7:00's Report

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

October 25th, 2013

Pre 7:00 Look

- Futures and most international markets, ex Japan, are flat this morning after a relatively quiet night.
- Japan was the big laggard o/n, as the Nikkei fell 2.7% thanks to weak earnings, peripheral worries about rising Chinese short term money rates and a stronger yen.
- Economically, data was mildly disappointing: German IFO Business sentiment slightly missed expectations, while EMU money growth was a touch slower than expected.
- Econ Today: Durable Goods Orders (E: 2.5%).
- Earnings Today: NOV (E: $1.32), PG (E: $1.05), UPS (E: $1.16).

Market	Level	Change	% Change
S&P 500 Futures	1746.75	-1.75	-.10%
U.S. Dollar (DXY)	79.30	.055	.07%
Gold	1341.60	-8.70	-.65%
WTI	97.49	.36	.37%
10 Year	2.522	.037	1.49%

Equities

Market Recap

Stocks rallied modestly Thursday thanks mainly to decent earnings announcements, as the market shrugged off two weak economic reports. The S&P 500 rallied 0.33%.

Stocks opened slightly stronger yesterday as the flash manufacturing Purchasing Managers' Index miss offset more good earnings from Europe overnight. After opening basically flat, the broader averages spent the majority of the morning and early afternoon grinding steadily higher. But the market was much more "micro"-focused yesterday, and the broader rally was really just the amalgamation of several different positive earnings releases, rather than some overarching macro event causing investors to buy stocks.

Activity slowed materially during the afternoon as there were no earnings releases of note, and stocks gave back some ground later in the afternoon in quiet trading, but closed solidly positive.

Trading Color

Given the huge amount of earnings releases yesterday, sector trading was driven primarily by individual results, as you'd expect.

Winners yesterday started with consumer discretionary, which was the best-performing sector in the S$P 500, as hotels rallied off Starwood Hotels' (HOT) strong print. Industrials also performed well yesterday, as did transports. U.S. Airways (LCC) was upgraded by Deutsche Bank, and Southwest (LUV) beat earnings, which benefited the entire airline space.

Yesterday's losers included the financials, which were weighed down by the asset managers, thanks to T. Rowe Price's (TROW) miss. Consumer staples also lagged, with Altria's (MO) earnings miss the main negative catalyst (the stock was down 1% yesterday).

Looking at earnings season more broadly, the results have stayed pretty consistent this week despite the huge volume of reports. Of the 211 S&P 500 companies that have reported, 76% have beaten earnings estimates (which is in-line with the average), but only 50% have beaten on revenues (so top line growth remains a concern, and revenue "beats" this earnings season remain well off their average of 61%). Basic materials and financials continue to provide the biggest upside vs. estimates

Market	Level	Change	% Change
Dow	15518.23	104.90	.68%
TSX	13324.76	81.44	.61%
Brazil	54877.15	-562.88	-1.02%
FTSE	6708.98	-4.21	-.06%
Nikkei	14088.19	-398.22	-2.75%
Hang Seng	22698.34	-.60%	-137.48
ASX	5368.35	13.46	.25%

Prices taken at previous day market close.

(which more reflects the negative sentiment towards those sectors coming into earnings, rather than "blow out" results by basic materials and financials companies).

Market	Level	Change	% Change
Gold	1345.70	11.70	0.88%
Silver	22.73	.113	0.50%
Copper	3.269	.0015	0.05%
WTI	97.05	0.19	0.20%
Brent	106.92	-.88	-0.82%
Nat Gas	3.642	.023	0.64%
Corn	440.25	-2.50	-0.56%
Wheat	696.50	-5.25	-0.75%
Soybean	1309.75	-.25	-0.02%
Prices taken at previous day market close.			

Volumes were heavy yesterday, but again that was mostly because of the number of earnings, not because of increased overall activity in the market. On the charts, the S&P 500 continues to see support at 1,729 while resistance is the all-time high of 1,759.

Bottom Line

Stocks are doing little more than consolidating at the moment, as there doesn't seem to be much conviction on either side at the moment (bulls don't want to chase stocks higher, and no one wants to short this market). Overall, earnings seasons continues to be "ok" and analysts will bemoan the lack of earnings growth, but that's been a problem for 2+ years and the S&P hasn't really minded. I'm not saying that won't be a problem at some point, but right now it's not going to kill this rally.

The Gold Miners have been a value "trap" all year and ultimately are at the mercy of gold prices. But, with tapering of QE being delayed, perhaps there's finally some reason to be cautiously bullish.

As far as earnings season, the real takeaway is that most analysts estimates for S&P 500 earnings remain unchanged (so $110 for '13 earnings, $120-$123 for '14), and given we're at about 14.5 times the '14 number, the case can be made for multiple expansion going forward, as long as the economic data doesn't turn very bad (and we'll have to wait till December for "Clean" data anyway).

Bottom line is despite all this, sentiment remains skeptical and the path of least resistance higher, although I'd not be surprised to see a bit more of a consolidation at these levels. And, I continue to prefer Europe, Australia, and global miners as the best way to get "long" the global recovery.

Gold is Breaking Out, But Is It a Buy?

As far as what to do here, you can make the case that some risk capital allocated to gold makes sense … although it's important to understand its high risk.

The Fed tapering in October is nearly impossible, and there is little chance the economic data over the coming weeks will be positive (it'll be negatively skewed by the government shutdown). So, there shouldn't be a ton of positive catalysts for the Dollar Index to rally, which should be supportive of gold.

For those who are willing to take the chance, I think a long position with a stop at $1,320 is worth the risk, as we're looking at about $70 in upside for about $25 in risk, or a 3-to-1 risk/reward ratio.

The more-interesting play on gold may be, dare I say it, the miners. HSBC this week upgraded the miners, and Goldcorp (GG) reported pretty good numbers yesterday (earnings beat at 23 cents/share vs. (E) 20 cents/share). The company tightened its production guidance for this year (at the upper end of the range of 2.6 million to 2.7 million ounces) and updated guidance for 2014 of 3.2 million to 3.5 million ounces.

Obviously it's just one company, and all you have to do is look at a chart of the Market Vectors Gold Miners ETF (GDX) to see the "value" proposition in the miners.

But, *if* we are embarking on a period of higher gold prices, *then* initial results from some miners imply they are actually acting like decent companies. And, as such, they *may* benefit from a rebound in gold prices.

It's a contrarian call and certainly not for the faint of heart, but I am noticing a small undercurrent of cautiously optimistic sentiment surrounding the miners, and I wanted to point it out.

Economics

There were two normally important economic releases yesterday, and both signaled slowing growth in the economy. But, due to the government shutdown and other factors, both pieces of data were largely ignored due to concerns about their accuracy.

Jobless Claims

- Weekly Claims down slightly to 350K
- 4-Week Moving Average ticks up to 348.25K

Takeaway

Weekly jobless claims were higher than expected last week at 350K vs. 335K (estimate). This data came in modestly lower than last week's number that was revised up to 362K from 358K. The revision to last week, along with this week's claims number, drew the four-week moving average up to 348.25K, which is the highest level since mid-July.

While the jobless claims numbers keep ticking higher, the data was again largely ignored by the Street yesterday as concerns with the accuracy of the report (because of the government shutdown and computer problems in California) are still lingering.

Inaccurate claims data aside, it's clear from this week's September jobs report that the labor market is stuck in neutral, with the economy adding between 150K-200K jobs per month. And, that simply isn't enough to result in the Fed tapering QE, at least not within the context of more fiscal battles on the horizon.

Flash Manufacturing PMI

- October Flash Manufacturing PMI 51.1 vs. (E) 52.7.
- New Orders declined to 51.6 vs. 53.2 in September.

Takeaway

The October "Flash" PMI was a pretty ugly number, dropping to 51.1 from 52.8 in September, and the details of the report were soft as well.

New orders, the leading indicator in the report, declined to 51.6, the lowest reading since April, and Output fell into contraction territory (below the 50 level) for the first time in four years! So, clearly this flash PMI reading implies we're seeing a slowing in the pace of growth in the manufacturing sector of the economy.

But, the weak reading was largely disregarded by the markets (aside from futures dipping temporarily) and rightly so, as the data needs to be taken with a large grain of salt because the survey was conducted during the government shutdown.

And, while it's impossible to tell how much of the disappointing reading is attributable to temporary caution regarding the shutdown and debt ceiling (the answer is probably a fair amount), I'm not crazy about the fact that new orders dipped to nearly six-month lows. The reason I say that is because the weakness in the report was expected to be temporary; new orders shouldn't really be affected.

Bottom line is this was a disappointing reading, but for now it's being disregarded because of the shutdown. And, as such, it isn't being extrapolated out to infer a material slowdown in the manufacturing sector. But, with regard to WWFD (What will the Fed do), it certainly won't "Pull Forward" the date of the first tapering of QE (which is now either January or March).

Commodities

Market	Level	Change	% Change
Dollar Index	79.250	-0.79	-0.10%
Euro	1.3801	.00117	0.09%
Pound	1.6202	.000665	0.04%
Yen	.010280	.000002	0.02%
CAD $	.9580	-.0029	-0.30%
AUD $	.9618	-.003085	-0.32%
Brazilian Real	.4499	-.0038	-.84%
10 Year Yield	2.522	.037	1.49%
30 Year Yield	3.613	.031	.87%
Prices taken at previous day market close.			

Commodities were mixed Thursday and flat in aggregate, with the PowerShares DB Commodity Index Tracking Fund (DBC) trading basically unchanged. Continuing the recent theme, industrial commodities and the energy space in particular lagged, as the soft U.S. flash PMIs and lingering concerns about a Chinese credit crunch weighed on the industrials. Meanwhile, precious and semi-precious metals continued to threaten to start a new uptrend thanks to the weaker dollar and prospects for further delays to the tapering of QE.

Gold was the best-performing commodity yesterday, rallying more than 1% to trade to a one-month high (and importantly trading above Tuesday's high of $1,343).

There isn't much mystery to gold's recent rally – gold had "priced in" a December or January QE taper, but the soft jobs report and sluggish economic data recently is pushing the expected date of tapering out to March and, according to some analysts, out to June.

In fact, I read one analyst yesterday who thought the Fed wouldn't taper at all in '14 (that's a bit bold as there are a lot of things that can happen).

Because we have no fundamental data (the Commitment of Traders report hasn't been released in 3+ weeks because of the government shutdown), the precious-metals market is basically trading off the dollar and on technicals, and the technical outlook is improving. Gold appears to have broken the downtrend in place since late August, and now appears poised to rally further.

WTI crude actually managed to rally yesterday for the first time in several days, eking out a marginal gain (WTI rose 0.25%). The soft October flash manufacturing PMIs weighed on oil initially, but oil had become deeply oversold.

Shorts booked some profits and we saw some value buying at the $96.00 level. But, after collapsing more than 5% over the last several trading days, it's somewhat disheartening that WTI crude couldn't rally much more than 0.25%.

With regard to crude, the "conundrum" remains – is the drop in crude all supply related, or is it forecasting some significant loss of economic momentum? At the moment, it seems like it's mostly the former, but if data continues to roll in over the coming weeks like we saw from the flash manufacturing PMIs, concerns will grow that it's the latter—and that won't be good for equities.

Elsewhere in energy, natural gas saw mild gains despite inventories rising more than expected. Last week natural gas inventories rose 87 Bcf vs. (E) 80 Bcf, and inventories now sit just 2% below last year's levels (cutting the deficit significantly since the beginning of the summer).

Bottom line is natural gas remains weather-driven, as surging supply and increasing demand from power generation remain largely balanced, making weather the tipping point.

If we get a cold winter, natural gas is a buy at these levels – if we get a warm winter, it's a sell. Longer term, though, I continue to believe LNG and the transportation and gathering of natural gas, not necessarily the movement in price, remain the best way to play the sector (so LNG tankers, pipelines, terminals, etc.)

Currencies & Bonds

Yesterday was a relatively uneventful day in the currency markets. The Dollar Index was little-changed, while the euro and pound saw small gains (less than 0.2%) vs. the dollar. Those moves reflected the economic data yesterday: U.S. "Flash" PMIs missed, EU "flash" PMIs were mixed, but importantly German manufacturing PMI met expectations at 51.5.

Turning to Asia, the "Aussie" wasn't able to rally despite the better-than-expected Chinese manufacturing PMI, as concern about the rise in short-term rates offset the good data, while the yen was flat.

Bonds saw modest declines yesterday (30-year down 0.25%) despite the flash manufacturing PMI miss and the Fed buying $1.5 billion worth of long bonds at 11:00 a.m.. But, Treasuries have seen a sharp rally over the last week, and yesterday's declines were mostly profit-taking, nothing more.

The counter-trend rally remains very much intact, and I doubt we've seen the highs for this counter-trend rally in Treasuries.

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	*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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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 are weighing on indsutrials, 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 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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**