7:00's Report

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

September 20th, 2013

Pre 7:00 Look

- Futures little changed as markets continue to weigh the implications of the surprise Fed decision.
- The big news o/n was a surprise rate increase by the Reserve Bank of India, designed to combat rising inflation. The Sensex and Rupee declined modestly on the news.
- Econ Today: No reports today, but there are several Fed speakers: George, Tarullo, Bullard and Kocherlakota all speak between 12:30—1:30 PM EST.

Market	Level	Change	% Change
S&P 500 Futures	1717.25	-0.25	-.01%
U.S. Dollar (DXY)	80.425	-.055	-.07%
Gold	1357.00	-12.30	-.90%
WTI	106.01	-.38	-.36%
10 Year	2.748	.04	1.48%

Equities

Market Recap

Stocks drifted slightly lower Thursday and frankly felt a bit shell shocked over the Fed surprise, as investors spent the day digesting the Fed decision. The S&P 500 declined 0.18%.

News-wise, there wasn't a ton to move markets. And really, assessment of the Fed was again the main news item of the day. The economic data largely was good, with Philly Fed being a blowout number, but it didn't really move markets that much.

There were headlines all day from Washington, but no real developments. At this point, it looks like it'll be late next week by the time the Senate votes on the continuing resolution bill coming from the House. So, in the meantime, we will all be subjected to speeches, squabbling and name-calling. The afternoon was quiet as markets mostly drifted slightly in the red, and closed quietly.

Trading Color

Trading was pretty slow yesterday. The Nasdaq was the only major index to finish positive, thanks to recent good earnings—Adobe (ADBE), Oracle (ORCL) and a nice Apple (AAPL) rally (up 1%).

Looking internally, most sectors, like the major averages, spent the day drifting aimlessly—although financials and homebuilders were notable exceptions, as both declined moderately.

So, far, while the market assimilates the Fed surprise, the one clear conclusion we can draw is that financials, and especially the regional banks, are the clear losers, as many investors had moved into that sector based on the expectation of increasing net interest margins thanks to presumed Fed tapering. Now that tapering is delayed, we're seeing a rotation out of those names as investors re-allocated towards deep cyclicals like industrials, which were the best performing S&P 500 sub-sector yesterday.

Trading volumes were decent but activity didn't seem to match the volumes, as there was widespread re-assessment in the wake of no tapering. On the charts the S&P 500 barely moved, so the technical picture remains largely the same: Support sits at 1,709, 1,700 and then the 50-day moving average (1,678).

Focus Turns to Washington – Here's What's Next

Market	Level	Change	% Change
Dow	15636.55	-40.39	-26%
TSX	12926.78	-4.62	-.04%
Brazil	55095.69	-607.21	-1.09%
FTSE	6623.47	-1.92	-.03%
Nikkei	14742.42	-23.76	-.16%
Hang Seng	23502.51	385.06	1.67%
ASX	5276.69	-18.86	-.36%
Prices taken at previous day market close.			

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The House is moving forward with a vote today on the continuing resolution to fund the government that is directly tied to Affordable Care Act (ACA), as I explained yesterday. This bill will certainly be rejected in the Senate, but we probably won't get that vote until mid- to late next week. At that point, the Senate will send an amended bill back to the House that funds the government but strips out the de-funding of the ACA. Then, it's up to the House to pass that bill by Sept. 30 or else the government will shut down.

Market	Level	Change	% Change
Gold	1368.00	60.40	4.62%
Silver	23.20	1.636	7.59%
Copper	3.3435	.065	1.98%
WTI	106.16	-1.91	-1.77%
Brent	108.65	-1.95	-1.76%
Nat Gas	3.711	-.002	-0.05%
Corn	459.50	3.25	0.71%
Wheat	657.00	10.50	1.62%
Soybean	1339.50	-8.25	-0.61%
Prices taken at previous day market close.			

Logic (and the fact that next year is an election year) tells us the House will pass the separate continuing resolution sometime before the 30th, but there will certainly be another round of drama in the next 10 days.

Economics

Weekly jobless claims, existing home sales and the Philadelphia Fed survey all hit the tape yesterday morning and all of the reports were positive. Although, given the focus on the Fed, there was little market reaction.

Weekly Jobless Claims

- Jobless Claims were 309K vs. (E) 341K.
- 4 Week Moving Average fell to 314K from 321K.

Takeaway

Weekly jobless claims rose from last week's slightly revised 294K to 309K; however, this was well-below consensus estimates of 341K. Despite the big headline beat vs. expectations, the Street seemed to look right past the number due to more computer upgrade issues.

Nevada and California, for the second-straight week, gave incomplete data. With these states not reporting accurate numbers, or any numbers at all, the report is essentially worthless. But, based on the trend of the data before these computer glitches, we can safely assume we're probably going to see small, incremental improvement in the labor market once all the data is in.

Existing Home Sales

- August existing home sales increased to 5.48M Seasonally Adjusted Annual Rate vs. (E) 5.255M SAAR.

Takeaway

Existing home sales was a surprise beat, but you have to remember this report represents completed transactions in August. So, this really reflects sales data from back in June (when contracts were signed with a 30- to 60-day closing period). So, these strong numbers likely reflect a "pull forward" of demand as interest rates started ticking higher.

Presumably we'll see a dip in next month's data, but bottom line is inventory remains light (4.9 months) and prices are holding up. So, while we'll see the housing data dip a bit, the important takeaway from this report is there aren't any signs the recovery is reversing.

Philadelphia Fed Survey

- General Business Conditions index 22.3 vs. (E) 10.0

Takeaway

The statistics out of the Philadelphia Fed were shockingly strong in yesterday's report. The general business index crushed estimates of 9.3 and the reading of 22.3 is the strongest in 2.5 years, which shows strong economic improvement in the Mid-Atlantic region. The details of the report were also very strong: New orders, the leading indicator in the report, jumped to 21.2 vs. 5.3 in August, and both employment indices (number of employees and average hours worked) also saw strong gains.

Bottom line is the Philly Fed further confirms we're seeing a building recovery in the manufacturing sector, and obviously that's positive for the economy and industrials and basic materials sectors. Importantly, the Philadelphia Fed survey has been the best predictor of the Institute for Supply Management's manufacturing Purchasing Managers' Index, so this strongly implies further acceleration can be expected when that number hits next week.

Commodities

Commodities in aggregate declined marginally yester-

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day, as the complex digested Wednesday's huge post-FOMC rally. Energy was broadly lower while precious and industrial metals were able to hold their gains from yesterday.

Copper was actually the best-performing commodity, rallying more than 2% as the Fed "tapering" headwind has cleared, and investors focus on the recent strong economic data from China. I pointed out last week that copper wasn't trading off the good data from China, and now with the Fed still fully supporting the economy, the commodity is playing catch-up. Copper rallying is an encouraging anecdotal sign for the global economy.

Both gold and silver were little changed yesterday, but given the huge rallies we saw Wednesday afternoon, that should be considered a victory.

The Fed withholding tapering of QE has given gold and silver a boost. But if the rally is to resume in earnest, it'll have to be because of inflation concerns finally materializing, not because the Fed shocked the market by maintaining QE.

But, certainly the landscape has become more-favorable for gold: The Fed is not tapering QE, and importantly the Indian rupee has rallied hard vs. the dollar. This should continue—boosting demand from India, despite the Indian government's efforts to curtail gold imports. (All they've done is create a thriving black market for gold in India.)

Energy was universally lower Thursday, with RBOB gasoline leading the way down, as it fell 1.6%. WTI crude also declined a more-modest 0.73%, and the weakness in energy came despite the universally good economic data (jobless claims, Philly Fed, existing home sales).

But, yesterday's pullback in energy was more about short-term momentum than anything else. The energy complex simply got too short-term overbought off the Fed, and some of those weak-handed longs (who were likely bailed out of losing positions by the Fed) booked profits yesterday.

More important than one day of random trading noise, energy—and oil in particular—traded down right to support at the lower bound of the $105.50-ish to $110-ish range, and now sits right in the middle of it. With the Fed's foot on the gas and the economy turning, though, I'd continue to be a buyer of "energy" either via oil futures or ETFs like the U.S. Oil Fund (USO) or Energy Select Sector SPDR (XLE) on any material dip. (So, sub-$107 in oil and a corresponding fall in the ETFs would interest me on the long side.)

The one piece of fundamental news in the markets yesterday was the natural gas inventory data, which showed a smaller-than-expected inventory build of 46 Bcf vs. estimates of 62 Bcf. Initially gas rallied off the data, but natural gas at $3.70 isn't exactly cheap at these levels. The rally invited some profit-taking, which saw gas close down 0.5%. Natural gas remains weather-dominated in the short term as we move closer to the seasonal draw period.

A growing global economy and almost-global 0% interest rates are a double positive for the commodity space. And, while I think we've see the top of the commodity "super cycle," the PowerShares DB Commodity Index Tracking Fund (DBC) is still down on the year nearly 5% compared to the S&P 500, which is up 20%. The asset class has lagged badly due to a number of factors, but with the Fed now a headwind on the dollar and global growth turning, the stage is set for commodities to play some catch-up.

Currencies & Bonds

Market	Level	Change	% Change
Dollar Index	80.495	.128	0.16%
Euro	1.3526	.0017	0.13%
Pound	1.6023	-.0075	-0.47%
Yen	.010080	-.000134	-1.31%
CAD $	.9725	-.0045	-0.46%
AUD $	.9385	-.0063	-0.67%
Brazilian Real	.4470	-.00095	-.21%
10 Year Yield	2.748	.04	1.48%
30 Year Yield	3.805	.05	1.33%
Prices taken at previous day market close.			

The Dollar Index bounced back slightly yesterday from Wednesday's obliteration, rising 0.15%. But, the dollar was actually a stronger than the index lets on, as a 0.17% rally in the euro overshadowed a strong dollar move against the pound, yen, Aussie and Loonie.

The pound fell 0.5%, backing off its multi-month highs as

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there was finally a piece of disappointing news to prompt profit-taking. UK retail sales declined more than expected in August, although the vast majority of data in the UK still points to a recovering economy. If anything, the pound is a buy here on a dip.

The big mover yesterday was the yen, which fell a very surprising 1.4% vs. the dollar, after rallying to a three-week high Wednesday. The reason for the yen weakness was a report from the Nikkei that Prime Minster Shinzo Abe will go forward with the sales tax hike next spring, and the announcement will be made perhaps as early as Oct. 1.

In a normal world, that news would be yen-bullish, not bearish. But in the bizarre world of yen trading, it's actually bearish, as everyone now expects the Bank of Japan or finance minster to unleash more monetary or fiscal stimulus to offset the impending tax increase.

Despite the Fed's surprise yesterday, I still think the likely direction of the yen is lower vs. the dollar, because I believe the BOJ is targeting a weaker yen and, as a result, will be more forceful at devaluing than the Fed will be at devaluing the dollar. So, the BOJ will win the race to the bottom. But, for now I'd stand on the sidelines and prefer to just stick with the WisdomTree Japan Hedged Equity Fund (DXJ) rather than wade back into the currency waters.

Bonds sold off modestly, with the 30-year falling 0.54%, which frankly is more than I thought it would give back. But, it's safe to say that in all likelihood the declines in the Treasury market are over in the near term.

What's Next For Bonds & The Dollar

Given the total surprise from the Fed, I spent time yesterday stepping back and wondering what "no tapering" means for the dollar and bonds beyond the immediate short term. I think the answer for both is "go nowhere" in the near term.

Starting first with the dollar, I was a nervous dollar bull prior to the Fed surprise, and while I'm no longer a dollar bull, I'm not a bear either. I advocated being long dollars because they Fed was going to be the first central bank to begin to remove monetary accommodation, hence making the marginal direction of Fed policy less "dovish" than other central banks. Put simply, the Fed was going to be the first major central bank to start down the path of eventual policy tightening. And, although delayed, I think that thesis probably will end up being correct—just in several months.

But, for now the Fed "tapering" tailwind is gone, which basically puts the dollar on par with other major currencies. (And with the risk of Washington, you could make the case for the dollar being at a slight disadvantage.) So, I'd expect a chop in the dollar as the market re-prices the outlook for Fed action over the next few months, but I would not expect a protracted dollar decline vs. most other currencies (especially the euro) unless Washington really screws something up.

With bonds it's much the same story. The longer-term trend in Treasuries remains lower, but bonds priced in a small tapering of QE in September that didn't materialize. But, I think most investors will view this rally as a temporary reprieve from the declines of the past 4 months, not as a trend change (and rightly so). And, I think you saw some of that materialize in the Treasury market yesterday, where the declines were bigger than you'd have expected.

Bottom line is, bonds have to decline. Either the Fed tapers, which eventually leads to tightening ... or the Fed never tapers, and we get massive inflation, which will hurt bonds. One way or the other (assuming we don't get inflation, which would be an utter disaster), the bond market decline isn't over. As a result, I don't expect any substantial rally in bonds either, but instead more of a drift sideways over the coming months, dependent on the data. And, I'd use that lift to get properly positioned for the next leg down, which will come eventually.

Have a good weekend,

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	*Stocks shot to all time highs on a surprisingly dovish "no taper" Fed decision. Although valuation is starting to be a bit of a concern at these levels, the performance chase into quarter end will likely be a tailwind on stocks. The benefit of the doubt remains with the bulls, even though markets are stretched.* *Markets are all time highs while support sits at the old highs of 1709 and then the 50 day MA, which is in the 1670ish range.*

Trade Ideas

Long/Overweight: **International markets and basic materials (HAP, IYM) should continue to outperform due to the Fed's surprise no taper decision. Internationally, European economic data shows the EU economy 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.**

More broadly, expect cyclicals to outperform, although utilities, which have been killed on a move out of "bond proxy" sectors, are an interesting potential value play at these levels and should see further short covering.

	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, and the Fed's decision not to taper QE only will serve to stoke inflationary fires and benefit hard assets as the US Dollar declines.*

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.**

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	Neutral	Neutral	Neutral	*The US Dollar plunged after the Fed's "No taper" surprise and broke a multi-year up trend. The dollar had risen in anticipation of Fed tapering, and with that out for now, there will be little in the news to push the dollar higher. Eventually the Fed will taper, but its months in the future.*

Trade Ideas

Long: **Emerging market currencies (ETF is CEW) such as the Brazilian Real (BZF), Indian Rupee (ICN) or Mexican Peso, as those currencies should see a large rally after the Fed's "no taper" surprise.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	Neutral	Bearish	Bearish	*The Fed's "no taper" surprise has likely marked the end of this initial leg down in Treasuries. Although the fundamentals long term remain negative, we should see a bounce of some sort, although I would look at that longer term as a great entry point on a bond short. If you missed the intial leg down, now's your chance to get back in over the coming weeks/month.*

Trade Ideas

Buy on a significant dip: **TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury). 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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