7:00's Report

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

August 29, 2013

Pre 7:00 Look

- Futures and international markets marginally higher as emerging markets rebound and action against Syria looks to be delayed. Economically it was quiet o/n.
- The Reserve Bank of India, and the Central Bank's of Brazil and Indonesia all moved to defend their currencies, with the later two raising interest rates.
- Military action against Syria appears to have hit a delay, as Parliament refused to authorize any action in the UK and the United Nations wanted more time to investigate.
- Econ Today: GDP (E: 0.7%), Jobless Claims (E: 330K).

Market	Level	Change	% Change
S&P 500 Futures	1633.25	1.00	.06%
U.S. Dollar (DXY)	81.89	.425	.52%
Gold	1410.00	-8.80	-.61%
WTI	109.21	-.89	-.81%
10 Year	2.781	.061	2.24%

Emerging Market debt ETFs are now sitting on the lows of last week, and if they are decisively broken, that will likely mean more downside for equities.

Equities

Market Recap

Stocks rallied small Wednesday as sellers took a breather and some additional clarity on Syria (more on that below) resulted in some mild nibbling on the long side. The S&P 500 rose 0.27%.

Despite widespread weakness in international markets, U.S. markets started Wednesday slightly higher, but more on seller exhaustion than anything else. There was little in the way of news yesterday, and most of the focus remained on Syria, the emerging markets and central banks. The "reasons" behind Wednesday's rally included more clarity on Syrian military expectations, a "not as bad as feared" pending home sales report, and a big rally in the energy sector. (ExxonMobil (XOM) added nearly 1 point to the S&P 500 by itself.) Stocks spent almost the entire day higher, although the markets limped into the close. This continued a recent worrisome trend that has seen markets consistently fading into the close, which is normally a bearish signal

Trading Color

Sector trading was mixed and relatively inconclusive yesterday, with the only really big theme being that of energy sector outperformance (for obvious reasons). The energy sector rallied more than 1.5% on Syria concerns and short-covering, while consumer discretionary also rallied despite some downgrades on J.C. Penney (JCP) and Tiffany & Co. (TIF). Most other sectors were little changed, and there's simply not a lot of insight to glean.

The S&P 500 was basically flat so the picture on the charts remains the same: 1,620 is the next major sup-

Market	Level	Change	% Change
Dow	14824.51	48.38	.33%
TSX	12607.22	16.01	.13%
Brazil	49866.92	-224.63	-.45%
FTSE	6461.40	31.34	.49%
Nikkei	13459.71	121.25	.91%
Hang Seng	21704.78	180.13	.84%
ASX	5092.41	5.25	.10%
Prices taken at previous day market close.			

port while resistance lies up near the 50-day moving average (1,659). Volumes were again very low and trading thin, and the lack of conviction remains an issue that, while largely ignored, could be important.

This entire correction has come as a result of a buyers' strike, not aggressive selling—so it remains to be seen what happens next week when desks are again fully staffed and people start worrying about finishing strong into the end of the year.

Market	Level	Change	% Change
Gold	1417.30	-2.90	-.20%
Silver	24.34	-.31	-1.26%
Copper	3.31	-.02	-.65%
WTI	109.56	.55	.50%
Brent	116.07	1.71	1.50%
Nat Gas	3.57	.03	.93%
Corn	4.81	-.05	-1.13%
Wheat	6.46	-.04	-.65%
Soybean	13.73	-.02	-.16%

Prices taken at previous day market close.

Bottom Line

Emerging markets aren't stable, so I'm inclined to think this decline isn't over yet—and yesterday felt as much like a bounce in a heavy market as I've seen in a while. But, it looks like we'll finally get some action on Syria, so the removal of that uncertainty and the end of the week could see a bit of a rally here today and tomorrow. But, until emerging markets are settled, I don't see how the market can mount a material rally (one we actually want to allocate to, not some two- or three-day bounce).

So, I'd hold tight here for the rest of the week and take a look again once the market is fully staffed early next week—and continue to focus on areas of greater relative opportunity into the end of the year: Commodities (on a dip), European equities (EWU), basic materials, shorting bonds (on any decent bounce).

Syria Update

Markets yesterday got a bit more comfortable with Syria, as multiple press outlets reported that any action toward Syria will likely be a small, targeted cruise missile launch or bombing run. This is supposed to act as a "deterrent" toward using any further chemical weapons of weapons of mass destruction.

Whether that type of strike will be effective obviously remains to be seen, but from a market standpoint, that puts the type of military action closer to a Clinton-type bombing of Iraq or the Sudan in '98 as opposed to something that is the start of a greater level of involvement in the Syrian civil war.

Point being, that type of action isn't going to cause a material sell-off in markets by itself, unless there are some significant, unintended consequences. We may see the downward pressure of Syria continue to abate, as it did yesterday.

Economics

Pending Home Sales Index

- June Pending Home Sales fell 1.3% vs. (E) 1.0%.

Takeaway

Pending home sales largely met expectations yesterday, and they further confirm the other housing numbers we've seen lately that show higher mortgage rates are slowing the housing recovery. (Importantly, though, they aren't stalling the recovery, yet.)

Pending home sales are particularly important because they are based off contracts signed, not closings, so this number reflects the level of sales activity in June. So, the pace of sales did slow, but it didn't fall off a cliff. Keep in mind May saw pending home sales reach their highest level since December 2006.

From a market perspective, in the context of the horrible new home sales numbers we saw last Friday, yesterday's pending home sales report was actually better than feared, so it wasn't the negative reading the headline implied and stocks didn't really move off the news. From a Fed standpoint, this won't alter policy, and expectations remain in place for a September announcement of QE tapering.

Commodities

Commodities indices were higher again Tuesday but the trading was more mixed, as energy was again very strong off Syria angst, while industrial metals and grains declined.

Energy extended the rally, as the impending Syrian conflict continues to push prices higher. Brent in particular saw the biggest effect (up 2% yesterday to a six-month high) and that makes sense, because if there is any disruption in the production of crude (which, despite the market's reaction, is very unlikely), it would be a disruption of Brent crude as opposed to WTI.

Not to get in the way of a run-away train, but with most reports predicting a very small, tactical, one-time missile strike being the consensus expectation, the geopolitical risk premium in crude seems to be getting pretty rich at these levels. That is, unless one of the big producers (Saudi Arabia or Russia) is dragged into the mess. I'm certainty not advocating shorting it, but WTI and Brent at these levels are pricing in some decent turmoil in the Middle East right now. Based on the facts, that doesn't look like the most-likely outcome.

Brent Crude: Certainly the Syria situation is worth some increase in the geo-political risk premium in oil, but the big rally seems a bit ahead of itself.

Turning to the metals, gold and silver were both initially higher on Wednesday, but sold off shortly after 9 a.m. after Steve Liesman on CNBC said that he believes the announcement of tapering in September will occur, based on his time at Jackson Hole over the weekend. That declaration only helped to further the expectation of a September taper, and helped remove some of the "no taper" premium in gold and silver (of which there isn't a lot, but it's there).

Like energy, both gold and silver are pricing in some pretty nasty outcomes in the short term from a geopolitical perspective. But it's important not to confuse the fact that gold and silver are short-term overbought with the reality that the environment is turning more-bullish for precious metals. Gold remains about the only place to really hide if the emerging-market turmoil continues or gets worse. Even if it doesn't, though, the improving global economy should eventually spur inflation, as central banks promise to remain very, very accommodative.

Market	Level	Change	% Change
Dollar Index	81.47	.27	.33%
Euro	1.3341	-.0045	-.34%
Pound	1.5524	-.0014	-.09%
Yen	1.0238	-.0063	-.61%
CAD $	.9529	-.0001	-.01%
AUD $	.8928	-.0041	-.46%
Brazilian Real	.42615	.0053	1.26%
10 Year Yield	2.782	.061	2.24%
30 Year Yield	3.754	.051	1.38%
Prices taken at previous day market close.			

A general short-term pullback in commodities is certainly likely once the "rumor" of a Syrian military strike gives way to the "news" of what is actually going to be done. But, as long as economic data continues to improve on a global basis, then I think commodities can continue to outperform going forward, short-term pullbacks aside.

Currencies & Bonds

Emerging-market currencies were again lower Wednesday, although there were some silver linings. First, though, the rupee absolutely plunged Wednesday, at one point falling nearly 4%, its biggest drop in 18 years, as the decline of that currency is starting to get out of hand. Rhetoric and intervention by the Reserve Bank of India had little effect, and the rupee went out just off its lows.

One of the reasons for the extreme weakness in the rupee is the calendar. Apparently at the end of every month, Indian oil companies see payments for oil and other energy products increase substantially, and they pay for these things in dollars. So, they sell rupees and buy dollars, and then buy oil.

Well, the normal monthly selling of those rupees in this market at least partially caused the huge declines yesterday. The RBI responded by opening a "special window" to sell rupees to oil companies directly, to alleviate some of the selling pressure.

While the RBI continues to flail about and try to stabilize the rupee, the Central Bank of Brazil took measures last Friday to help the real. Unlike the RBI, those measures appear to be working. The real rallied 2% yesterday and appears to have put in some sort of a bottom.

Bottom line, though, is until we see some broad stabilization across the emerging markets, starting with India, then EM currencies will remain the main driver of risk assets.

Turning to the dollar, it was higher yesterday on a number of factors:

1) Safe-haven buying off the Syrian news,
2) A better-than-feared pending home sales report, and
3) Liesman's comments that tapering is "on" for September.

The strength in the dollar was pretty widespread: The euro, pound, yen, Loonie and Aussie all fell vs. the greenback. Most of those declines were trading noise (the yen was down 0.7% but that was just some give-back from Wednesday's big rally—no news broke), but the British pound was the big exception.

New Bank of England Governor Marc Carney gave his first major speech as head of the BOE, in which he reiterated the BOE's forward guidance and, in some ways, made it even more dovish than before. In some of the most-direct comments yet in the defense of "forward guidance," Carney said the markets are dramatically off on their expectation for higher rates in the future.

But, as has been the case since early July, the market appears intent on calling the "bluff" of central bankers with regard to just how long they intend to keep interest rates low. The pound rallied off the speech and UK bonds declined. Regardless of this game of chicken in the UK between Carney and the markets, the bottom line is the economic data continues to come in better than expected (distributive trades, which is a retail sales report, beat estimates yesterday). Forward guidance or not, the BOE will remain ultra-accommodative for a long time, which to me means higher equity prices. Let Carney and the bond traders fight it out—the ultimate beneficiary is UK equities.

Turning to the bond markets, then, emerging-market debt continued to decline yesterday, and both PCY and EMB are now sitting on the lows of last week. If those lows are definitively violated, then that would confirm my expectation that yesterday's rally in share prices was merely an oversold bounce, and that we're not done on the downside. At the risk of sounding like a broken record, EM currencies and bonds have to stabilize before equities can rally.

Optimistically, though, if I'm right about 2.90% being a near-term top in the 10-year yield, that may be the first step toward some EM stability, although the Reserve Bank of India needs to stabilize the rupee.

Treasuries saw moderate declines yesterday, keying off the "OK" pending home sales data and Liesman comments. Also weighing a bit on bonds was a soft five-year Treasury auction that saw a bid-to-cover ratio of just 2.38, the lowest since July 2009. But, while it seems like lackluster demand, don't read too much into the auction results during the last week of August, when attendance is very thin.

Bottom line is the trend remains lower in Treasuries, but I get the feeling that 2.90% may be the top for a bit in the 10-year yield. But, I'd shorting any rallies into "tapering" in the Treasury market.

Have a good day,

Tom

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 yet (which would be a signal to de-risk) but stocks will have a hard time rallying until the emerging markets stabilize.* *The S&P broke through the lows of last week, and support is now around 1620ish.*

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	**Bullish**	**Bullish**	**Bullish**	*The commodity complex continues to see the environment turn more favorable. Global economic growth appears to be turning for the better, especially in China and Europe, while the Fed appears committed to tapering in very, very small increments.*

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. The Syrian conflict has resulted in WTI and Brent moving to multi-month highs, but I'd wait for a bit of a pull back as at this point any military strike will be a one off, as opposed to a greater intervention in the region.**

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.**