7:00's Report

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

July 8th, 2014

Pre 7:00 Look

- Futures are slightly lower again this morning as markets continue to digest the rally, following another quiet night
- Europe is modestly weaker for the 3rd day on mild follow through selling after Great Britain Industrial Production missed estimates (-.03% vs. (E) 0.7%), breaking a string of "beats," while German trade balance was in-line.
- Econ Today: No economic reports today.
- Fed Speak: Lacker (1:00 PM), Kocherlakota (1:45 PM).
- Earnings today: AA (E: $0.13).

Market	Level	Change	% Change
S&P 500 Futures	1968.25	-2.75	-0.14%
U.S. Dollar (DXY)	80.33	.063	0.08%
Gold	1320.80	3.80	0.29%
WTI	103.39	-.14	-0.14%
10 Year	2.617	-.031	-1.17%

Equities

Market Recap

Stocks were lower to start the week on profit-taking and digesting of last week's rally. The S&P 500 fell -0.39%.

Stocks were lower pre-open Monday as they were weighed down mainly by Europe. But the early selling was never very convicted and the S&P 500 hit its low for the day immediately following the close in Europe (shortly after 11:30). A small rally followed, but that ran out of steam by 2 p.m. The accelerating declines in small caps caught traders' attention and the S&P 500 re-tested the lows of the day right before 2:30. Stocks lifted a bit during the last 90 minutes of trading to close down modestly but off the worst levels of the day.

Russell 2000: Small caps sold off hard on profit taking yesterday and the Russell is sitting on key support. 1180 needs to hold, otherwise a 2 month long uptrend will be broken.

As far as "reasons" cited for the declines yesterday, weakness in Europe (caused by a double-whammy of Erste Bank's profit warning Friday and a big miss from German industrial production yesterday) was the main "cause." Also making the list was news that the Iraqi Parliament won't re-convene till Aug. 12 (meaning, no new PM) and some selling ahead of the start of earnings (which kicks off today with AA).

Trading Color

Yesterday's selling was mostly profit-taking as the Russell 2000 fell -1.8%, the Nasdaq fell -0.77% and recent strong-performing sectors got hit (biotechs, Internet stocks, airlines and semiconductors). More broadly, defensive sectors bounced as utilities and consumer staples rallied +0.5% and +0.15% respectively. Tech, helped by the +2% move in AAPL, was the only other S&P 500 sector to finish in the green.

Market	Level	Change	% Change
Dow	17024.21	-44.05	-0.26%
TSX	15172.93	-42.03	-0.28%
Brazil	53801.83	-254.07	-0.47%
FTSE	6789.70	-33.81	-0.50%
Nikkei	15314.41	-65.03	-0.42%
Hang Seng	23541.38	-0.46	-0.00%
ASX	5510.94	7.96	-0.14%
Prices taken at previous day market close.			

Volumes were very low as was activity, and the declines came more from a lack of bids than any aggressive selling (although no one was eager to step into some of those momentum sectors on the dips, given the run they've had).

On the charts the S&P 500 is about 10 points off the all time highs, while support lies lower at 1,955.

Market	Level	Change	% Change
DBC	26.20	-.20	-0.75%
Gold	1319.1	-2.20	-0.17%
Silver	21.03	-.17	-0.80%
Copper	3.26	-.0105	-0.32%
WTI	103.47	-.30	-0.29%
Brent	110.17	-.44	-0.40%
Nat Gas	4.228	-.139	-3.18%
RBOB	2.987	-.0261	-0.87%
DBA (Grains)	27.16	-.22	-0.80%
Prices taken at previous day market close.			

Bottom Line

The market has gone down so infrequently over the past two months that yesterday's decline took people by surprise. But, in the context that the S&P 500 rose +5.3% since mid-May (basically in straight line), we're due for some sort of a pause or health-restoring correction—and we've been due for it since late June.

Earnings season is now upon us and certainly some sellers locked in gains ahead of it yesterday, as earnings need to be good this quarter; otherwise we risk running into a valuation issue. (If 2015 EPS isn't $130/share, the current consensus, then stocks can be viewed as potentially expensive.)

More generally, besides earnings it's quiet in the market over the next few weeks (no critical economic data), so it makes sense the market would digest/pause during that period.

When a Normal Correction Becomes Something More

The market needs to pause/correct in the near future, but even if we get a decent correction (say > 5%), unless it invalidates one or more of the 4 core reasons stocks have rallied for 2+ years (what I call the 4 pillars of the rally), then it's a dip we need to buy. Given we may be ready for a short term correction, I want to provide **a reference sheet for sell-offs**, because unless news accompanies a sell-off that invalidates one or more of these "pillars," then the trend remains decidedly higher.

Pillar 1: Globally Accommodative Central Banks

For the first time in history (that I can remember), all the world's major central banks are historically accommodative. The Fed, ECB, BOE and BOJ all have overnight lending rates below 1%, and all of them are still actively pursuing some form of quantitative easing (the ECB is shuffling toward QE "light" but they have bought PIIGS' bonds and are providing virtually free money via their TLTRO programs).

Additionally, while the People's Bank of China doesn't have rates sub-1%, Chinese officials are actively conducting "mini" stimulus measures to help prop up the economy.

I'm not telling you anything new here, just emphasizing that basically the whole world is pumping easy money, which I believe is an under-appreciated support of global equities.

Pillar 2: A Growing Global Recovery Coupled with Macroeconomic calm

Over the past several years, markets have lurched from one global crisis to another, starting with the U.S.-based financial crisis of 2008-'09, and followed by the European sovereign-debt crisis of 2010-'12.

Along the way, the Japanese tsunami crippled one of the world's largest economies in March 2011. Then there were the three separate U.S. government funding and shutdown dramas: the debt ceiling scare of July 2011, the "fiscal cliff" of December 2012, and the actual government shutdown of October 2013.

Throw in the Cyprus bailout of March 2013, and fears of a "hard landing" in the Chinese economy throughout '12/'13, and investors have had to deal with multiple (and, in some cases, overlapping) "once in a blue moon" issues.

But, for now at least, the macroeconomic horizon is as clear as it has been in six years. And, as a result, we are seeing the global economy finally start to recover. The U.S. economy is seeing growth accelerate ... the EU has backed off the edge of the cliff and is seeing a tepid recovery (but is recovering) ... Chinese growth has stabilized and the risk of a true "hard landing" has been diminished ... the Japanese economy appears to be finally turning a corner ... and even emerging markets are relatively stable.

Pillar 3: Reasonable Valuations

The U.S. stock rally of the past two years has mostly been the result of old-fashioned multiple expansion, which began in 2012 once the euro-zone crisis began to fade.

Summer is when most analysts begin to switch the basis year for the P/E calculations, so we're going to see the S&P 500 shift from trading at a high 16.5X 2014 $120 EPS, to a more reasonable 15.2X 2015 $130 EPS.

Does that make stocks cheap? No, it doesn't.

But, at the same time, given the larger backdrop room remains for stocks to rally further before they get prohibitively expensive. (For example, 16X 2015 EPS is 2,080 in the S&P 500, 17X is 2,210 and 18X is 2,340.) I'm not saying we'll necessarily get there, but the point is the market isn't prohibitively expensive at these levels.

Pillar 4: Sentiment toward stocks is more skeptical than enthusiastic.

Despite the gains of the past several years and an absurdly resilient rally, investors remain very distrustful of stocks, and most view this rally as simply a Fed-induced bubble that will inevitably go "pop" at some point and result in a steep, nasty correction. And, they will likely be right one day, but the fact remains this is the most-hated bull market I've ever seen. Instead of hearing a litany of reasons why stocks will make everyone rich, I continue to hear much more cautious comments about why the rally *can't* last and how this will all end in tears.

There is no irrational exuberance in the market. My lawn guy isn't giving me stock tips or saying how much he's making in the market.

Again, I'm not saying the skeptics are wrong; rather, so far they've *been* wrong. Until we get some sort of bubbling-over enthusiasm for stocks as an investment, skepticism of this rally will continue to be a quiet tailwind on the markets.

Stocks won't keep rallying in a straight line and there will corrections (and we are overdue for one now – yesterday's drop notwithstanding). But, in the bigger picture, as long as these four realities remain, the trend remains higher and I'm a buyer of cyclicals on dips.

Economics

There were no economic reports yesterday.

Commodities

Commodities were universally lower to start the week yesterday. The sector was once again led down by the energy sector as WTI crude oil futures tested support at the 50-day moving average and natural gas dropped more than 3% on more mild weather forecasts. The benchmark commodity tracking index ETF, DBC, fell -0.8%.

Natural gas was the worst-performing commodity yesterday, falling -3.6% on the day and importantly breaking through support at the 50-day moving average. The sellers have gained some momentum since former support at the lower end of the "uptrend channel" (that was in place for nearly four months) was broken in late June.

The reason for the selling pressure is nothing new. Extended weather forecasts continue to show mild weather patterns across much of the country over the near term, which obviously reduces the need for natural gas to produce power to satisfy higher air conditioning demand. This, in turn, will allow supply builds to remain comfortably above the 100 Bcf/week mark.

On the charts, the next level of technical support is near $4.10. Taking a shot on the long side with some risk capital around that level with a stop just below $4.00 could result in decent profits with limited risk, especially if the weather begins to heat up this month. A reasonable price target for a long position would be back up toward the middle of the former trend channel around $4.60 for the medium term.

WTI crude oil was down for the 6th consecutive session

Market	Level	Change	% Change
Dollar Index	80.265	-.016	-0.02%
EUR/USD	1.3605	.0012	0.09%
GBP/USD	1.7128	-.003	-0.17%
USD/JPY	101.85	-.25	-0.24%
USD/CAD	1.0674	.0021	0.20%
AUD/USD	.9373	.0014	0.15%
USD/BRL	2.2218	.0088	0.40%
10 Year Yield	2.617	-.031	-1.17%
30 Year Yield	3.440	-.043	-1.23%
Prices taken at previous day market close.			

yesterday, but closed well off the lows of the day above support at the 50-day moving average ($103.41). Up until yesterday, the sellers have clearly had momentum on their side. But looking ahead, we are at a near-term tipping point on the charts. If support at the 50-day holds, we could see a short-covering rally back toward the $105 level. But if it is broken, the next level of support is below at the 100-day moving average at $102.20.

And, it would actually be healthier for the oil markets to see a pullback to the 100-day MA, as the price became rather overextended in mid-June thanks to the conflict in Iraq. Having said that, over the longer term, rising demand as a result of a growing economy will continue to support the long crude argument. So, buying this dip is a fundamentally sound trade.

Moving to the metals, gold again traded well despite finishing the day slightly lower, down -0.2%. For the very near term, gold is also at a "tipping point", trading up against an uptrend line that has been in place since bottoming at $1,240 last month. If the uptrend holds, the near-term target would be in the $1,350 area while a break would see the price fall back to initial support at $1,300.

Fundamentally, the market is beginning to get overbought according to the CFTC's Commitments of Traders report that was released last week. The report indicated net long positions in gold held by money managers rose by 26K to 126K last week, the highest level since late November. The COTs aren't in exuberance territory (that happens above 160k), but the market is a bit more "long" than I would like—but I still remain bullish.

Copper prices took a bit of a breather yesterday, slipping -0.33%, but was the best-performing commodity last week, rallying +3.33%. It is now up +8.7% since the Chinese financing debacle caused a material sell-off in late May. And, over the medium term, copper is poised to continue rallying as the global economy continues to grow and demand rises. But, since bottoming just above the $3 mark in mid-June, copper has risen in pretty much a straight line, so there is a risk for a profit-taking pullback in the near future. Until we see that correction, we will remain sidelined with copper.

Currencies & Bonds

Currency markets were pretty boring yesterday, as most currencies saw some digestion of last week's moves. Case in point, the Dollar Index was flat on the day while the euro rallied small (+0.11%), bouncing a bit after last week's drubbing. That small rally happened despite a pretty sloppy May industrial production report from Germany, but yesterday's trading wasn't about fundamentals as much as it was just bouncing a bit from steep declines last week.

Helping the euro rally were comments by ECB member Ewald Nowotny, who said the steps taken in June by the ECB were already having an effect (implying there's no reason to do anything further at this point. But, no one credible expected the ECB to deploy any additional stimulus measures anytime soon, so it's not like he said something new).

Bottom line with the dollar and euro is it looks like the three-week old counter-trends in both currencies have ended, and the primary trends of stronger dollar/weaker euro should resume—albeit very, very gradually.

Elsewhere in currencies the trend of reversion from last week's moves was prevalent in the pound, which fell -0.2% despite no news (after hitting a new 6-year high vs. the dollar last week); the yen, which rallied +0.2% vs. the dollar (after declining last week); and the Aussie, which drifted +0.17% higher after sharp losses last week and ahead of a key jobs report this Wednesday. But, nothing yesterday would lead me to believe any of those trends from last week (pound stronger, yen weaker, Aussie weaker) are about to change. Yesterday was just some random trading "noise."

Looking at bonds, there wasn't any fundamental news in the markets yesterday and they followed currencies in reverting a bit from last week, as the long bond bounced +0.4% after falling sharply last week and breaking the 2014 uptrend last Thursday/Friday. With the market down like it was yesterday, it's not surprising bonds bounced, but the rally failed right at the uptrend (135'30-ish). Unless bonds can close materially above that uptrend again (so solidly above 136'00) then I remain of the opinion that the bond rally of 2014 is over. 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
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 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 (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 7.7.14)

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 thanks to strong economic data (PMIs and jobs report). Despite being short term overbought, the outlook for stocks remains favorable as the global economy is accelerating while central banks remain very accommodative. Focus now shifts to earnings, but the path of least resistance remains higher.*

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 Grains (DBA)

U.S. Dollar	Neutral	Bullish	*The Dollar Index rallied last week and broke a three week downtrend thanks to the strong economic data. Given the data and recent sluggish economic readings out of Europe, I expect the dollar to trade with a slight upward bias going forward.*

Best Idea: Buy the Pound (FXB)

Best Contrarian Idea: Long Canadian Dollar (FXC)

Treasuries	Neutral	Bearish	*Treasuries sold off hard last week on the strong economic data, and the 30 year bond broke the 2014 uptrend, likely signaling this 2014 rally has ended. I don't expect a sharp drop in bonds, but I believe this 2014 rally is over.*

Best Idea: Short long bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)