardly revised 103.8 (prior 103.9) in May.

There was a lot negative commentary on the release, which was in part because nothing else was going on. But, bottom line, the negative number in June was the first drop in four months (so gains March-May) so generally the trend remains positive. More broadly, the housing data for June wavered a bit, but not enough to case material doubt about whether the housing recovery is seeing some acceleration.

Commodities

Commodities were mixed in what turned out to be a fairly uneventful start to the week yesterday. There was broad weakness in the energy space while the metals outperformed to close the day with modest gains while the grains continued to see a bounce. The benchmark commodity tracking index ETF (DBC) was little-changed, down -0.14%.

Beginning in energy, crude oil futures tested support early in the session yesterday and briefly dipped below the $101 mark before quickly recovering and bouncing back to close right in the middle of the current trading range between $101 and $103. The crude oil market is currently a trader's game, as fast money and algorithms are dictating the price action. Over the medium term, however, the fundamentals continue to support the bulls from a demand standpoint as the economy continues to improve—and specifically, the labor market.

Natural gas futures were under pressure yet again yesterday, falling -0.77%, but do appear to be consolidating in the mid-$3.70 area. The key indicator to watch in natural gas futures continues to be the sharp downtrend line that has been in place since mid-June. Until we see futures break that level and, most importantly, close above it, the path of least resistance will be lower.

Moving to the metals, trading in gold was very slow yesterday with futures finishing the day essentially unchanged. Futures quietly drifted sideways in a very tight, $4 range as traders positioned to start a busy week of economic data and Fed-speak. It is worth noting however that in pre-market trading, gold futures dipped down and reversed off the 100-day moving average—a promising technical signal for the bulls.

Looking ahead, it will be interesting to see what happens with gold this week because, as you know, a hawkish Fed is historically gold-bearish. So, we could see a sharp sell-off on any hawkish surprise from the Fed. But, that dip should be a good opportunity to buy because one of the key reasons the Fed is shifting to more-hawkish is an uptick in inflation. Also, the PCE deflator within the Q2 GDP report (Wednesday) as well as the PCE Price Index within the Personal Income and Outlays Report for June (Friday) will be closely watched by precious metals traders, as those are widely followed by economists as key measures of inflation.

In industrial metals, copper remains one of the better-performing commodities as futures bounced +0.14% yesterday. We will continue to hold our long positions as a way to gain exposure to the global reflation trade. On the charts, resistance remains just below the $3.30 level while trend support has edged up to $3.23.

Long DBC

At the end of the day, fundamentals always prevail and the current global economic environment is fundamentally favorable for the general commodity space. Yesterday we initiated long positions in DBC as a low-risk/high-reward opportunity had presented itself. In DBC, support has formed at $25.50 while the 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 dollars.

Market	Level	Change	% Change
Dollar Index	81.12	-.005	-0.01%
EUR/USD	1.3432	.0003	0.02%
GBP/USD	1.6982	.001	0.06%
USD/JPY	101.84	.02	0.02%
USD/CAD	1.0797	-.0013	-0.12%
AUD/USD	.9406	.0013	0.14%
USD/BRL	2.2227	-.0058	-0.26%
10 Year Yield	2.491	.022	0.89%
30 Year Yield	3.262	.018	0.55%
Prices taken at previous day market close.			

Currencies & Bonds

Bonds were mostly weaker yesterday as the 10-year note fell -0.12% while the 30-year bond was down -0.16%. Bonds generally ignored the economic data (we didn't see much of a pop despite the soft Pending Home Sales). But, the "reason" bonds declined yesterday had more to do with people positioning ahead of a potentially "hawkish" surprise from the Fed. In particular, bonds began to roll over yesterday after Liesman's comments about the potential two dissenters. But, with bonds at new highs this morning, clearly there's not a lot of concern of a Fed surprise.

There were several Treasury auctions yesterday including 3 short-term bill auctions (4-week, 3-month and 6-month), but the notable one was for the 2-year note. The results of the 2-year auction were as expected. The bid to cover, a measure of demand, was a little light at 3.22 vs. the rolling 3-month average of 3.37. So, bidding was ever so slightly soft for the short term debt, but clearly there remains generally strong demand .

Bottom line, bonds are just ticks away from the highs of the year and the market remains well-supported. But, the high-yield bond fund JNK, which we have been watching as a potential leading indicator, continues to trade with a heavy bias. If we see JNK roll over, the Treasury market would likely not be far behind.

It was a very, very quiet day in the currency markets as everyone looked ahead to the key catalysts coming later this week (FOMC decision, jobs report, Argentina, EU HICP). Demonstrating how downright boring it was in the currency markets yesterday, the Dollar Index, euro, pound and yen all moved less than 0.1%, while the "big" movers were the commodity currencies, as the Aussie and Loonie rose +0.12% and +0.14% yesterday.

As we said at the end of last week, major currencies (dollar, euro, yen specifically) are at a major tipping point with regard to recent trends. How the data later this week turns out will be key in deciding if the dollar continues to rally, while the euro and yen sell off.

If Argentina Defaults, Watch CEW.

There was no resolution or progress with regard to the potential Argentine default yesterday. While mediators between the two sides are meeting today, hope of an extension (there's no realistic hope of a deal) is fading. That means by Thursday, Argentina could default, again.

Contagion is the reason why everyone is watching this – Argentina defaulting is, by itself, not really that big a deal (unless you're in Argentina, where it'll make the current stagflation even worse as inflation will increase and it'll hurt the economy). But, it's the potential contagion that's got people nervous.

So, the question is, "Will an Argentine default weigh significantly on other emerging-market currencies and bonds?" We won't know until it happens, but given that EM currencies and bonds are being used in massive global carry trades (borrowing money in the U.S., EU and Japan at 0%, and then leveraging it and buying higher-yielding EM currencies and debt), there's the chance that even if moderate fallout is felt in the emerging markets that contagion could spread. And, that's not all theoretical – remember the EM shakeouts we last saw in June 2013 and earlier this January? The causes were different, but the markets demonstrated how vulnerable they could be to turmoil.

Bottom line is as Argentina nears (and enters) default, keep an eye on CEW – it's the emerging-market currency ETF. If that comes for sale in a big way, it's a sign of contagion – if it doesn't, that means an Argentine default will likely stay isolated and, as such, won't be major negative on global equity prices.

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	25.65	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 dollars.*
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 7.29.14)

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)**

	Near Term Trend	Long Term Trend	Market Intelligence
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)**

	Near Term Trend	Long Term Trend	Market Intelligence
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)**

	Near Term Trend	Long Term Trend	Market Intelligence
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)**