7:00's Report

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

September 23rd, 2013

Pre 7:00 Look

- Futures flat to start the week as markets digest mixed economic data and look ahead to a busy week.
- Global flash PMIs were mixed o/n but generally a positive. Chinese manufacturing (MFG) PMI rose to a 6 month high at 51.2 but EU MFG PMI surprisingly declined from August and missed expectations, although remains above 50.
- German elections went as expected and the key is there will be no disruption to Germany's support of Europe.
- Econ Today: Flash MFG PMIs (E: 54.0). Fed's Lockhart (9:20 AM), Dudley (9:30 AM), Fisher (1:30) PM speak.

Market	Level	Change	% Change
S&P 500 Futures	1705.00	2.50	.16%
U.S. Dollar (DXY)	80.535	-.024	-.03%
Gold	1321.50	-11.00	-.83%
WTI	104.93	.18	.17%
10 Year	2.732	-.016	-.58%

Equities

Market Recap

Stocks rallied nearly 1% last week during volatile trading sessions, as confusion over the Fed and a brewing budget battle in Washington overshadowed several pieces of positive macro- and microeconomic news. The S&P 500 is up 19.9% year-to-date.

Stocks rallied to new all-time highs last week, grinding higher early in the week in anticipation of the Federal Open Market Committee tapering (on an expected "sell the rumor, buy the news" reaction) and then absolutely exploding after the Fed shocked markets by not tapering QE. But, on Friday the reality of a less-credible and apparently conflicted Fed caused a nasty sell-off.

Stocks gave back all of the "post-FOMC meeting" rally. James Bullard's "close call" comment on tapering was most responsible for the sell-off, and Esther George's remarks that the Fed is now confusing the market didn't help either, mainly because it's true.

Away from the Fed, last week actually saw several pieces of positive news. Economic data was largely good, and August quarter-end earnings from Adobe (ADBE), FedEx (FDX) and Oracle (ORCL) beat expectations. Geopolitics even improved, as there was a diplomatic solution reached with regard to Syria. Plus, late in the week the Iranian regime signaled it's willing to negotiate with the Obama administration on its nuclear program in an effort to have international sanctions lifted.

Sector-wise it was volatile last week, but we definitely saw an unwind of the "tapering" trade after the FOMC meeting. Financials, and especially regional banks, lagged while bond-proxy and safety sectors like utilities, REITs and consumer staples saw a short-covering rally after the Fed surprise.

On Friday, though, "bond proxy" sectors once again underperformed, in part because of the Bullard comments and as investors continue to expect tapering of some sort over the coming months (which will likely put upward pressure back on rates).

I received some questions late last week asking whether

Index Universe Inside Commodities Conference

Today I'm in New York attending a commodities conference hosted by my friends at IndexUniverse.com.

If any of you are also in attendance, please look for me as I'd love to meet you in person.

Market	Level	Change	% Change
Dow	15451.09	-185.09	-1.19%
TSX	12806.47	-120.31	-.93%
Brazil	54110.03	-985.66	-1.79%
FTSE	6577.82	-18.61	-.28%
Nikkei	14742.42	-23.76	-.16%
Hang Seng	23371.54	-130.97	-.56%
ASX	5252.46	-24.23	-.46%

Prices taken at previous day market close.

utilities and REITs were a "buy" now that the Fed delayed tapering. My response is that they may be a "buy for a trade," but the trend of rates is higher—regardless of Fed tapering this month or next. So, I'm not sure just how much value there is in those names. The one exception, though, would be MLPs, where there may be some opportunities. (I plan to do more research into that this week.)

Market	Level	Change	% Change
Gold	1237.20	-5.50	-.41%
Silver	21.86	-.07	-.36%
Copper	3.29	-03	-.78%
WTI	104.66	-.09	-.09%
Brent	109.22	.46	.42%
Nat Gas	3.67	-.01	-.30%
Corn	4.50	-.09	-1.96%
Wheat	6.46	-.11	-1.67%
Soybean	13.16	-.24	-1.75%
Prices taken at previous day market close.			

Tech and industrials also outperformed thanks to the aforementioned positive earnings and surprisingly still-accommodative Fed. Deep cyclicals like industrials (and to a lesser extent basic materials) will benefit from further accommodation.

On the charts, Friday's sell-off notwithstanding, the week was bullish, as virtually every major index hit new all-time or multi-year highs.

Support on the S&P 500 now sits at 1,709-ish (where we closed Friday), 1,700 and the 50-day moving average, which is in the 1,670s. Volumes on the week were in line or above recent averages (activity has definitely picked up since the summer doldrums).

Next Week

It going to be another busy week. On the macroeconomic front, there are several economic releases (most important are the flash Purchasing Managers' Indexes that came this morning), and all eyes will remain on the Fed and Washington. There are multiple Fed presidents speaking throughout the week (I'll detail who and when each morning in our "Pre-7 a.m. Look"). If Friday is any guide, markets have the potential to trade off the remarks.

In Washington, on Friday the House passed a continuing resolution to fund the government that also defunds the "Affordable Care Act," and that bill will certainly die in the Senate. A "clean" continuing resolution bill (that doesn't include defunding Obamacare) will likely head back to the House later this week from the Senate ... and that's where the real drama begins.

But, at this point, it appears no one wants to shut down the government. And while there undoubtedly will be drama, passage of the continuing resolution to fund the government is expected before Sept. 30 (which clears the way for the next fight over the debt ceiling).

Finally, on the microeconomic front, August quarter-end reporting season continues with multiple companies releasing earnings results. KB Home (KBH) and Lennar (LEN) report tomorrow morning and are the highlights of the week. Bed Bath & Beyond (BBBY) reports Wednesday and new Dow component Nike (NKE) reports Thursday.

Bottom Line

Friday's sell-off was all about the uncertainty the Fed has now created with last week's surprise, and there is a growing concern that the Fed doesn't quite know what it's doing. (You'll see this referred to as "losing credibility.")

The Fed took pains over the past three months to prepare the market for QE tapering, and it achieved that goal. So, it was absolutely shocking when they did not taper.

This is important because it introduced uncertainty with regard to the Fed's effectiveness and policies, and there is no bigger headwind on risk assets than when the market loses confidence in the Fed.

By not tapering, the Fed has made it seem like they don't understand the reality they've created in markets via multiyear 0% rates and multiple rounds of QE. (And that reality is an ocean of cash sloshing between asset classes and trading "risk on" and "risk off.")

In fact, this is the second time in three months the Fed has implied they don't fully understand the situation they've created in markets. Earlier this summer, many Fed presidents were surprised by the turmoil and plunge in emerging markets as a result of expected tapering of QE, and frankly that really shouldn't have been that surprising.

I point this out because global central banks, through their own doing, have now become the largest force in the market. And, if they can't convey that they have a credible plan to safely unwind all this stimulus and QE, then markets will not react well … and that will be a potentially bearish game-changer.

While we certainly aren't there yet, the Fed losing credibility is a new headwind on this market, and yet another reason I favor international exposure (via ETFs in the United Kingdom, Ireland and Japan like EWU, EIRL and DXJ) into the end of the year over domestics.

We are all subject to, at minimum, another month of Fed tea-leaf reading and gyrations around Fed speakers, and at this point I think it'd probably just be best if the Fed just did the damn tapering and let us know in the statement afterward. (i.e., "This month we only bought $75 billion of Treasuries—deal with it!")

The benefit of the doubt still lies with the bulls and I wouldn't sell any longs or materially reduce exposure, but I'm getting more and more nervous.

Economics

Last Week

The big event last week was obviously the FOMC, which borderline shocked markets when the committee decided to not taper QE thanks to three main factors:

- **Continued fiscal drag** (meaning the possibility of a mini-crisis surrounding the continuing resolution and debt-ceiling debates coming).
- **The big increase in yields since May** (1.60% to 3% in the 10-year yield.
- **Stubbornly low inflation.** Taken together, the committee decided it was better to err on the side of caution and not taper QE.

There was some clarity last week with regard to the Fed, however, as Janet Yellen is now widely expected to be the next Fed chairman, and that announcement could potentially come this week.

Market	Level	Change	% Change
Dollar Index	80.565	.016	.01%
Euro	1.3515	-.0009	-.07%
Pound	1.6010	-.0014	-.09%
Yen	1.011	.0041	.41%
CAD $	.9684	-.001	-.10%
AUD $	.9360	.0006	.06%
Brazilian Real	.44410	-.0029	-.65%
10 Year Yield	2.732	-.016	-.58%
30 Year Yield	3.76	-.045	-1.18%
Prices taken at previous day market close.			

Turning to the actual economic data, it was largely positive last week, contradicting the Fed's cautious outlook on economic growth.

The first look at September economic activity was good, as the Philly Fed, which has been the best predictor of the Institute for Supply Management's manufacturing PMIs that come later this month, crushed expectations and rose to a multiyear high. Empire State manufacturing wasn't as impressive, but did continue to show growth in the manufacturing sector. Both reports further imply that manufacturing is seeing the rebound accelerate.

Housing was the other area of focus last week, and while the data wasn't great, both housing starts and existing home sales showed the housing market recovery isn't losing significant momentum. This is a positive with regard to the economy.

Finally, jobless claims remains at multiyear lows, but computer issues from California and Nevada are skewing the data, so the reports of the last two weeks can largely be ignored.

This Week

There's a lot of data this week but foremost on everyone's mind will be the Fed. One of the consequences of the Fed not tapering is to extend this torturous dissection of every Fed president statement to try and glean insight into when the Fed will taper.

The biggest influence in the market will be Fed speakers, of which there are many this week.

Evidence of this can be seen in Friday's price action, where James Bullard said it was a "close call" on tapering at the meeting, which caused a sharp sell-off.

Expect more Fed comment-induced whiplash this week. There are six Fed presidents' speeches this week, but the one to really watch is Bill Dudley this morning, as he represents the "mainstream" of the Fed and is generally most representative of the Committee's consensus.

Away from Fed drama, there is actually a lot of important hard data this week. The highlight is the global flash PMIs. (China and Europe came last night and this morning, while the U.S. is in about 2 hours. China's index rose to a six-month high.)

There's also more housing data this week. Case-Shiller Home Price Index, New Home Sales and Pending Home Sales will all be watched closely for confirmation of last week's reports. If so, this would imply the housing recovery—while being slowed by higher mortgage rates—isn't reversing and that the recovery is still ongoing, just at a slower pace. Housing remains a critical component to the overall economic recovery, so continued positive momentum in housing, however slow, is key. Other data to watch will be the final look at Q2 GDP, August durable goods (these have been soft lately and it'll bode well for Q3 GDP if durable goods shows an uptick) and jobless claims (hopefully we can finally get a clean, reliable number).

Commodities, Currencies & Bonds

Commodities declined last week after Fed induced volatility caused whiplash in the sector. DBC was down more than 1%, despite the macro-economic landscape getting more bullish for commodities, as global economic data continues to point to an acceleration in growth (and the PMIs this morning further confirm that). Commodities, like most assets, remain at the mercy of the Fed, and initially declined last week on tapering expectations and a further reduction in geo-political risk premium with regards to Syria, but saw a massive rally post FOMC on Wednesday, before selling off hard Friday on the "hawkish" comments by Bullard.

Despite the FOMC surprise, gold remains under pressure as there remains absolutely no inflation, statistically speaking, and global tensions continue to recede. WTI Crude also declined more than 3% last week despite good economic data and bullish weekly inventories. I remain a nervous commodity bull based on the turn in global economic growth, and would be a buyer of energy and DBC down here, although the lows of last week are the stop.

The dollar index declined sharply last week and broke a multi-year uptrend, as the no taper surprise sent the dollar down nearly 1.5% last Wednesday. The dollar stabilized late last week, however, and I'd expect it to hold this range over the coming weeks as we digest more Fed speakers and the possibility of a taper in October. Turning to Europe, the euro and pound traded to multi-month highs against the dollar before giving some back Friday (they were just trading off the dollar, there as no fundamental news last wee), while emerging market currencies absolutely surged last week as shorts were caught off guard and got squeezed. The yen was the one currency not to have a big rally vs. the dollar, as the yen fell sharply on Thursday after a report came out saying PM Abe will go ahead with the national sales tax increase, but off set its impact by cutting corporate taxes. The yen remains sluggish and I'd not be shocked to see it break 100/dollar again this week.

Treasuries saw a big rally last week, as you'd expect, and traded to a one month high. Yields on the ten year declined to 2.70 from 2.9% last Monday. I've spent the last few weeks warning that the sell off in bonds looked about done in the near term, and given the Fed decision that now looks to be the case. Expect continued volatility in both currencies and bonds, over the coming weeks as tapering of QE as the market prices in probability of a October or December taper. Despite the surprise last week, I remain a bond bear and a dollar bull, although clearly in the near term both those trends have been disrupted. But, tapering is coming, whether its September or December, and economic data is improving. As long as the later continues, then the former must occur, otherwise we'll see massive inflation. So, I would use any continued strength in bonds/weakness in dollars as a buying opportunity for medium/long term accounts.

Have a good week, 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	*Stocks shot to all time highs on a surprisingly dovish "no taper" Fed decision but concerns are growing about the Fed's credibility and plan to unwind QE. At this point, though, the benefit of the doubt remains with the bulls, and performance chase into month/quarter end will be a short term tailwind on stocks.* *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 continue to remain attractive based on improving economic data, and looming political and monetary clouds in Washington. 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.**

Domestically, I'd look to allocate to deep cyclicals like industrials (XLI) and basic materials (IYM), as they should benefit from continued Fed stimulus.

	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, although I don't envision a continued sell off either, as the FOMC will taper at some point (Oct or Dec).*

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.**