7:00's Report

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

March 26, 2015

Back to Biotechs: They led markets lower yesterday, and now NBI (Biotech Index) is sitting on key support.

Pre 7:00 Look

- Futures and international markets are trading lower this morning while both gold and oil are rallying on geopolitics.
- Saudi Arabia began airstrikes in Yemen to defend the Yemeni government from Houthi forces who have taken control of several key cities.
- Economically, British Retail Sales was the only notable release and it was better than expected (0.7% vs. E: 0.4%) but markets are largely focused on geopolitics this morning
- Econ Today: Jobless Claims (E: 293K), PMI Services Flash (E: 57.0) Fed Speak: Dennis Lockhart (9:00 AM)

Market	Level	Change	% Change
S&P 500 Futures	2040.50	-13.25	-0.65%
U.S. Dollar (DXY)	96.545	-.652	-0.67%
Gold	1209.60	12.60	1.05%
WTI	51.23	2.20	4.10%
10 Year	1.920	.042	2.24%

Equities

Market Recap

Stocks fell sharply yesterday as a surprising decline in biotechs acted as an anchor on an otherwise rudderless market. The S&P 500 sank 1.46%.

The day started relatively fine, with the S&P 500 trading flat pre-market and at the open. The soft Durable Goods report even provided a bit of a temporary dovish boost on markets. But, by mid-morning stocks started to trade heavy.

There were multiple reasons cited, including a hawkish Q&A from Fed President Lockhart in the *New York Times* and general angst regarding Greece. In reality, it was the bad breakdown in biotech stocks that weighed down markets.

Biotechs were weak from the outset yesterday thanks to a WSJ article that implied they were in "bubble" territory. If that sounds like déjà vu, it should, as about this time last year the "biotechs are a bubble" meme resulted in the S&P 500 dropping several percentage points in early April.

Biotechs traded lower throughout the afternoon and the broad market followed them down, as stocks declined right into the bell to finish virtually on the low tick for the third day this week.

Trading Color

We are back to watching the "momentum" stocks. Remember, momentum stocks is what we called biotechs and internet names last year during the April dip in markets. NBI (Nasdaq Biotech Index) dropped 4.4% yesterday and is approaching some pretty important support at the 3,535 level.

Market	Level	Change	% Change
Dow	17,718.54	-292.60	-1.62%
TSX	14,929.37	-151.89	-1.01%
Brazil	51,858.30	352.23	0.68%
FTSE	6,905.58	-85.39	-1.22%
Nikkei	19,471.12	-275.08	-1.39%
Hang Seng	24,497.08	-31.15	-0.13%
ASX	5,879.06	-94.26	-1.58%
Prices taken at previous day market close.			

Semiconductors also were very weak yesterday (SOX down 4.6%), and given the weakness in biotech and semis it's not surprising the Nasdaq and Russell 2000 dropped 2.3% each.

Market	Level	Change	% Change
DBC	17.32	.05	0.29%
Gold	1195.30	3.90	0.33%
Silver	16.97	-.013	-0.08%
Copper	2.7915	-.0115	-0.41%
WTI	48.89	1.38	2.90%
Brent	56.21	1.10	2.00%
Nat Gas	2.726	-.06	-2.15%
RBOB	1.8258	.0261	1.45%
DBA (Grains)	22.56	-.05	-0.22%
Prices taken at previous day market close.			

Sector wise there was wide-spread weakness with eight of the S&P 500 sectors falling more than 1%. The two outperformers were consumer staples, which fell only modestly thanks to the Heinz/Kraft Foods merger; and energy, which rose 1.3% as oil had a huge rally.

Despite the ugly day, and ugly close, the sector trading didn't imply any real panic or urgency as there was not tremendous cyclical underperformance with the exception of (predictably) the tech sector.

Watch the 100-Day Moving Average

The S&P 500 is now close to the 100-day moving average, again. This has been the key support level for the market going on two-plus years now, and it was again earlier in March, as stocks broadly held the 100 day at 2,040. Well, now the 100 day has moved up a bit and sits at 2,055.

The 100 day moving average, with the exception of last October, has been consistent support for the S&P 500 for over a year. It currently sits at 2055.

Bottom Line

Stocks have now retraced almost the entire "post-FOMC rally" of last week, and are again solidly in the 2,000-2,100 trading range. Yesterday's drop in the momentum names was surprising, and probably reflective of some faster money exiting before the onset of earnings season. However, overall the general market dynamic hasn't changed. The weaker dollar is supportive but the jobs report looms and anxiety over the upcoming earnings season seems to be rising (something we'll cover more next week).

Unless we see NBI (Biotech Index) and the SOX (Semiconductor Index) break support, or unless we see a material rally in the dollar, I'd be surprised to see stocks break materially below the 100-day MA ahead of the jobs report. I am thus expecting a sideways chop over the next few days.

Programming Note

Finally, for those of you who were watching yesterday, I was bumped from CNBC Wednesday afternoon after the TV studio was booked up by MSNBC! Such is the TV business, I suppose.

Payroll Companies

Earlier this week I mentioned that I was interested in staffing/payroll companies as a potential way to benefit from the Fed shifting of NAIRU (Non-Accelerating Inflation Rate of Unemployment) down to 5.0% or below at the March meeting. Keep in mind, NAIRU for the last 30+ years has been widely assumed to be around 5.5%, so dropping it sub 5% is not an immaterial change.

But, yesterday's PAYX earnings results has given me pause. By all analysts' accounts, PAYX put up a good number. They met street estimates on EPS and slightly beat on revenue, and overall business metrics were positive. Yet, the stock was down 2.5% in early trading before the market began to sell-off.

The reason? Valuation. Simply put, all the good news in this company is priced in, so that confirmation was used as a selling opportunity on what has been a good trade.

PAYX isn't exactly a staffing company, but the point holds: MAN, RHI and KELYA all are at or near 52-week highs, and while new highs alone aren't a bad thing, I am concerned about buying at these levels seeing the reaction in PAYX. If we do get a dip in the broad market, these staffing companies are absolutely something I would want to buy along with retailers, regional banks, and small-cap growth, as the fundamentals remain compelling given the Fed.

Economics

Durable Goods Orders

- February Durable Goods was -1.4% vs. (E) 0.2%.
- New Order for Non-Defense Capital Goods also was –1.4%.

Takeaway

This was a bad number, regardless of weather. As per usual, you can ignore the headline in durable goods as it's massively skewed by airplane orders, and like most analysts we immediately look inside the release for the New Orders for Non-Defense Capital Good Ex-Aircraft (NDCGXA). That metric also showed a –1.4%, and perhaps more disconcerting was the January number was revised to –0.1% vs. (E) 0.5%.

This dip in durable goods (which is correlated to the Non-Residential Fixed Investment metric in GDP) resulted in many analysts cutting expected Q1 '15 GDP to 2% or below, which is a disappointment.

But, from a Fed standpoint, it doesn't change anything because it's already known that Jan/Feb manufacturing was subdued, and we can blame the stronger dollar, weather, West Coast port closures and any other excuse we want on it. And, remember yesterday's flash manufacturing PMI for March ticked up a bit, so that helped ease the blow of this report. So, while a disappointing report, it's not materially altering expectations for the economy or the Fed.

Commodities

Commodities continued to be supported by the weaker dollar yesterday as the broad-based commodity ETF, DBC, rose 0.61% while the Dollar Index declined 0.33%. Energy components and precious metals all outperformed while copper pulled back from recent gains and natural gas sold off within its current, multi-month trading range.

Market	Level	Change	% Change
Dollar Index	97.165	-.281	-0.29%
EUR/USD	1.0961	.0037	0.34%
GBP/USD	1.4867	.0018	0.12%
USD/JPY	119.49	-.23	-0.19%
USD/CAD	1.2517	.0026	0.21%
AUD/USD	.7838	-.0036	-0.46%
USD/BRL	3.1982	.0588	1.87%
10 Year Yield	1.920	.042	2.24%
30 Year Yield	2.501	.035	1.42%
Prices taken at previous day market close.			

Crude oil surged following a bearish inventory report for the fifth week in a row, primarily due to the largely overcrowded short side of the trade that we've been referencing for weeks. The EIA reported a +8.2M barrel build in supply vs. expectations for just +5.6M barrels. The fact that oil prices rose on a bearish "inventory day" for the fifth time in a row, further confirming our aforementioned "oversold market" thesis. And this morning, we are seeing the recent short covering rally extend gains thanks to the Saudi airstrikes in Yemen.

Fundamentally, the outlook remains largely bearish as supply obviously continues to steadily rise while global growth concerns persist, dampening demand forecasts. And, as a result of the recent short-covering rally, futures have moved up into multiple levels of resistance in the high $40s which leaves us at a "tipping point" on the charts.

If the downtrend line from the 2015 highs is violated today on a closing basis we can expect to see some follow-through buying and a retest of those aforementioned highs. If it holds, the near- term technical direction of oil prices will obviously remain lower. At this time, we believe the benefit of the doubt remains with the bears over the medium term, especially with the dollar holding support so far this week. However, crude oil is starting to trade a little bit better, and we could potentially be seeing the initial stages of a "bottom" forming.

Natural gas futures currently remain pinned between support at $2.65 and resistance at $2.90. Today, all eyes will be on the EIA's inventory report for which analysts are forecasting a build of +23 Bcf.

The metals were mixed yesterday as gold continued to be supported by dollar weakness, while some of the "froth" came out of the copper market.

Copper started this week with a sharp and violent extension of Friday's surge, but since then has been consolidating that move. Copper has returned to the flat mark YTD after trading down as much as 14.2% in January.

The recent rally has largely been a result of shorts unwinding multi-month positions and most recently a violent squeeze of new, weak-handed short sellers trying to time the market. As far as where we go from here, there is solid resistance on the chart between $2.80 and $2.85 which could finally exhaust the rally, but if futures continue up through the December high of $2.95, the technicals will suggest a change in trend may be imminent.

Gold futures rallied 0.32% into a key resistance level between $1,190 and $1,200 yesterday thanks to the continued weakness in the dollar. And, those gains were extended overnight as gold caught a "fear bid" on geopolitics. If the trend support for the dollar that we mentioned early in the week can continue to hold as it did yesterday, then the initial resistance level between $1,190 and $1,200 could mark the exhaustion point for this counter-trend rally in gold. Continue watching the dollar in coming sessions as it continues to have an impact on the entire commodity space. The key level to watch in gold is the February high of $1,223, as a violation of that level would be a bullish "higher high."

Currencies & Bonds

The Dollar Index declined again Wednesday but it finished well off the lows, and positively for the bulls the Tuesday lows held again on an intraday basis—further implying we may be in for a sideways chop for the next week or so.

The Dollar Index started Wednesday modestly lower but really came for sale following the disappointing Durable Goods report at 8:30, as the Dollar Index hit a low of 96.67 vs. Tuesday's 96.57. But, that level and uptrend again held, and as stocks sold off midday yesterday the dollar caught a bit of a "risk off" bid and managed to close back above 97.

Turning to the euro, there was continued good data early Tuesday, as the German IFO Business Expectation Survey beat estimates, continuing the momentum from Tuesday's flash PMIs. The euro was moderately higher in the wee hours Tuesday, although once the Durable Goods number hit it spent most of the day trading off the dollar. The euro closed up 0.41% and inched closer to the 1.10 level (a two-week high).

The rest of the currency markets were mostly quiet. The yen was little changed (up 0.1%) while Aussie and the Loonie saw mild selling (down 0.3% and 0.1%).

The only other currency with news yesterday was the pound, which caught a bit of a bid on comments by Bank of England Monetary Policy Member Miles, who said that the likely next move in rates in Great Britain would be higher. That's not exactly a surprise, but given some sluggish inflation data there has been some chatter about another potential cut by the BOE, but we considered that wishful thinking by the doves and didn't bother repeating it here. Mr. Miles confirmed our suspicion.

Bottom line is the currency markets remain dollar dominated and they will remain that way until there is material clarity on when (and if) the Fed raises rates. It's a dollar world at the moment, and every other currency is just living in it.

Turning to bonds, they surprisingly declined yesterday for just the third day in the last 13 sessions. The 30-Year Treasury bond dropped 0.45%, and most of that drop came following a very soft 5-year Treasury note auction. It's fair to say Treasuries were a bit heavy all day yesterday, which is odd given the bad Durable Goods report, higher German bunds and a falling stock market. But, Treasuries haven't traded off domestic economic fundamentals since late February, so I suppose it isn't that surprising in this environment.

Regardless of the decline, obviously the momentum still lies with the bulls in the Treasury market. If past is prologue, this may be the beginning of some profit taking by bond longs into next Friday's jobs number (the last several jobs numbers have seen selling of the long bond into the report and then a rally after).

Bottom line, it'll take good data in the US *and* good data in Europe (which we are starting to get) to reverse this rally, although again I do still maintain that I think we have seen the lows in yields for the year. I continue to hold my bond short positions despite the pain.

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
9/11/14	EUM	24.05	None	*Short Emerging Markets. With the dollar surging higher and the global bond yields rising, this should put pressure on the emerging markets, as money rotates out of those economies back towards developed markets. Original Issue*
9/4/14	HEDJ EUFN EWI EWP	59.35 24.67 16.44 41.34	None	*"Long Europe" Portfolio. The move by the ECB to start a private market QE program, combined with the impending TLTROs, should give the European economy a significant boost over the coming months. HEDJ remains the best way to hedge out a falling euro, while higher beta sectors of the EU economy (financials, Italy, Spain) should rally the hardest. Finally, the moves should end the German bond mania, which should weigh on Treasuries. Original Issue*
12/13/13	FCG XOP	18.97 65.62	None	*Natural gas supplies low, increasing 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
September 2014	**Long Europe**	**HEDJ**	*On a longer time frame, Europe is poised to outperform other major developed economies as the ECB is proving their unanimous commitment to increasing the Balance Sheet. HEDJ is the equivalent of Japan's DXJ ETF and is the best way to gain exposure to Europe while hedging against currency depreciation.*

Strategy Update (11/6/14): The ECB continues to slouch towards more stimulus and QE, and at the October ECB meeting Mario Draghi did as good of a job as possible to "speak" dovish and reiterate that the ECB remains unanimously for more stimulus if needed. Additionally, the ECB staff has begun work on modeling more stimulus, which is the most concrete sign yet the ECB is planning to do "more" in early 2015. We continue to view dips as buying opportunities.

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 (11/3/14): The Bank of Japan shocked markets last week by announcing massive new monetary stimulus. I have been a Japan bull since late 2012, and I never thought the BOJ would go this far. The trend lower in the yen/higher in DXJ has clearly resumed, with a reasonable target for the dollar/yen now 115-120. This is a trend that will outperform over the coming months/quarters as the yen devalues and the BOJ/GPIF buys Japanese stocks.

Date Initiated	Strategy	Position (s)	Investment Thesis
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 (11/6/14): Treasuries are finally beginning to roll over here on the charts. The fundamentals for this trade remain decidedly negative, but once again money flows (specifically European) have recently been trumping the fundamentals.

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Asset Class Dashboard

(Updated 3.23.15)

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 rebounded more than 2% last week after the FOMC surprised markets with a very "dovish" statement. That helped ease concerns about a looming rate hike and most importantly likely capped the dollar rally. That said, though, we do not think that it ignites a material rally higher because valuations remain elevated and uncertainty regarding the first rate hike remains.*
Best Idea: Buy Retail (RTH). **Best Contrarian Idea:** Buy Energy (XLE)			
Commodities	**Neutral**	**Bullish**	*Commodities caught a bid late last week thanks to the falling dollar (which was courtesy of the Fed). The plunging dollar overwhelmed continued bearish fundamentals for most commodities, but despite the dollar decline we do not think we are embarking on a broad commodity rally.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index dropped more than 2% last week following the "dovish" FOMC meeting. And, that selling is continuing early this week as the very crowded "Long Dollar" trade is reversed. Going forward we view the dollar rally as likely capped at 100 but do not see a downtrend emerging. 95 should provide support.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long British Pound (FXB)			
Treasuries	**Neutral**	**Bearish**	*Treasuries surged last week thanks to the dovish FOMC. The thirty year hit a new nominal high and the ten year yield dropped below 2%. Going forward, with the FOMC more "Dovish" than thought and continued support from European buyers, it will be hard for Treasuries to mount a material decline near term unless economic data turns materially better in the US.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			