7:00's Report

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

September 12th, 2013

10 Year Yields: I'm as big of a long term bond bear as there is, but 1.6% to 3.0% in 4 1/2 months is a hell of a move, and some consolidation makes sense here.

Pre 7:00 Look

- Futures flat and international markets slightly weaker after several disappointing economic releases weighed on sentiment o/n.
- Global economic data broke the recent positive trend this morning and was surprisingly weak. EU industrial production, Australia's Labour Force Survey and Japan's machine orders all missed expectations.
- Econ Today: Jobless Claims (E: 330K). Geopolitically, Kerry meets with Russian foreign minster Lavrov to discuss Syria.

Market	Level	Change	% Change
S&P 500 Futures	1687.50	-1.25	-.06%
U.S. Dollar (DXY)	81.52	-.002	0.00%
Gold	1342.40	-21.40	-1.57%
WTI	108.58	1.02	.95%
10 Year	2.92	-.039	-1.32%

Equities

Market Recap

Stocks continued their grind higher Thursday during a quiet session, as the S&P 500 rose .31%, despite the fact that AAPL and QCOM took nearly 3 points off the index (so the rally was stronger than it looked).

News flow yesterday was very, very light, and most markets seemed to suffer from Syria fatigue yesterday, as that situation is now presumably in limbo for the next several weeks, and focus of investors turns towards the FOMC next week.

Stocks opened marginally lower Wednesday and hit their lows mid-morning after the wholesale trade data was released (but I think that was more coincidental than causal). By the European close, though, stocks had slowly turned and started a methodical grind higher amidst little news and low volumes.

For the third straight day stocks rallied throughout the afternoon and went out basically at their highs, as this lift in the markets continues to drag investors off the sidelines, as the widely expected pullback, once again hasn't come.

Trading Color

The Dow was actually the best performing major index yesterday, rallying .89% while tech and small caps lagged (thanks to AAPL and its supplier companies shares declining). Sector wise it was a pretty directionless day, as there wasn't any definitive cyclical outperformance yesterday, as there has been over the past few weeks. The majority of S&P 500 subsectors finished higher, led by energy, consumer staples and telecom, while utilities fell

Market	Level	Change	% Change
Dow	15326.60	135.54	.89%
TSX	12825.42	.94	.01%
Brazil	53570.46	-408.57	-.76%
FTSE	6571.08	-17.35	-.26%
Nikkei	14387.27	-37.80	-.26%
Hang Seng	22953.72	16.58	.07%
ASX	5242.54	8.15	.16%
Prices taken at previous day market close.			

1% despite lower bond yields, as the exodus out of that sector continues regardless of short term moves in the bond market. Other income sectors traded "ok" though, as healthcare and REITS both saw nice rallies. Overall, there wasn't a lot to glean from sector trading yesterday other than utilities remain under severe pressure.

Market	Level	Change	% Change
Gold	1362.80	-1.20	-0.09%
Silver	23.15	.134	0.58%
Copper	3.2645	.002	0.06%
WTI	107.65	.26	0.24%
Brent	111.43	.18	0.16%
Nat Gas	3.566	-.018	-0.50%
Corn	473.00	4.00	0.85%
Wheat	647.50	1.00	0.15%
Soybean	1358.25	3.25	0.24%

Prices taken at previous day market close.

On the charts the S&P 500 continues to grind higher towards 1700 and the old all time highs, while support sits at the 50 day moving average.

Volumes fell sharply from levels earlier in the week, as Syria fatigue set in and investors looked forward to the FOMC next week..

What's Next for Syria

At this point it's all about the negotiations, and whether the US and Russia can come to terms on the specifics of any deal for Syria to hand over weapons. As far as logistics, Secretary of State Kerry meets with his Russian counter part in Geneva today, and the UN Security Council will begin debating a French sponsored resolution to have Syria hand over its chemical weapons. Bottom line is unless there's some sort of fallout between Kerry and the Russians (which isn't totally out of the question) this will likely fade from the headlines over the next few weeks.

What's Next Beyond Syria

Although Syria has been fumbled to the back burner, focus will stay in Washington for the next several weeks. The FOMC meeting next Wednesday now takes center stage (and at this point the expectations of tapering seem pretty well priced in), but more importantly, negotiations on a debt ceiling and continuing resolution to fund the government must begin soon, as we're out of money sometime in October. At this point, most reports imply the two sides are (shockingly) not even close, and as per usual the Republicans are already fighting with each other. Congressional leaders are scheduled to meet next Thursday to begin the process, but its safe to say the "silly season" is fast approaching.

Bottom Line

This market continues to defy expectations by steadily grinding higher, although the tailwind of skepticism and negative positioning is starting to abate. The rest of the week should be pretty quiet, assuming there are no major set backs with Syria. Bottom line, though, is emerging markets remain calm and sentiment still is skeptical, so even through I'm not a raging equity bull, the path of least resistance remains higher in the near term, and as I've been saying, a test of the old highs (which are less than 2% from here) wouldn't be shocking.

But, unless you think the global equity markets are in for a nasty correction, I still think international markets (EWU, DXJ, EIRL) offer more upside between now and year end than the S&P 500 does (even if we make new marginal highs, I have a hard time seeing what could push us up through 1750, unless the economy starts roaring, and with Washington back in session that's not likely).

Finally, as an aside, I mentioned in Tuesday's Report about potentially profitable "offshoots" from this huge trend on declining bond prices, and one of those "offshoots" is increased M&A fees for investment banks. Well, somewhat apropos, Verizon yesterday floated what I think is the biggest corporate bond offering in history to help fund their purchase of VOD's stake in Verizon Wireless. The offering was for 49 billion dollars, nearly 3X AAPL's 17 billion dollar offering earlier this year. I point this out because these types of offerings don't happen normally, and the underwriting fees have got to help the bottom line of investment banks on the deal (Barclays, BAC, JPM and MS led the syndicate). I'm not an I-Banker, and I'm sure VZ got a big break on fees, but I'm just pointing out that this fundamental shift in the direction of rates will have many offshoots, and looking at VZ as anecdotal evidence, I've got to think most of them will be profitable ones for the I-Banks.

Economics

No reports yesterday.

Commodities

It was a sleepy day in the commodity markets yesterday as a bit of exhaustion from Syria derived volatility set in across the complex. The major commodity indices were basically flat, and in testament to how slow things were, silver was the best performer in the commodity markets, rising .6% on nothing more than a low volume, oversold bounce, thanks to a weaker dollar.

There was little fundamental news in the markets yesterday except for the weekly inventory data in oil, which showed a much smaller draw (200k barrels) than expectations (2.1 million barrels). WTI sold off initially on the news, but was already short term oversold given Tuesday's "Syria de-escalation" beating, and WTI rebounded to close up .23%. The broader supply/demand situation in oil didn't really change last week, as the market remains relatively balanced.

With WTI back in the $107/bbl range, most of the Syria geo-political premium has now been taken out of WTI, and at this point any geo-political risk is tilted back to the upside (for instance if the negotiations with Russia and Syria over the handing over of the weapons breaks down). I'd continue to look to be a buyer of WTI and "energy" generally on any dip towards the $105.30 level.

Gold finished the day flat after spending much of the session marginally weaker, and that's again disconcerting given the dollar weakness. That weakness was prophetic, as gold broke down through support in the overnight session. As focus turns towards the Fed next week, gold needs to trade back above $1347 soon if this rally is still intact.

Inflation remains the next catalyst for gold, and that makes things interesting heading into the FOMC meeting next week. While a taper of 10-15 billion is expected, it's also widely believed the Fed will counter tapering with more dovish language and "forward guidance."

One specific tactic that might be used will be to tweak the inflation threasholds that would constitute a continuation of QE or ZIRP (zero interest rate policy). For instance, the FOMC might say something like "as long as inflation stays below our 2% year over year target, we will keep rates at 0%." If they do something like that, then look for gold to jump, because that will be the clearest admission yet that the Fed is trying to manufacture inflation, and one of the oldest rules of trading is "Don't Fight the Fed." It's not a certainty that they'll say something like that by any means, but on an otherwise slow day, it's helpful to layout any surprises that might come next week.

Broadly, commodities continue to consolidate their recent breakout, as focus moves off Syria and onto the Fed next week. I'd continue to be a cautious buyer of commodities (DBC) at these levels.

Currencies & Bonds

The dollar drifted modestly lower Wednesday (down .34%) as the Syria inspired safe haven dollar rally of last week finishes unwinding, now that the whole situation appears to be in limbo for the foreseeable future. Also, as Syria fades into the background, the FOMC meeting next week is coming more into focus, and although everyone now expects some tapering of QE, overall it's being viewed as a potentially "dovish" meeting on the margin, as tapering is already priced in, and thought to be very small. Plus, any commentary from the Fed (it's a meeting with a press conference) should be very "dovish."

Market	Level	Change	% Change
Dollar Index	81.685	-.332	-0.40%
Euro	1.3317	.0045	0.34%
Pound	1.5809	.0089	0.57%
Yen	.010007	.000038	0.38%
CAD $	.9668	.0028	0.29%
AUD $	.9276	.0024	0.26%
Brazilian Real	.43190	.0019	.44%
10 Year Yield	2.92	-.029	-.75%
30 Year Yield	2.92	-.039	-1.32%

Prices taken at previous day market close.

From a fundamentals perspective, wholesale inventories was the only economic data point yesterday, and I heard that cited as a reason for the dollar weakness, although I think that's a stretch (no one cares about wholesale inventories).

The dollar weakness was universal, as almost every other major currency was higher versus the dollar. The euro, Aussie and yen all rallied between .2% and .5%, but it was the British Pound that was the best performer yesterday, rallying .6% to a new high for the year.

While most currencies were stronger vs. the dollar because of dollar weakness, the Pound rallied because of more good economic data out of the UK. The latest Labour Market Report showed fewer unemployed than expected, and adds to the recent string of reports that implies the UK economy is seeing growth not only return, but also accelerate. This strong data is resulting in a continuing dismissal of the Bank of England's "Forward Guidance," and the Pound is rallying as the market expects rates to rise in the UK well before the 2016 time frame currently cited by the BOE.

The bond market caught a nice bid yesterday, as VZ's enormous $49 billion offering of 10 year debt was very well received, while Treasury bonds saw a rally yesterday as well, with the 30 year rallying .53% as they continue to consolidate near recent lows. Bonds caught a bid yesterday thanks to a very strong 10 year Treasury auction, which saw a bid to cover of 2.86, the highest since March. Clearly the nearly 3% yield on the offering brought out some pent up demand. Focus will be on the 30 year auction today at 1 PM, but if that meets strong demand, I'll take it as further anecdotal evidence that a least a short term top is 'in" on bond yields (remember, 10 year yields haven't been this high in nearly 2 years, so if I were a bond fund, I'd at least nibble a bit if I were planning to hold them). The longer term trend remains lower, but we've some a long way in a short time with rising yields, and I think a pause of some sort is in order.

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 and skeptical positioning have helped stocks rally. But, the market will likely settle at these levels ahead of the FOMC meeting next Wednesday.* *The S&P 500 support now sits at the 50 day MA around 1665, while resistance is the old highs of 1700.*

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.**