7:00's Report

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

October 23rd, 2013

Pre 7:00 Look

- Futures are modestly lower this morning as the market takes a breather. Soft earnings in Europe and a jump in short term lending rates in China are the reasons for the weakness. Focus today will be on earnings.
- Economically it was quiet o/n, although a big jump in China's 7 day repo rate is causing some concern, as it's reminding everyone of the credit squeeze earlier this year.
- Econ Today: No Reports Today.
- Earnings Today: BA (E: $1.54), T (E: $0.65), CAT (E: $1.00), LLY (E: $1.05), GD (E: $1.68).

Market	Level	Change	% Change
S&P 500 Futures	1738.75	-10.75	-.61%
U.S. Dollar (DXY)	79.39	.10	.13%
Gold	1333.00	-9.60	-.72%
WTI	97.80	-1.42	-1.43%
10 Year	2.512	-.097	-3.72%

Equities

Market Recap

The S&P 500 hit another record level Tuesday, as stocks disregarded the largely disappointing September jobs report and instead focused on "good" earnings. The S&P 500 rose .57%. Yesterday's rally puts the SPX 6.7% above the recent lows from the government shutdown and debt-ceiling debacle.

The major "macro" focus of the day was the unimpressive employment number, and the "dovish" market reaction of stocks modestly higher, and the dollar and bonds

NFLX: That has got to be the biggest bearish "outside reversal" I've ever seen, in any asset, period.

sharply lower, was based on the belief that the Fed will look to continue asset purchases (QE) well into early 2014. Additionally, early morning earnings yesterday were generally "ok" (as has been the trend).

Stocks opened strong yesterday off the soft jobs number (again on continued expectation of QE) and hit their highs shortly after the open. The remainder of the day was relatively quiet, and stocks drifted for most of the afternoon, as there was little additional news besides earnings and the jobs report yesterday. Stocks closed marginally higher but well off their best levels of the day in quiet trading.

Trading color

All of the major indexes were higher yesterday, led by the S&P 500. However, both the Russell 2000 and the Nasdaq failed to hold their morning highs and finished the day up just 0.28% and 0.24%, respectively, imply we may be seeing a bit of short term exhaustion in stocks (which is to be expected). In addition, Treasury yields are falling and the curve is flattening while momentum stocks are losing steam— again all indications we may be due for (at the very least) a consolidation at these levels.

Market	Level	Change	% Change
Dow	15467.66	75.46	.49%
TSX	13248.06	61.53	.47%
Brazil	56460.38	382.95	.68%
FTSE	6664.24	-31.42	-.47%
Nikkei	14426.05	-278.20	-1.95%
Hang Seng	22999.95	-316.04	-1.36%
ASX	5356.10	-17.05	-.32%
Prices taken at previous day market close.			

Having said that, for now the "pain trade" remains higher as investors continue to chase performance into year end..

Market	Level	Change	% Change
Gold	1340.20	24.40	1.85%
Silver	22.765	.487	2.19%
Copper	3.3385	0.35	1.06%
WTI	98.43	-1.25	-1.25%
Brent	110.08	.44	0.40%
Nat Gas	3.589	-.079	-2.15%
Corn	438.25	-5.75	-1.29%
Wheat	700.75	1.00	0.14%
Soybean	1302.25	-1.00	-0.08%
Prices taken at previous day market close.			

Looking at the sector trading yesterday, there are a few themes that are worth point out. First, Tech stocks largely underperformed yesterday led by Netflix (NFLX), which put in what has to be the biggest "outside reversal" I've ever seen after opening much higher on good earnings, and then crashing lower after the CEO basically implied the stock is at unsustainable levels! Traders followed through with the selling and the stock closed down 9% with a price range of more than $67 between the high and low, about 20% of the stock's closing value.

The jobs report, or should I say the reaction to the jobs report in the bond and currency markets, was another major theme yesterday in sector trading. The plunge in interest rates, resulted in rate-sensitive sectors like utilities, homebuilders and consumer staples leading markets higher, as each rallied more than 1%. And, more generally we did see a small outperformance of "safety vs. cyclicals" as tech, financials and energy largely lagged (and that makes sense given the soft jobs report).

The one outlier from the cyclical underperformance was the basic materials sector, which rallied thanks to the sharply lower US Dollar. Commodity-linked stocks moved higher including Alcoa (AA), Century Aluminum (CENX), Alpha Natural Resources (ANR) and Freeport-McMoRan (FCX), which was responsible for helping the broader equity markets close in the green. The weaker dollar was the main positive catalyst for the materials space.

On the charts the situation hasn't changed much—light support sits at 1729 in the S&P 500 while resistance is the all time highs (1759).

Economics

Employment Situation

- Non-Farm Payrolls 148K vs. (E) 185K.
- Unemployment Rate was 7.2% vs. (E) 7.3%.
- U-6 Unemployment Rate declined to 13.6% from 13.7% in August.

Takeaway

The September jobs report was a disappointment, and at less than 150K it met my "Ugly" scenario mentioned in Monday's report. And, as expected, the market traded "dovishly" in response, with the Dollar Index falling sharply, and gold and bonds rallying on the news.

There were strong positive revisions to the August data (up 24K to 193K) but they were largely offset by negative revisions to July, making the net jobs additions a meager 9K.

In addition, the details of the report were also lackluster. The average hourly workweek was unchanged from August at 34.5 hours. (An increasing workweek is a leading indicator of the labor market, as employers work current employees more before hiring additional workers.) The U-6 unemployment rate (which is the one we should all follow because it includes the under-employed) ticked down marginally, but remains elevated at 13.6%.

Bottom line is this report further confirms the stagnation we saw all summer in the labor market. Given the Washington drama of early October, it's not likely that we'll see any material improvement in the jobs reports in October or November.

This report doesn't imply a material slowing in the labor market (rather, it's mostly status quo). But from a WWFD (What will the Fed do?) standpoint, this makes the case for a further delay of QE tapering, as clearly the jobs market has lost a bit of the positive momentum we saw back in May.

Commodities

Commodities were mixed yesterday after the release of a relatively poor September employment situation. The benchmark PowerShares DB Commodity Index Tracking Fund (DBC) was down 0.23%

Energy vastly underperformed in the commodity space yesterday, led down by natural gas, which was off by more than 2%. Natural gas traded to a two-week low in response to warmer weather forecasts and a supply build of 77 BTUs, regardless of the fact that expectations were for 80 BTUs. (A build is a build when warm weather is on the way.)

Other fuels also lost ground, with heating oil down 0.42% and RBOB gasoline down 1.35%. The weakness in products was a direct result of crude oil prices trading comfortably below the $100/Bbl level—reaching a low of the day and closing near $98/Bbl.

Most traders are attributing the loss to the weak employment data released yesterday morning combined with the bearish supply build that was released Monday morning. (Note that EIA data releases will resume their normal schedule starting today.) Brent crude, on the other hand, traded higher yesterday—widening the spread between it and its U.S. counterpart, WTI. This raises some concerns regarding the economic outlook and where demand will be in the coming months as jobs data continues to be weaker than anticipated.

Gold, pushed higher thanks to the collapsing dollar traded up through resistance at the $1,330 level and closed at $1,342.50. While technically a break out, I remain skeptical and experience has taught me to look for a few closes above $1,330 this week, before declaring the uptrend is back on.

Bottom line is most commodities are trading in response to a weaker dollar—with the exception of energy, which is turning out to be a rather ugly breakdown, and it's unclear if were seeing weakness because of rising supply, or is the decline represents fears of a slowing U.S. economy.

Market	Level	Change	% Change
Dollar Index	79.28	-.471	-0.59%
Euro	1.3784	.01194	0.87%
Pound	1.6236	.01154	0.72%
Yen	98.11	-.2075	-0.21%
CAD $	1.0285	-.002095	-0.20%
AUD $	.9708	.00621	0.64%
Brazilian Real			%
10 Year Yield			%
30 Year Yield			%

Prices taken at previous day market close.

Currencies & Bonds

Currency and bond markets traded "dovishly" Tuesday after the disappointing jobs report, as expectations for tapering of QE continue to get pushed further into 2014 with some analysts expecting the Fed to wait as long as the second quarter of the new year. Tapering expectations remain the main driver of the global currency and bond markets.

The Dollar Index dropped to fresh eight-month lows yesterday after the soft jobs report created a "dovish" response in currencies and bonds. The dollar fell 0.58% and was universally weaker against other major currencies. Dollar weakness remained the driving force in the currency markets yesterday, as all other currencies were simply higher by default (meaning, there wasn't much bullish news internationally). Currency markets remain totally dollar-dominated for the time being.

The euro smashed through 1.37—rallying 0.87% and trading to new highs for the year to levels not seen since November 2011. The pound rose a slightly more modest 0.72% and is now close to the highs of the year, while the Aussie dollar rallied 0.05% to six-month highs.

The one real "laggard" yesterday was the yen, which only rose a mere 0.10%, as the fundamental picture remains weak. And, you get the feeling that, if the dollar could simply stabilize on the global currency markets, the yen would resume its decline. But, that won't happen until the dollar can stop falling seemingly every day. (But, it ultimately will happen, which is why I continue to advocate selling yen on rallies.)

Looking at bonds, Treasuries rallied hard on the "dovish" jobs report, rallying nearly 1% and trading to three-month highs. The 10-year yield traded all the way down to 2.50%, the bottom of the range. As I've been saying, I think this counter-trend rally in bonds has more room, and would remain patient and look to get short at higher levels. The move higher isn't over yet.

How Low Can the Dollar Go?

The most-important question now in the currency markets is, "When will the dollar stop declining?" Right now I'd point to the 79.00-ish level.

First, there's support on the charts (it's the low for the year).

Second, although I didn't appreciate just how much the dollar would decline over the past few weeks (I thought 79.50 would be decent support), at some point other countries are not going to appreciate their currencies trading to multi-month and multi-year highs. That's especially true in the EU and Japan, where it'll certainly crimp exports and be a headwind on the economic recovery.

Dollar Index: The DXY has gotten hammered by delayed expectations of tapering of QE. Support at 79 needs to hold, otherwise the decline will accelerate substantially.

So, I'd expect some sort of "dovish" response either through rhetoric or policies sooner or later, if the dollar continues to fall.

Third, I've got to think, at these levels, the dollar has priced in a March-June tapering of QE. So the risk, I think, would be to the upside on any sort of uptick in the data.

Bottom line, I certainly wouldn't be selling dollars here at the moment, as we're due for a bounce. But, even if the economic data remains lackluster, I've got to think we're about as low as we're going to go, for now, anyway.

Thinking about "who wins" from the dollar declines, obviously the euro has been the big beneficiary. But, for reasons mentioned earlier, I'm not sure that can last much longer. Instead, I'll continue to point to emerging markets, as the weaker dollar and falling interest rates benefit the resumption of the "emerging markets" carry trade that unwound so painfully earlier this summer. (Traders are inherently greedy, and have short memories, and there's nothing wrong with getting in position to profit from it.)

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 traded to new all time highs last week on resolution in Washington and a "clear" macro horizon. While valuations are elevated, cautious sentiment remains one of the bigger drivers of stocks, and until sentiment becomes much more enthusiastic, the path of least resistance for stocks remains higher.* *The S&P 500 support again sits at the old highs of 1729 while there is no real resistance on the charts.*

Trade Ideas

Long Europe: **Although Washington drama is resolved, I continue to favor international exposure as "Europe" is seeing economic stabilization and a return of growth, and remains a better value than the US, and I like VGK (Europe ETF), EWU (UK ETF) or EIRL (Ireland ETF), and, for the gambling ilk, GREK (Greece ETF) and EWI (Italy ETF).The**

Long Japan: **The "Long Japan" trade has stalled a bit thanks to a rising yen (which was 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 and Global Miners: **Domestically, I'd look to allocate to deep cyclicals like industrials (XLI), basic materials (IYM) and global industrial miners (PICK). Those sectors are most exposed to the "global economic recovery" thesis.**

Commodities	Bullish	Neutral	Neutral	*With Washington drama removed from the markets, commodities hopefully can resume the rally based on the global "economic recovery. Commodities remain on of the few asset classes where you can make a "value" argument.*

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 concerns of growth thanks to the debt ceiling drama 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.**

U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar will now once again trade off Fed expectations and economic data, and with tapering expectations being pushed out to early next year, there is little reason to expect a rally in the Dollar Index.*

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 further upside as Fed tapering has likely been delayed until early '14.**

Treasuries	Neutral	Bearish	Bearish	*Bond will likely resume their counter trend rally given that Washington is out of the headlines, as Fed tapering looks to be pushed out to next year. But, remember this rally is just one enormous shorting opportunity.*

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.**