7:00's Report

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

July 31st, 2014

Pre 7:00 Look

- Futures are decidedly lower this morning following some disappointing earnings and the Argentine default.
- Argentina was declared in default by S&P last night after failing to reach an agreement with creditors. Argentine stocks fell hard on the news after hours.
- European data was mixed o/n. German retail sales beat estimates, while EU July flash HICP slightly missed (0.4% vs. (E) 0.5). But, after the soft German CPI number yesterday, a miss was expected. The euro is flat on the news.
- Econ Today: Weekly Jobless Claims (E: 305K).

Market	Level	Change	% Change
S&P 500 Futures	1953.75	-11..25	-0.57%
U.S. Dollar (DXY)	81.575	.059	0.07%
Gold	1296.80	-0.10	-0.01%
WTI	99.57	-.70	-.70%
10 Year	2.554	.092	3.74%

Equities

Argentina Defaults...Kind Of

There was no deal between Argentina and its creditors last night, and the S&P 500 declared Argentina in default on some of its bond holdings Wednesday evening. Argentine shares fell sharply overnight and the news is weighing on sentiment here this morning.

But, as far as the implications for the broader emerging markets, it's unclear at this point. Apparently there is still a way a deal can be struck and the default "reversed" as it takes time for credit default swaps and other financial instruments to be enacted. And, to that end, there is talk of Argentine banks guaranteeing payment of 250 million to the creditors in exchange for re-opening negotiations, but that's not a done deal.

Bottom line is this appears contained for now (futures are already bouncing back as I write), but watch CEW (emerging market currency ETF). If "contagion" starts to set in from the default, CEW will be one of the first things to react (negatively).

Market Recap

Stocks acted tired again yesterday. The S&P 500 traded flat, as it was unable to rally off a stronger than expected GDP report and not-hawkish Fed, although the index did close well off the lows of the day. The S&P 500 rose +0.1%.

Markets spiked on the open Wednesday following the stronger than expected GDP report and more good earnings (notably, TWTR posted a blowout number, and the stock closed up 20%). But, the initial strength was a mirage as the buying was mostly program- and algo-driven. Stocks drifted lower throughout the morning before making the lows for the day right around lunchtime, just below support at 1,965. There weren't any real reasons "why" stocks declined, although headlines saying the G-7 was considering additional sanctions on Russia coincided with the declines. But again, that is more coincident than causal, as the market is generally ignoring Russia/Ukraine at the moment.

I'll be joining hosts Kelly Evans & Bill Griffeth today on 'Closing Bell' to discuss the Fed and the outlook for markets. Be sure to tune in!

Stocks drifted slightly higher in the early afternoon into

Market	Level	Change	% Change
Dow	16,880.36	-31.75	-0.19%
TSX	15,524.82	78.27	0.51%
Brazil	56877.97	-240.84	-0.42%
FTSE	6758.70	-14.74	-0.22%
Nikkei	15620.77	-25.46	-0.16%
Hang Seng	24756.85	24.64	0.10%
ASX	5632.91	10.03	.18%

Prices taken at previous day market close.

the FOMC statement, mostly on light short-covering.

Stocks initially spiked higher after the FOMC as the statement wasn't as "hawkish" as feared. But much like the initial rally at the open, there was no follow-through to the buying. Stocks traded back to flat during the last 90 minutes of trading and closed quietly.

Market	Level	Change	% Change
DBC	25.47	-.09	-0.35%
Gold	1297.70	-2.80	-0.22%
Silver	20.63	.047	0.23%
Copper	3.243	.024	0.75%
WTI	99.85	-1.12	-1.11%
Brent	106.25	-1.47	-1.36%
Nat Gas	3.779	-.045	-1.18%
RBOB	2.8058	-.0394	-1.38%
DBA (Grains)	26.67	.03	0.11%
Prices taken at previous day market close.			

Trading Color

For the first time all week, there were some sector performances worth noting yesterday. The big trend was of "defensive" underperformance, as SPLV closed down -0.5% and utilities got hammered (down -1.7%) on higher rates and the strong economic data. Consumer staples also fell -1% and REITs were lower. So, we definitely saw selling in the defensive and lower-beta sectors.

Conversely, banks were the big outperformers yesterday as a "higher interest rate" trade was on. Regional banks (KRE) continue to rebound, as that ETF was up +1%, outperforming the larger KBE. Meanwhile semiconductors, biotechs and social media stocks (courtesy of TWTR) also rallied.

I point this out because this "higher rate" trade is something that can work despite an overall flat (or down) tape if bonds finally do break.

Broadly, the market continues to act "tired" and this consolidation phase isn't over. Support at 1,965 and 1,955 remains key. I'd expect more "chop" in the near term, although with the Fed still fully "easy," the path of least resistance remains higher.

Economics

GDP

- Advanced Q2 GDP was 4.0% vs. (E) 3.1%

Takeaway

The advanced report for Q2 GDP was a welcomed beat on the headline, printing 4.0% vs. (E) 3.1% while the Q1 figure was revised for the better, up from -2.9% to -2.1%.

Looking to the details of the report, this was definitely a "good" report, but not as great as the 4% headline number suggested. Final sales of domestic product (GDP excluding inventories) bounced back from -1.0% in Q1 to 2.3% in Q2. PCE (consumer spending) rose +2.5% in Q2, beating estimates of 2.0%, while non-residential fixed investment (think business investment in plants, equipment, etc.) rose +5.5% vs. 1.6% in Q1. But, inventory accumulation did add 1.7% to GDP, and that's important because with such an inventory buildup, that'll act as a headwind on Q3 GDP.

Regardless, the bottom line here is that Q2 GDP did confirm the economy rebounded in Q2 and importantly kept expectations for full-year GDP at 3%, which is the current market expectation and a positive for the market. Finally, the uptick in inflation in Q2 did show up in GDP, with core PCE rising at a 1.7% annual rate—a decent uptick from 1.3% in Q1. But, as we saw from the FOMC statement yesterday, that's not enough to make the Fed turn "hawkish" just yet.

FOMC Decision

- No change to interest rates and "tapered" QE by an additional 10 billion dollars (as expected).

Takeaway

The FOMC statement contained both "hawkish" and "dovish" points, but the key takeaway is that while the Fed did acknowledge the improvement in the economy and inflation (both moving closer to their goals), they also maintained a very strong "dovish" bias, so any progress towards prepping the market for "policy normalization" was minuscule. Bottom line is if you were nervous the Fed is currently too "easy" then nothing yesterday will alleviate that fear.

Yesterday's statement upgraded the economic commentary (as expected) in almost every way: Employment, consumer spending, even fiscal policy (the government) is less of a restraint on economic growth. Also, there was an acknowledgement that inflation has moved "somewhat" closer to the Fed's objective.

Despite that material upgrade to the economy and uptick in inflation, Yellen and the doves continued to keep the monetary pedal down in two specific ways:

First, the FOMC introduced language that moved the unemployment goalposts again, countering the improvement in the labor market by introducing new language that highlights the "significant underutilization of labor resources." Basically they are referring to slack in the labor market (think labor participation rate and underemployment). But, that's a pretty esoteric thing, and it's hard to quantify just what the Fed thinks underemployment is, because there are a lot of ways you can measure it. So, point being, there's no "goalpost" of unemployment that the market can focus on. Even though the unemployment rate may be going down, with underemployment in focus, the Fed can still justify being "easy."

Second, the FOMC again stated that "it likely will be appropriate to maintain the current target range for the Federal Funds rate for a considerable time after the asset purchase program ends."

As far as my take, I understand the Fed's caution about the economy and the various "false starts" we've had. But with jobless claims sub-300K, monthly job adds consistently above 200K, PMIs at multi-year highs and a 4% print on 2Q GDP (even though the headline was a bit deceiving), at some point the Fed will have to acknowledge they need to pull forward the time for raising rates. As stated, I think the longer it's delayed, the more volatility that moment creates.

Commodities

Market	Level	Change	% Change
Dollar Index	81.52	.205	0.25%
EUR/USD	1.339	-.0019	-0.14%
GBP/USD	1.6905	-.0038	-0.22%
USD/JPY	102.84	.73	0.71%
USD/CAD	1.0898	.0048	0.44%
AUD/USD	.9326	-.0056	-0.60%
USD/BRL	2.2478	.0175	0.78%
10 Year Yield	2.554	.092	3.74%
30 Year Yield	3.310	.088	2.73%
Prices taken at previous day market close.			

Commodities were mostly lower yesterday in spite of the better than expected economic reports and largely bullish inventory data in the energy space. Copper, however, remains a notable outlier as futures continue to outperform. The benchmark commodity tracking index ETF, DBC, fell -0.35% to a nearly 6-month low yesterday as the dollar rallied +0.25%.

Beginning with the energy space, crude oil futures continued lower yesterday, down -1.11% for the 5th daily drop in a row, in spite of universally bullish inventory data released by the EIA. According to the EIA, crude oil stockpiles fell -3.7M barrels vs. (E) -1.8M, Gasoline inventories grew a modest +365K barrels vs. (E) +800K, and distillate supplies increased +789K vs. (E) +1M barrels. So, crude inventories fell more than expected and product builds missed estimates, which is supply-side-bullish.

It appears as though there are two key forces at work here. Day traders, fast money funds and algos continue to dictate the price action and are putting pressure on fresh, fundamental longs in the market by fishing for stops. And, that has led to a bit of a "momentum trade" to the downside. Two, The strengthening dollar is curbing demand for WTI oil as international alternatives become more attractive.

Bottom line, near term the bears are in control of the market, and the path of least resistance remains lower. But, looking at the big picture, if supply metrics continue to trend in favor of the bulls, and the U.S. economy is really growing at 4%, then higher oil prices are all but inevitable. On the charts, the 200-day moving average is in focus as support at $99.79.

Natural gas futures continue to consolidate; however, we do get a look at inventory data from the EIA today. Analysts are calling for a 93 Bcf build in supply. Near term, the key level to watch in futures is the longstanding downtrend line, which has edged down to $3.89. A close above that will be considered bullish and worthy of taking a shot on the long side with some risk capital.

Shifting over to the metals market, gold and silver saw knee-jerk moves upon release of both the GDP report as well as the FOMC minutes. However, when the dust settled, they were both little-changed on the day. Gold finished down -0.2% while silver closed up +0.23%.

In gold, trading was "confused" because of the very points we mentioned in yesterday's and Tuesday's Reports. Which is the fact that a growing economy, stronger dollar and hawkish Fed are all gold-bearish, but the elephant in the room is inflation. And, everyone knows that gold rallies, and rallies hard, as speculation of higher inflation rates increases. So, for now the gold market remains stalled here at the $1,300 level. On the charts, the level to watch is the 50-day moving average ($1,295), which held as support for the 4th time this month. Initial resistance is above near $1,305.

Copper was the best-performing major commodity yesterday, rallying +0.75% on the better than expected GDP print. Copper continues to outperform the space as global economic data remain strong to better than expected, which is a primary supporting factor of our "long commodities" trade.

Long DBC Trade

Like the bond market has done all of 2014, commodities markets are currently defying fundamental logic by selling off while economic data are showing growth accelerate. Some are questioning whether it could be a warning sign of an economic slowdown to come. But given the current economic environment, there is no reason we should be seeing commodities sell off. We cautiously maintain our long call on commodities; however, if we don't see a reversal soon, we will be forced to the sidelines on the trade.

Currencies & Bonds

There was heavy selling in bonds yesterday as the 10-year note fell -0.59% while the 30-year dropped a whopping -1.08%, both closing the day at two-week lows. Ahead of the open yesterday, bonds hovered around the unchanged mark but fell a sharp -0.45% on the strong GDP report. After the report, 30-year bond futures sold off steadily until they were down more than -1% going into the FOMC minutes. Upon release of the minutes, there was a "not as hawkish" pop. But investors sold into the rally and bonds closed the day on the low ticks.

Bottom line, yesterday's sell-off in the bond market was obviously welcomed by us ardent bond bears. And additionally, we saw some confirmation in the high-yield market as JNK (junk bond ETF) fell -0.4%. But, we have been fooled before, so we obviously need to see some follow-through selling here to be sure that the uptrend is indeed finally breaking. Going forward, we would ideally like to see the 10-year yield hold the 2.5% level, as many analysts and investors see that as a line in the sand.

The Dollar Index was universally stronger yesterday, as you'd expect given the strong headline Q2 GDP print. The Dollar Index traded on an intraday basis to highs for the year, and although the greenback came in a bit following the FOMC statement (which wasn't as hawkish as some thought it would be), the dollar remains strong. Going forward, the dollar is overbought in the short term. So, unless we see a "blowout" jobs number, we likely will see some consolidation in the dollar. But, even if the Fed was not as "hawkish" as some expected, clearly the recovery is ongoing. The risk of rate hikes is almost entirely sooner, not later. I remain bullish the dollar.

The dollar was higher against every major currency yesterday, but it was strongest vs. the yen, which declined -0.7% vs. the dollar for multiple reasons: The stronger data here in the U.S., some weak industrial production data from Japan (-3.35% in June vs. (E) -1.2%), which added to a recent string of disappointing economic reports and finally Yen longs noticeably bailing out, as the dollar/yen pair has decisively broken the downtrend in place since the beginning of the year.

Going forward, with the yen resuming its decline (the "target" for the yen from the Shinzo Abe administration has always been thought to be between 110-115 yen/dollar), DXJ remains an attractive destination for capital.

Turning then to Europe, the euro declined, as you'd expect. It lost -0.13% ahead of the HICP data overnight, but importantly the euro closed below 1.34 for the first time since November 2013. The reasons for the weakness were soft German and Spanish inflation numbers, which were taken as foreshadowing a disappointing EU flash HICP this morning, which was a touch light. But, given the German data and the recent declines, the soft HICP isn't causing material weakness in the euro, and I'd expect some consolidation ahead of the jobs report.

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. Original Issue*
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)**