7:00's Report

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

October 7th, 2013

Pre 7:00 Look

- Futures and international markets sharply lower to start the week on escalation of rhetoric in the debt ceiling fight.
- Comments by John Boehner that there aren't enough votes in the House to pass a clean CR/Debt Ceiling bill are responsible for the weakness this AM.
- Economically things were very quiet o/n. Final look at 2Q GDP in the EU met expectations, rising 0.3%.
- Econ Today: No Reports Today.

Market	Level	Change	% Change
S&P 500 Futures	1668.00	-16.75	-.99%
U.S. Dollar (DXY)	80.10	-.15	-.12%
Gold	1312.00	2.10	.16%
WTI	102.58	-1.26	-1.21%
10 Year	2.652	.046	1.77%

Equities

Last Week

The S&P 500 was basically unchanged last week despite volatile, headline-driven trading pertaining to the government shutdown and debt-ceiling drama. The S&P 500 is up 18.53% year-to-date.

Stocks started last week nearly 1% lower on soft economic data (ISM manufacturing PMIs) and concern over the government shutdown, which officially started Tuesday. Nearly everyone spent the remainder of the week headline-watching, and the market basically traded in lockstep with the latest changes in sentiment regarding the shutdown and debt-ceiling drama.

Stocks hit their lows for the week Thursday as the Obama administration went on a P.R. offensive to raise concern about the negative effects of the shutdown (i.e., Obama's CNBC interview, and a Treasury report detailing a potential debt-ceiling breach as creating an '08-style crisis). Stocks bounced Friday on short-covering, however, based on comments from House Speaker John Boehner. (He said he won't let the U.S. default.)

From a sector standpoint, given the headline-induced volatility, there wasn't a ton to read into trading last week, although one thing that sticks out to me was the lack of any "defensive bid" in the market. Despite the volatility, "defensive" sectors like utilities, consumer staples and telecom didn't outperform more-cyclical sectors. Consumer staples were actually one of the big underperformers last week thanks to a profit warning from Unilever and some cautious comments from Wal-Mart management about the negative effects of government-employee furloughs on sales. Materials and tech were the outperformers last week from a sector standpoint, thanks to optimism from MOS and X in the materials space and strong performance in the Internet names (FB, YHOO, YELP) within tech.

I'm pointing this out because I think it reveals two assumptions the market has: First, investors still widely assume a benign outcome to all this political drama (meaning, we don't breach the debt ceiling). Second, investors are more concerned about missing a "Washington resolution" rally than getting caught in some big sell-off.

As we start the week, investors seem more interested in buying dips in cyclicals than they are in "de-risking."

Market	Level	Change	% Change
Dow	15072.58	76.10	.51%
TSX	12758.65	23.53	.18%
Brazil	52848.97	359.11	.68%
FTSE	6402.14	-51.78	-.80%
Nikkei	13853.32	-170.99	-1.22%
Hang Seng	22973.95	-165.59	-.71%
ASX	5161.11	-46.90	-.90%
Prices taken at previous day market close.			

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Volumes and volatility were elevated last week, and that's to be expected given the headline-driven nature of the trading. (And we can expect more of that this week.) But, the increase in volatility and volumes comes amid very little participation from "real money" funds like large mutual funds and hedge funds.

Market	Level	Change	% Change
Gold	1309.90	-7.70	-0.58%
Silver	21.752	-.034	-0.16%
Copper	3.301	.0325	0.99%
WTI	103.84	.53	0.51%
Brent	109.50	UNCH	0.0%
Nat Gas	3.506	.007	0.20%
Corn	443.25	4.00	0.91%
Wheat	687.00	-2.25	-0.33%
Soybean	1295.00	6.75	0.52%
Prices taken at previous day market close.			

Trading is being completely dominated by algos, day traders and fast-money funds. There is little real conviction in this market, as most of the big money is firmly in "wait and see mode" with regard to what will come out of Washington.

On the charts, the S&P 500 tested and held support at the 50-day moving average (1,681) while 1,700 remains resistance.

Washington Update

The rhetoric escalated a bit over the weekend, and Boehner said there are not the votes to pass a "clean" CR or debt ceiling debate without first having a "serious conversation" about what's driving the debt. That comment is responsible for the weakness in risk assets this morning. Democrats re-affirmed their stance that they will not negotiate on the CR or debt ceiling.

From a market standpoint, despite the escalation, the very widely held expectation is that a deal will get done, and the market views the fact that the CR and debt ceiling are now one negotiation as a positive. Most expect some sort of resolution later this week (CNN reported a six-week CR and debt-ceiling deal is gaining momentum), although if we go into another weekend with no progress, expect the anxiety level to creep higher. For now though, we can expect a continuous stream of headlines as both sides posture and continue with their respective PR campaigns.

This Week

Away from Washington, there are several other important things going on. First, earnings season kicks off this week with AA and YUM posting results Tuesday after the close, but the big releases of the week will be bank earnings on Friday. JPM, WFC and WBS all release results Friday morning. Sentiment toward the banks has turned very negative since the "no taper" surprise, and recent reports of depressed trading volumes and revenues have added to concerns. So, it'll be very interesting to see if the reality of the results matches the low expectations.

Second, while economic data will be sparse, there are a number of Fed speakers this week (two on Tuesday and two on Thursday), in addition to the FOMC minutes being released on Wednesday. In addition to the Fed speakers, we will also hear from ECB head Mario Draghi, who makes comments in Massachusetts on Wednesday, and BOJ head Haruhiko Kuroda speaks Thursday in New York.

Economics

Last Week

The economic data last week implied the U.S. and global recoveries are still ongoing, but they've lost a little momentum from August. The most-watched numbers last week were the U.S. and international manufacturing and service sector PMIs. And across the board, they reflected continued expansion but a slight loss of momentum.

Chinese and European manufacturing PMIs remained above the 50 level (both at 51.1) but declined marginally from August readings, while service sector PMIs both beat expectations. It was the exact opposite in the U.S., as September manufacturing PMI hit another multi-month high at 56.2 vs. 55.0 (E), while non-manufacturing PMI declined to 54.4 from a high August reading (57.0).

The takeaway from the global PMIs is that, while they lost some momentum, they still imply the global economy is recovering. As such, the numbers don't give any reason to think the "global economic recovery" thesis, that has in part led to international outperformance over the past several months, is ending.

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Looking domestically, last week was "jobs week." But because of the government shutdown we didn't get the monthly Employment Situation report, making the week somewhat anti-climactic. Given that, the ADP report took on a bit more significance. So, the fact that it missed estimates and saw a decent downward revision to the August data weighed on markets and continues to imply we're not seeing the incremental improvement in the national jobs market that we would like. And, the drop in jobless claims, which remained just above 300K last week, isn't yet resulting in a pickup in hiring.

This Week

Even before the government shutdown, this week was going to be quiet from an economic standpoint. But because of the shutdown, the most-anticipated number of the week (retail sales on Friday) has been postponed. The Produce Price Index (PPI) and wholesale trade are also being delayed.

Turning to what will be released this week, the most-anticipated will be the Fed minutes on Wednesday. We have had an endless parade of Fed speakers since the surprise "No Taper" in September, and basically we've had two conflicting messages from them. Some Fed governors, such as Dudley and Williams, have been pretty dovish—implying the economy isn't strong enough for the Fed to taper. Conversely, some Fed governors such as Bullard have repeatedly said not tapering QE in September was a "close call." Given all the Fed confusion, the minutes will be poured over for clues as to just how close the Fed was and is to tapering. Going into the minutes this week, the overwhelming expectation is for tapering of QE at the December meeting at the earliest, and many are now expecting the first taper to occur in early '14.

Other than the minutes, data is very light, assuming the shutdown stays in effect. The three releases this week are consumer credit (Monday), jobless claims (Thursday) and University of Michigan Consumer Confidence survey.

Market	Level	Change	% Change
Dollar Index	80.250	.404	0.51%
Euro	1.3559	-.0065	-0.48%
Pound	1.5997	-.0154	-0.95%
Yen	.010258	-.00003	-0.29%
CAD $	.9696	.0026	0.27%
AUD $	.9395	.0037	0.40%
Brazilian Real	.44715	-.001	-.22%
10 Year Yield	2.652	.046	1.77%
30 Year Yield	3.732	.025	.67%

Prices taken at previous day market close.

Bottom line on data this week is nothing released is going to materially change the current expectation that both the global and U.S. economies are recovering at a slow pace. And, really, markets will be gaming on any potential negative effects of a protracted U.S. government shutdown and debt-ceiling crisis more than they will be trading off any data released this week.

Commodities

The broad-based commodity ETF, the PowerShares DB Commodity Index Tracking Fund (DBC), like the equity markets, was flat last week amidst volatile trading. Late-week strength in energy and agricultural commodities offset declines in precious metals. Industrial commodities did outperform last week but, disconcertingly for commodity investors, the complex didn't rally off a much weaker Dollar Index and generally good economic data.

Gold, much to the gold bugs' frustration, declined nearly 2% last week. It was the worst-performing major commodity in the market, as it didn't rally despite the weaker dollar and received no safety bid despite the government shutdown. Gold continues to trade poorly, and although we could see a small safety bid if the Washington drama drags on, inflation is the next positive catalyst for gold, and that appears to be months away. $1,280 remains critical support, and we can expect gold to trade off of Fed-speak and Washington this week. Looking at other metals, silver and copper were both were flat on the week, again reflecting the outperformance of industrials over non-industrials.

WTI crude rallied 1% thanks to a move higher late last week, as value buyers stepped in around $100/bbl. Also, a deceptively bullish inventory report (which appeared bearish but really wasn't) also lent support. Despite the bounce, the government shutdown will weigh on oil demand in the near term, so I'd expect a $100-$110/bbl range, which should last until we see an uptick in economic activity.

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Currencies & Bonds

The Dollar Index fell to an eight-month low last week before bouncing Friday on short-covering into the weekend on Washington concerns, soft economic data and shifting expectations for when tapering of QE will occur (more and more, the expectation is shifting to early '14). Also contributing to the Dollar Index weakness was strength in the euro, which rallied above 1.36, also to an eight-month high.

Euro strength was due to several factors: First, EU economic data continues to demonstrate a return to growth for the region and, on balance, it was a bit better than in the U.S. last week. More importantly, though, ECB chief Mario Draghi, at the press conference after the ECB meeting last Thursday, downplayed the possibility of more LTROs (Long Term Refinancing Operations) late this year. The market expects the ECB to use LTROs to further ease monetary policy and counter the global rise in interest rates we've seen since May.

But, with the Fed not tapering, global rates have recently declined, and it appears the ECB—while it will remain very accommodative—isn't about to offer more LTROs, which was taken as "hawkish" vs. expectations. Finally, Silvio Berlusconi's ouster from the Italian Senate and loss of power after his failed "coup" on the Enrico Letta government is seen as a positive for the region, as it should usher in more stability for the Letta government and remove uncertainty from the region.

Staying in Europe, the British pound was one of the few currencies that declined last week vs. the dollar, as several economic data points missed expectations (most notably, manufacturing PMI and retail sales). But, the pound has seen a huge rally over the last several weeks vs. the dollar, and most of the declines were due to profit-taking rather than a change in the bullish trend.

The yen saw big gains vs. the dollar last week and is now at a multi-week high. The rally came after PM Abe formally announced he will go through with the sales tax increase this spring (as was expected). But, he disappointed markets as he announced a $50 billion stimulus program to offset the increase, but failed to give any great details of what the program would include. The market took that as a sign that they don't really have a strong plan to offset the drag of the tax increase. Also helping the yen rally was the dollar weakness, and a small "safety" bid as investors bought yen in reaction to the U.S. government shutdown.

The Dollar Index is now short-term oversold, and it seems as though all but the worst-case scenario (a default or breach of the debt ceiling) is largely priced into the dollar at this point. That point aside, expect headlines from Washington to continue to be the main catalyst in the very short term for global currencies.

Looking past the short-term political drama, the dollar is also under pressure from the changing perceptions of a "dovish" Fed, and as such the FOMC minutes and Fed-speak this week will be important as to whether the Dollar Index holds last week's lows of 79.72. Finally, these multi-month highs for the yen and euro aren't exactly what's wanted by the ECB and BOJ, given those two economies' fledgling economic recoveries. So, it'll be interesting to see if Draghi and Kuroda try and talk down their respective currencies in their addresses this week.

Bottom line with the dollar, though, is while we may see a short-term oversold bounce, it's going to be hard to mount any significant upside given a progressively more "dovish" Fed. I'd expect the dollar to remain range-bound with a slight bias lower (a significant decline from these levels isn't likely unless we get closer to a debt-ceiling crisis).

Turning to bonds, Treasuries declined modestly despite soft economic data and a potentially more "dovish" Fed, as concerns about Washington constrained any rally. As I said last week, though, the big probability is still for a positive outcome in Washington, so I think this Washington-related weakness in bond prices only delays, but does not de-rail, the counter-trend rally in bonds that started after the September FOMC meeting—mainly because economic data is proving to be lackluster and the expectations for Fed tapering are moving toward early '14. I remain an ardent long-term bond bear, but would wait for a further rally to re-establish short positions in the bond market (via TBT, TLT or STPP).

Have a good week—Tom

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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 debt ceiling fight enters its second week, and will continue to be a headwind on stocks. The expectation is still that a deal get done before 10/17, but if we have no progress by the end of the week, expect a sharp sell off, as a "no deal" scenario is **not** priced into markets. That said, though, the benefit of the doubt remains with the bulls, as a deal is likely to get done.* *The S&P 500 has support at the 50 day MA (1680) while 1700 remains 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 US Dollar hit an 8 month low and is under pressure in the short term from fiscal drama in Washington and as Fed "tapering" expectations shift to early '14.*

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**	*The Fed's "no taper" surprise has likely marked the end of this initial leg down in Treasuries. Although the fundamentals long term remain negative, we should see a bounce of some sort, although I would look at that longer term as a great entry point on a bond short. If you missed the initial leg down, now's your chance to get back in over the coming weeks/month.*

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.**

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