7:00's Report

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

October 15th, 2013

Pre 7:00 Look

- Futures flat but most foreign markets moderately higher as expectations rise for a deal to be announced in Washington as early as today.
- Economically it was quiet o/n: German ZEW Business expectations survey beat estimates. Fed Speak: Dudley (10:00 AM), Williams (11:10 AM), Fisher (7:15 PM).
- Econ Today: Empire State Manufacturing Survey (E: 7.00).
- Earnings: C (E: $1.04), KO (E: $0.53), JNJ (E: $1.31), JBHT (E: $0.78), CSX (E: $0.42), INTC (E: $0.54), YHOO (E: $0.33).

Market	Level	Change	% Change
S&P 500 Futures	1705.75	1.50	.09%
U.S. Dollar (DXY)	80.70	.389	.48%
Gold	1257.40	-19.20	-1.50%
WTI	101.88	-.53	-.52%
10 Year	2.691	-.009	-.34%

Equities

Market Recap

Stocks started the week by continuing their rally on the expectation of an impending deal in Washington. The S&P 500 rose 0.41% and is now up nearly 4% from last Tuesday's close.

Expectations of a deal and events in Washington were the sole drivers of the equity market Monday. Stocks opened down modestly on disappointment that there was no deal over the weekend. But news that a potential deal would come from the Senate helped sentiment stay optimistic. (The Senate has found a solution to the last several fiscal crises.)

Global mining companies like RIO and BHP have lagged the market badly this year, but perhaps offer some value as the global economic rebound continues.

Headlines containing the adjectives "optimistic" and "hopeful" and adverbs like "very close" continued to hit the wires throughout the late morning and early afternoon, pushing stocks positive. A meeting scheduled at the White House between President Obama and congressional leaders was postponed, which was taken as a positive sign that meant they were close to a deal. This helped stocks go out at the highs of the day, as investors remain fearful of missing a "resolution rally."

Trading Color

Given the headline trading, it's tough to read too much into yesterday's sector trading. But, clearly "cyclicals" outperformed safety, and we saw a big bounce-back in the "momentum" stocks that have been beaten down during the past two weeks. Tech, consumer discretionary, energy and financials led the way higher, while utilities and telecom lagged. Healthcare outperformed on prospects that the medical-device tax would be post-

Market	Level	Change	% Change
Dow	15301.26	6.94	.41%
TSX	12892.11	-2.30	-.02%
Brazil	54170.60	1020.98	1.92%
FTSE	6560.97	53.26	.82%
Nikkei	14441.54	36.80	.26%
Hang Seng	23336.52	118.20	.51%
ASX	5259.15	51.29	.98%

Prices taken at previous day market close.

poned for two years as part of any deal.

Of note, while the S&P 500 is still several percentage points away from new all-time highs, the Russell 2000 made a new all-time high yesterday. The major takeaway is that investors, again fearful of missing a "resolution rally," are pushing into cyclical names to get long exposure.

Market	Level	Change	% Change
Gold	1277.20	9.00	0.71%
Silver	21.375	.116	0.55%
Copper	3.3025	.0335	1.02%
WTI	102.36	.34	0.33%
Brent	111.05	-.23	-0.21%
Nat Gas	3.816	.04	1.06%
Corn	437.00	3.75	0.87%
Wheat	692.50	.25	0.04%
Soybean	1273.00	6.25	0.49%
Prices taken at previous day market close.			

But, it is also worth noting that buying yesterday didn't have a lot of high conviction. Fast-money funds are still the main drivers of intraday trading, as "real money" remains on the sidelines. But, just like in late September/early October, markets fell because of a "buyers' strike," and yesterday the market rose more because of a total lack of selling pressure, as no one wants to step in front of this market at the moment. So, point being, the fast-money funds and algos are still controlling this market while everyone else awaits a deal.

Volumes weren't heavy yesterday (and well off last week's levels) while on the charts the S&P 500 is clearly through 1,700, and the old high near 1,729 is now resistance.

Bottom Line

A deal is now "priced in" to the market, so on some announcement I wouldn't be surprised to see stocks actually "sell the news" and then look for buyers to step in at lower levels. But, that's just a guess.

Bottom line is nothing changed—everyone always expected a deal; it looks like we'll get a deal, and hopefully it extends the debt ceiling into at least early '14, where we get to play this game all over again. (But at least it give us clarity into year-end.) Regardless, though, I don't see what's out there to get the S&P 500 up materially from current levels, and would think 1,750-ish remains about the best we can hope for into year-end. I continue to favor Europe to outperform into year-end.

A Leveraged "Value" Play on the Global Recovery

The strong Chinese import data released over the weekend (which was largely overshadowed by the soft data and missed by much of the financial media), furthers the bullish case for industrial commodities/basic materials.

Since mid-July I've been a cautious bull on global basic materials companies and industrial commodities. This investment thesis is based largely on the idea of a slow but steady "global reflation." It's not that I think we're going to see another rip-roaring commodity market. But based on relative value, a lot of the global basic materials companies seemed cheap, if we are indeed entering a period of global economic growth.

Well, the Chinese data over the weekend furthered that case. Commodity imports for the month of September were much stronger than expected, with copper imports up 7.2%, iron ore imports up 2.4%, aluminum imports up 27.8% and steel imports up 1.1%—all significant improvements from August.

Somewhat serendipitously, the WSJ also came out with an article highlighting the improved demand for industrial metals from Europe, as that region's economy recovers. The article outlined a 1.3% year-over-year increase in aluminum through the third quarter, and a 1% increase in copper demand for the same period. That compares to a 3.8% decline in demand for aluminum and 4% decline for copper last year. So, while the numbers aren't going gangbusters, it does reflect the turn for the positive in the EU economy.

There are a few ways to get exposure to this trend—and assuming we don't get some calamity out of Washington, this space should be able to further outperform. There are several ways to play this trend, and I've cited the iShares Russell 2000 Index (IWM) and the Market Vectors RVE Hard Assets Producers ETF (HAP) as two vehicles to get broad exposure to the basic materials sector.

But, one more targeted way to get exposure to this trend is via PICK, which is the iShares Global Metals and Mining Producers ETF. Since July, this ETF is up over 22%, versus 12% for HAP and 15% for IWM.

But, before you think you've missed the run, I need to point out that PICK is *down* more than 15% year-to-date, compared to the up-20% for the S&P 500! So, there is still a value argument to be made if you think the global recovery is going to continue.

The reason I point out PICK is because it's more focused on the global miners like BHP, RIO, FCX and others, while HAP and IWM have a lot of exposure to chemical companies and oil companies. So, consider PICK as a targeted way to play a continued global recovery.

Another beneficiary of this trend should be Australia. In the Sept. 10 issue, I pointed out the potential bullish turn in Australia, based on the fact that:

1) The Aussie dollar had collapsed to multi-year lows.
2) The RBA was remaining very, very accommodative.
3) The Chinese economy was stabilizing.
4) A "Pro-Business" government had just been elected, and they started by abolishing the carbon tax.

Since I pointed to the iShares MSCI Australia Index (EWA) in early September, the ETF has risen 3%. But, year-to-date it's badly lagging more major countries, and is up just 1.5% YTD. So, like PICK, if you think we're on the cusp of a global recovery (albeit a slow one) then there is some "value" in Oz.

The Chinese GDP data Thursday will be the next big data point for this trade, so pointing it out again now carries some risk. If GDP misses, then we'll see these names take a hit. But, short term aside, it does appear that the global recovery is ongoing, and being long PICK or EWA is a leveraged "value" play on that recovery, because there remains room to run if global growth continues to accelerate.

Economics

No reports yesterday.

Commodities

Commodities, like most risk assets, traded broadly higher yesterday. Natural gas and copper were the leaders, up approximately 1% apiece, while the PowerShares DB Commodity Index Tracking Fund (DBC) logged modest gains of 0.15%. The moves higher were primarily driven by the aforementioned strong Chinese commodity import data, and then peripherally by a slightly weaker US dollar and general optimism surrounding a deal in Washington.

Within the energy space, natural gas moved up to $3.855 primarily on technical trading. (The 50-day moving average turned up, showing a follow-through from buyers over the past six weeks or so.) The move put it above the $3.800 level I mentioned toward the end of last week, which continues to support the intermediate-term bullish case, although as always with natural gas, weather will be an important factor (and temperatures need to start dropping to support these price levels).

WTI Crude saw a nice reversal yesterday, as it started Monday testing support at $101.06, before turning around on general optimism from Washington, and closing not fat off the highs of the day, up .25%. But, trading noise aside, WTI crude remains in a $101-$105/Bbl range that, barring any catastrophes, will likely remain general support and resistance.

Two additional things to note in the oil markets: First, WTI Crude switched from backwardation to contango yesterday, as the November price is now lower than the December price. That's generally a bearish signal as it reflects reduced demand in the near term. Second, today is the resumption of the nuclear negotiations between Iran and the "P5 +1" (which is the 5 members of the UN Security Council and Germany). While nothing material is expected either way, its obviously something to watch (with small risks to the upside for WTI and Brent if there is no further progress).

Market	Level	Change	% Change
Dollar Index	80.350	-.102	0.13%
Euro	1.3572	.0015	0.11%
Pound	1.5983	.0031	0.19%
Yen	.010158	.000001	0.01%
CAD $	.9647	-.0007	-0.07%
AUD $	.9459	.0029	0.31%
Brazilian Real	.4545	.0007	.15%
10 Year Yield	2.691	.009	.39%
30 Year Yield	3.745	.01	.27%
Prices taken at previous day market close.			

Precious metals worked their way higher pre-market on dollar weakness before paring most of those gains over the course of trading yesterday to close up under 1%, and trading was totally dominated by Washington sentiment (the prospects of no deal over the weekend boosted gold, and things in Washington got more optimistic, gold sold off). But, this morning gold is through all recent levels of support (including last week's low of $1259) and a re-test of that $1200/oz. level is looking more and more likely.

As things slowly get figured out in Washington and the economy continues its recovery, as sluggish as it may be, demand is expected to increase for energy and raw materials while precious metals see a path of least resistance to the downside until inflation begins to rear its head.

Currencies & Bonds

The Dollar Index declined marginally yesterday in somewhat volatile trading. It started the day modestly lower thanks to no agreement on the debt ceiling over the weekend, but then steadily grinded higher throughout the day as positive headlines methodically trickled out of Washington. But, the Dollar Index gave up those gains and ended the day slightly in the red.

The movement in the dollar was the dominant force in the currency markets yesterday. The euro and pound rallied small vs. the dollar, mostly on dollar weakness. European Monetary Union Industrial Production did beat estimates, but most of the individual EU countries reported IP beats last week, so the EMU beat wasn't exactly surprising and was already largely priced in.

Looking at the yen, it finished virtually flat yesterday after giving up early modest gains. More and more I'm getting the feeling that the yen "wants" to resume its declines, if only Washington would stop being dysfunctional and engendering "risk off" rallies. I continue to advocate selling yen (via buying the ProShares UltraShort Yen ETF, or YCS) on any decent rally in the yen (like we saw yesterday morning), and buying dips on the WisdomTree Japan Hedged Equity Fund (DXJ).

If you assume, like I do, that Washington will avoid a calamity, then it's just a matter of time until the yen resumes its declines, and that's the way we want to be positioned in medium- and longer-term accounts.

The bond market was closed yesterday, although Treasury futures traded and actually saw decent declines. The 10-year Treasury note and 30-year bond declined 0.25% and 0.55% respectively in thin trading, ostensibly on a "risk on" bid in the markets. But, if anything, yesterday's dip was probably a short-term "buy." Treasuries never really rallied on the debt drama, and as such have little reason to sell off.

Keep in mind that, during the debt drama, expectations for Fed tapering have shifted to December at the earliest, with most expecting early '14 as the most-probable date. So, the Fed is incrementally more "dovish" than it was when this entire drama began.

I'm not going to buy Treasuries here because I've bought the lesson that when you are fundamentally bearish of something, like I am on Treasuries, then you can be very short, short or flat. But, for those with a trading ilk, I'd say there's probably a bounce in long bonds given yesterday's sharp, low-volume declines.

Have a good day,

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	*The S&P 500 rallied hard on news of a potential deal to end the week long government shutdown and extend the debt ceiling. While the news, if true, removes a potential "tail risk" event, further substantial upside in the S&P from 1700ish is tough to see, although the benefit of the doubt remains with the bulls.* *The S&P 500 support again sits at the 50 day MA (1679), while 1700 is resistance.*

Trade Ideas

Long International (Europe & Japan): **International markets continue to remain attractive vs. the US based on improving economic data, and looming political and monetary clouds in Washington. I like EWU (UK ETF) or EIRL (Ireland ETF) specifically. The "Long Japan" trade is under pressure thanks to a rising yen (which is a result of the debt ceiling drama) but long Japan remains one of the more fundamentally based trades in the market. DXJ remains the way to play it and I'd buy this dip for medium/longer term accounts.**

Long Deep, multi-national Cyclicals: **Domestically, I'd look to allocate to deep cyclicals like industrials (XLI) and basic materials (IYM), as Washington drama aside, they should benefit from continued Fed stimulus.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Commodities	Bullish	Neutral	Neutral	*Commodities are at the mercy of Washington, like every other risk asset. Most commodities haven't benefitted from the weaker dollar because of Washington drama, but looking beyond the short term, all major global central banks will be accommodative well into the future, and that should lead to am acceleration of global economic growth, which should be a tailwind for commodities.*

Trade Ideas

Long Industrial Commodities: **If we are seeing a return of global economic growth, then industrial commodities (Oil, Copper, Refined Products, Base Metals) should out perform over the coming quarters. In the short term debt ceiling drama and concerns of growth weigh, but if you believe the global economy Is recovering, the commodity space, and the ETF DBC, is one of the best "values" in the market, and a pretty contrarian idea right now.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index bounced back above 80 on hopes of a resolution to Washington fiscal drama, but expectations for the Fed continue to get more dovish, and any upside in DXY is likely capped in the near term.*

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	*Treasuries have been treading water since the Washington fiscal drama started, although it appears, with Fed tapering shifting to next year, that the counter trend rally in bonds isn't done yet. The longer term trend remains lower for bonds, but assuming a debt ceiling extension, there's more room to the upside in the short term.*

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.**