

July 12, 2011

MF Global Daily Report

U.S. Stock Index

Outlook:

Look for SPU to hold 1305 to 1292. News reports suggesting Greek debt holders may experience some type of default and a flaring of credit risk in Italy has undermined the financial sector and created an extra hurdle for buyer going into the release of earnings. Hard landing fears toward China have also risen in the wake of trade and inflation data, but the limited sell off in oil reduces the chance for the news to de-rail a stock rally. Profit reports are expected to be neutral to friendly for the market, but the trade has to feel comfortable about financial stability in Europe. The bottoming action in bank share has been questioned by yesterday's price action and a weak financial sector will inhibit a meaningful rally. M&A activity suggests stocks are attractive. Monday, CLX, ARJ, RADS/NCR, and ENP/VNR saw activity. Earnings from AA should provide support, but MCHP warned of weaker profits and NVLS guided Q3 EPS and revenues down, saying customers are cautious and may push orders into 2012. Watch the SOX at 400. A close below 1292 in SPU will turn the outlook sour and position the market to test the 1255 area. 1350 will remain a stiff resistance. Best guess for today's range in SPU: 1305 to 1328.

Support/Resistance

	SPU	NDU	DJU
R2	1335	2381/2390	12572/12600
R1	1328	2376	12510
S1	1312	2350	12415
S2	1305/1292	2331	12360

Perspective:

The market will eye the sovereign debt crisis in Europe, budget negotiations in the U.S., and Chinese economic data while digesting profit numbers. Weekly chain store sales and FOMC minutes will also get a look or two. The market has been optimistic about earnings, but signs of a hard landing in China, and flaring credit risk in the Eurozone are offsetting the outlook for continued profit growth. Factors to think about include:

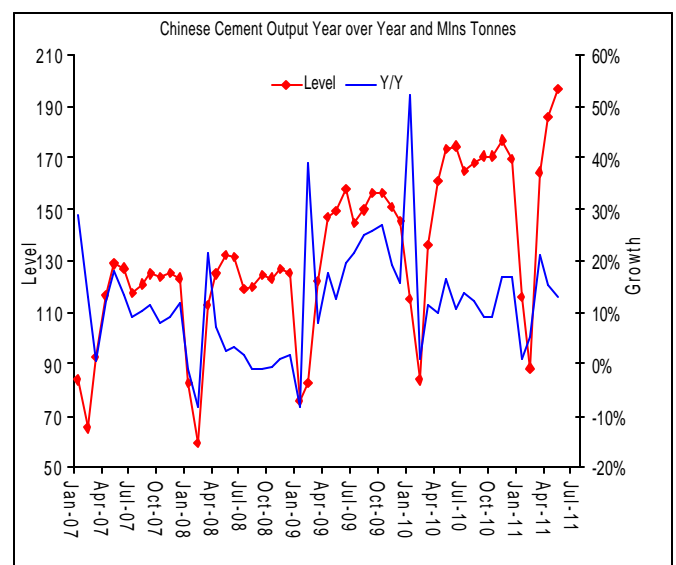
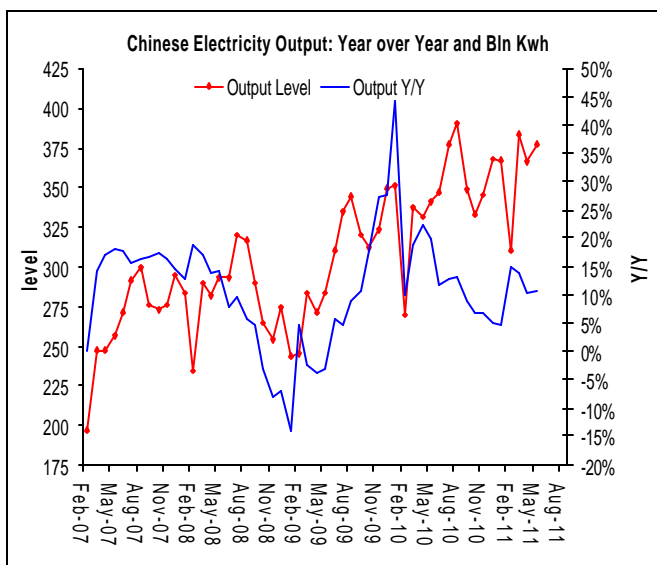
- China's trade numbers showed slower, but still high levels of growth in exports and imports, while inflation rose above estimate at 6.4%. The combination of slower growth and high inflation leave the Chinese economy vulnerable to hard landing risk. Chinese industrial production, retail sales and Q2 GDP will be released Tuesday night. June IP and retail sales are expected to show little change in growth rates up 13.1% y/y and 17.0% y/y, while Q2 GDP is expected to rise 9.5% y/y down from 9.7%.
- European credit risk has surged on concern over Italy and wires stories suggesting Greece may default on a portion of its debt. Greek 2 year debt is yielding 28%, and pricing a significant probability

of restructure/hair cut. Moreover, yields on 2 year debt for Portugal and Ireland are over 16% and are pricing serious risk of haircut. Italy's debt has come under attack in the last week with the 2 year yield up over 100 bps since July 4th. The events in Europe are pressuring bank valuation. Banks may have to write down debt and slow lending. Bank shares had shown signs of basing, and the pattern is now breaking down. There appears to be a failing bottoming opportunity.

- Chain store sales have displayed momentum in recent weeks, and the trade will be looking for continuation. Gasoline prices have firmed/stabilized in recent weeks and could dampen spending at the market.
- FOMC minutes are likely to paint a mixed picture on growth and signs of firming inflation. The Fed is set up to keep policy steady, and should be a non-factor for the equity market. Low short rates make equities an attractive alternative to cash.
- The trade will digest news from AA (mixed-see below), NVLS (bearish – see below), FAST, and INFY in the morning, while ADTN releases in the afternoon. Corporate data has been more constructive than macro data in recent weeks. That said, MCHP guided down late yesterday – see below.

Chinese data:

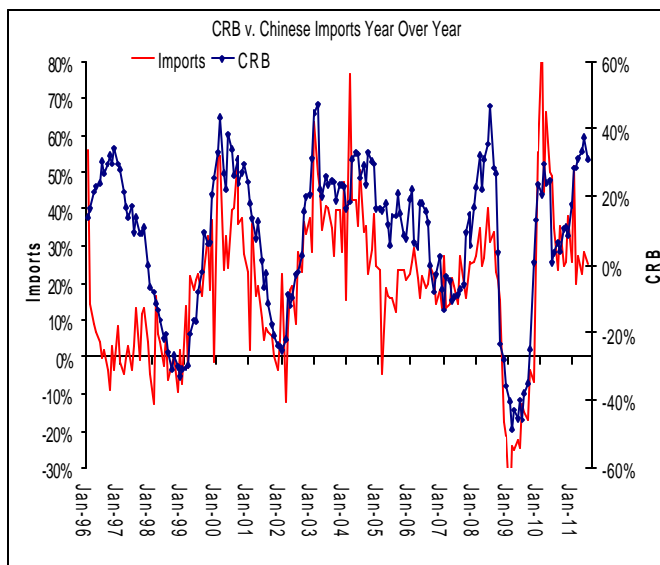
Chinese industrial production will shed light on the pace of economic activity in China. China is a key driver of corporate profit growth. Industrial shares seemed to sell off sharply on Chinese hard landing risk Monday. The first graphic below displays electricity usage in China. Notice that output has been flat sequentially since August of last year, but the growth rate is up about 10% y/y. Lack of a leg higher in electricity output may be a sign of slowing growth. The second graphic highlights cement production. Cement output has risen sharply over the past two months and is consistent with economic expansion. The year over year growth rate has remained steady in the 13% area showing health growth. A downturn in cement output would be a sign of a slowdown in the real estate sector. Government officials have been trying to slow the real estate sector.



Chinese trade data showed slowing demand for raw materials. Oil imports were especially weak falling both sequentially and relative to last year. Iron ore, copper and aluminum imports had a softer tone. The table above displays the trend in commodity imports. The data is consistent with the slower growth implied by the manufacturing PMI. The CRB index's recent rally seems to be ahead of the pace of Chinese imports. Commodity prices may be rich for the level of demand. The S&P 500 materials sector, as seen in the ETF XLB, has stalled and lower demand from China will dampen prices. Some may see a potential head and shoulders top in the sector, but prices need to close below \$36.44 to confirm a bearish reversal. A break below \$38.25 would be a sign of weakness in the sector, while movement over \$41.28 would signal a new leg higher.

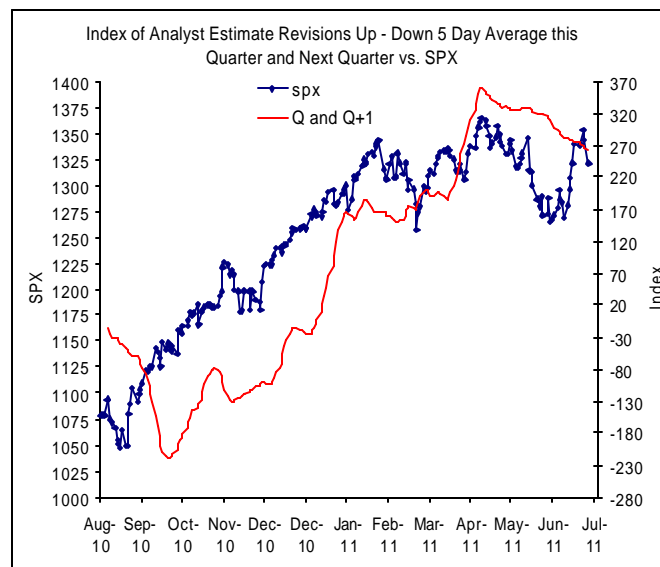
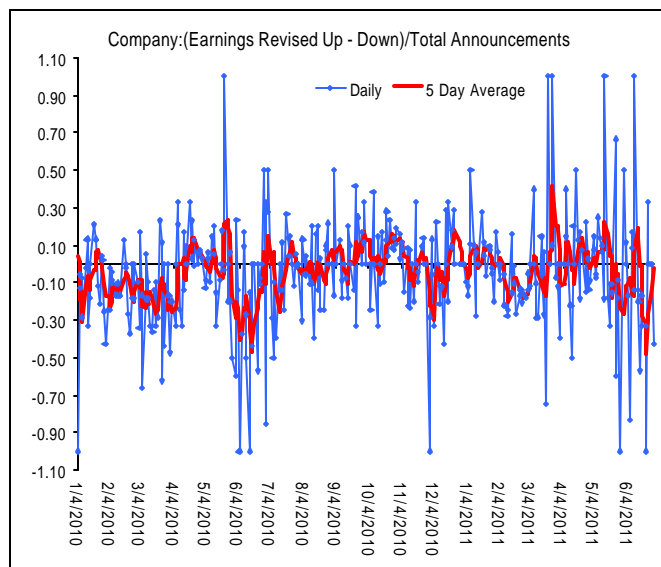
Select Chinese Imports

Item	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jun-10
Oil (mln tons)	20.86	21.80	19.95	21.67	21.54	21.55	19.70	22.27
Refined Product (mln tons)	3.96	3.85	3.30	3.88	3.22	3.39	3.40	3.31
Copper Scrap (thous tons)	430	360	250	390	380	400	420	350
Unwrought Copper (thous tons)	344.56	364.24	235.47	304.30	262.68	254.68	280.00	328.23
Alum Scrap (thous tons)	260.00	230.00	140.00	190.00	230.00	220.00	240.00	220.00
Unwrought Alum (thous tons)	82.93	96.28	60.20	87.73	76.72	74.88	64.49	74.58
Iron Ore (mln tons)	58.08	68.97	48.81	59.48	52.88	53.30	51.09	47.17
Soybeans (mln tons)	5.43	5.14	2.32	3.51	3.88	4.56	4.30	6.20



Corporate profits:

Companies have been spending the past few weeks lowering their profit outlooks but the downward revisions have been consistent with the last year and half (see graphic on left). The trade will be watching guidance closely in the coming weeks. The graphic displays the trend and the five day average of company revisions slanted downward over the past few weeks, but rebounding in recent days. The second graphic highlights analyst revisions. Despite signs of favorable chain store sales, strong RevPar numbers, and robust gaming revenues in Las Vegas, analysts have been cutting their profit outlooks. The short term trend is downward. This may allow the market to see some favorable analyst revisions.



- AA reported mixed numbers with EPS at \$0.32 [\$0.33 forecast], and revenues at \$6.59 bln [\$6.31 bln forecast]. The company affirmed 12% global aluminum demand growth. AA said: “Although the economic recovery is uneven, the outlook for AA and aluminum remains positive”. The CEO, on CNBC, seemed positive for growth in the EM and less constructive on the U.S.
- NVLS reported weak than expected revenues \$250.2 mln [\$352.6 mln expected], but stronger than expected EPS \$0.79 [0.76]. Q2 Bookings fell 24.9%. More bearish, NVLS said that end demand was softening in China and customers had become cautious over the past few weeks. Q3 books were expected flat to down 20%, revenues were projected \$300-\$340 mln [\$361 expected] and EPS were forecast 60 to 75 cents [84 cents expected]
- On a clear negative note MCHP cut its revenue forecast. Sales were down 1.5% sequentially in the June quarter and guidance was for +1% to +6%. EPS was projected 53 to 55 cents [59 cents expected]. June sales did not progress as expected. Auto and consumer business was soft. There were reduced purchases by multiple large clients.

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