7:00's Report

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

August 30, 2013

Pre 7:00 Look

- Futures marginally higher as emerging markets are stable again this morning.
- Lots of second tier economic data o/n from Europe largely met expectations, showing the EU economy is continuing to stabilize.
- Little changed o/n on Syria—expectations are for some type of strike from the U.S., but those expectations are falling.
- Econ Today: Personal Income and Outlays (E: 0.2%/0.3%) Consumer Sentiment (E: 80.0).

Market	Level	Change	% Change
S&P 500 Futures	1640.25	3.50	.21%
U.S. Dollar (DXY)	82.015	.007	.01%
Gold	1395.90	-16.80	-1.21%
WTI	108.26	-.57	-.53%
10 Year	2.751	-.031	-1.11%

Equities

Stocks managed to fight their way through a very, very slow trading day Thursday to end a second consecutive session positive. Characterizing the action in the markets yesterday, I think it was more of an ambling forward rather than any kind of real rally as volumes were extremely low, and news, outside of Syria conjecture, was light. The S&P 500 rallied .20%.

The "big" news yesterday was the defeat of authorization of a military strike on Syria by the UK Parliament, and in reaction to that we saw a general unwind of the "Syria strike" trade as energy (and commodities generally) got hit. As of right now, expectations are still for some kind of small, limited missile strike in the coming days, although that's no longer the certainty it was 36 hours ago.

Despite the markets logging two straight positive days, though, stocks continue to trade "heavy," and the averages again finished well off their intra-day highs yesterday, continuing a worrisome trend of fading into the close (something the market has done every day this week).

From a sector standpoint, as you'd expect energy led markets lower on the "Syria strike" unwind. Conversely, also as you'd expect, airlines got a bounce from lower all prices, but really this is a lot of short term trading noise around military expectations towards Syria. More fundamentally, we saw a renewal of "bond proxy" sectors relatively underperforming, as utilities and REITs lagged, and it seems that when the market isn't in free fall (like Tuesday) that generally those "bond proxy" sectors will continue to lag.

On the charts the S&P 500 remains caught between support around 1620 and resistance at the 50 day moving average (1659ish). Volumes and attendance were very, very low, as you'd expect with the looming holiday.

Bottom Line

Lost in the coverage of geo-politics yesterday were the steps taken to defend emerging market currencies by Brazil, Indonesia and India and that, more than Syria, was the important takeaway from yesterday. The Rupee rallied 3% yesterday and is higher this morning after the RBI again intervened in markets, selling dollar over night.

Its too early to tell if this is the stabilization we're look-

Market	Level	Change	% Change
Dow	14840.95	16.44	.11%
TSX	12704.73	97.51	.77%
Brazil	49921.88	54.96	.11%
FTSE	6457.30	-25.75	-.40%
Nikkei	13388.86	-70.85	.53%
Hang Seng	21713.37	26.59	.12%
ASX	5134.96	42.55	.84%

Prices taken at previous day market close.

ing for in emerging markets, but they remain the real driver of risk assets—not Syrian political drama.

And, at some point emerging markets will be a buying opportunity as well, but at this point I'd say it's a touch early to draw any conclusions (the history of these things is that the market challenges interventions by central banks, so I'd not be surprised to see the Rupee fall next week when desks are fully staffed—what the RBI does if that occurs will be key).

Market	Level	Change	% Change
Gold	1405.70	-7.20	-.51%
Silver	23.87	-.27	-1.12%
Copper	3.26	-.01	-.17%
WTI	107.24	-1.47	-1.34%
Brent	114.42	-2.19	-1.88%
Nat Gas	3.64	.02	.47%
Corn	4.96	-.08	-1.54%
Wheat	.40	-.06	-1.01%
Soybean	13.68	-.05	-.35%
Prices taken at previous day market close.			

But, emerging markets remain key as global markets won't be able to rally until they stabilize.

Economics

GDP

- Q2 GDP 2.5% vs. (E) 2.2%.

Takeaway

GDP growth for Q2 was revised up from 1.7% to 2.5% beating expectations. But, the positive revisions didn't come from areas of the core economy and, as was highly anticipated, the bulk of this upward revision was due mostly to the trade data, as net exports were revised up from -$451bn to -$422bn. The key surprise in the report relative to what most economists were forecasting was related to inventories, which were revised up from $57bn to $63bn.

Bottom line with 2Q GDP is growth is looking better than originally thought, but still remains frustratingly slow. So, the economy continues to recover, just at a subdued pace. From a tapering standpoint there was nothing in the GDP report that would make the Fed think about their present course of action (so nothing in the release would delay tapering of QE).

Jobless Claims

- New Claims 331k vs. (E) 330K
- 4 Week Moving Avg. moved up fractionally to 331k.

Takeaway

There were two economic data points on Thursday worth noting. First, we got the initial jobless claims numbers that showed a decline of 6,000 to 331,000 during the week ending August 24. That was from a figure for the previous week that was revised higher. The latest decline undid almost half of the increase reported for the prior week. Of course, the main thing to watch when it comes to this metric is the trend over the past four weeks. Judging by that standard, there has been some real improvement in the labor market of late.

The four-week moving average for initial jobless claims was barely changed at 331,000 during the week ending August 24, which is just about the lowest four-week average since the economic expansion began. It's also an improvement when compared to the July payroll survey period. And it does mean things are improving in the labor market, and that is one key factor that influences the decision-making process at the Fed.

Commodities

Commodities traded mostly lower Thursday, as Syrian tensions somewhat settled down. That brought sellers into the gold and silver trade, with the gold finishing down 0.79% to $1,406.38 while silver fell 2.12% to $23.84. Copper also traded lower in the session, off about 1.5%.

The real action Thursday was in the oil pits, as traders tried to scramble to position themselves for the uncertainty in the Middle East. Oil has been bid up significantly over the past couple of weeks, but on Thursday there was volatile trading that sent oil closing decidedly in the red. Crude was down 2% to $107.94/barrel, as the delay in a military attack quelled the risk premium in oil.

Other action in commodities included a rise in natural gas prices of 1.06% to $3.62. Corn saw a very modest 0.16% uptick to $4.81/bu, while wheat sold off in the session, finishing down 0.80% to $6.54/bu.

As a whole, commodities were overdue for a little pullback, especially considering the recent string of up days. The benchmark PowerShares DB Commodity Index Tracking (DBC) was down over 1% Thursday, yet for the month DBC still is higher by nearly 5%.

Currencies & Bonds

The US dollar traded higher for the second consecutive session, driving all other dollar-based currency pairs lower. The strong GDP print we saw this morning helped ensure the greenback's gains, as did the lack of any real news on the Syria front.

Now, as I've said repeatedly for some time now, the real action in currencies is taking place in the emerging markets, particularly in India. Here the rupee actually rebounded on Thursday from recent record lows, as the Reserve Bank of India announced its decision to help the country's oil importers. India's trade and current account imbalances are often blamed on the country's costly oil imports, so a move to help oil importers was viewed as rupee bullish. The rupee now trades at 66.55 to the dollar, up more than 3% from Wednesday's close. Still, the rupee is down more than 25% vs. the US dollar year-to-date, and that should give you a real sense of how much damage has been done to that currency of late.

When it comes to the rupee, as well as the action in other emerging market currencies such as the Brazilian real, and the price of emerging bonds, we simply must see some stability before a sustainable rally in US equities can take place. I know I keep saying this, but until circumstances change, these will remain key factors affecting equities here at home.

Finally, the stronger GDP data caused another pullback in Treasury bond yields. The yield on the benchmark 10-year note fell to 2.75% on Thursday.

Market	Level	Change	% Change
Dollar Index	82.025	.56	.69%
Euro	1.3236	-.0007	-.05%
Pound	1.5496	-00.29	-.19%
Yen	1.0165	-.0013	-.13%
CAD $	.9487	-.0005	-.05%
AUD $	.8914	-.001	-.11%
Brazilian Real	.41295	-.00685	-1.63%
10 Year Yield	2.751	-.031	-1.11%
30 Year Yield	3.703	-.051	-1.36%
Prices taken at previous day market close.			

As I wrote yesterday, I am starting to get the sense that 2.90% may be the top for a bit in the 10-year yield, and Thursday's action certainly argues in support of that thesis. Of course, I also think that any rally here in bonds represents a shorting opportunity in Treasuries, and that means a chance to get long TBF (unleveraged short 20+ year Treasury) and TBT (2X leveraged short 20+ year Treasury) at very attractive levels.

Have a good long weekend,

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.**