7:00's Report

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

September 27th, 2013

While the general market is in "Wait and See" mode, investors have been quick to punish any bad news in specific stocks, implying underlying nervousness.

Pre 7:00 Look

- Futures and most international markets modestly weaker as geo-political angst in the US and Europe weighs on risk assets.
- Economically there were multiple releases but most met expectations and none were moving markets.
- In Italy, the threat of a government collapse reappeared as Berlusconi's allies again threatened to quit the governing coalition if he is expelled from the Senate.
- Econ Today: Personal Income and Outlays (E: 0.4%), Fed Presidents Rosengren (8:30AM), and Dudley (2:00PM).

Market	Level	Change	% Change
S&P 500 Futures	1685.25	-7.50	-.44%
U.S. Dollar (DXY)	80.515	-.123	-.15%
Gold	1325.20	1.10	.08%
WTI	102.46	-.57	-.55%
10 Year	2.643	.029	1.11%

Equities

Market Recap

Stocks broke their five-day slide Thursday as a very strong weekly jobless claims report and expected passage of the continuing resolution to fund the government helped stocks bounce modestly. The S&P 500 rose 0.35%.

Stocks started the day stronger, as the weekly jobless claims number was by far the most-impactful piece of news. But, like each day this week, there was more volatility to be had, as yesterday Fed President Jeremy Stein echoed James Bullard's comments that tapering QE in September was a "close call." The hawkish comments turned the S&P 500 negative and sent it to the lows of the day.

Stocks managed to mount a small rally in the afternoon, however, as sentiment improved around the chances of the House passing a "clean" CR bill (and actually getting it Friday instead of Saturday).

But, truth is Thursday's rally was far from strong, and it was as much an oversold bounce as it was anything else. Most investors remain on the sidelines and action is being dominated by fast-money funds, as markets remain in a "wait-and-see mode."

One thing I did notice over the last two days that I want to point out is the market seems to quickly and harshly punish any "bad news." Wal-Mart (WMT) Wednesday and Hertz (HTZ) yesterday are two examples, and that echoes what I said yesterday—there are no bids in this market and no one is willing to step in. But, there hasn't been any aggressive, widespread selling either.

Market	Level	Change	% Change
Dow	15328.11	54.85	.36%
TSX	12841.62	4.91	.04%
Brazil	53782.97	-478.14	-.88%
FTSE	6522.79	-42.80	-.65%
Nikkei	14760.07	-39.05	-.26%
Hang Seng	23207.04	82.01	.35%
ASX	5307.06	12.61	.24%

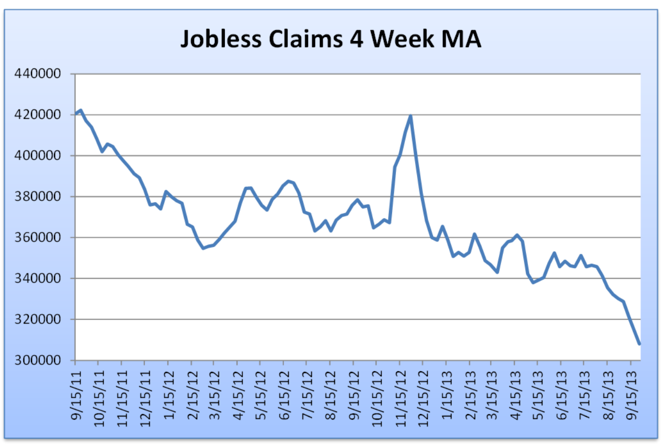
Prices taken at previous day market close.

Being from a trading background and always thinking about what could go wrong, I get nervous that if something "bad" happens, we could see a potentially nasty decline. Let's hope there's some clarity from Washington and some bids in this market before we do get some inevitable bad news, though.

Market	Level	Change	% Change
Gold	1322.70	-13.50	-1.01%
Silver	21.705	-.181	-0.83%
Copper	3.301	.029	0.89%
WTI	103.00	.34	0.33%
Brent	109.20	.88	0.81%
Nat Gas	3.583	.037	1.04%
Corn	456.75	2.00	0.44%
Wheat	678.25	7.75	1.16%
Soybean	1316.75	-5.00	-0.38%
Prices taken at previous day market close.			

Trading Color

Consumer discretionary was the best-performing sector yesterday thanks to several factors. First, Bed Bath & Beyond (BBBY) earnings were better than expected. Also Thursday morning Li & Fung, which is a major supplier to WMT, said it has seen no mass cancellations of orders—further refuting the negative story from Wednesday. (WMT actually closed fractionally lower, but the positive sentiment helped the sector to rally.) The WMT news also helped consumer staples rally as well.



Generally speaking there was cyclical outperformance yesterday as basic materials, industrials and tech all outperformed, which makes sense given the economic data. Meanwhile utilities once again lagged (they were the only S&P sub-sector to finish negative).

Financials, however, continue to be under pressure and underperform, and they lagged the broader market after enjoying a one-day bounce Wednesday. I'll feel a lot better about any rally once financials start participating and acting better.

Volumes continued to be borderline pathetic as Washington-inspired paralysis gripped markets, leaving the intraday swings at the mercy of day-traders and algos. On the charts the S&P 500 moved away from support at the 50-day MA (1,680) and but once again couldn't hold 1,700, which is now resistance.

"Oct-Taper" vs. "San-ta-per"

Wall Street never ceases to amaze me with the creativity to come up with silly sayings for important events, and as such we are now faced with the choice of "Oct-Taper" (tapering in October) vs. "San-ta-per" (tapering in December. Yes, Santa and "taper").

At this point, very few people expect tapering in October, even if yesterday's impressive claims number results in a strong September jobs report. So, for now, the consensus expectation is for tapering to start in December, although we all know how good the consensus was on the last one.

One thing I will point out, though, is that Treasury Secretary Jacob Lew sent a note to Congress earlier this week saying the U.S. will hit the debt ceiling on or before Oct. 17. So, there is a possibility that we could have the "fiscal drags" the Fed has continuously warned about (and that I think are largely responsible for the Fed not tapering in September) removed by the time the October meeting comes around.

So, if the September jobs report is good (it'll be the last one before the October meeting) and there is positive resolution from Washington on the debt ceiling and the continuing resolution, the Fed may just surprise us again. Food for thought.

Economics

Yesterday morning was a busy one with key economic data hitting the tape at 8:30 a.m. Both GDP and jobless claims were announced.

Jobless Claims

- Jobless claims fell to 305K vs. (E) 330K

Takeaway

After two weeks of skewed data due to computer software issues in Nevada and California, we received a legitimate number out of the labor department surprisingly confirming the positive data of the past two weeks. (Last week's data was only revised higher by 1K claims.) The number beat analysts' expectations by 25K claims, coming in at 305K. This drew the 4-week moving average down to 308K, a recovery low and potentially very positive for the September employment situation report coming next Friday.

The surprisingly good report was initially met with skepticism given previous data issues, and most of the traders on Wall Street were hesitant to react. (Apparently they had their HFTs, algos and black boxes in the off position!) But, once the data was confirmed, futures rallied to the highs of the morning, as again this implies potential upside to the monthly jobs report.

<u>Final Look 2nd Quarter GDP</u>

- 2nd Quarter GDP grew by 2.5% vs. (E): 2.7%.

<u>*Takeaway*</u>

Real GDP growth for the second quarter was unchanged from last month's estimate but missed analysts' expectations of 2.7%. Within the report, Personal Consumption Expenditures (consumer spending) remained subdued at 1.8%.

Earlier this week, New York Fed President Bill Dudley mentioned he would not be comfortable scaling back on QE until GDP hit a sustainable level of 3% growth. So clearly this report doesn't increase the chances of an October taper. Bottom line is this report tells us what we already know—the economic is firmly in slow growth mode, plodding along at somewhere between 3% and 3% annual GDP growth.

Commodities

Market	Level	Change	% Change
Dollar Index	80.655	.212	0.26%
Euro	1.3486	-.0039	-0.29%
Pound	1.6027	-.004	-0.25%
Yen	.010119	-.000042	-0.41%
CAD $	.9677	-.0001	-0.01%
AUD $	.9304	-.0009	-0.01%
Brazilian Real	.4394	-.0031	-.70%
10 Year Yield	2.643	.029	1.11%
30 Year Yield	3.69	.042	1.15%
Prices taken at previous day market close.			

Commodities in aggregate rallied for the second-straight day and it seems, in the post-FOMC world, commodities want to trade in one of two ways. The first is a "pro-economic growth & hawkish" manner, where industrial commodities rally while the precious metals decline. That happened yesterday. The second is a "no growth & dovish" manner, where gold and silver rally, and industrial metals decline. That happened Wednesday. Such is the reality in Fed-obsessed asset markets.

Fed President Stein's "close call" comments and the strong weekly jobless claims were the "hawkish" influences on the market yesterday, and we saw industrial commodities trade higher in sympathy. Copper was the best performer, playing a bit of catch-up after recent underperformance and rallying 1%. Base metals also rose as did RBOB gasoline, reflecting the positive economic data. The one laggard was WTI crude, which rallied on the day but only marginally, rising just under 0.5% by reclaiming $103/bbl (barely).

That was mostly because of more overtures from Iran regarding its nuclear program. Iranian President Rouhani was quoted as saying he wanted the nuclear situation resolved within "three to six months." If true, this would be an unbelievable acceleration, considering they've been negotiating for 2+ years with literally zero progress. But, obviously comments like that are encouraging from a geo-political standpoint.

One of the more-interesting commodities yesterday was natural gas, which fell almost 3% in the morning after the weekly inventory data showed an inventory build of 87 Bcf vs. estimates of 82 Bcf. But, natural gas bounced hard off of the $3.45 level and rallied all afternoon, closing fractionally positive. Natural gas remains totally weather-driven, but the fact that shorts are covering and some dip-buying was that aggressive at the $3.45 level is worth noting. As mentioned last week, focus in gas now turns to cold weather, as heating demand will now become the near-term bullish catalyst (as opposed to cooling demand in the summer).

Looking a bit longer term, though, there was an interesting article in the WSJ yesterday about how the marine industry is looking at natural gas as a potential replacement for diesel! It's obviously way off in the future, if ever, but I wanted to point it out because the movement for natural gas as a transportation fuel is continuing to gain steam (pun intended). Link to the article here.

DBC once again has regained the $26 level and it looks like the pre-FOMC lows have held, for now. I would remains a nervous long in DBC, but it would take a break of $26.41 to get me more enthusiastically bullish. The fundamentals for an industrial and non-industrial commodity rally are there (decent global economic data, weaker dollar), but the complex needs to respond before anyone should get aggressively long.

Currencies & Bonds

The Dollar Index bounced as it continues to trade at the mercy of Fed speakers. The reiteration of the "close call" comments by Stein and the strong jobless claims helped put a bid in the Dollar Index early and that lasted all day. As had been the case for the last week-plus, pretty much every other currency traded off the dollar (as opposed to its own fundamentals). The euro and pound both declined 0.3%, while the Aussie was marginally weaker.

The yen declined amid increasing chatter that, on Oct. 1, PM Abe will indeed announce he is going forward with the sales tax increase next spring, but will offset it with a cut in corporate taxes, which should be economically stimulative. The yen continues to trade around this 98-100 range it's been in for the last few weeks, and probably will continue to do so until we have a bit more clarity on tapering. But, the trend in the yen remains ultimately lower. While some analysts I respect think the ultimate goal for the yen is 150 vs. the dollar (!), I think a bit more reasonable target over the next 12 months is 115 vs. the dollar. The yen and euro (given the ECB will likely unleash new LTROs in December) remain the two currencies I think have the most potential to decline vs. the dollar. If you've got a decent time horizon, meaning several months, and some patience for the trade to work, I think EUO and YCS both still make sense here, even with a less-credible Fed.

Turning to bonds, it was a "hawkish" day so bonds declined, although given the sharp rally since last week, the declines should be considered pretty mild. The final Treasury auction of the week came yesterday, a $29 billion offering of 7-year bonds. Unlike the 2-year and 5-year offerings Tues/Wed, which saw strong demand, the 7-year auction was a bit underwhelming. But, unlike some reports I read, it has nothing to do with the debt ceiling. (Why would an investor buy 5-year bonds but not 7-year based on some debt ceiling circus that, if it goes bad, will go bad in the next 6 weeks?)

Longer-dated auctions have been met with mixed demand for months, so this shouldn't be that surprising. The bid to cover was below recent averages at 2.46 (actually the second-lowest of the year) and the yield was 1 basis point above the "when issued" yield, again implying slightly soft demand.

Bottom line, I'm not sure anyone is thinking the bull market in bonds is going to resume anytime soon. And, while the short term rally in bonds will likely last some time longer, that's mostly because the market got so oversold. Remember, there are only three ways this can work out: 1) the Fed eventually tapers in the next 6 months and rates generally rise over time, which is bad for bonds. 2) The Fed never tapers, which means eventually inflation absolutely explodes, which is bad for bonds. Or, 3) The Fed never tapers, the economy never recovers, and we become Japan—stuck in deflationary cycle, which would be bond-positive (although our currency would drop like a stone so I hope we don't have to buy anything that isn't made here—oh wait…). Bottom line is bond yields will rise, and they'd better, because the alternative isn't good. So, this rally in bonds remains a shorting opportunity long term, and longer-dated Treasuries will continue to see lackluster demand.

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	*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 have fallen nearly 2% from recent highs. Major support sits at the 50 day MA, which is at 1679.*

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.

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.

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.**

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.**