7:00's Report

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

August 6th, 2014

Pre 7:00 Look

- Futures are moderately lower as international markets universally declined with Europe the laggard (down more than 1%).
- In Europe, German Manufacturers' Orders missed estimates (-3.2% vs. E: .9%), but the real negative catalyst was Italian GDP which turned negative in Q2 (-.2% vs. E: .1%)
- Geopolitically Russian and Ukraine continue to weigh on the sentiment, however a cease fire in Gaza is holding.
- Econ Today: International Trade (E: -$45.0B).

Market	Level	Change	% Change
S&P 500 Futures	1906.75	-6.25	-0.33%
U.S. Dollar (DXY)	81.75	.139	0.17%
Gold	1291.3	6.00	0.47%
WTI	97.53	.15	0.15%
10 Year	2.483	-.008	-0.32%

Equities

Market Recap

The sell-off resumed Tuesday as the S&P 500 fell to new multi-week lows on more Fed concern and Russia/Ukraine anxiety. The S&P 500 declined -0.97%.

Stocks were lower pretty much all day yesterday, as the good economic data (ISM non-manufacturing and factory orders) again failed to elicit much of a positive response. Stocks drifted in negative territory for much of the morning.

The S&P 500 couldn't hold last week's lows yesterday, and now support at the 100 day moving average (1912) is the next level to watch. If that's broken today, we could see a test of 1900.

But, almost exactly at 1:30, stocks broke several levels of support (morning lows of 1,926, Monday lows of 1,921) and the declines accelerated as the S&P 500 traded through last Friday's low also of 1,916.

The sharp declines coincided with comments by the Polish foreign minister that a potential Russian invasion of Ukraine was imminently possible. (This got a lot of attention around desks, but it's important to note that Radoslaw Sikorski didn't say anything that wasn't in a NYT article released earlier in the morning. And, honestly, he has a bit of a history of making outrageous claims.)

The S&P 500 hit a low of 1913 but found some support slightly under that level and rebounded into the close to finish off the lows.

Geopolitical Update (Russia & Iraq)

The most cited reason for the sell off yesterday was a report initially released by the NYT that Russia is again massing large numbers of troops on the Ukrainian border in a "war game" exercise. Seeing as a Russian invasion of Ukraine would be a materially bearish event for stocks, the market certainly took notice. However, it's

Market	Level	Change	% Change
Dow	16429.47	-139.81	-0.84%
TSX	15187.71	-27.55	-0.18%
Brazil	56202.10	-414.23	-0.73%
FTSE	6613.56	-68.92	-1.03%
Nikkei	15159.79	-160.52	-1.05%
Hang Seng	24584.13	-64.13	-0.26%
ASX	5511.99	-6.57	-0.12%
Prices taken at previous day market close.			

important to stress that a Russian invasion remains a low -probability event, even with the increased activity.

In many ways, the situation in Iraq is actually the one that's deteriorating further. ISIS is stalled in the north, but it's making lateral movements and shoring up forces. Plus, it's capturing key infrastructure in the country (dams, oil fields, etc.)

Market	Level	Change	% Change
DBC	25.19	-.12	-0.47%
Gold	1292.50	3.60	0.28%
Silver	19.885	-.348	-1.72%
Copper	3.2015	-.0425	-1.31%
WTI	97.38	-.91	-0.93%
Brent	104.52	-.89	-0.84%
Nat Gas	3.89	.056	1.46%
RBOB	2.7136	-.0113	-0.41%
DBA (Grains)	26.59	-.14	-0.52%
Prices taken at previous day market close.			

Again, with regard to ISIS, the key remains the southern oil fields and Basra, where the vast majority of Iraqi crude is exported. Taking Baghdad is a tall order, but if progress is made in capturing southern portions of Iraq, the situation becomes more dire.

Bottom line is both situations remain ones to monitor but at this point are still local problems (meaning there's little contagion risk). And, neither at this point qualify as breaking the relative geopolitical calm we've seen for the last 2+ years, despite the headlines.

Trading Color

Despite the declines yesterday we saw relative outperformance by cyclical and higher-beta sectors. The Russell 2000 was actually positive most of the day and closed down just -0.29%, solidly outperforming the S&P 500. Additionally, SPHB outperformed SPLV (down -0.79% vs. -0.94%), which is not what you typically see on a day the S&P 500 is down -1%. This tells me that yesterday's sell-off was mostly driven by day traders and fast money funds who were looking to push the SPX around on technicals—not some broad move to reduce exposure (which is a silver lining on a down day).

Sector-wise there weren't many places to hide, though, as all 10 S&P 500 sub-sector were lower. Energy was the big laggard (down more than -2%) while consumer staples and consumer discretionary relatively outperformed.

Interestingly, sectors exposed to higher interest rates outperformed (relatively). KRE was down only fractionally while utilities continue to get clobbered (XLU down another 1.2%). More traditionally defensive names did better, but clearly there's an ongoing influence by investors positioning for higher interest rates in the future.

Despite the broad declines, volumes and activity were relatively muted, and there wasn't the same conviction to yesterday's sell-off that there was last Thursday. On the charts, 1,916 was violated on an intraday basis, but that remains near-term support going forward.

Bottom Line

Yesterday wasn't a good day but it wasn't as bad as it seemed, either. Russian headlines were a catalyst for trading but the "cause" of the investor angst more broadly remains the Fed. And, the parade of people voicing caution on the market (e.g., Goldman Sachs, Jeff Saut, several hedge fund mangers via investor letters) is weighing on sentiment.

Again, while things haven't turned "negative" on a fundamental basis, part of the problem is that Fed angst is at the core of this decline and we don't get anything incremental from the Fed for another 2+ weeks, so there's simply no reason to buy and no support for the market.

So, while fundamentally the market still looks fine, the calendar speaks to potential further downside in the near term. However, I'd be very, very surprised if we trade materially lower from here (say mid-1,800s).

Economics

Markets yesterday were focused on Russian geopolitics and technical levels, not economics. So, in a continuation of last week, the market largely ignored positive economic data.

ISM Non-Manufacturing Index

- July Non-Manufacturing PMI 58.7 vs. (E) 56.5

Factory Orders

- July Factory Orders rose 1.1% vs. 0.6%.

Takeaway

This was a strong report, plain and simple. The headline PMI rose to the highest levels since 2005, and the details of the report were also strong. New orders, the leading indicator, rose to 64.9 vs. 61.2 in June, while prices paid actually declined (so again, that helped alleviate some inflation concerns).

June factory orders were also better than expectations, as the headline beat while the details were also strong. Shipments rose +0.5% and inventories rose +0.3%. Importantly, the June factory orders report implies we're seeing continued strong business spending, which has been one of the parts of the economy that has lagged.

Although ISM non-manufacturing PMIs and factory orders aren't the most-followed economic releases ... and while the numbers certainly won't alter any Fed policy ... they offer more confirmation that economic growth is continuing to accelerate higher and the economic recovery here in the U.S. is for real. That, more than anything else, was the takeaway from the data yesterday.

Global Composite PMIs

The surprisingly disappointing July service sector PMI in China, which fell to 50 from 53.1 in June, was blamed for the early weakness in stocks yesterday. But that was a bit of an overstatement.

First, the service sector is by far the least important sector of the Chinese economy, as manufacturing is much more important. *Second*, while the service sector PMI was disappointing, a lot of it had to do with a slowdown in the property sector and associated service businesses. *Finally*, this number was the outlier, as almost all the other data from July were strong. Bottom line is "China" is overbought and in need of a correction, but this one data point shouldn't get anyone nervous that the economy there hasn't stabilized.

Commodities

After catching an oversold bid on Monday, commodities traded mostly lower yesterday with the sole exception of natural gas, which rallied primarily on technical short-covering. But, that changed early yesterday afternoon when headlines regarding a potential Russian invasion of Ukraine hit the newswires, causing a broad "fear" reaction in risk assets. Notably in commodities, gold and wheat futures rallied sharply and turned positive on the day. DBC fell -0.44% but closed well off the intraday lows.

Market	Level	Change	% Change
Dollar Index	81.59	.185	0.23%
EUR/USD	1.3375	-.0046	-0.34%
GBP/USD	1.6877	.0015	0.09%
USD/JPY	102.51	-.07	-0.07%
USD/CAD	1.096	.0055	0.50%
AUD/USD	.93	-.0032	-0.34%
USD/BRL	2.285	.027	1.20%
10 Year Yield	2.483	-.008	-0.32%
30 Year Yield	3.279	-.016	-0.49%
Prices taken at previous day market close.			

Beginning in energy, it was more of the same yesterday as the selling pressure on crude oil futures continued. WTI fell -0.93%, ticking down to another 6-month intraday low of $97. But, crude did finish well off the lows as futures participated in the broad "fear" trade, rallying due to the Russia/Ukraine headlines. Looking ahead, the near-term path of least resistance remains lower while the fundamentals continue to favor the bullish case over the medium term. On the charts, $97 is becoming the first level of support while there is resistance above at $99.

Natural gas was the standout of the space, rallying +1.64% yesterday largely thanks to technical short-covering after the sharp downtrend dating back to the middle of June was broken on Monday.

There is likely more room for futures to rally in the very near term, as short-sellers continue to take profits. But it wouldn't be a bad idea to enter tight stops to protect long profits (a 1.65% move in one day is pretty good!). Going forward, we believe the risk/reward of buying natural gas at these levels is favorable, especially as some hot weather is showing up in the extended forecasts, and supply builds are beginning to trend lower.

Having said that, this week's EIA inventory report (tomorrow at 10:30 AM) will be closely watched to see if that trend in ongoing, and if it is, expect further appreciation in nat gas prices.

Looking to the metals, that market was mixed yesterday as gold gained +0.3% on the aforementioned fear trade. Silver and copper fell -1.31% and -1.74% respectively thanks to the disappointing Chinese service PMI data. One thing that was clear in the metals market yesterday was that the industrial metals continue to trade with great sensitivity to Chinese economic data and remain a highly correlated proxy for Asian economic health as a whole. But, one report (and more specifically, one on the service sector as opposed to manufacturing) does not materially change the outlook on the Chinese economy. We continue to look to copper as one of the best ways to gain exposure to the recent outperformance in Asia, specifically China.

In gold, futures reversed off the lows of the day when the Russia/Ukraine news hit, causing a geopolitical rally. But, that rally was short-lived and likely a result of fast money algorithms. On the charts, the technicals continue to favor the bears as futures are trending lower and former support has become initial resistance at $1,295.30 but there is some support at $1,286.20.

Currencies & Bonds

Yesterday was a mixed and volatile day in the currency markets, as the early part of Tuesday saw the dollar trade materially higher and move to a new 11-month high, thanks to the strong ISM non-manufacturing and factory orders reports. And, that movement continued a trend where the currency markets (and specifically the dollar) react much more to economic data than equities currently do.

With the dollar stronger, every major currency was weaker vs. the greenback throughout the morning except the pound, which rallied thanks to a stronger than expected composite PMI. (The pound was a bit oversold, so that better data point prompted some short-covering.)

But, shortly after 1:30, things changed in the currency markets. About 20 minutes after the S&P 500 saw its declines accelerate, the dollar got hit by big waves of selling, and the day's gains got cut nearly in half. The sell-off coincided with the comments by the Polish government official regarding a potential invasion of Ukraine by Russia, but the reaction from the dollar to that news was the opposite of what one would expect (the dollar should rally in that instance on a "risk off" bid). The net effect was for the Dollar Index to give back the entire morning "post-ISM/Factory Orders" rally and close up +0.25%.

The euro was lower all day yesterday thanks to the in-line/slightly disappointing service sector PMIs and retail sales. But the euro caught a decent rally off the early afternoon dump in the dollar, and it managed to recoup half its losses before the close to finish -0.33% lower.

And, this morning the euro is hitting new lows for the year following disappointing June German manufacturer's orders (their durable goods).

Commodity currencies got hit yesterday and were the worst performers vs. the dollar, as the Loonie dropped -0.46% and Aussie fell -0.27%. While there were some events in 'Oz (trade balance and RBA meeting), neither changed the outlook for the Aussie as both met consensus expectations. Instead, both currencies got hit on a combination of the weak Chinese data (although service PMIs have nothing to do with commodity demand), general risk-"off" trading and the continued drop in commodities.

The Aussie is now moving toward multi-month support at $0.92 vs. the dollar, while the Loonie traded to a 3-month low ahead of a critical jobs report this Friday.

Turning to bonds the 30 year was down as much as 50 basis points yesterday morning following two better than expected domestic economic reports (ISM Non-Manufacturing Index and Factory Order), which helped stocks move modestly higher in the first hour of trade.

But, Treasuries caught a bid midday when stocks began to roll over, and then the buying accelerated when the geopolitical headlines regarding Russia and the Ukraine hit the newswires. And, that rally is continuing this morning as the 30 year is again at highs for the year, as the soft German economic data has caused Bund yields to decline, sending capital into the Treasury market, as money flows continue to trump fundamentals in the bond market.

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. 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*
6/11/14	SPHB	32.73	30.32	*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 8.4.14)

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 suffered its biggest weekly decline in a long time last week, and although fears of faster than expected Fed tightening were the main "cause," really this remains part of a larger correction/consolidation that has been going on since early July. Stepping back, though, the outlook for Fed policy didn't change, and with still strong fundamentals the benefit of the doubt remains with the bulls.*
Best Idea: Buy global industrial miners (PICK, FCX, RIO, etc.) **Best Contrarian Idea:** Buy Retailers (XRT)			
Commodities	**Neutral**	**Bullish**	*Commodities broke down badly last week after WTI Crude plunged 4% on general "risk off" sentiment and dollar strength. The stronger dollar is becoming a headwind for broad commodities in the near term, but with global growth improving further and inflation bottoming, longer term the set up is still bullish.*
Best Idea: Long Oil (USO) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index traded basically to the highs of the year last week before giving some back after Friday's jobs report. The Dollar Index is overbought here and in need of some very short term digestion, but with inflation now squarely in focus of the market, the upward trend should continue.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long Canadian Dollar (FXC)			
Treasuries	**Bullish**	**Bearish**	*Treasuries actually declined last week on rising inflation concerns, although the 30 year again held a test of the 2014 uptrend thanks to Friday's jobs report. Fundamentals continue to turn negative for Treasuries, but the near term trend remains higher.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			