7:00's Report

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

July 3rd, 2014

Pre 7:00 Look

- Futures are slightly higher after another busy night of economic data, but again there were no real surprises (China's service PMI was the big positive o/n surprise, but markets aren't really reacting that much). Markets close at 1:00 PM EST today.
- Ahead of the ECB meeting this morning there was more mixed data: German June service PMI slightly missed expectations and the theme of slightly weaker German data continues. The broader EMU service PMI met consensus.
- Econ Today: ECB Meeting 7:45 AM (No policy changes expected), Employment Situation (E: 213K), Weekly Jobless Claims (E: 314K), ISM Non-Manufacturing Index (E: 56.2).

Market	Level	Change	% Change
S&P 500 Futures	1696.50	2.00	0.10%
U.S. Dollar (DXY)	80.06	.075	0.09%
Gold	1323.00	-7.90	-0.59%
WTI	104.01	-.47	-0.45%
10 Year	2.628	.065	2.54%

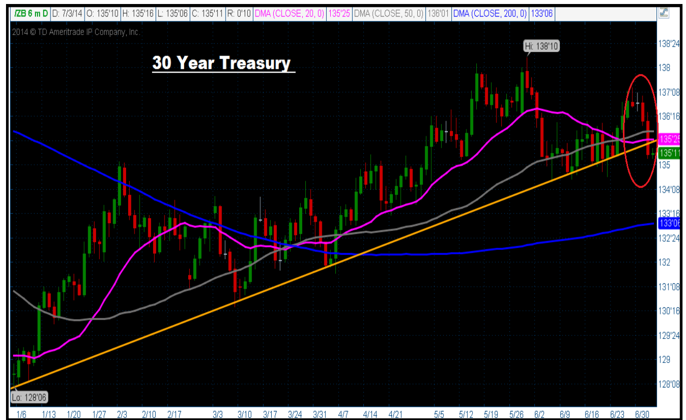
Equities

Market Recap

The S&P 500 was flat Wednesday despite a blowout ADP jobs report. The S&P rose just +1.3 points, or +0.07%.

The ADP report was the catalyst in early trading yesterday, and stocks initially spiked higher on the news. But buyers were exhausted after Tuesday's move and, after the open, stocks spent most of the day just meandering around the flat line.

Fed Chair Janet Yellen's speech on monetary policy at 11 AM was the other bigger event yesterday but it really turned out to be a non-event as she didn't reveal anything new regarding her policy outlook. Stocks barely moved once the transcript was released and through the Q&A.



30 Year Treasury: Yesterday the long bond closed below the 2014 uptrend for the first time this year.

Afternoon trading was typically "holiday-like" as volumes slowed and stocks barely budged before closing basically unchanged.

Trading Color

Yesterday was generally quiet but the Russell 2000 declined -0.5%, making it the worst-performing major index in the markets yesterday (the Dow Industrials, S&P 500 and Nasdaq were flat). But that drop in the small caps was more profit-taking than anything else.

Outside of the small caps the utilities were in focus, as XLU collapsed -1.9% (it's off nearly -4% in two days) as interest rates rose sharply yesterday going into the jobs report and as investors continued to rotate into more cyclical names. XLU is now sitting just above the 2014 uptrend, and a break of $42.70 might elicit more selling.

Most other sectors were little-changed on the day ex-

Market	Level	Change	% Change
Dow	16976.24	20.17	0.12%
TSX	15209.79	63.78	0.42%
Brazil	53028.78	-142.71	-0.27%
FTSE	6845.80	29.43	0.43%
Nikkei	15348.29	-21.68	-0.14%
Hang Seng	23531.44	-18.18	-0.08%
ASX	5491.25	35.84	0.66%
Prices taken at previous day market close.			

cept for healthcare, which was the other big mover (up +0.78% on continued outperformance from the biotechs). But other than that, most S&P 500 sub-sectors moved less than 0.25%.

Market	Level	Change	% Change
DBC	26.48	-.02	-0.09%
Gold	1328.30	1.70	0.13%
Silver	21.195	.128	0.61%
Copper	3.262	.058	1.81%
WTI	104.31	-1.03	-0.98%
Brent	111.02	-1.27	-1.13%
Nat Gas	4.368	-.087	-1.95%
RBOB	3.0186	-.018	-0.59%
DBA (Grains)	27.49	.18	0.67%

Prices taken at previous day market close.

Basic materials stocks — specifically industrial miners and precious metals miners — rallied hard yesterday thanks to the breakout in copper and as optimism continues to grow toward an acceleration of the global economy. (The positive Chinese PMIs from Tuesday continue to be the main catalyst, but the strong service PMIs this morning will help as well) Names like PICK have a long way to go before they get "expensive." More broadly, keep in mind global industrials have lagged this year, and if we see an uptick in this global recovery, DIA and similar names could play catch-up to tech and other sectors.

Predictably, volumes were very low given the holiday week and half-day today, while on the charts the S&P 500 remains just below the all-time highs of 1,978.00.

"I do see pockets of increased risk-taking across the financial system. … For example, corporate bond spreads, as well as indicators of expected volatility in some asset markets, have fallen to low levels, suggesting that some investors may underappreciate the potential for losses and volatility going forward."

Fed Chair Janet Yellen 7/2/14

Bottom Line

It's so slow out there right now that I don't want to waste your time overanalyzing. Case in point, according to MKM Partners, three of the narrowest trading ranges in the S&P 500 since 1982 (so 30+ years) have occurred this year (2014).

Generally the outlook for stocks remains very positive as we head into earnings season (AA kicks off on 7/8). And, although we're not going to go up in a straight line, the path of least resistance is higher for the foreseeable future. Cyclicals should continue to outperform, especially if we see this 2014 bond uptrend break (as you can see in the chart, we're testing it again).

Economics

APD Employment Report

- Non-Farm Payrolls surged 281K in June vs. (E) 213K

Takeaway

Yesterday's ADP employment was far better than analyst expectations of just 213K. While the May data were left unrevised at 179K. Stock futures spiked up to session highs upon release of the report but quickly pared those gains as again buyers seemed a bit exhausted yesterday.

With regard to the government number today, the first print of the ADP report has overshot the actual government number every month since January of this year by an average of 28.5K. So, if we keep things simple, that implies a print of 256K-ish this morning.

Jobs Report Preview

Although the jobs report isn't the market-mover it was 3 months ago, it's still an important report. Rather than focusing entirely on the overall number (expectations are for 213K job additions while the "whisper number" is north of 220K thanks to ADP), focus will also be on the participation rate, hours worked and wages. Those factors all play into whether the labor market is starting to "tighten," which could further stoke inflation.

- ***The Too Hot Scenario: > 230K.*** If we get a print above 230K, it'll be taken in the context of this week's strong economic data (PMIs, auto sales, ADP) to again imply the Fed is "behind the curve" on growth and inflation and the economy is strengthening while the Fed is too "easy." That will elicit a hawkish reaction: Bonds will fall (likely hard), gold will decline moderately, while the dollar will rally. Stocks will likely be flat to slightly lower in this instance (it's not that good news is bad; it's just that any expectation the Fed may get less accommodative sooner than expected will be a bit jarring in the near term).

- ***<u>The "Just Right" Scenario: 225K—170K jobs added.</u>*** This is the sweet spot, as it further confirms the jobs market is improving, but not at a pace that would make the Fed pull forward tightening. In this instance, <u>the market shouldn't really react that much</u> (we may see a little bond weakness or dollar strength, but that's it).
- ***<u>The "Too Cold" Scenario: <170K jobs added.</u>*** After ADP, the employment index in the ISM PMI and weekly jobless claims, everyone would be shocked if we print a number this low, so this is a low probability. But, if it did happen, <u>look for a massively "dovish" response</u> that would see gold and bonds trade sharply higher and the dollar lower. Stocks likely wouldn't rally as you think (remember growth is better than more Fed easing). Again, though, this is a remote possibility.

Commodities

Commodities were mixed yesterday as both industrial and precious metals extended recent gains while the entire energy sector sold off following the weekly EIA inventory report. The divergence in the space left the benchmark commodity index, DBC, little-changed.

The most important developments in commodities yesterday were in WTI crude oil futures, which broke down through support, and copper futures, which continue to grind higher.

Beginning in energy, WTI crude oil fell -1.11% yesterday to close well below the 2014 supporting uptrend line that has been tested and held firm three other times this year. WTI has been trading heavy all this week and fell yesterday in spite of a bullish EIA inventory report that stated crude stockpiles fell by 3.2M barrels vs. expectations of a 2.4M barrel draw. (Cushing supplies fell 1.36M barrels to 20.5M, also bullish.) Gasoline inventories fell 1.24M barrels vs. estimates calling for a 550K barrel build.

Market	Level	Change	% Change
Dollar Index	79.98	.135	0.17%
EUR/USD	1.3655	-.0024	-0.18%
GBP/USD	1.7164	.0016	0.09%
USD/JPY	101.81	.29	0.29%
USD/CAD	1.0668	.0037	0.35%
AUD/USD	.9438	-.0058	-0.61%
USD/BRL	2.2237	.0224	1.02%
10 Year Yield	2.628	.065	2.54%
30 Year Yield	3.466	.071	2.09%

Prices taken at previous day market close.

But, sometimes bullish inventory data can't overcome a market with momentum, and yesterday that proved to be true as sellers re-took control after the EIA-driven "pop" mid-morning. And, there was bearish news for Brent crude out of Libya, which added to the selling pressure in WTI. Libyan officials declared their multi-year oil crisis "over," and the actual and expected increase in Libyan production has been a little followed but important headwind on oil this week.

Case in point, Brent crude prices came under pressure yesterday, falling -1.2% thanks to news that two more Libyan oil ports have been re-opened, which is obviously price-bearish as global production rises. The two ports, Es Sider and Ras Lanuf, have a combined capacity of 560K barrels a day, which will nearly triple the country's current level of exports, which is just 320K.

On the charts, futures became rather overbought since the violence began in the Middle East more than 2 weeks ago and were trading far above the major moving averages (50-day: \$103.26, 100-day: \$102.30, 200-day: \$99.86). This is historically unsustainable unless there is a continuous, fundamental driver behind the market, which there currently is not as the market is largely "OK" with the situation in Iraq.

Looking ahead, we can expect some follow-through selling as the market looks to find support in the moving averages, with the next line of solid support being at the aforementioned 50-day moving average: \$103.26, while \$105.25-\$105.50 will act as initial resistance.

Elsewhere in energy, natural gas sold off sharply, falling -2.15% on the day. But, futures importantly reversed and closed above support at the 200-day moving average at \$4.35. And, tomorrow is inventory day for natural gas with analysts expecting a rise of 102 Bcf, which is a touch below the recent average.

So, the risk in the market is for a short-covering rally if the supply build in natural gas surprises the market (coming in below 100 Bcf). Technically, the 200-day moving average remains support at \$4.35 while resistance is above toward $4.55.

Looking to the metals, the long precious metals trade we initiated earlier in the week continues to work as gold and silver grinded higher yesterday, adding +0.13% and +0.61%, respectively. It is important to note that gold was able to close the primary session above $1,330 (at $1,331 even) which is a promising sign for the bulls. The initial target of the gold trade is $1,350 while solid support remains below at $1,310.

Copper continues to surge with futures adding another +1.8% yesterday. The Chinese copper financing debacle continues to affect the market and we believe that is why futures have not pulled back or even consolidated yet. (As lenders sell physical copper that was used for collateral, they are buying back futures positions used to hedge.) But, looking at the longer term, buying copper remains one of the better ways to play the global recovery. As economic data continue to improve, this is supportive of increasing copper demand. On the charts, there is support at $3.18 while resistance is above at $3.30.

Currencies & Bonds

Bonds were the big story yesterday as the 30-year fell -0.76% ahead of today's jobs report. Bonds were weak early Wednesday, but took a leg lower immediately following the ADP report, for obvious reasons. But, yesterday's weakness (which lasted all day—bonds closed basically on the lows) was about more than just ADP, and instead was about the multiple strong reports we've seen this week (PMIs, auto sales) that show the U.S. economy is continuing to accelerate out of the Q1 GDP hole.

The yield curve continued to steepen yesterday, as it's done all week, and the yield on the 10-year is back above 2.6%.

And, for the first time this year, the 30-year closed below the 2014 uptrend line (it had violated it several times on an intraday basis, but it's never closed below it). With the jobs report looming I'm not ready to declare this bond rally dead yet, but we're as close as we've been all year.

The big mover in the currency markets yesterday was the Aussie (for the second straight day). The Aussie dropped -0.6% and gave back nearly all of Tuesday's rally. The reason for the stark reversal was a very, very bad trade balance report for May.

Remember I mentioned the plunge in iron ore prices since April? Well, it showed up in the trade balance report in May. April trade balance was revised to -780 million from the initial -122 million, while May saw a huge plunge, down -1.9 billion in May (consensus was for -200 million)!

I know this is trade balance and kind of esoteric, but for export-heavy countries like Australia, this is a big problem, as much of their domestic economy is based on metals and mining exports.

The moves are so big in this report, we'll likely see some revisions in the coming months, but the point remains that there is now downside risk to the Aussie economy.

Elsewhere in the currency markets, things were relatively quiet. The dollar rallied marginally (+0.18%) and briefly reclaimed the 80 level, although it couldn't hold it into the close. Also helping the support the dollar was the weaker euro, which declined an opposite but identical -0.17%, mostly on some light selling ahead of the ECB this morning.

To offer a brief ECB preview (because only a brief one is needed) this meeting should be a relative non-event given the measures taken by the bank in June. But, the euro remains basically at pre-June ECB meeting levels, and that's got to annoy ECB President Mario Draghi. So, some suspect he may try to "talk" the euro down a bit, and that makes sense.

Finally, it was another day, another new multi-year high for the pound, which is now comfortably above 1.72 vs. the dollar, as economic data continue to come in better than expected (construction PMI and home price index).

Have a good long weekend and happy 4th of July,

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)**