7:00's Report

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

September 9th, 2013

Pre 7:00 Look

- Futures drifting higher after a quiet night. Positive data from China over the weekend is supporting risk assets.
- Chinese econ data over the weekend was generally bullish. Export growth for August was stronger than expected, while CPI and PPI met expectations, implying the government will remain supportive of the economy.
- The Nikkei rallied more than 2% after Japanese 2Q GDP growth was revised higher and Tokyo was awarded the 2020 Olympics.
- Econ Today: No reports today.

Market	Level	Change	% Change
S&P 500 Futures	1658.00	4.50	.27%
U.S. Dollar (DXY)	82.12	-.047	-.06%
Gold	1386.70	0.30	.02%
WTI	110.07	-.46	-.42%
10 Year	2.938	-.041	-1.38%

Equities

Market Recap

The S&P 500 rallied 1.5% last week thanks to several pieces of strong economic data (excluding the jobs report), stabilization in emerging-market currencies, and the market defying any negative sentiment/positioning. The S&P 500 is up 16% year-to-date.

Three themes have been dominating trading for several weeks now (and continue to do so):

1. Emerging-market turmoil in reaction to rising bond yields.
2. Economic data and its effect on when and by how much the Fed will taper.
3. Geo-politics (Syria).

All three themes saw "positive" events last week, so it's not surprising stocks rallied.

First, emerging markets showed signs of stabilization last week, thanks primarily to U.S. Treasury yields slowing their run higher. But, confidence-instilling moves by the Reserve Bank of India and other emerging markets over the past two weeks have also helped calm nerves. The SENSEX and Bovespa (Brazilian stock market) rallied 3.5% and 7% respectively last week, and the currencies have held recent lows.

Second, economic data last week was strong. Although the jobs report left a bad taste in everyone's mouth, the good data last week (Purchasing Managers' Indexes, auto sales, jobless claims) should be enough to solidify a September announcement of QE tapering. At the same time, though, the data also ensured the taper will be very, very small. (Kansas City Fed President Esther George, a hawk, said she was in favor of a taper of no more than $15 billion, so we can consider that the high end of the range.)

Finally, last week the movement for military action against Syria continued to lose momentum, and speculation rose that President Obama might not get this

A Small Favor, Please

Starting next week, to ensure faster and consistent Report delivery, I'm making a change to how it is e-mailed each morning.

You likely won't notice the change and I don't anticipate any hiccups.

But, in preparation for it, please be sure to sign up to be able to download the Report off the website each morning, just in case there are any initial issues. Instructions can be found by clicking here.

Thank you.

Market	Level	Change	% Change
Dow	14922.50	-14.98	-.10%
TSX	12820.92	-24.1	-.19%
Brazil	5374.42	1397.56	2.67%
FTSE	6520.16	-27.17	-.41%
Nikkei	14205.23	344.42	2.48%
Hang Seng	22750.65	129.43	.57%
ASX	5181.47	36.48	.71%

Prices taken at previous day market close.

"Strike Syria" resolution through the House, although he doesn't need it to carry out the strikes. But, with support slim internationally and domestically, all signs point to any strike—if it happens—being very limited and an isolated event, which is positive from a market standpoint.

Market	Level	Change	% Change
Gold	1388.60	15.80	1.15%
Silver	23.865	0.61	2.62%
Copper	3.2585	0.0145	0.45%
WTI	110.48	2.11	1.95%
Brent	116.06	0.80	0.69%
Nat Gas	3.533	-0.042	-1.17%
Corn	468.25	7.25	1.57%
Wheat	647.75	7.50	1.17%
Soybean	1367.75	0.25	0.02%

Prices taken at previous day market close.

From a trading color perspective, the rise in Treasury yields last week and good economic data resulted in a big "out of safety, into cyclicals" sector rotation.

Industrials were the best-performing sector almost every day last week. Financials, transports (helped by airlines and rails as United Continental (UAL) recalled furloughed pilots, and crude-by-rail got a boost on concerns on a Keystone pipeline denial), consumer discretionary, tech and energy all outperformed.

Conversely, "bond proxy" sectors lagged badly last week, with utilities finishing the week negative while REITs, consumer staples and telecom badly lagged the broader markets.

On the charts the S&P 500 is sitting right below its 50-day moving average (1,661-ish) while initial support sits at the 1,630 August low. Volumes last week were elevated compared to the anemic August levels, but activity was still slow thanks to lots of caution in the market and the Rosh Hashanah holiday.

This Week

Syria will be center stage, as a vote is expected later this week after Obama addresses the nation on Tuesday. (A vote could come as early as Wednesday.)

In Europe, the Italian Senate begins discussing whether Silvio Berlusconi will be expelled from the Senate due to his fraud convictions. This matters because Berlusconi has threatened to pull his party's support for Prime Minister Enrico Letta's fragile government if he is expelled. This is Italian politics, so it'll be a wild ride. Most expect some sort of compromise to keep the government intact, although be ready for plenty of headline risk.

From a stock-specific standpoint, there are no real earnings although there are some sell-side conferences where we could see guidance updated. (Barclays' financials conference is probably the highlight.) Finally, Apple (AAPL) has a product event tomorrow. (Expect a new, cheap iPhone model; nothing revolutionary is expected.)

Bottom Line

Emerging markets remain key to any risk-asset rally, and their stabilization last week enabled the modest rally. But, even with emerging markets showing some signs of stabilization, domestically stocks seem stalemated.

On one hand, sentiment continues to be very skeptical. For weeks, the market has been dissecting and fretting about a series of potentially negative events in September: QE tapering, Ben Bernanke's successor, Syria, German elections, Italian politics, market valuation, etc. But, despite all the legitimate obstacles on the horizon, the S&P 500 sits just 2.7% below its all-time high.

I don't know how all those aforementioned events will work out, but I don't think they are the potentially negative "rally killing" events the market has assumed. But, even if I'm right and those events are resolved favorably, the question investors are wrestling with is: "How much upside from here is there in the U.S.?"

The S&P 500 isn't expensive, but at just under 14 times 2014 earnings of $120/share, it isn't cheap either. I think we saw this current market dilemma play out last week: The S&P 500 was up 1.5% but it lagged many other markets as "Europe" was up 3%, the Nikkei was up 3.5% and Shanghai was up 2%.

So, with a potential debt-ceiling fight looming in October, and the S&P 500 "rich" compared to international markets, I think Europe and basic materials (tied to the revival of global growth) remain the "value" play if you think (like I do) that we're seeing a return to global growth. So, I continue to think names like the iShares MSCI United Kingdom ETF (EWU), the iShares MSCI Ireland Capped ETF (EIRL), the iShares Dow Jones Basic Materials ETF (IYM) and the WisdomTree Japan Hedged Equity Fund (DXJ) offer greater upside between now and the end of the year vs. the SPDR S&P 500 ETF Trust (SPY) or some such. (I'd go with the PowerShares S&P 500 High-Beta Portfolio (SPHB) or something similar on a continued outperformance of cyclicals domestically if I were constricted to the U.S.)

Economics

Last Week

In almost an exact repeat of the first week of August's data, almost every economic report last week pointed to an economy gaining steam, except the monthly jobs report.

The Institute for Supply Management's manufacturing and non-manufacturing PMIs surged higher, with the non-manufacturing rising to the highest levels since '05. Additionally, the details of both PMIs were as strong as the headline numbers. New orders (the leading indicator in both reports) rose sharply, and most sub-components pointed to increased activity. The PMIs last week strongly imply the domestic economy is continuing to grow, and that the pace of this growth may be accelerating.

Auto sales were also strong last week, both in aggregate (total motor vehicle sales) and on a company-specific level. As I said in the Report last week, despite the tech industry hogging most of the headlines, the U.S. is an autos- and housing-driven economy, and it's pretty difficult for the economy to be slowing when sales of both are rising (as they are now).

But, once again a disappointing jobs report left a bad taste, economically speaking, in everyone's mouth.

To spend a few seconds on the newest jobs data—it certainly was an underwhelming report, but as always, the monthly jobs report should be taken with a grain of salt.

First, even on its best day, this report is subject to massive revisions. Second, it's also subject to crazy one-offs. For instance, the big downward revision to the July jobs report came almost entirely because of more temporary layoffs from car manufacturers than expected due to scheduled maintenance on plants. Those job "losses" were job "gains" in August. Second, and I'm not making this up, a work stoppage in the porn industry centered around an AIDS case could have skewed the data. (You can read the Washington Post story here.)

The internals of the report were actually "OK." Average workweeks moved up 0.1 hour and hourly earnings moved up 0.05 (both are leading indicators of employment growth). The U-6 unemployment rate—which is the one we should all watch because it includes underemployed workers and is a better measure of the labor market than typical unemployment—declined to 13.7% from 14.0 in July.

Bottom line is the data from last week, when taken in aggregate, showed the domestic economy is definitely continuing the trend of slow growth, and potentially seeing some marginal growth acceleration. And, jobs report aside, the data further cemented the market's expectation for a $10 billion-ish QE tapering announcement at the September Fed meeting.

This Week

Things should slow considerably from an economics standpoint this week. Retail sales on Friday is the highlight, as there are concerns the U.S. consumer is slowing down, given less-than-stellar June and July retail sales reports, and a slew of retail stocks missing earnings or issuing lower guidance (WMT, TGT, AEO and ANF, to name a few).

While the rebound in the manufacturing sector is good to see, the consumer still carries the U.S. economy. If data shows the consumer is materially pulling back (the data hasn't shown that yet, but that's the concern), then that will dampen the outlook for equities going forward.

Market	Level	Change	% Change
Dollar Index	82.195	-.473	-0.57%
Euro	1.3179	.59	0.45%
Pound	1.5629	.0039	0.25%
Yen	.010073	.000086	0.86%
CAD $	.9614	.0095	1.00%
AUD $	.9184	.0069	0.76%
Brazilian Real	.42715	.00465	1.10%
10 Year Yield	2.938	-.041	-1.38%
30 Year Yield	3.873	-.005	-.13%
Prices taken at previous day market close.			

Jobless claims Thursday is the second-most-important number, and after the disappointing August jobs report, markets will want to see claims continue to fall and make new lows for the recovery. If claims can continue to fall, that will help ease some of the anxiety the monthly jobs report caused.

Really everyone's focus should be on the Chinese economic data this week, as we have already gotten the August trade balance (which was positive), the Consumer Price Index and the Producer Price Index.

Chinese industrial production and retail sales come very early tomorrow morning, and obviously if the data can confirm the manufacturing PMIs and continue to show a continued stabilization in the Chinese economy, that will help commodities and basic materials stocks continue their outperformance vs. domestic equities. (Expect European equities to peripherally benefit as well.)

China growing at minimum 7.5% this year is essential to the "return of global growth" investment thesis. If these numbers are good, we could see that trend accelerate.

Bottom line is, outside of China, this is a slow week. Expect further digestion of last week's numbers and lots of conversation about when and how the Fed will taper QE, as well as whether Larry Summers will be Bernanke's replacement. But, don't expect any of the data this week to change the market's expectations of a September taper. Unless the retail sales data are just awful (and I doubt even that would be enough to change Fed expectations, but people will speculate), a "small" taper looks like it's on the very near horizon.

Commodities, Currencies & Bonds

The big story in bonds last week was that yields on the ten year hit 3% o/n Thursday, accelerating higher as a result of the good economic data and anticipated tapering of QE. The disappointing jobs report Friday saw yield trade back down to low 2.90% range, though, as bonds had "priced in" a better jobs report.

While I'm still a big bond bear medium and longer term, I can't help but think we are close to exhaustion for this latest stage of the bond market selloff. Yields have moved higher over the past month because of the expectation of Fed tapering in September and because Larry Summer's is the favorite to become Fed Chairman. With both those events expected to occur in September, I'm having a hard time seeing what takes bonds materially lower from here over the next month or so (so a sell the rumor, but the news reaction). Perhaps I'm wrong, but I still think that the 2.90% - 3.00% range in the 10 year yield will serve as a near term top, but I'd use any material bounce in bonds over the coming weeks to get more short for longer term accounts.

Given the economic data and Fed tapering expectations, the dollar was strong last week, trading to a one month high. The euro fell on "dovish" comments by Mario Draghi at the ECB press conference, and appears to have traced out a "double top" at that 1.34 area. Turning to Asia, the yen was lower last week despite a big rally last Friday (thanks to dollar weakness off the jobs number), but more importantly the yen broke support and traded through 100 yen/dollar before Friday's bounce. I think we are seeing a resumption of yen weakness after a 3 month counter trend rally, as ultimately the Abe/Kuroda team needs to engineer a much lower yen to create the type of economic growth they've promised. I think you can sell yen/buy YCS off Friday's bounce and would be shocked if 100 yen/dollar holds for very long.

Commodities in aggregate were flat last week, as DBC was unchanged. But, that flat aggregate result was due to strength in industrial commodities offsetting weakness in precious metals and grains, due to the stronger dollar. Commodities (both industrial and precious) have soundly outperformed stocks since August, but appear to be consolidating their breakout now. But, the fundamentals of a revival in global economic growth appear to be accelerating, so allocating to commodities on this dip makes sense to me via the ETF DBC, as I think we haven't seen the end of the rally. But, the stronger U.S. dollar remains a potential headwind, so from a risk management standpoint, a break of the $26.20 in DBC level would tell me this recent weakness in commodities isn't a consolidation and perhaps something more. Bottom line is commodities remain a "value" if the global economy continues to rebound.

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	*US equities have been consolidating recent gains and going through a typical correction. Emerging market turmoil has acted as a headwind, but stabilization last week in EM's helped stocks rally. But, for now, markets appear stalemated ahead of a mid-September FOMC meeting where tapering will be announced.* *The S&P 500 support is now around 1630ish 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 bounced off support over the past few weeks and is now at a one month high. 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 (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 due 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.**

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.**