7:00's Report

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

July 9th, 2014

Pre 7:00 Look

- Futures are flat this morning despite continued weakness in Asia and Europe. Helping support futures this morning was a beat from AA to kick off earnings season.
- Economically, Chinese CPI and PPI both came in under expectations (CPI 2.3% vs. (E) 2.5% yoy), but that was mostly because of a drop in pork prices.
- Bottom line is inflation at these levels won't prevent further stimulus in China (which is a positive despite Chinese shares ending lower o/n).
- Econ Today: FOMC Minutes (2:00 PM).

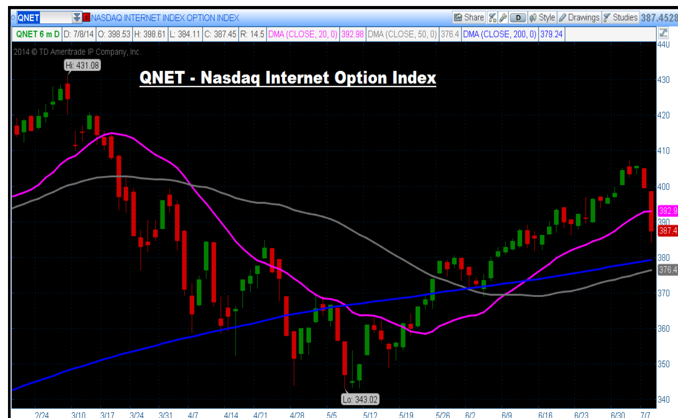
Market	Level	Change	% Change
S&P 500 Futures	1960.25	-.25	-0.01%
U.S. Dollar (DXY)	80.225	.004	0.0%
Gold	1325.80	9.40	0.71%
WTI	103.34	-.07	-.07%
10-year	2.565	-.052	-1.99%

Equities

Market Recap

The sell-off continued yesterday as stocks declined in sympathy with European markets and on further profit-taking in "momentum" sectors, although stocks did manage to bounce in the afternoon and finish off the worst levels of the day. The S&P 500 fell -0.70%.

Stocks were modestly lower pre-open Tuesday, but shortly after the bell we saw more profit-taking in momentum sectors. This pulled the entire market decidedly lower within the first hour of trading, and the selling



QNET is one of the best proxies for "internet" momentum stocks. It's gotten hit hard over the last 48 hours, but it's still well off the "bubble" levels of late March/early April.

continued despite stronger than expected "JOLTS" numbers (job openings). Selling continued through the European close and markets bottomed shortly before lunchtime.

Stocks bounced in the afternoon on some dip-buying that happened to coincide with comments by Fed presidents Kocherlakota and Lacker, although neither broke any new ground (the former was dovish and the latter hawkish, as usual).

Stock spent the remaining two hours of the trading day drifting slightly lower, although again markets closed well off the worst levels of the day.

Trading Color

Intense selling in "momentum" sectors again yesterday gave everyone flashbacks of early April. QNET (Internet stocks) dropped -3% while NBI (biotechs) fell -2.2%. But, the selling spread beyond those two groups as airlines got hit (Air France issued a profit warning) as did semiconductors (all of the above have been some of the best performers YTD). Friends on the desk said a lot of the

Market	Level	Change	% Change
Dow	16906.62	-117.59	-0.69%
TSX	15137.18	-35.75	-0.24%
Brazil	53635.69	-167.14	-0.31%
FTSE	6697.64	-40.81	-0.61%
Nikkei	15302.65	-11.76	-0.08%
Hang Seng	23176.07	-365.31	-1.55%
ASX	5452.48	-58.46	-1.06%
Prices taken at previous day market close.			

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selling was from hedge funds booking profits.

More broadly we saw cyclical underperformance as the Russell 2000 was down another -1.2% and the Nasdaq was down -1.3% (of note, the Russell is down -3% from Friday's close).

Market	Level	Change	% Change
DBC	26.11	-.08	-0.31%
Gold	1318.70	1.70	0.13%
Silver	21.00	.034	0.16%
Copper	3.259	-.002	-0.06%
WTI	103.57	.04	0.04%
Brent	108.98	-1.26	-1.14%
Nat Gas	4.229	.004	0.09%
RBOB	2.973	-.016	-0.54%
DBA (Grains)	27.12	-.06	-0.22%
Prices taken at previous day market close.			

Sector-wise, things were as you'd expect, as utilities were the only S&P 500 sub-sector to finish positive (up +0.7%) while cyclicals badly underperformed (banks, tech and consumer discretionary all got hit close to or over 1%).

On the charts it was a mixed bag. Encouragingly, the S&P 500 held some initial support at the 1,965 level, although the Russell 2000 smashed through the May uptrend I noted in yesterday's Report. 1,965-ish and 1,955-ish (the 20-day MA) remains support for the S&P 500.

Bottom Line

I find two things surprising about the two-day sell-off. First, I'm starting to think investors have forgotten what a real sell-off is. (On Monday, when the S&P 500 was down just 8 points, I heard an anchor on one of the business networks say that we were seeing "deep declines.") Second, sentiment can really whip around, as yesterday I heard multiple calls that "this is it" with regard to the inevitable correction that's been looming for the last two years.

Now, I'm not trying to downplay the declines, as there are fundamental reasons, chief of which has been Europe (more on that below). But, other "reasons" cited over the past 48 hours have included "we're very overbought" (the NYT article of bubbles everywhere yesterday helped further that narrative) and concern that today's Fed minutes will reveal a more "hawkish" Fed than we think.

To those last two points, first this market does need to pause, but it's a stretch to say everything is overvalued (because it's not, yet). Second, we may well get insight into the Fed's exit strategy in the minutes today, but the Fed is going to stay "easy" for quiet a while (keep in mind this is coming from a bond bear, and even I have to admit that). Also, we learned yesterday that Chair Yellen will given her semi-annual "Humphrey-Hawkins" testimony next week, so she will have a chance to remind everyone how dovish she is – and that it's still the Chairwoman's Fed.

Finally, the sell-off in momentum names this week is painful, but keep in mind Internet stocks and to a lessor extent the biotechs are still below levels of late March/April, so while there is still some froth in that market, it's not like we're back at those highs and there's there same level of "exuberance" in the bio-techs and internet stocks.

Bottom line is nothing material has changed from last week domestically (all of the above points could have "caused" a sell-off anytime during the last few weeks), and so far this looks like nothing more than a typical correction/consolidation.

What's Wrong With Europe?

We were stopped out of three of our four "long Europe" positions yesterday (VGK, EWP, and EWI) booking small losses, as European shares have traded through the levels just prior to the June ECB meeting. And, the surprisingly sharp sell off in Europe has been the main "reason" for weakness in US shares so far this week.

Keeping things simple, Europe has sold off for three reasons: lackluster economic data, a string of bad news about European banks, and the perception that the ECB is on hold going forward.

Starting with the first point, economic data in Europe (which excludes the UK) have softened a bit over the past month. Specifically, it's been German data that's weighed on markets, because as Germany goes, so goes the rest of Europe.

It's not like the recovery there is definitively faltering or there's a risk that we're going to see another potential recession. But whether it's German industrial production, June manufacturing or service PMIs, or EMU retail sales, we've definitely seen a bit of a loss of momentum over the past few weeks.

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Second, European banks have been warning on earnings for weeks now (Standard Chartered was early last week, Deutsche Bank before them, and most recently Erste Bank last Friday). Additionally, there have been regulatory headwinds. BNP Paribas was hit with a $9 billion fine and suspended for dealing in U.S. dollars for 1 year by U.S. authorities last week, and overnight Monday it appears Commerzbank will be next to get hit with U.S. penalties.

Much like in the U.S., in Europe as banks go, so goes the market. And, the SX&P (the European bank index) is down nearly -8% from the highs of the year, which was back in early April.

Finally, the general perception is that the ECB is now "on hold" for the future until we get more clarity on how effective the measures announced on 6/5 turn out to be. So, if the market eventually wants the ECB to do "QE" (and it does), then this is being viewed negatively as the current measures will only serve to delay QE.

(It's always about the "rate of change of change" – so while the ECB got more accommodative in June in an absolute sense, they also did so much that they won't get incrementally any accommodative in the near future. So the "rate of change of change" is zero.) And the market doesn't like that.

Bottom line is this sell-off is more about Europe than is readily being realized, although that influence should start to fade a bit once earnings reports begin.

More broadly, does this recent decline in Europe mean the "long Europe" trade that has worked so well is over? No, I don't think so.

The dip in data isn't enough to cast too much doubt on the European recovery (yet). And with the ECB backing the markets (grudgingly though it may be), there's still a tailwind. And, European shares still have not seen the general multiple expansion that we've seen here in the U.S., and are a relative bargain compared to much of the rest of the world.

Market	Level	Change	% Change
Dollar Index	80.235	-.032	-0.04%
EUR/USD	1.3609	.0005	0.04%
GBP/USD	1.7128	.0002	0.01%
USD/JPY	101.57	-.25	-0.25%
USD/CAD	1.0673	-.0009	-0.08%
AUD/USD	.9398	.0026	0.28%
USD/BRL	2.212	-.0117	-0.53%
10-year Yield	2.565	-.052	-1.99%
30-year Yield	3.380	-.060	-1.74%
Prices taken at previous day market close.			

Bottom line is short term we're seeing a correction, but medium/longer term there remains value in Europe. An opportunity to again get long Europe gain will come out of this dip.

Economics

There were no economic reports yesterday.

Commodities

Commodities traded mostly lower again yesterday, although the selling pressure seemed to lighten up a bit as shorts appeared to book some profits. Trading turned out to be mostly quiet as only Brent crude moved more than 1% on the day. The general space has now been under pretty heavy pressure since the end of last month, but a general theme has been the outperformance of the metals (which continued yesterday). DBC, the benchmark commodity ETF, fell -0.31%.

Beginning with the outperformers, gold and silver futures both managed to bounce back from a sharp morning sell-off to finish the day slightly positive, up +0.13% and +0.16% respectively. The sell-off was triggered by the JOLTS survey, which is not very widely followed, but surprisingly spurred heavy selling during the 10 a.m. hour when it was released (JOLTS were good, meaning more jobs openings).

But, like we saw after the June jobs report last Thursday, buyers stepped in on the dip and futures recovered to $1,320 in afternoon electronic trading. The components of the long argument for the precious metals remain intact, including the supporting uptrend line that futures have bounced off of 3 times in the last week. So, we continue to recommend buying dips in gold with a stop on a close below $1,315.

Elsewhere in metals, copper continued to digest its recent 3 week "tear" in which futures have rallied over +8% to a near-5-month high. Yesterday, copper was little -changed, down just +0.03%. The fundamentals continue to favor the bulls over the longer term. However, near

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term, futures are rather extended and we are continuing to look for a better entry point to initiate a long position (possibly toward the 200-day moving average at $3.20).

Moving to the energy sector, WTI crude oil futures fell to a one-month low yesterday in early trading before futures reversed just after lunch and steadily rallied into the close. WTI finished the day slightly positive, up +0.04%. The reason for the midday reversal off the lows was mostly a result of the 50-day moving average being defended by the bulls. And, the bulls were successful yesterday as futures were able to close above the 50-day MA ($103.47), albeit only barely. But, the way WTI traded yesterday was not exactly impressive. With sellers continuing to be so aggressive, a breakdown toward the 100-day ($102.33) remains a possibility.

Moving to natural gas, futures fell another -2.25% yesterday morning to a 6-month low, before shorts began to take some profits and prices finished the day little-changed. The sellers still have the momentum for now, but we continue to like buying dips toward $4.10 with a stop just below $4.00 for two reasons.

First, traders are becoming way too comfortable with the supply situation. And, although the weekly builds have consistently topped 100 Bcf for nearly two months, supply levels remain historically low. It would only take a few weeks of hotter-than-average weather to interrupt those builds in supply as demand for natural-gas-driven power would increase.

Second, the risk/reward is favorable (risking 10 cents for a possible 30-50) and that is always something we look for when initiating any trade, but specifically commodity positions due to the volatility.

Currencies & Bonds

It was a very quiet day in the currency markets yesterday as the Dollar Index, euro, pound, and Loonie all moved less than 0.05%, as those currencies simply treaded water and ignored both the sell-off in global equities and economic data (which was good in the U.S. and bad in Europe).

But, the fact that the euro was flat yesterday was interesting, because it should not have been flat – it should have been down. Between the soft German trade balance numbers and the continued equity sell-off, you would have expected the euro to trade lower. And, the fact that the euro continues to be well-bid at the 1.36 level, in spite of disappointing data, will frustrate the ECB. (An Airbus exec Tuesday called the level of the euro "insane" and said it should be more toward the mid-1.20s vs. the dollar.)

This is important because a weaker euro is both a positive for the EU economy and the global market. That's because it will reflect the fact that the ECB's policies are working and European investors believe the ECB will continue to provide stimulus and accommodation and break the threat of deflation. That didn't happen yesterday (and it hasn't happened this week). If that continues, pressure will grow on the ECB to do "more" to send the euro lower.

Asia was the only place currencies actually moved yesterday, as the yen rallied +0.3% on a general "risk off" bid given the global stock sell-off, but the gains did send the USD/JPY back below the 200 day moving average. 101.31 in USD/JPY (last week's low) is now key – and the longer the yen dances around that 200-day MA, the more yen shorts will throw in the towel. Fundamentally the yen is still bearish, but it needs a jolt to get the currency to sell off and get materially above that 200-day.

Bonds surged higher yesterday on a combination of short-covering, buying from Europe and a "risk off bid." The 30-year rallied +0.76% and closed back above the 2014 uptrend, potentially making last week's violation one enormous head fake.

Treasuries did sell off slightly at midday after a 3-year Treasury auction wasn't very well-received, but there were buyers on dips and they rallied into the close.

Bottom line is both the fundamentals and the technicals tell me we've seen the top in this market for 2014. But given several different influences (not the least of which is European demand for Treasuries), this market is going to take a long time to roll over, so patience is needed (as it's been all year in this trade).

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)**

	Near Term Trend	Long Term Trend	Market Intelligence
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)**

	Near Term Trend	Long Term Trend	Market Intelligence
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)**

	Near Term Trend	Long Term Trend	Market Intelligence
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)**

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