7:00's Report

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

August 23, 2013

The Russell 2k has held Monday's lows, which is an encouraging sign as during the last two corrections the Russell bottomed first.

Pre 7:00 Look

- Futures and European markets mostly flat after a night of calm in emerging markets.
- Emerging markets currencies bounced o/n, with the Rupee leading a broad rally against the dollar. Brazil announced a $60 bln currency market program to support the Real.
- Economically it was quiet: Revised 2Q GDP was unchanged for Germany and revised .01% higher for the UK (to 0.7%).
- Focus will be on headlines out of Jackson Hole, although no major policy changes are expected.
- Econ Today: New Home Sales (E: 487K).

Market	Level	Change	% Change
S&P 500 Futures	1653.50	-1.25	-.08%
U.S. Dollar (DXY)	81.595	.372	.46%
Gold	1375.30	4.50	.33%
WTI	105.32	.29	.28%
10 Year	2.886	.031	1.09%

Equities

Market Recap

Stocks rallied Thursday as good global and domestic economic data and relative emerging-market calm helped markets to their best day since Aug. 1. The S&P 500 rose 0.86%.

Stocks started yesterday higher on a rash of stronger-than-expected economic data. Chinese manufacturing PMIs, EU composite PMIs, jobless claims (the four-week moving average) and the U.S. flash manufacturing PMIs all beat expectations, helping futures to rally. Additionally, there was a nervous calm over the emerging markets yesterday, allowing investors to focus on the seemingly ever-improving global economic data.

Stocks moved steadily higher throughout the morning, with Europe closing not far off its highs. But, when the Nasdaq went down at noon, obviously volumes dried up significantly. Although markets did drift higher throughout the afternoon, any moves that occurred with the Nasdaq out of commission came on very low volumes. Regardless, markets went out just off the highs of the day.

Trading Color

Yesterday was a nice rally and, regardless of the Nasdaq closure, it was good to see markets rebound after a very ugly Wednesday close. And, it'll make the bulls happy that the Russell 2000 again outperformed, rallying 1.4%.

But, that optimism has to be tempered by the fact that much of the buying yesterday was short-covering and volumes, even ignoring the Nasdaq, were very, very low.

From a sector standpoint, yesterday saw broad strength as all 10 S&P 500 sub-sectors were higher. And, as you'd

Market	Level	Change	% Change
Dow	14963.74	66.19	.44%
TSX	12674.35	101.27	.81%
Brazil	51397.66	992.46	1.97%
FTSE	6457.83	10.96	.17%
Nikkei	13660.55	295.38	2.21%
Hang Seng	21863.51	-31.89	-.15%
ASX	5123.36	47.61	.94%
Prices taken at previous day market close.			

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expect given the positive global economic data, the market was led by basic materials, industrials and energy. Homebuilders also had another good day on follow-through from the Toll Brothers (TOL) earnings Wednesday, so the two anecdotal positives in the market—small cap outperformance and a bottom in the homebuilders—both continued Thursday.

Market	Level	Change	% Change
Gold	1372.10	2.00	.15%
Silver	23.09	.08	.33%
Copper	3.32	.02	.45%
WTI	104.94	1.09	1.05%
Brent	109.84	.03	.03%
Nat Gas	3.54	.08	2.37%
Corn	4.64	-.19	-3.83%
Wheat	6.40	-.09	-1.31%
Soybean	12.86	-.17	-1.32%

Prices taken at previous day market close.

Although they all finished higher, "bond proxy" sectors all relatively underperformed—with REITs, utilities and telecom lagging the tape—as did other "safety" sectors like consumer staples and healthcare.

Volumes, as you'd expect, were anemic, while on the charts the S&P 500 once again failed to close above its 50-day moving average at 1,658.

Bottom Line

Nothing much changed yesterday. The continued outperformance of small caps and the homebuilders is something to watch, but until the emerging markets settle down (and yesterday was just a pause, the volatility isn't done), then I think it's hard to get too aggressive on the long side with adding incremental capital. If you were to do so, I'd continue to look to Europe first, though.

Thoughts on the Nasdaq Yesterday

What happened with the Nasdaq yesterday doesn't really have to do with the direction of the markets, so I wasn't going to touch upon it. But several people wrote in and asked my thoughts, so I figured I'd share them.

Bottom line is I'm not sure how many times you need to be warned about something before it becomes a big problem. Or, to quote one of my favorite movies, "Jaws," as Richard Dreyfuss says to the mayor: "I'm familiar with the fact that you are going to ignore this particular problem until it swims up and bites you in the ass."

Whether it's the flash crash, the FB debacle, Knight Trading, the GS erroneous options trades earlier this week or the Nasdaq stoppage yesterday, we have had plenty of warning that the infrastructure of the exchanges is fragile. And, although we don't know what caused the Nasdaq to shut down yesterday, the bottom line is that we are operating in a market that is becoming more and more dominated by HFTs, algos, black boxes, etc. How many warnings does the SEC need before something serious, like an '87-style crash, happens because of HFTs or algos gone haywire?

The point of a stock market is to provide liquidity and capital to companies looking to sell shares. As HFTs and algos come to dominate the market more and more, we move further and further away from that core mission.

And, while Eric Holder is busy threatening to sue banks for the financial crisis and the Fed is telling banks to raise more and more capital, it seems little, if anything is being done to 1) rein in the growth of HFTs or algos, 2) monitor that they are abiding by a set of standards so they don't disrupt the market, and 3) set up a process by which they can he held significantly monetarily accountable for disrupting an orderly market. And, as I'm no HFT expert, if there are already such processes in place, then clearly they aren't really working very well.

Again, for all we know the Nasdaq issue yesterday had nothing to do with HFTs or algos directly, but the truth is the exchanges are adding to infrastructure to cater more and more to these firms (because they are the revenue-generators) and yesterday something broke.

Oh, and don't hold your breath for the SEC to do anything. The SEC won't seriously address this problem because reining in the HFTs and algos would be a killer for the big brokerage firms. Since the margins in the equity business have been destroyed over the past several years, the only way to keep revenue steady is to cater to the big-volume traders (HFTs, algos, etc.). If the big brokerages lose them, the equity business will take a huge hit, because you can't charge but a penny or two or three per share anymore (if that).

I'm not sure there's an easy fix here, and I'm not blaming

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the brokerage firms—it's not their fault the equity margins got destroyed; they're just trying to stay in business. But, sooner or later this problem, if not addressed, is going to bite all of us. But, we can't say we haven't been warned.

Economics

Economic data yesterday was better-than-expected, and while it doesn't solidify some sort of tapering announcement, it does imply that the economy is seeing incremental improvement. So, on balance, I think the chances of a September announcement of tapering of some sort got incrementally better because of yesterday's data.

Jobless Claims

- Weekly claims were 336K vs. (E) 329K.
- 4-week moving average declined to 331K, a new low for the recovery.

Takeaway

Jobless claims backed up a bit last week, but regardless it's fair to say we've seen some incremental improvement in the labor market over the past several weeks.

The weekly jobless claims report covers the previous week (so yesterday's report is for the week ending Aug. 17). I point that out because the government's monthly employment report is a based on surveys, and those surveys are conducted the third week of every month (so the survey was conducted last week, ending Aug. 17).

Comparing July and August weekly claims during the week of the government's monthly employment surveys (week ending July 17 in July, and last week in August), we see the level of weekly unemployment claims was exactly the same (336K).

But more importantly, the four-week moving average fell from 345K on the week ending July 17, to 331K yesterday (week ending Aug. 17). So, we can infer from this that the jobs market is marginally better, which infers a better jobs number in August, which should solidify a tapering announcement in September.

PMI Manufacturing Index Flash

- August Flash Manufacturing PMI was 53.9 vs. (E) 53.5.
- New Orders rose to 56.5 from 55.5 in August.

Takeaway

This was another strong report on the manufacturing sector, as national manufacturing activity accelerated further in August. Both the headline and the details of the report were good, as new orders, the leading indicator of the report, moved higher in August.

Most importantly, this report shows that nationally the manufacturing sector is still seeing accelerating growth, and counters the two "ho-hum" regional reports we got last week (Empire State and Philly) that implied we were seeing a slowing of growth in the manufacturing sector.

Commodities

Commodities saw a mild but broad rally yesterday, as the good economic data from China, Europe and the U.S. offset a stronger U.S. dollar.

Industrial commodities were the best performers yesterday, and that makes sense given the strong global manufacturing data. WTI crude rallied 1% on a combination of short-covering and some value-buying, as the manufacturing data clearly showed the U.S. economy is continuing to grow, albeit slowly. But, when we have a growing domestic economy, oil will go up with it over time, and some bulls undoubtedly bought the recent dip. Until we get a breakout above $108/bbl, though, WTI remains range-bound.

Market	Level	Change	% Change
Dollar Index	81.472	.259	.32%
Euro	1.3358	.0003	.02%
Pound	1.5587	-.0078	-.50%
Yen	98.62	.94	.96%
CAD $	.9502	-.0045	-.47%
AUD $	.9009	.0040	.45%
Brazilian Real	.4095	.0020	.49%
10 Year Yield	2.896	.000	.00%
30 Year Yield	3.877	-.047	-1.21%
Prices taken at previous day market close.			

Copper, which did rally yesterday on the Chinese manufacturing data, was a bit of a mixed bag. Yes, copper finished up 0.5%, but that was well off the early morning highs. (Copper peaked up 1.5% in the morning but failed to break above the high

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of last week at $3.37.) So, the news was bullish and copper rallied, but it wasn't quite as good a day as I would have liked.

Natural gas was actually the best-performing commodity yesterday, and as you can guess it was mostly weather-related. First, though, the weekly inventory data was mildly bullish (inventories rose by 57 Bcf vs. (E) 69 Bcf). But, supply concerns aren't really the story in natural gas—expected weather is. And, it looks like this late-summer heat wave is going to stick around a bit longer, and that's causing shorts to cover.

Finally, turning to the precious metals, both gold and silver were marginally higher yesterday. But given the dollar was at one point more than 0.5% higher, I think that this positive close for gold is a sign of relative strength. Gold has held in very well so far this week, which has got to make shorts nervous. $1,384, the high from last week, is now the next resistance, and if that's broken, it's likely a straight shot to $1,400/oz.

Commodities continue to see the fundamentals turn more and more bullish. Global economic data continues to improve and they imply we're seeing the major economies of the world (Japan, China, EU, USA) all growing together for the first time in years. But, the commodity complex isn't immune to the concerns in emerging markets. As we saw in copper yesterday, like equities, commodities will have a tough time moving materially higher until emerging markets settle down. But, I'd continue to look to be a buyer on dips in the commodity space given the economic data.

Currencies & Bonds

It was a pretty quiet day in the emerging-market currencies yesterday, as the rupee, real, and Mexican peso all saw relatively muted moves. But, I think that's more from market exhaustion rather than it is any sort of positive fundamental resolution of the issues in emerging markets. So, consider yesterday a pause, not a sign of stabilization.

With emerging markets behaving for at least one day, the developed-market currencies were back in focus. The Dollar Index continued its bounce, at one point rising as 81.95 on short-covering before giving back a lot of those gains to close around the 81.50 level, up 0.4%.

Why the Dollar Index is higher isn't that much of a mystery: The FOMC minutes imply tapering in the fall is all but a certainty, and jobless claims and flash manufacturing PMIs were both better than expected.

The euro was down slightly yesterday, as the dollar strength trumped the strong EU economic data. But the British pound was the big mover in Europe, falling 0.7% vs. the dollar after Monetary Policy Committee Member Martin Weale said in an interview with the London Telegraph that more QE could be necessary in the future. That's not exactly news, but the pound has seen a big rally vs. the dollar over the past several weeks (really since the BOE's forward guidance), and this was an excuse for the market to correct a bit. From a monetary policy standpoint, though, nothing really changed.

Turning to Asia, the Aussie dollar failed to catch a bid despite the better Chinese data, as emerging-market uncertainty undoubtedly weighed on that currency. The more interesting moves in Asia came from the yen, which fell 1% not because of anything really yen-negative, but instead on dollar strength. The yen over the past week has quietly started to exhibit signs of fatigue, and I'm starting to think this three-month-long counter-trend rally might be coming to an end, as the likely course of action is for more easing from the BOJ and PM Abe, not less. I'd look to short yen the next time is breaks through 100/dollar, as I continue to think ultimately we see the yen at 115-120 vs. the dollar before Mssrs. Abe and Kuroda are done with their work.

Finally, EM bonds were flattish while Treasuries were marginally lower, but rallied off their lows early Thursday morning. But, like in the emerging markets, I think we're seeing a pause in the bond market declines, not a stabilization, and part of me thinks we'll have to see the 10-year hit 3% in some sort of short term capitulation before we confidently say this period of interest-rate-related volatility is over. I hope I'm wrong, though, because if I'm right it means we're not done on the downside yet in equities.

Have a good weekend—Tom.

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The 7:00's Report Asset Class Dashboard

(Outlook on the primary trend for major asset classes over the next month)

	Fundamental Outlook	Technical Outlook	Overall	Comments
Stocks	Neutral	Bullish	Bullish	*US equities have been consolidating recent gains and going through a typical correction. But, turmoil in emerging markets is threatening to be a potentially bearish game-changer. EM bonds haven't moved to new lows (which would be a signal to de-risk) but stocks will have a hard time rallying until the emerging markets stabilize.* *The S&P has broken through its 50 day MA and support now lies in the mid 1620 area.*

Trade Ideas

Long/Overweight: **The biggest trend in the equity markets currently is the rotation out of "bond proxy" sectors and into sectors positively correlated to higher rates and more economic growth. So, banks are the most favored sector in that environment, followed by other typical cyclicals like tech, consumer discretionary, and energy. For those looking for a contrarian play, basic materials remains on of the biggest underperformers in the market, but offers value if the economic recovery turns global in the coming months.**

Internationally, European economic data shows the EU economic is finally stabilizing, so long EWU (UK ETF) or EIRL (Ireland ETF) are two ways to potentially get exposure to a recovery in Europe. Also, the "Long Japan" DXJ trade appears to be back "on" and I'd use any decent dip to initiate or add to positions.

Commodities	Neutral	Neutral	Neutral	*Commodities continue to try and "bottom," as recent global economic data appears to be showing signs of stabilization in Europe and China. Commodities, as measured by broad based commodity ETFs like DBC finally broke out of a months long downtrend last week .*

Trade Ideas

Long: **WTI crude remains one of the more bullish commodities, as increasing domestic demand should help push oil higher over the coming months. A double top appears to have been traced out at $108, but I would look to be a buyer of oil on any material decline down to support at $103/bbl (using the ETFs USO or XLE).**

Copper has broken its months long downtrend as global growth appears to be stabilizing, and if that continues, industrial commodities offer some value, and an ETF like DBB will offer substantial upside. More broad based commodity ETF's (like DBC) are also a potential value at these levels, if growth continues to stabilize. Commodities and raw materials are the ultimate "contrarian" investment in the current market environment.

U.S. Dollar	Bullish	Bullish	Bullish	*The dollar index has traded to support at the 81.00 level, which should hold if the trend is still higher in the dollar. I remain dollar bullish based on the marginal direction of monetary policy, but if the uptrend at 81.00 is decisively broken, I'll have to admit I'm wrong.*

Trade Ideas

***Short*:** **Japanese Yen on any decent bounce (YCS being the ETF to use), like we've seen now, especially in the face of weak GDP reports. Short the euro (EUO) on any further bounce due to the fact the ECB is squarely focused on economic growth, and won't let the currency appreciate too much as that would cause a stagnation in exports.**

Treasuries	Bearish	Bearish	Bearish	*The outlook for FOMC tapering is more cloudy after the recent FOMC meeting, but the bottom line is whether tapering occurs in Sept or Oct, as long as economic data stays good, tapering will occur, which is bearish bonds.*

Trade Ideas

Buy: **TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury). SJB (inverse junk bond ETF) is also rallying during this period of global uncertainty, and basically has acted as a hedge against falling equity prices. Finally, with the Fed committed to holding down near term rates, the yield curve will steepen dramatically, so STPP should continue to do well.**

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