7:00's Report

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

October 29th, 2013

Pre 7:00 Look

- Futures drifting and are virtually unchanged after a somewhat uneventful night.
- The Chinese central bank injected liquidity into the Chinese financial system o/n, easing fears of a credit crunch. But, they also slightly tightened policy, implying they are looking to slow credit growth amidst concerns of a bubble.
- Economic data from Japan and the UK o/n largely met expectations and there is little reaction in the markets.
- Econ Today: Producer Price Index (E: 0.2%), Retail Sales (E: 0.0%).

Market	Level	Change	% Change
S&P 500 Futures	1758.75	-0.25	-.01%
U.S. Dollar (DXY)	79.50	.194	.24%
Gold	1345.60	-6.60	-.48%
WTI	98.35	-.33	-.33%
10 Year	2.512	.009	.36%

Equities

Market Recap

Stocks finished trading Monday little-changed, again shrugging off disappointing economic data as the market looks ahead to the Federal Open Market Committee meeting tomorrow. The S&P 500 rose 0.13%.

Stocks spent most of Monday running in place, after starting higher on some follow-through buying from last Friday's strong close. News-wise it was very quiet yesterday, as the industrial production report and pending home sales data were the only real "events" that had

A Defensive Rotation? Consumer staples and other defensive sectors have outperformed lately, while market leaders like TSLA and others have seen big profit taking.

the ability to effect trading.

And, despite both reports being weak, stocks drifted higher throughout the afternoon, again touching a new all-time high on the S&P 500, in slow, conviction-less trading.

After touching those new highs, the market suffered from some profit-taking during the final hour of the day, and stocks went out off their highs but still slightly higher on the day. Overall, it was a pretty quiet day, and if someone didn't tell you, you would have never known the market made a new all time high (point being there was no real enthusiasm).

Off to The Palmetto State

Today I'm on the road to speak at a client event for Wells Fargo Advisors in Florence, SC., so the Report will be a touch earlier than usual given flight times both today and tomorrow.

Trading Color

Despite the higher close yesterday in the S&P 500, it wasn't a particularly strong day. First, the S&P 500 was the only major average to close higher (the Dow, Nasdaq

Market	Level	Change	% Change
Dow	15568.93	-1.35	-.01%
TSX	13371.84	-27.58	-.21%
Brazil	55073.37	919.22	1.70%
FTSE	6755.49	29.67	.44%
Nikkei	14325.98	-70.06	-.49%
Hang Seng	22846.54	39.96	.18%
ASX	5415.53	-25.88	-.48%
Prices taken at previous day market close.			

and Russell 2000 were all down marginally). More importantly, though, the defining factor of trading yesterday was the continued plunge of the momentum stocks that have led this market higher for months, and the surge in consumer staples and other "safety" sectors.

Market	Level	Change	% Change
Gold	1354.30	1.80	0.13%
Silver	22.525	-.114	-0.50%
Copper	3.267	-.002	-0.06%
WTI	98.73	.88	0.90%
Brent	109.57	2.64	2.47%
Nat Gas	3.565	-.142	-3.83%
Corn	430.75	-9.25	-2.10%
Wheat	681.00	-9.75	-1.41%
Soybean	1271.25	-28.75	-2.21%
Prices taken at previous day market close.			

Consumer staples were the best-performing S&P 500 sub-sector, surging 1.3%, while telecom and healthcare also finished higher on the day (that's your prototypical "safety" rally). Energy was the only other sub-sector to trade in the green, and it was up just 0.08%.

Conversely, not only were typical "cyclical" sectors weaker yesterday—led lower by homebuilders, basic materials and financials—but high-flyers like TSLA, NFLX, PCLN and others fell between 1% and 4%.

Now, that breakdown in the previous market leaders doesn't by itself mean the market is losing momentum, but it is certainly something to keep an eye on, because if the Internet/mobile stocks and the bio-techs can't lead this market higher (as they have all year), then its not entirely clear which "growth sector" can.

Volumes were light yesterday, which is normal for a Monday with little news right before an FOMC meeting. On the charts, the S&P 500 continues to grind higher. To say this market is stretched in the short term would be an understatement, though. as the nearest support lies at 1,729, nearly 2% from current levels.

Bottom Line

There certainly are anecdotal warning signs popping up (loss of leadership from momentum stocks, soft economic data, breakdown in European financial stocks), but the market remains resilient and trying to "front run" a correction has been a losing trade multiple times this year. So, while those warning signs bear watching, they aren't enough to inspire me to start materially de-risking, yet. A consolidation/pause is likely because this market does feel a bit tired (as it should).

But, with the warning signs popping up not just in the U.S., but also subtly across the globe (both the U.S. and the European Citi Economic Surprise Indices have recently fallen back to zero), I continue to think a **long "Europe"/ short "SPY" spread trade** remains one of the best ways to play this market into year end.

That trade has worked very well since I suggested it several weeks ago, and I think even if we do get some sort of a correction, there is still a good chance that spread still makes money as I don't see Europe declining as much as the S&P. Conversely, if stocks remain resilient and continue to make new highs, we should see continued outperformance from Europe into year end. Either way, this spread should continue to work, given the environment we're currently in.

Economics

Industrial Production

- September Industrial Production rose 0.6% vs. (E) 0.4%
- Manufacturing Index rose just 0.1% vs. (E) 0.3%

Takeaway

September industrial production beat expectations, but that was thanks to unseasonably warm weather pushing utility production higher (utility production was up by 4.4%).

The more-important part of the report, the manufacturing index, not only missed expectations by rising just 0.1%, but the data from August were also revised lower from the initial number of 0.7% down to 0.5%.

So, despite the headline "beat," this IP number joins an increasing number of reports that imply the manufacturing sector definitely saw a loss of momentum in September, and that was before the government shutdown.

Pending Home Sales Index

- September Pending Home Sales dropped to 101.6 from 107.6 in August.

Takeaway

The Pending Home Sales Index was a big disappointment yesterday morning, falling by 5.6% month-over-month. Since the rise in interest rates started back in May, we've seen pending home sales (which are counted at the time contracts are signed) decline for four-straight months. With this drop, the index is now down 1.2% year-over-year. That's significant because it's the first negative year-over-year reading in over 2 years.

This is the first really "bad" housing number we've seen (the others haven't been very good, but they weren't this bad, either), and it will certainly increase concern that higher interest rates are starting to materially slow the housing market.

Given pending home sales are a leading indicator for existing home sales (counted at the closing of a sale), we can expect more weakness in that market as well. While it doesn't signal the housing recovery has stalled, this will certainly keep people watching housing metrics closely.

Bottom Line on Both Reports

Yesterday's soft economic data is again worrisome because it's September data—so it further implies the economy was losing momentum before the shutdown.

Again, the recent data don't signal the economy has stalled, but it certainly has lost positive momentum, which further solidifies that the Fed will delay tapering (and in turn is "dovish").

Commodities

Commodities generally drifted higher yesterday in a quiet day of trading. The PowerShares DB Commodity Index Tracking Fund (DBC) was up .39%. The bounce in the commodity space was widely expected after we saw a bit of a sell-off last week, led down by WTI crude oil. The soft economic data didn't really weigh on industrial commodities yesterday, but that was more because they were so deeply short term oversold and in need of a bounce. But, the data yesterday certainly wasn't a positive for the industrials, regardless of the one day reaction.

Market	Level	Change	% Change
Dollar Index	79.295	.049	0.06%
Euro	1.3807	.000365	0.03%
Pound	1.6162	-.000975	-0.06%
Yen	97.615	0.00	0.00%
CAD $	.9567	.0012	0.13%
AUD $	.9582	-.00155	-0.16%
Brazilian Real	.45425	.00105	.23%
10 Year Yield	2.512	.0009	.36%
30 Year Yield	3.602	.009	.25%
Prices taken at previous day market close.			

WTI crude oil futures ticked higher in primarily technical trading yesterday, rising 1%. The psychological $100/Bbl remains the likely ceiling for now, while pretty weak support has formed down at the lows of last week (just under $96). Oil has been consistently trading in about a $5 ranges this year after sharp rallies or sell offs, so look for this $95-$100 level to settle into that range for the next several weeks.

Looking to the precious metals markets, gold continues to trade well, and is now sitting at fresh one-month highs. Gold closed above the $1,350 level I discussed last week, which is good news for the bulls, and as such I'm cautiously bullish we could see a further rally.

Importantly, Gold saw modest rally yesterday despite a stronger dollar, which is about the first time in weeks I've seen gold higher when the dollar wasn't negative, and its anecdotally bullish for gold.

The big loser in commodities yesterday was natural gas, which traded down more than 3.5% in the primary session and landed right at current support levels near $3.55. Natural gas traded lower on warmer-than-expected weather forecasts across the nation, putting it in danger of technically breaking down. If support doesn't hold here, look for natural gas to continue lower with the next target around $3.45, which was the low for September.

Currencies & Bonds

It was a quiet day in the currency markets, as the dollar ignored the soft economic data and traded flat (which isn't surprising, given the FOMC meeting Wednesday and how oversold the dollar is) while the euro and pound were also little-changed amidst no news.

The yen was actually the "big" mover on the day, falling a whopping 0.3% after BOJ Deputy Governor Kikuo Iwata made comments reaffirming the BOJ's commitment to ultra-easy money.

(His comments weren't anything new, but they served to remind everyone that the BOJ remains committed to sparking inflation, which is obviously yen-bearish.)

Given the relative strength in the yen lately, I'm not surprised to get these types of comments from a BOJ member, as a sub-98 yen to the dollar simply isn't going to create the economic rebound the BOJ or Prime Minister Shinzo Abe desire.

And, I imagine they are getting frustrated that the fiscal drama in Washington and now rising Shanghai Interbank Offered Rates (SHIBOR) in China are causing artificial support for the yen— in effect thwarting their efforts to push the yen down and boost exports.

I would imagine that if you told the BOJ in April, when they announced their massive stimulus program, that the yen would still be below 100 to the dollar, they'd have not believed you. I don't think the BOJ eases further at this week's meeting (expectations are for a non-event). But the bottom line is, if the economic and inflationary momentum stalls, they will act to ease policy further—and it's always nice have a country's central bank be on the same side of the trade you are.

Turing to the bond market, Treasuries also treaded water to start the week, generally ignoring the soft economic data and looking ahead to the FOMC meeting that starts today. Treasuries initially rallied off the disappointing industrial production report and pending home sales data, but there was never any real strength to the rally. That also makes sense given the big run we've seen in Treasuries over the past two weeks and the impending FOMC meeting. (A consolidation here should be expected, at least into tomorrow.) But, I would imagine the Fed will be "dovish" in their commentary, and as I've been saying, this counter-trend rally will continue for a bit longer.

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 expectations of a further delay in tapering of QE. 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: **Industrial commodities have stalled lately, as economic data, especially in the US, has shown a loss of some positive momentum, and it bears close watching as to whether this is a temporary blip, or a bearish game changer. 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.**

Long Gold: **If the Fed is going to delay tapering substantially, then gold is the clear winner and a "value" at these prices, although I'd use a tight stop (around the $1320 level).**

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.**