7:00's Report

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

September 6th, 2013

Pre 7:00 Look

- Futures flat ahead of the jobs report this morning after a quiet night.
- The G-20 summit saw little news, although the "BRICS" announced a 100 billion dollar fund to help stabilize EM currencies. That's a positive but not a "fix" for current EM problems, as details on implementation are lacking and the fund is less than the $240 billion that had been rumored.
- Econ data o/n slightly disappointing, as German industrial production and trade balance both missed expectations.
- Econ Today: Employment Situation (E: 180k).

Market	Level	Change	% Change
S&P 500 Futures	1652.25	-.50	-.03%
U.S. Dollar (DXY)	82.59	-.078	-.09%
Gold	1368.90	-4.10	-.30%
WTI	10866	.28	.25%
10 Year	2.979	.082	2.83%

Equities

Market Recap

Stocks were virtually flat Thursday in relatively quiet trading ahead of the big jobs report today. The S&P 500 rose 0.12%.

The two "reasons" for stocks to finish higher yesterday were strong economic data (ISM Non-Manufacturing PMI and jobless claims) as well as re-affirmation by global central banks that they have no plans to change policy anytime soon. (This week we've gotten interest-rate decisions from the European Central Bank, Bank of England, Reserve Bank of Australia, Royal Bank of Canada and Bank of Japan, and they all remain firmly on "hold.")

Normally good data and global central banks on hold would be a recipe for a rally, but stocks barely moved throughout trading yesterday. Most equity investors spent their day looking ahead to the jobs report this morning, or watching the big rise in bond yields, waiting to see if the 10-year yield would hit 3%.

Stocks meandered throughout the day in low-volume trading and closed quietly, as no one wanted to make any big moves ahead of the jobs number.

Trading Color

With bond yields moving sharply higher, the trend of cyclical sector outperformance, and "safety" and "bond proxy" sector underperformance accelerated. Dow Transports and the Russell 2000 were the best-performing averages and, for the third day in a row, industrials were the best-performing S&P 500 sub-sector. (Industrials continue to be boosted by strong global and domestic economic data.) Basic materials, financials and energy were also outperformers from a sector standpoint, as money is rotating broadly into cyclicals.

In a familiar refrain: Utilities, REITs, telecom and consumer staples didn't all just underperform; they finished decidedly negative—with REITs falling more than 1%.

Volumes were very low, to be expected given the holiday and the jobs number looming, while on the charts the S&P 500 sits just below its 50-day moving average at 1661ish.

Jobs Report Preview

While actual consensus for this number is around 180K, really the market is looking for from this report is some color on how much the Fed will initially taper QE, versus

Market	Level	Change	% Change
Dow	14937.48	6.61	.04%
TSX	12845.06	87.25	.68%
Brazil	52351.86	635.70	1.23%
FTSE	6523.21	-9.23	-.14%
Nikkei	13860.81	-204.01	-1.45%
Hang Seng	22621.22	23.25	.10%
ASX	5144.99	2.48	.05%
Prices taken at previous day market close.			

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an exact hit or miss vs. the expectation.

- It'll take a print below 100K to take a tapering announcement off the table in September, which is extremely unlikely.
- Anything from the low-100Ks to around 200K will likely result in a small initial taper announced in September between $5 billion and $15 billion. This is the current market expectation and the most likely outcome.
- It'll probably take a number north of 250K to increase the size of the initial taper announcement to between $20—$30 billion.

Market	Level	Change	% Change
Gold	1365.7	-24.30	-1.74%
Silver	23.220	-.0195	-0.83%
Copper	3.2475	.0065	0.20%
WTI	108.37	1.14	1.06%
Brent	115.27	0.36	0.31%
Nat Gas	3.576	-0.107	-2.91%
Corn	461.50	-8.00	-1.70%
Wheat	639.50	-6.75	-1.04%
Soybean	1368.25	15.75	1.16%
Prices taken at previous day market close.			

The biggest reaction to the report should come from the bond and currency markets, which is what happened yesterday in reaction to the economic data. So, watch the 10 year yield on the release in addition to S&P futures.

With regard to stocks reaction to the number—remember that good news is good (and bad is bad). If the jobs number is strong, that will be viewed as a positive for stocks unless Treasury yields absolutely spike (and I mean the 10-year yield breaking through 3.10%). Likewise, a soft number will weigh on stocks, because the market knows we need a good economy more than we need more QE.

Economics

ISM Non-Manufacturing PMI

- August PMI: 58.6 vs. 55.0 (E).
- New Orders increased to 60.5 vs. 57.7 (E).

Takeaway

Service sector PMIs, like the manufacturing sector PMIs earlier this week, were very strong, and it wouldn't be too much of a stretch to call this a blowout number. Service sector PMIs reached their highest level since 2005, and new orders—the leading indicator of the report—increased substantially. In fact, like the manufacturing PMIs, the details of this report were equally as strong as the headline.

The market rallied off the release, but the effect was somewhat muted because of the looming jobs report today. Bonds, however, sold off hard on the release because both PMIs this week strongly imply the economy is seeing the pace of growth start to accelerate again, after pausing during the summer months.

While the jobs number will be the deciding factor, other economic evidence this week almost guarantees some tapering of QE to be announced in September.

Weekly Jobless Claims

- Claims were 323K vs. (E) 330K.
- 4-week moving average fell to 328K.

Takeaway

While volatile week-to-week, jobless claims continue their decline, with the four-week moving average (the more-important number to monitor in this release), falling to a new low for the recovery.

The weekly claims continue to imply we're seeing incremental improvement in the labor market, although this number won't have any effect on the jobs report coming today. (That survey was taken a few weeks ago, but the claims number does speak to a potentially better monthly jobs number next month.)

BOE & ECB Rate Decisions

Both the Bank of England and European Central Bank left rates unchanged Thursday, as expected, and the BOE made no changes to its QE program, also as expected.

The Bank of England rate decision was a non-event, as the statement was brief and offered no commentary on the economy or the outlook for rates or the QE program.

Mario Draghi's press conference following the ECB rate decision was eventful, however, as the market interpreted a specific comment he made as "dovish," which led to the sell-off in the euro yesterday.

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I said in Thursday's preview of the meeting that the market was looking for hints that the ECB is considering unleashing a new Long-Term Refinancing Operation to help combat rising interest rates and its shrinking balance sheet (in an effort to keep monetary policy very accommodative).

Well, Draghi gave the markets the "hint" they were looking for when he was asked about the decline in "excess liquidity" (meaning the expiration of the original LTROs). He responded that he was "particularly attentive" to developments there.

In central-banker vernacular, most have taken that comment to be a hint that the ECB is planning on doing something to counteract rising rates and falling liquidity as the original LTROs roll off, and presumably that means more LTROs.

In addition to that comment, the markets took it as "dovish" that the ECB didn't upgrade its language when describing the EU economy, despite a clear uptick in the data.

Plus, it was also revealed that an interest-rate cut was openly discussed at the meeting, with a number of governors saying the recovery remains "green" and may need additional help. (But, ultimately, they chose not to cut rates.)

Overall it was a somewhat "dovish" ECB meeting, and as expected, the ECB remains committed to very, very accommodative policies well into the future.

While the next Fed move will be toward less accommodation, if the ECB moves in the near future, it'll be to provide more accommodation. That's bearish for the euro, and I expect it to decline further going forward.

Market	Level	Change	% Change
Dollar Index	82.665	0.46	0.56%
Euro	1.3122	-0.0085	-0.64%
Pound	1.5590	-0.0032	-0.20%
Yen	.9983	-0.0042	-0.43%
CAD $	.9516	-0.001	-0.10%
AUD $	.9112	-0.005	-0.55%
Brazilian Real	.4262	.00505	1.20%
10 Year Yield	2.97	.082	2.83%
30 Year Yield	3.87	.079	2.08%
Prices taken at previous day market close.			

Commodities

Commodities finished trading Thursday only marginally weaker (DBC fell 0.23%), rallying back from substantial weakness early Thursday morning.

Industrials led the rebound in commodities, rising in reaction to the strong domestic economic data. The higher dollar, however, weighed on non-industrial commodities, as gold closed below recent support ahead of the crucial jobs report.

WTI crude was the best performer in the commodity space yesterday, rallying more than 1% and closing above $108/bbl on a combination of strong economic data and bullish weekly inventories. The weekly draw in inventories was 1.8 million barrels vs. expectations of just a 600K-barrel decrease.

Brent crude and copper, the other two major industrial commodities, finished trading yesterday with mild gains (0.2%) each, again reflecting the outperformance of industrials.

Staying in the energy patch, natural gas was the big laggard yesterday, falling more than 3% on a combination of in-line inventory data (59 Bcf build vs. (E) 58 Bcf) and expectations of moderating temperatures across the Midwest and Northeast.

While the inventory declines were in line with expectations, the natural gas bulls need hot temperatures to keep the rally intact as we enter the shoulder season before the weather turns cold. With supplies continuing to rise, simply meeting inventory builds won't be enough to keep natural gas rallying. The burden of proof remains with the bulls in the natural gas market.

Gold had an ugly day yesterday. It traded more like a currency than a commodity, falling as the dollar rose in reaction to the strong ISM non-manufacturing (services) PMI and jobless claims data.

Gold has now retraced nearly all of its breakout from two weeks ago, and today is a big day for gold, plain and simple. Support at the $1,353 level needs to hold if the rally is going to continue.

Currencies & Bonds

Emerging-market currencies caught a nice rebound Thursday, led higher by a strong move in the Indian ru-

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pee. They continue trying to stabilize, as the lows of last week (and earlier this week) are holding—for now.

Today will obviously be an important day with regard to the jobs report—if the jobs report is much better than expectations and you see the 10-year move decisively through 3%, watch the emerging markets.

If they can hold those lows in the face of higher yields (like they did back in early July in reaction to the strong June payrolls report) then stocks can rally from here. If those recent lows in the rupee, real and in ETFs like PCY and EMB are broken, look for stocks to sell off.

In some ways, it was impressive that emerging-market currencies were able to trade so well yesterday in the face of sharply higher Treasury yields. The 30-year Treasury fell 1% to a new low for the year, while the yield on the 10-year note moved sharply higher, nearly touching 3% (the high was 2.979%). To boot, Treasuries went out on the lows/yields on the highs. This is very surprising given the jobs number this morning.

Obviously I was wrong about 2.90% being the "top" for 10-year yields in the short term, and yesterday's big move ahead of the jobs report definitely caught some of us off-guard. Despite the big rally yesterday, though, I just don't see this pace of increase in yields being able to sustain itself for that much longer. (And this is coming from as big a bond bear as there is.)

If we're not near a short-term exhaustion point in the rise in yields, then I'll be very, very surprised (perhaps it'll come with the actual announcement of tapering in September). Longer term, bonds are headed much, much lower, but this recent pace of the declines can't be sustained for that much longer.

Turning to developed currencies, the Dollar Index was strong, rallying 0.55% Thursday against virtually every other currency thanks to the strong economic data and increased expectation of the Fed announcing tapering in September.

Helping the dollar rally to a one-month high yesterday was the aforementioned dovish ECB, which weighed pretty heavily on the euro (down 0.7%). But, as mentioned, dollar strength was pretty universal, as it was higher vs. the pound, yen, loonie and Aussie.

Of note, the yen broke through 100/dollar. As long as nothing crazy happens with regard to this morning's jobs report (meaning a shockingly weak report that implies no tapering) I'd add to short positions in the yen now that 100 has been "given" once again. The weaker yen remains one of the most fundamentally strong trades in the market, as ultimately the yen must go substantially lower if the Japanese economy is ever to start growing again.

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	*US equities have been consolidating recent gains and going through a typical correction. But, turmoil in emerging markets is threatening to be a potentially bearish game-changer. EM bonds haven't moved to new lows yet (which would be a signal to de-risk) but stocks will have a hard time rallying until the emerging markets stabilize.* *The S&P 500 support is now around 1620ish 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" and I'd use any decent dip to initiate or add to positions.

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. The Syrian conflict has resulted in WTI and Brent moving to multi-month highs, but I'd wait for a bit of a pull back as at this point any military strike will be a one off, as opposed to a greater intervention in the region.**

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 has traded to support at the 81.00 level, which should hold if the trend is still higher in the dollar. 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 on any decent bounce (YCS being the ETF to use), like we've seen now, especially in the face of weak GDP reports. Short the euro (EUO) on any further bounce due to the fact the ECB is squarely focused on economic growth, and won't let the currency appreciate too much as that would cause a stagnation in exports.**

Treasuries	Bearish	Bearish	Bearish	*The outlook for FOMC tapering is more cloudy after the recent FOMC meeting, but the bottom line is whether tapering occurs in Sept or Oct, as long as economic data stays good, tapering will occur, which is bearish bonds.*

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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