7:00's Report

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

July 30th, 2014

Pre 7:00 Look

- Futures are slightly higher while international markets are mixed ahead of a busy day of catalysts.
- German CPI slightly missed expectations (0.9% yoy vs. (E) 1.0%) and that's lowered expectations for tomorrow's EU HICP reading. The euro briefly dropped below 1.34 on the news before recovering.
- Don't sleep on Argentina: The payment deadline is tonight at midnight, and prospects for a deal don't look good.
- Econ Today: ADP Employment Report (E: 235k), Advanced Q2 GDP (E: 3.1%), FOMC Meeting Announcement (2:00).

Market	Level	Change	% Change
S&P 500 Futures	1967.50	4.50	0.23%
U.S. Dollar (DXY)	81.39	.075	0.09%
Gold	1300.20	-.30	-0.02%
WTI	101.29	.32	0.32%
10 Year	2.462	-.029	-1.16%

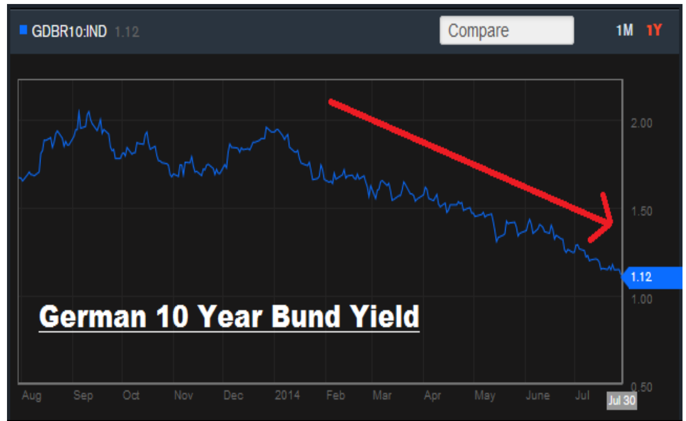
Equities

Market Recap

Stocks logged modest declines Tuesday during another relatively quiet session, as a late-day sell-off saw the S&P 500 fall -0.45%.

Stocks spent most of the day trading around unchanged, as most investors looked ahead to the start of key macro data today and for the rest of the week.

Data were sparse (the Case-Shiller and consumer confidence numbers were ignored) and earnings, while still



German Bonds: The yield on the ten year bund hit a new all time low yesterday, and that, more than anything else, is why Treasuries continue to rally.

numerous, are much more company-specific and no longer have a "macro" impact.

The S&P 500 again tried to breach 1,985 within the first hour of trading, but news that the EU and U.S. were significantly escalating sanctions on Russia weighed on stocks. A lack of liquidity created an "air pocket" as the S&P 500 fell nearly 10 points in half an hour.

But, while the U.S. and the EU appear to be getting more "serious," the issue remains a largely "local" one. Stocks rallied back to flat during quiet trading into the afternoon before dropping again during the last 90 minutes of trading mostly on positioning ahead of a busy few days of key catalysts.

GDP Preview

Again I'm not going to waste anyone's time dissecting the sector trading when there was little volatility and what volatility there was, was earnings induced.

More broadly the market has simply "ran in place" for the past two days ahead of a string of key events, with

Market	Level	Change	% Change
Dow	16,912.11	-70.48	-0.42%
TSX	15,446.55	1.33	0.01%
Brazil	57,118.81	-576.91	-1.00%
FTSE	6,805.80	-1.95	-0.03%
Nikkei	15,646.23	28.16	0.18%
Hang Seng	24,732.21	91.68	0.37%
ASX	5,622.89	34.45	0.62%

Prices taken at previous day market close.

GDP this morning starting things off.

This morning's Q2 GDP print needs to have a "3" handle on it or be in the very highs "2's," otherwise the broad assumption of full year 3% GDP growth will come into question, which will be equity and dollar negative.

The only reason the horrid Q1 GDP hasn't weighed more on the markets is because it's assumed we'd see a big Q2 bounce back, and that would keep full year 3% growth on track. If we print GDP this morning in the mid "2's" look for the market to react negatively.

Market	Level	Change	% Change
DBC	25.56	-.08	-0.31%
Gold	1301.60	-4.20	-0.32%
Silver	20.625	.058	0.28%
Copper	3.220	-.0235	-0.72%
WTI	100.87	-.80	-0.79%
Brent	107.55	-.02	-0.02%
Nat Gas	3.818	.053	1.41%
RBOB	2.8409	.0154	0.55%
DBA (Grains)	26.65	-.19	-0.71%

Prices taken at previous day market close.

Bottom Line

Generally the consolidation/correction continues. The S&P 500 tried again to get through 1985 yesterday, but that remains stiff resistance. It's the end of the month, so if the data is good today and the Fed dovish, we could see some "window dressing" try and push the SPX towards 2000, but even If that happens I'd be hesitant to call it a material break out unless there's a surge in volumes.

Short of that happening, the 1965-1985 range should remain in tact, although much like the March-May period opportunities remain in specific sector selection and geographical location. It would appear we're again becoming a "market of stocks" vs. a "stock market."

Tougher Sanctions on Russia but still a "Back Burner" Issue for Markets. This Remains all about the Fed.

One of the bigger headlines yesterday was that the EU announced tighter sanctions on Russia, and in a clear escalation is how targeting sectors of the economy versus previously just targeting individuals and oligarchs.

The increase sanctions certainly have more bite, and the potential for Putin to retaliate in some way is rising, but despite the headlines this remains very much a back burner issue for markets (if anything the Yukos court decision this week of having to pay 50 billion to investors is a bigger blow to Russia than the sanctions).

First, the Ukrainian military has made important gains the last week, and is now in a battle for Donetsk, the so called "capital" of the rebels. If the Ukrainians can retake Donetsk, it'll be a serious blow to the rebels, and in another month Russia might not have anyone to send weapons to.

More broadly, unless Russia invades eastern Ukraine, this issue will remain "local" from a market standpoint, and not a materially disruptive event.

Economics

FOMC Preview

- No change to policy expected.
- Further "tapering" of QE by another $10 billion.

Risk of a "Hawkish" Statement is Probably Overdone

In all likelihood this FOMC meeting, which just contains a rate decision and statement (and not a press conference or forecasts), will be a relative non-event. Current expectations are for the FOMC to upgrade its assessment of economic activity and unemployment from the June meeting, but importantly to leave this broad monetary message in place: *"It will likely be appropriate to maintain the current target range for the Federal Funds rate for a considerable period of time after the asset purchase program ends."*

The risk out of this meeting is for a "hawkish" surprise, though. **In particular, people will be watching to see whether the FOMC adopts an explicit warning, similar to Yellen's comments at the "Humphrey-Hawkins" testimony in July, that if the economy continues to improve at the current pace, then the Fed will hike interest rates sooner and faster than current expectations.**

So within the newest statement, everyone will be looking for those "sooner" and "faster" comments. Additionally, the market expects at least one dissenter from the statement (Dallas Fed President Richard Fisher) and there may be at least one other (Philly Fed President Charles Plosser). If there are more than two dissenters, expect that to be taken "hawkishly" as it'll show the FOMC is more divided about policy than currently thought.

Again, the overwhelming likelihood is this meeting is very much "status quo," and the point above probably won't come to pass. From a market reaction standpoint, if the abovementioned items do happen, we can expect stocks and bonds to decline while the Dollar Index moves higher.

But, if the Fed meeting is "status quo" and the above-mentioned don't occur, expect stocks to rally mildly and the dollar to sell off, as those markets have been flat and higher, respectively, in fear of a "hawkish" tinge to the statement. If it doesn't come, then we'll see those market re-price.

Finally, something to consider: I don't know exactly how this works, but I imagine that the FOMC already knows the results of Friday's jobs report, including the wage data and the PCE Price Index contained in the Income and Outlays Report (also out Friday). So, already it has the next round of key growth and inflation numbers. So, if the Fed does surprise "hawkishly" or "dovishly," that may offer some insight into the data coming later in the week.

Commodities

Trading in the commodities space yesterday was largely driven by trader positioning ahead of upcoming economic data and Fed-speak. This was specifically the case in the metals, where gold fluctuated ahead of the FOMC minutes while there was profit-taking in copper ahead of the important Chinese economic data due out tomorrow night. The stronger dollar, up +0.25%, also weighed on the space. DBC, the benchmark commodity ETF, fell -0.37% on the day.

Market	Level	Change	% Change
Dollar Index	81.305	.183	0.23%
EUR/USD	1.3409	-.003	-0.22%
GBP/USD	1.6942	-.004	-0.24%
USD/JPY	102.09	.24	0.24%
USD/CAD	1.085	.0056	0.52%
AUD/USD	.9384	-.0021	-0.22%
USD/BRL	2.2305	.0085	0.38%
10 Year Yield	2.462	-.029	-1.16%
30 Year Yield	3.222	-.040	-1.23%

Prices taken at previous day market close.

Beginning in the metals, gold popped $10 overnight, reaching a high of $1,314.60 before selling off sharply to dip below $1,300 on the Comex open in New York. When the dust settled, gold again finished the day little-changed, down -0.3%, but importantly managed to bounce back and close above the 100-day moving average at $1,301.50.

Not to sound like a broken record, but with the FOMC announcement later today and with more economic data to come this week, it is worth repeating our thoughts from yesterday's Report.

> *"A hawkish Fed is historically gold-bearish, so we could see a sharp sell-off on any hawkish surprises 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 (8:30 AM) 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."*

There was consistent selling pressure in copper yesterday as prices fell -0.7%. But, the dip was somewhat anticipated after futures have seen solid gains (+3%) over the past week. The selling was largely a result of traders positioning and taking profits off the table ahead of several key events in the second half of the week, namely the official Chinese manufacturing PMI due out tomorrow.

Crude oil futures fell for the fourth session in a row yesterday, losing -0.78% on the day. The price action in crude suggested that the market is trading off technicals and being pushed around by day traders with deep pockets and smart-money algorithms. Due to the resulting intraday volatility, we will adjust the lower end of the current trading range down to the $100 mark with resistance still above toward $103. Today, focus will be on the EIA inventory report due out at 10:30. Estimates are calling for a 1.8M barrel drop in crude oil stocks, a build of 800K barrels of gasoline inventories, and an increase of 1M barrels of Distillate supplies.

Natural gas bounced yesterday, up +1.38% after hitting fresh 2014 lows on Monday. But, nat gas remains in consolidation mode and until the sharp downtrend dating back to mid-June breaks at $3.91, it is a trader's market and we will remain sidelined.

Currencies & Bonds

Bonds traded to new highs again yesterday and the yield on the 10-year fell solidly below 2.5% despite the looming FOMC meeting tomorrow. The reason for the strength in bonds was Europe, as German bunds saw yields fall to their lowest levels on record in a "risk off" reaction to tougher sanctions enacted on Russia by the EU. So, the move higher in German bonds (lower in yields) continues to exert upward pressure on Treasuries, as European money comes west for a better yield with a similar (or better) risk profile.

To illustrate just how attractive Treasuries are at the moment compared to European paper, the yield on the Spanish 10-year actually fell *below* the yield on the 10-year Treasury yesterday for a short period of time (yes, Spain, the country that teetered on the brink of a bailout last year).

So, bottom line is money flows continue to negate fundamentals. Despite other assets cautiously expecting a potentially "hawkish" Fed, the strength in European bonds continues to weigh on Treasuries.

In addition to money flows, though, there was some positive fundamental news in the bond markets yesterday. The Treasury auctioned $35 billion of 5-year notes, and the bid-to-cover was the third-highest for the year at 2.81 while the actual yield of 1.72% was more than 1 basis point lower than the "When Issued" yield. The good 5-year auction exacerbated the short-squeeze further yesterday afternoon, as bonds hit their highs for the day following the auction results.

Bottom line is the Treasury market remains very disconnected from the fundamentals, and as long as European bonds continue to trade higher, Treasuries will continue to receive inflows from foreign buyers. We're getting so disjointed from apparent fundamentals that the risk of some sort of huge reversal is rising. At some point that market will break, but for now, clearly, the uptrend isn't over. So, the right play for anything other than long-term accounts is to stay on the sidelines until this relentless flow of money breaks.

Trading in currencies yesterday, like most other risk assets, was driven by trader positioning ahead of the FOMC announcement and multiple upcoming economic reports. And, there was a bit of a hawkish tone as the dollar was universally stronger against major currency pairs, rallying +0.23% on the day.

The dollar traded up to a 7-week high yesterday ahead of today's FOMC minutes release (2:00 PM). Obviously, and as we have been saying for weeks, the biggest risk in the market is that the Fed is "behind the curve." And, the way the Dollar Index rallied yesterday confirms that many investors are speculating that the Fed may be hawkish this afternoon, possibly alluding to an increase in interest rates sooner than formerly thought. And although the consensus continues to suggest that today's minutes release will be a non-event, the risk for hawkish verbiage within the release does exist.

In Asia, the yen fell for the 8th-straight session against the dollar yesterday, closing through both the 100- and 200-day moving averages at 102.03 and 102.01 respectively.

The Aussie dollar was also lower yesterday, down -0.3%, which was again a result of traders positioning ahead of data. More specifically, currency traders will be focused on the Chinese manufacturing PMI due out tomorrow night. Looking at the bigger picture, the Aussie remains largely range-bound between $0.93 and $0.95, but if the number is good, expect a bounce back toward the top end of that range.

In Europe, both the euro and the pound were lower, down -0.22% and -0.24% respectively. But the move was mostly a result of dollar strength as opposed to euro or pound weakness, as there was no market-moving data or news yesterday.

Have a good day,

Tom

7:00's REPORT

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

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.*			

7:00's REPORT

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

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)