7:00's Report

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

September 13th, 2013

Pre 7:00 Look

- Futures and most international markets little changed after a very, very quiet night. There was no econ data released.
- The "big" news o/n is a report from the Nikkei news service that stated Larry Summers will be named the next Fed Chairman as early as next week, although the article is being met with some degree of skepticism.
- Geopolitically, the meeting between Kerry and Lavrov resulted in a two week "punt" when more negotiations will occur at the UN General Assembly.
- Econ Today: PPI (E: 0.2%), Retail Sales (E: 0.5%).

Market	Level	Change	% Change
S&P 500 Futures	1676.75	-1.50	-.09%
U.S. Dollar (DXY)	81.575	.084	.10%
Gold	1314.30	-.16.30	-1.23%
WTI	107.63	-.98	-.90%
10 Year	2.907	-.013	-.45%

Equities

Stocks saw mild declines in slow trading Thursday. It was a day that was more about the consolidation of the recent rally than it was about anything outright "negative." The S&P 500 fell 0.34%.

There was more news in the markets Thursday than Wednesday, but it was still very slow. The Assad interview was the main "reason" cited for the weakness in shares (he said he wouldn't agree to anything as long as the U.S. was arming the rebels), but there were also peripheral concerns in Washington about the upcoming

Industrials have led this September rally thanks to strong Chinese economic data. But, the sector is now overbought, and a pause of some kind seems in order.

debt ceiling/continuing resolution fight. Nothing new happened; people are preparing for the circus in Washington to come to town.

Unlike the past several days, stocks faded into the close Thursday, as markets declined during the last hour of trading to go out at their lows.

Trading Color

Cyclical sectors—the leaders of the September rally—lagged badly yesterday, as transports fell 1% and the Russell 2000 fell 0.6%. Additionally, industrials and basic materials, which have been the big outperformers so far in September and led the markets higher, were also weak yesterday. Given that we don't get any new China data for 10 days, it looks like both sectors need to take a bit of a breather after their big run higher.

"Safety" sectors performed relatively well yesterday, reversing the recent trend. Consumer staples was the only S&P 500 sub-sector to finish trading higher, and telecom, healthcare and utilities all relatively outperformed (but finished lower).

Market	Level	Change	% Change
Dow	15300.64	-25.96	-.17%
TSX	12701.05	-124.37	-.97%
Brazil	53307.09	-263.37	-.49%
FTSE	6570.67	-18.31	-.28%
Nikkei	11404.67	17.40	.12%
Hang Seng	22915.28	-38.44	-.17%
ASX	5219.63	-22.91	-.44%
Prices taken at previous day market close.			

In general, from a sector standpoint, yesterday it looked a bit like the cyclicals that led the market higher are a bit overextended, and this rally may be running out of steam in the short term.

Market	Level	Change	% Change
Gold	1329.10	-34.70	-2.54%
Silver	22.095	-1.077	-4.65%
Copper	3.211	-.046	-1.41%
WTI	108.63	1.07	.99%
Brent	112.66	1.16	1.04%
Nat Gas	3.632	.065	1.82%
Corn	466.50	-6.00	-1.27%
Wheat	652.75	-4.75	0.73%
Soybean	1397.50	39.25	2.89%
Prices taken at previous day market close.			

Volumes were light yesterday and well off the pace of earlier in the week. Meanwhile on the charts, the situation remains the same: Support sits at the S&P 500's 50-day moving average at 1,671, while resistance lies at 1,700 and the old highs of 1,709.

Bottom Line

In the very short term this market is a bit extended, and to a degree the short term negative sentiment that pushed stocks to one month highs has largely abated. The question now is do we get a pause, or another correction. I'd keep an eye on XLI (Industrials ETF) as that seems to have taken the role of leading indicator from small caps. The ETF is overbought, and a pause of some kind should be expected, but if this market is going to correct, XLI should go first. More broadly, a consolidation, at minimum, should be expected at least into the Fed meeting on Wednesday.

The Summers article overnight, whether it turns out to be true or not, does reinforce the fact that, for the first time since the "Fiscal Cliff" last year, Washington will be a major news force in markets once again.. Given recent history, I think that only re-enforces the attractiveness of international markets, as Washington and politics come to the forefront in late September and October. Perhaps I'm wrong and we see smooth sailing through the debt ceiling and continuing resolution negotiations, but even that's a little much for an eternal optimist like myself.

Economics

Jobless Claims

- New Claims 292K vs. (E) 330K
- 4 Week Moving Average fell to 321K from 329K.

Takeaway

The headline on weekly claims was almost jaw-dropping, as weekly claims fell significantly below the 300K level for the first time in more than five years. But, as the saying goes, if something looks too good to be true, it usually is. The big drop in claims was likely the result of computer upgrades in two states that delayed their filing data. It wasn't clear which two states it was, but clearly we can expect some pretty heavy revisions to the number next week.

Bottom line, though: Even if we ignore this week's data, the four-week average has recently made new multi-year lows. And, despite the stubbornly soft monthly employment situation report, the labor market is seeing small, incremental improvement. I suspect when the data is revised next week, that trend will continue, although it won't look as good as it did this week.

Commodities

It was a tale of two markets in the commodity space Thursday as energy enjoyed a nice oversold bounce, while precious metals saw heavy technical selling, once again declining despite the slightly lower U.S. dollar.

Starting with the winners, energy was broadly higher yesterday, led by a 2% bounce in RBOB gasoline and natural gas, while WTI and Brent crude were both 1% higher.

There were several pieces of fundamental (and somewhat conflicting) pieces of data in the energy space yesterday, although most of the trading was driven more by sentiment and positioning than the statistics.

The International Energy Agency, in its monthly oil report, had an anecdotally bearish outlook. It expects global oil supply to increase over the next few months, as maintenance in the North Sea and Gulf of Mexico ends and production increases. Additionally, the IEA cautioned that the collapse in emerging-market currencies, if it continues, could potentially crimp demand going forward. That's because oil is priced in dollars and the depreciation of those currencies makes oil moreexpensive. But, unless there is significant demand destruction from the emerging markets (something that's unlikely), the information released yesterday doesn't make a convincingly bearish case for crude … not as long as the global economic recovery continues.

Yesterday's rally in oil and the refined products was more about the settling of geopolitical sentiment after a week filled with whiplash. On Monday, energy was strong because a military strike against Syria seemed imminent. By Tuesday, it looked as though a diplomatic solution was the certain outcome, and energy got hit hard. Now, like the three bears, expectations seem about "just right" and energy rallied yesterday to reflect the fact that the diplomatic solution is likely, but not certain. (The Assad comments helped push energy higher yesterday.)

While energy is still assessing the geopolitical situation, clearly the metals have moved on and are focusing on the fact that, next week, the Fed is supposed to taper QE. It's an old trading adage that when something should rally on the news but doesn't, it's a warning sign. So it was with precious metals this week.

I pointed out twice that gold couldn't rally despite a weaker dollar, and that worried me. Well, overnight on Thursday the bears took control, broke through support in the mid-$1,300s, and you know the rest. Gold is continuing to trade lower this morning, and at this point it appears as though the rally we've seen off the June lows is indeed failing, and it'll take a increase in Syria tensions or some signs of inflation (or the Fed being dovish) to arrest the selling at this point.

The fact that gold and silver fell didn't really surprise me. But, I was surprised by copper's 1.6% decline yesterday, as there wasn't any fundamental news to justify the fall. (If anything, news this week has been bullish copper.) Perhaps it was large-scale fund liquidation (palladium also fell more than 2%), but the bottom line is the bears are back in control in the metals markets—barring some sort of dovish surprise from the Fed Wednesday (which isn't out of the question).

Market	Level	Change	% Change
Dollar Index	81.655	-.056	-0.07%
Euro	1.3306	-.0008	-0.06%
Pound	1.5802	-.0013	-0.08%
Yen	.010073	.000063	0.63%
CAD $	.9662	-.0007	-0.07%
AUD $	.9208	-.0067	-0.72%
Brazilian Real	.43185	-.00005	-.01%
10 Year Yield	2.907	-.013	-.45%
30 Year Yield	3.845	-.015	-.39%
Prices taken at previous day market close.			

Despite the dichotomy in the commodity markets, DBC saw a nice rally yesterday off support at the 50-day moving average, and I remain bullish on the complex as long as DBC can hold the lows of this week ($26.17). But, I'm a nervous long.

Currencies & Bonds

Currencies mostly traded off fundamental news yesterday, which is a welcome respite from them trading off Syria drama. The dollar was flat on no news, the euro and pound both declined marginally thanks to the weak EU industrial production data, and the Aussie dollar declined 0.7% after a surprisingly bad labor market report.

The yen was the big outperformer vs. the dollar, as it rallied 0.5% on the weak machine orders report, and also after several articles implied Prime Minister Shinzo Abe is indeed going to adopt the national sales tax next spring.

That solidifying of the sales tax implementation created a small "buy the news" reaction, as the yen sold off earlier this week on the idea that Abe would counter the tax increase with some stimulus. (The articles pegged the expected stimulus at somewhere around $50 billion, providing some news to the rumor from earlier in the week.)

Interestingly, while the news of the tax increase helped push the yen higher, the soft economic data also helped, and that provides a good opportunity to show why it acts like a bizzaro currency from time to time.

Normally, weak economic data is negative for a currency because it implies easier monetary policy. But, in Japan, policy can't get all that much easier, and the market's way of expressing angst in the yen is to buy it, not sell it. So, oddly, when there is evidence that "Abenomics" isn't working, like the soft machinery orders, the yen can actually rally as a result, contrary to common sense. So, while it's not an absolute rule, good economic data is generally "bad" for the yen, while bad economic data can result in a yen rally.

Bottom line, though, the yen has broken support, and unless there is some material change in the economic data (one data print doesn't change a trend) then the yen is heading lower from here.

Treasuries finished Thursday higher, although they faded badly into the close after spending almost the entire day modestly higher. And, the decline late in trading came despite a pretty good 30-year Treasury auction. The results showed decent demand, as the bid-to-cover was 2.40, which is above the six-month average. (Although that's a bit misleading, as summer demand was typically seasonally weak. So, the six-month average is lower than it would be if this was March.)

The actual yield was 1 basis point below the "when issued," implying decent demand, while both direct and indirect bidders' (domestic buy-and-hold accounts and foreign central banks) participation was near recent averages. The fade in bonds aside, though, 10-year yields traded below 2.90% for the first time in a week, and I still think bond yields settle here for the next few weeks.

Have a good 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**	*Equities have rallied to one month highs because of decent economic data and very negative short term sentiment and positioning. Now markets are looking towards the FOMC meeting and developments in Washington. While risks abound, though, the benefit of the doubt remains with the bulls, as this market is resilient.* *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.**