7:00's Report

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

September 11th, 2013

Today is September 11th, and it's amazing how, after only 12 short years, that day seems to be fading into the national memory, and that's something that really bothers me. I left NYC one month before 9/11, but I'll always remember starting my career by walking from the Fulton Street station through the Twin Towers, across the bridge over West Street into the World Financial Center. Regardless of how it changes, this will always be what I see when I think of Downtown Manhattan.

Pre 7:00 Look

- Futures flat after President Obama's address to the nation offered nothing new and did little to resolve uncertainty surrounding the Syrian situation.
- With regards to Syria, next steps involve negotiations on details of the Russian plan to acquire Syrian chemical weapons, which could take weeks.
- Economic data o/n was sparse, although the latest UK Labour Market Report was positive, showing continued improvement in the UK jobs market.
- Econ Today: No reports today.

Market	Level	Change	% Change
S&P 500 Futures	1681.25	-1.25	-.07%
U.S. Dollar (DXY)	81.81	-.009	-.01%
Gold	1363.50	-0.5	-.05%
WTI	107.62	.22	.20%
10 Year	2.959	.062	2.14%

Equities

Market Recap

In a repeat of Monday, stocks saw a strong rally thanks to good economic data from China and continued Syria de-escalation. The S&P 500 rose 0.73% and is now up 6 days in a row, and 7 of the last 8.

Stocks opened Tuesday up almost 1%, and spent the entire day near those levels, as news-wise it was a quiet day after the open. Although there were a million stories about Syria, really everyone was just looking toward President Obama's address to the nation last night. The afternoon was very quiet in anticipation of that event, and stocks went out basically at their highs, as there was very little intraday volatility.

President Obama's address to the nation didn't really change much with regards to Syria other than to basically put the whole issue in a holding pattern. At this point, any vote in Congress is delayed indefinitely as specifics get worked out on the Russian proposal to have Syria hand over its chemical weapons.

From a trading perspective, this is as odd a geo-political situation as I've seen in my career. It's now unclear whether the preference of the President is military action or a diplomatic solution, and we literally may have to wait weeks or months for the negotiations on the Russian proposal to give markets any final resolution.

Market	Level	Change	% Change
Dow	15191.06	127.94	.85%
TSX	12824.48	-30.16	-.23%
Brazil	53979.03	-272.82	-.50%
FTSE	6578.86	-5.13	-.08%
Nikkei	14425.07	1.71	.01%
Hang Seng	22937.14	-39.51	-.17%
ASX	8039.97	0.79	.01%

Prices taken at previous day market close.

Bottom line is the market will be subjected to several more weeks of uncertainty, but expect fatigue on the issue to set in. I'd say markets have priced in the current Syria situation, and going forward any formal declaration of a peaceful resolution is probably worth, if anything, a small rally in stocks, while any back tracking towards military involvement probably results in a pretty decent sell off. So, risk on the issue now appears to be on the downside for equities.

Market	Level	Change	% Change
Gold	1365.8	-20.90	-1.51%
Silver	23.095	-.622	-2.62%
Copper	3.2670	-.011	-0.34%
WTI	107.36	-2.16	-1.97%
Brent	111.27	-2.45	-2.15%
Nat Gas	3.584	-.021	-0.58%
Corn	469.00	5.50	1.19%
Wheat	646.50	5.25	0.82%
Soybean	1355.00	-1.50	-0.11%
Prices taken at previous day market close.			

Trading Color

The rotation into cyclicals continues, and it's accelerating. The Russell 2000 once again outperformed, while the positive Chinese economic data led to basic materials and industrials once again leading all S&P 500 subsectors higher. The Nasdaq lagged a bit yesterday, but that was due to the AAPL sell-off after yet another underwhelming product refresh. Point is, tech was stronger than it looked.

For the second-straight day, all 10 S&P sub-sectors were higher, led by the aforementioned "China-sensitive" sectors while financials and telecom also outperformed.

Safety and "bond proxy" sectors lagged, as ConAgra (CAG) reported weak earnings that weighed down staples. Homebuilders lagged thanks to some cautious comments from the Barclays Financial conference about the pace of mortgage origination as the nation's largest banks see it.

Volumes once again were elevated compared to recent levels, and on the charts the S&P 500 is now zeroing in one resistance at the 1,692 level.

Bottom Line

While Syria and China get the credit for the rally this week, really this move higher in stocks is occurring because of emerging-market calm and positioning. Yesterday's rally (and really the last week and a half) has had a very "painful" feel to it. Most investors were expecting September to be a rough month and once again they have been caught being too cautious and are now grudgingly adding long exposure.

Sentiment is now much less pessimistic and skeptical than it was a week ago, thanks to the last several trading days. But, we remain a long way from exuberance.

The market is due for some sort of a breather here, but as long as the macro data is good, bond yields keep their acceleration higher in check, emerging markets behave and Syria evolves peacefully (or any military action gets substantially delayed), then the levels of investor skepticism investors will be a tailwind on stocks.

Even though I'm not a raging U.S. equity bull by any means, I'd not be shocked if we test those all-time highs in the coming days.

Is the "Long Japan Trade" Back On?

One of the better calls I've made in my career was to get long Japan back in late November/early December of last year. The trade was based on the premise that then newly elected Prime Minister Shinzo Abe was going to actively devalue the yen to try to break the decade-plus stranglehold deflation had on the Japanese economy.

Large trends like "ending Japanese deflation" take a long time to play out, which is why I didn't think the "long Japan" trade was over just six months after it started when the WisdomTree Japan Hedged Equity Fund (DXJ) topped out in May. Trends like this go in fits and starts, and consolidations can take months and sometimes quarters. But, if the underlying fundamentals of the trade remain intact, then it's just a waiting game.

Well, as I pointed out in the chart yesterday, at the risk of tempting fate twice, I think the next phase of the "long Japan" trade is starting, due to two fundamental reasons.

First, it looks at though PM Abe is going to go forward with the national sales tax increase next spring. But, importantly, it is widely expected that he will counteract that sales tax increase by unleashing more stimulus on the economy. In an economy where companies derive much of their revenues through exports, like they do in Japan, the benefit of the stimulus should more than offset any pullback in domestic demand, making this a net positive for most companies (and their share prices).

Second, the awarding of the Summer 2020 Olympics to Tokyo over the weekend will provide more opportunity for fiscal stimulus, as the various stadiums, villages, etc. will need to be constructed. And, while that's still years away, it adds to the overall bullish narrative and might just have been the anecdotal "spark" to ignite the next stage of the rally.

DXJ remains the way to play Japan, as it hedges you from the declines in the yen—and unlike the last time I got bullish on Japan, I'm going to point out WisdomTree Investments (WETF). WETF is the issuer of DXJ, and their stocks have rallied as the DXJ's assets under management have grown. If I'm right about DXJ, WETF should rally too.

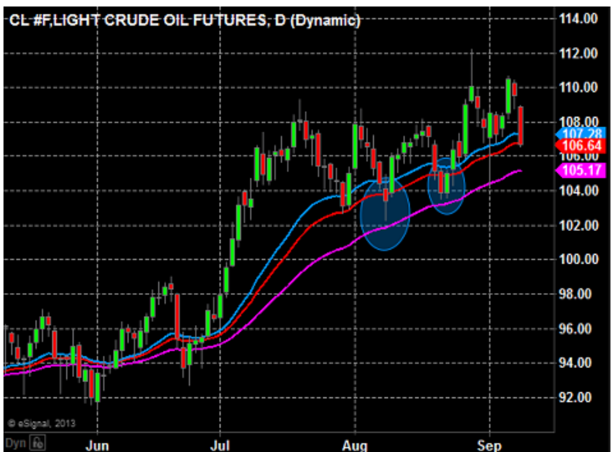
Economics

No reports yesterday.

Commodities

Commodities declined sharply yesterday, with DBC falling 1% and testing recent support levels, as the de-escalation of the Syrian situation led to a big sell-off in oil and gold. This sell-off came despite more positive economic data from China that showed the pace of economic growth in the country is stabilizing. So, yesterday, sentiment and fast money trumped positive fundamentals in the commodity markets.

Every major commodity in the energy and metals sectors was lower yesterday, led by silver falling 3%, WTI and Brent crude falling 2% each and gold declining 1.5%. The "outperformer" was copper, which spent part of Tuesday morning positive, but eventually got sucked in by the selling pressure across the commodity space and finished down 0.41%.



WTI Crude: We've seen a reduction of the geopolitical risk premium in crude, but as long as WTI holds the 50 day EMA, the trend is higher and we should buy dips in energy.

Market	Level	Change	% Change
Dollar Index	82.025	.023	0.03%
Euro	1.3271	.0006	0.05%
Pound	1.5719	.0027	0.017%
Yen	.009970	-.000075	-0.75%
CAD $	.9639	.0017	0.18%
AUD $	.9252	.008	0.87%
Brazilian Real	.4300	-.0011	-.26%
10 Year Yield	3.889	.049	1.28%
30 Year Yield	2.959	.062	2.14%
Prices taken at previous day market close.			

There's not much point in going into why everything traded the way it did yesterday. Bottom line is the commodity space had enjoyed a bit of a geopolitical risk premium being built into it (especially in WTI, Brent crude and gold) and now we are seeing those weak-handed longs bail out after the surprise of the apparent diplomatic solution to the Syrian crisis.

The Syrian situation is still fluid, but unless you have an "in" at the White House, I'm afraid we're all at the mercy of the headlines. More importantly, though, the fundamentals for commodities continue to improve, as evidence continues to roll in that shows the global economy is indeed turning for the better.

We've gone from two extremes with regard to Syria in the past 48 hours: from a military strike being a certainty to a diplomatic solution being a certainty. So, the event risk has shifted back into the commodity bulls' favor, as the diplomatic solution is now largely priced in.

So, despite the surprising weakness yesterday, I still think commodities can offer outperformance between now and year-end. The fundamentals are positive, and I think this Syria-related dip is a buying opportunity, especially in oil and energy stocks.

I also think there's still an opportunity in DBC, although I wouldn't want to see it trade much lower than it did yesterday (a break of $26 would be a definite sell signal and make me re-think my bullish commodity thesis).

Gold, meanwhile, needs to hold $1,357 and $1,347, respectively, otherwise this rally is in danger of failing.

Currencies & Bonds

Treasuries sold off surprisingly hard yesterday with the 30-year note trading down 0.65% and the 10-year yield rallying to 2.959%.

Ostensibly, the same drivers of all other markets were the main drivers of the Treasury sell off, namely Syria de-escalation and strong Chinese growth. (The Syria de-escalation creates less of a safe-haven demand for Treasuries, while strong Chinese data implies more upside for equities vs. debt.)

I'm not sure those two events are enough to drive such a decline in Treasuries, though, and instead I think yesterday's sell-off had more to do with this surprise rally we're seeing in equities. That's because it's proving painful once again for skeptical or pessimistic investors who thought it best to hide in Treasuries for what looked like would be a bumpy September.

Yesterday's surprisingly deep sell-off aside, I still think we've seen a near-term top in yields (at least for a few weeks), although yesterday felt like a traditional "out of debt, into equity" rotation. The further stocks rallied, the worse the bond sell-off got. I do think that rotation (which, regardless of the statistics people throw out, still hasn't happened in any material fashion yet) will be the catalyst for the next leg of this bond market decline—I just don't think it's happening yet.

Looking at currencies, the Dollar Index, euro and pound were all flat as there was little news in the markets. As has been the case for the past few months, the volatility in currencies came from Asia, where the Aussie dollar rallied 1% thanks to the latest round of strong Chinese economic data. Meanwhile the yen sold off 0.7%, broke back above the 100 yen/dollar level and made a new multi-month low vs. the dollar, as speculation is growing that Abe will indeed unleash more stimulus to offset any negative effect of the sales tax increase.

In a world driven in the short term by Syrian headlines, currencies (especially Asian currencies) appear to be the only thing trading off their own fundamentals. I continue to think we're seeing the next stage of systematic devaluation of the yen. The ProShares UltraShort Yen (YCS) remains attractive at these levels, and I'd add to any position you've got in it.

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. Emerging market turmoil has acted as a headwind, but stabilization last week in EM's helped stocks rally. But, for now, markets appear stalemated ahead of a mid-September FOMC meeting where tapering will be announced.* *The S&P 500 support is now around 1630ish while resistance is at 1660ish.*

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" as its broken through resistance, and I'd initiate or add to any positions at these levels or on any dip.

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. I'd look to buy oil or "energy" in general on any further dip to between \$105—\$107 on the removal of geo-political risk as the Syrian situation evolves.**

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 bounced off support over the past few weeks and is now at a one month high. 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 (YCS) as three month long support has been broken, and the declines in the yen have once again begun. Short the euro (EUO) on any further bounce due as the ECB appears ready to act with more LTROs to combat the general lift we are seeing in interest rates as the Fed prepares to taper QE.**

Treasuries	**Bearish**	**Bearish**	**Bearish**	*Recent economic data has cemented the expectation of a small tapering of QE being announced in September. Bonds have sold off hard in anticipation of that announcement, so we may have seen a short term low in bonds, although the longer term trend is still negative.*

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.**