7:00's Report

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

September 16th, 2013

Pre 7:00 Look

- Futures and international markets surging higher after Summers withdrew his name from consideration for Fed Chairman.
- Larry Summers withdrew his name from consideration for Fed Chairman, making Yellen the presumptive favorite, which is being viewed as a "dovish" event. Stocks, gold and bonds are rallying while the dollar is selling off.
- There was also progress in Syria over the weekend with a plan for Syria to hand over weapons by mid-'14. But, a diplomatic solution was already priced in so don't expect much reaction outside of oil.
- Econ Today: Empire Manufacturing Index (E: 9.0), Industrial Production (E: 0.5%).

Market	Level	Change	% Change
S&P 500 Futures	1700.75	18.75	1.11%
U.S. Dollar (DXY)	81.35	-.298	-.37%
Gold	1317.90	9.30	.71%
WTI	106.89	-1.31	-1.21%
10 Year	2.898	-.009	-.31%

Equities

Last Week

Stocks rallied strongly last week thanks to a surprisingly diplomatic solution to the Syria drama, and a continued stream of better-than-expected Chinese economic data. The S&P 500 rose 2% last week and is up 18.36% for the year.

Global equity markets rallied hard last Monday and Tuesday on Syria and Chinese data, but those two events were the only real catalysts last week, and almost all of the week's gains came during the first two days of trading. (The S&P was basically flat from Tuesday's close.)

Focus during the back half of last week turned to the Sept. 18 Federal Open Market Committee meeting. Despite some Apple (AAPL) product-related drama, markets largely drifted Wednesday through Friday on low volume and little conviction ahead of this busy week.

Sector-wise, industrials, basic materials, tech and other cyclicals strongly outperformed through Tuesday, which makes sense given the strong Chinese data. Conversely, the exodus out of "bond proxy" sectors, especially utilities, continued early last week despite any big move higher in yields. Utility underperformance has been one of the most-consistent sector-trading themes since the summer. (Longer term the trend should continue, but utilities are very oversold and "hated" in the short term so some sort of a bounce is likely.) The cyclical outperformance trend reversed itself somewhat later in the week and "safety" sectors rallied, but it was on low volume.

I'll be watching industrials this week (the ETF is XLI) to see if the underperformance from late last week was just short-term exhaustion, or the start of some sort of a correction.

On the charts, the S&P 500 closed back above the 50-day moving average, which is now support at 1,672, while resistance is really the old highs of 1,709. Volumes were much higher than recent averages Monday and Tuesday, but fell sharply as the week wore on.

Larry Summers was a casualty of Syria

The big news over the weekend was Larry Summers withdrawing his name from consideration for Fed Chairman. Summers withdrew after Democratic Senator Jon Testor from Montana signaled Friday he would not vote for Summers, making it virtually impossible for Summers

Market	Level	Change	% Change
Dow	15376.06	75.42	.49%
TSX	12723.40	22.35	.18%
Brazil	53797.51	490.42	.92%
FTSE	6634.70	50.90	.77%
Nikkei	14404.67	17.40	.12%
Hang Seng	23252.41	337.13	1.47%
ASX	5247.99	28.36	.54%
Prices taken at previous day market close.			

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to make it out of the Senate banking committee vote needed before full Senate confirmation, which basically killed any chance for nomination.

Market	Level	Change	% Change
Gold	1311.30	-19.30	-1.45%
Silver	21.87	-.279	-1.26%
Copper	3.213	.003	0.09%
WTI	108.30	-.30	-0.28%
Brent	112.75	.12	0.11%
Nat Gas	3.674	.036	0.99%
Corn	459.00	-7.25	-1.55%
Wheat	641.50	-11.50	-1.76%
Soybean	1381.50	-14.50	-1.04%
Prices taken at previous day market close.			

This is a surprise, as Summers was largely "priced in" in the Treasury market, the dollar, and gold, especially after last Friday's Nikkei article (bet that reporter didn't have a good Monday).

Yellen will now be the overwhelming favorite to replace Bernanke, with Don Kohn a longshot. Very short term (and I mean basically just today) this is positive gold, equities and Treasuries and negative for the dollar. Longer term, Yellen over Summers isn't a major game changer from a policy standpoint, but it is "dovish" on the margin and likely a boost for inflation linked assets.

The important positive from this news has more to do with continuity than it does policy. The Fed is more involved in markets than ever, and I think it is a positive there's going to be continuity (assuming it's Yellen) as the Fed unwinds its balance sheet, because the truth is they are making this up as they go along. As we know, markets hate uncertainty, and Summers, however qualified, was an unknown. With Yellen as Chairman, there will be continuity, and that is a positive for stocks. Bottom line is the market "knows" the Fed under Yellen, and happily one major decision from Washington appears to have resolved itself without major fighting or drama.

This Week

It's a busy week. First, there's the FOMC as well as a decent amount of economic data. Second, a vote is slated for Wednesday in the Italian Senate on whether to expel Silvio Berlusconi. No one knows which way it'll go, but right now most think a Berlusconi expulsion doesn't collapse Prime Minister Enrico Letta's government. The microeconomic calendar also gets busier this week, as we get several companies posting August quarter-end earnings. Oracle (ORCL) and FedEx (FDX) are the highlights, both on Wednesday.

Bottom Line

This rally basically to the old highs is largely thanks to stabilization in emerging markets, continued strong economic data and, once again, too-negative positioning by investors coming into September, which in turn made the "pain trade" higher.

But, the benefit of that positioning has largely run its course. While sentiment remains very pessimistic and skeptical for a market up 18%, it's well-below levels of two weeks ago and it won't be enough to push markets materially above the old highs. And, I'm not sure what positive catalysts there are out there to push us materially higher in the S&P 500 from the old highs, given Washington is looming as a potential headwind for the first time since the "Fiscal Cliff." And, if there has been one constant in the markets over the past several years, it's been that when Washington gets active, it's a big headwind for stocks.

Funding the government and addressing the debt ceiling, are the two major issues Washington needs to work out in the coming weeks, and things are already getting testy (Obama reiterated Sunday he won't negotiate over the debt ceiling).

Although Europe has its own problems to work out this fall, on a valuation basis I continue to think it will outperform into year-end, as it has been doing recently. (Europe is up 9% quarter-to-date vs. 5% for the S&P 500.) The iShares MSCI United Kingdom Index (EWU), which hit a new high last week, and the iShares MSCI Ireland Capped Investable Markets Index Fund (EIRL) remain my best ideas going into the end of the year.

Economics

Last Week

There wasn't a lot of economic data last week, and the reports that did come didn't really change the outlook on the economy or WWFD (What Will the Fed Do). But there are a few important things to note.

First, last week's most-important economic takeaway was that the Chinese economy is now showing clear

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signs of stabilization. Pretty much all the data early last week beat expectations, while the Consumer Price Index and Producer Price Index didn't increase. This implies the government has no reason to try slowing the growth in the economy. In the context of the global economy returning to growth, the data out of China was another encouraging sign and it should continue to provide a tailwind for global markets.

Turning back to the U.S., the 'highlight" domestically last week was retail sales. The headline missed expectations, increasing 0.2% in August vs. (E) 0.5%. But, it's more important to look at the "control" number in retail sales to get the best look possible at consumer-spending trends. The "control" number shows retail sales less autos, gasoline and building materials. It rose 0.2% also, continuing a trend of slow but steady monthly increases. Bottom line on retail sales is that consumer spending has slowed from last year's levels, but importantly it is still increasing—albeit at a slow pace. But, with rising payroll taxes, the sequester and rising healthcare costs, that really shouldn't surprise anyone. The important thing to watch is whether consumer spending turns negative. The economy and market can grow with slow consumer spending, but if the consumer becomes a drag on the economy, that's a problem.

Finally—and this was mostly overlooked Friday—"core PPI" was flat month-over-month, as was the 1.2% year-over-year increase. As I mentioned in the Report last week, there are some who think the Fed may try to "target" inflation going forward—not in an effort to break it, but instead to spur it. Inflation is too low, and recently we've seen the FOMC focus on this issue more and more. I don't think the CPI report, which is on deck for Tuesday and should echo the PPI report, will change any minds for Wednesday with regard to tapering QE by $10 billion, but it could make the committee more "dovish" going forward.

Market	Level	Change	% Change
Dollar Index	81.625	-.049	-0.06%
Euro	1.3311	.0003	0.03%
Pound	1.5869	.0066	0.42%
Yen	.010079	.000018	0.18%
CAD $	.9652	-.0012	-0.12%
AUD $	.9196	-.0015	-0.16%
Brazilian Real	.4309	-.00095	-.22%
10 Year Yield	2.898	-.009	-.31%
30 Year Yield	3.847	.002	.05%
Prices taken at previous day market close.			

This Week

It's a pretty busy week of domestic economic data, with the FOMC meeting obviously the highlight. I'll preview it more in Wednesday's issue, but right now the consensus expectation is for a $10 billion monthly tapering, concentrated almost entirely in Treasuries. This meeting includes the Fed governors' projections for the economy, as well as the chairman's press conference, so we can expect the forecasts and Ben Bernanke to be "dovish" in an effort to offset the reduction. Tapering between $10 billion and $15 billion is currently priced into both the equity and bond markets, so if there are no surprises, the meeting might not move markets all that much.

Away from the FOMC, we get the first look at September economic data via the Empire State Manufacturing (today) and Philly Fed (Thursday) reports. Both indices have been trending higher lately. Although these are just regional surveys, if they can continue to show growth, it'll imply the rebound we're seeing in manufacturing is continuing to gain steam, as evidenced by the national PMIs.

Also this week we get the kick-off of the August housing data, with housing starts Wednesday. Clearly we've seen the housing recovery lose some momentum because of higher interest rates, but it'll be important to see if that momentum loss is continuing, or if it was just part of an initial shock from the jump in rates over the summer.

Commodities

Commodities were a push/pull market last week, as strong Chinese data was the "push" while the reduction of geopolitical risk premium in energy and precious metals was the "pull." The "pull" won out on the week, as the broad-based commodity ETF DBC finished 1% lower.

Precious metals were the worst performers last week, and failed to rally despite the lower dollar. The surprise diplomatic solution in Syria

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led to gold-selling. The yellow metal broke technical levels and then traded down 4%. Silver, as usual, did what gold did only with more volatility, and declined 7% on the week. Obviously this week's FOMC meeting is key for gold, which is teetering on support around that $1,300 level (and if it breaks, look out below). I "think" that the $10 billion-$15 billion tapering is priced with gold at these levels, but the sellers once again have the upper hand. It'll take something "dovish" out of Bernanke to turn the tide in gold's favor. (Or, if the FOMC doesn't taper, obviously that will be potentially explosive to the upside, but it's a remote possibility.)

Energy was also broadly weaker last week, but the trading was almost entirely geopolitically driven. WTI, Brent and the entire energy complex rallied to multi-month highs two weeks ago on Syria, but when it became apparent that there would likely be a diplomatic solution, this geopolitical premium (and then some) came out of the energy complex. Energy rebounded late in the week and WTI finished 2% lower. With Syria likely fading into the background, focus should once again turn to economic growth and supply.

Bottom line, while we're seeing a Syria related sell off this morning, I remain bullish WTI because we are seeing incrementally positive GDP growth, which should boost demand. And I'd continue to be a buyer of WTI crude via USO, or "energy" more broadly via XLE, on any dip to the $105-$107 range as long as economic growth domestically is accelerating. I continue to like commodities as a "contrarian play" on the return of the global economic growth story, and would cautiously buy DBC at these levels. I think industrial commodities can outperform into year-end; a few closes below $26.17 (last week's lows) makes me nervous and ultimately $26.00 tells me I'm wrong.

Currencies & Bonds

Treasuries were oversold and due for some sort of a bounce, which they got thanks in part to good 10-and 30-year auctions, and despite the fact that the news last week was mildly Treasury-negative.

Ten-year yields closed the week back below 2.90%, and while the FOMC is a wild card this week, I continue to think we've seen the top in the 10-year for the next several weeks. Longer term, there's much more room on the downside in bonds, but it's been a big move over the past four months. With "tapering" becoming a reality and Larry Summers no longer the assumed heir apparent to the Fed throne, I'm not sure what the next near-term catalyst is for a further decline in bonds.

Currency markets saw the Dollar Index decline modestly (about 0.5%) on a reduction of safe-haven demand as Syria evolved, and on strength in other currencies. The FOMC meeting is the major catalyst for the dollar, but the trend remains higher as long as DXY can stay above 81.20 (that's the upward-sloping trend line dating back to May '11). I would buy UUP on any FOMC-related dip to that level (including any "No Summers" related sell off today).

The euro had a big rally last week thanks mostly to dollar weakness, as economic data from Europe was mixed. But, seeing as I'm a dollar bull, I'm by default a euro bear, and there are growing expectations that the European Central Bank will unleash another LTRO to spur growth in the fall. The euro is trading up near resistance at 1.34 (where it has failed twice), and I'd look to sell euros on any FOMC meeting bounce toward that level. The pound was the big winner vs. the dollar, as it rallied to a new high for the year thanks to a strong Labour market report and positive commentary on the economy by Bank of England Governor Marc Carney. The UK economy is clearly improving, and that's bullish for the pound and UK stocks (EWU).

Finally, turning to Asia, the yen briefly broke through 100/dollar midweek before recovering. The topic du jour in Japan is the sales tax increases coming next spring and what measures the government will take to offset them. This will lead to short-term volatility as the details are revealed, but the bottom line is 100 yen/dollar won't engender an economic recovery in Japan. On the charts, the yen has broken support from the May lows, and DXJ has broken a downtrend from the same time. So, I believe this three-month consolidation in the "long Japan" trade is over, and this trade should start working again into year-end.

Have a good day—Tom.

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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.* *Support in the S&P 500 sits at the 50 day MA (1670ish), while resistance is the old highs of 1709.*

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.

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Bullish	Bullish	Bullish	*The dollar index is weaker to start the week on the Summer's news, but regardless of the short term moves, I remain dollar bullish based on the marginal direction of monetary policy. But if the uptrend at 81.20 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 to the 1.34 level, 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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**

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