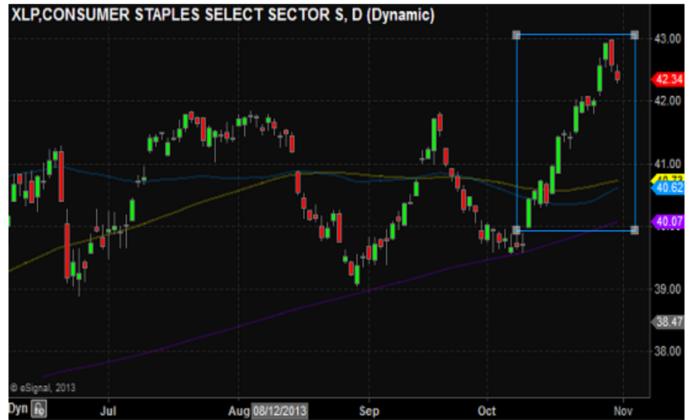
7:00's Report

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

November 1st, 2013



Consumer staples ran to new highs on the expected delay of tapering of QE, but are now getting hit hard as those expectations adjust. But, I'd look to be a buyer on any further substantial weakness as tapering still isn't likely until early 2014.

Pre 7:00 Look

- Futures slightly higher thanks to stronger than expected Asian manufacturing PMIs, led by China.
- Chinese manufacturing PMI for October beat expectations, rising to the highest level in 18 months (51.4 vs. (E) 51.2).
- In Europe, the UK manufacturing PMI largely met expectations at 56.0 vs. (E) 56.1.
- Econ Today: ISM Manufacturing PMI (E: 55.0).
- Fed Speak: Bullard (8:00 A.M.), Kocherlakota (11:15 A.M.), Lacker (12:00 P.M.).

Market	Level	Change	% Change
S&P 500 Futures	1753.50	2.50	.14%
U.S. Dollar (DXY)	80.525	.262	.33%
Gold	1316.10	-7.60	-.58%
WTI	96.36	-.02	-.02%
10 Year	2.542	.015	.59%

Equities

Market Recap

Stocks seesawed Thursday between gains and losses, before continued profit-taking pushed the markets down marginally. The S&P 500 closed down 0.38%.

It was a bit of a hump day in the market yesterday, as stocks opened lower and sold off to the lows of the day immediately following the open. This happened after a much better-than-expected Chicago PMI report. (Yes, I said better-than-expected, which doesn't make any sense, but I'll get to that in a second.) Stocks arrested their declines shortly after 10 AM, and then spent the entire middle part of the day rallying into positive territory before selling off somewhat sharply during the last hour of trading (so the daily chart looked like a big hump).

The fact that the market accelerated to the downside following the good Chicago PMI report didn't make any sense, but the general explanation was that stocks had a knee-jerk reaction and the good data was seen as pulling QE tapering forward, which is bad for stocks. I don't think that explanation is in any way accurate, because "good" economic data is not bad for the market.

A more-plausible explanation I heard was a rumor about a large re-allocation occurring given that it was the last day of the month. This, then, pushed markets lower as the program sold out of certain names and then re-allocated later in the day (pushing stocks higher).

I have no idea whether that's true or not, but it does fit the movement of the tape. Stocks rallied throughout the

Market	Level	Change	% Change
Dow	15545.75	-73.01	-0.47%
TSX	13361.26	-94.07	-0.70%
Brazil	54256.20	83.38	0.15%
FTSE	6726.09	-5.33	-.08%
Nikkei	14201.57	-126.37	-.88%
Hang Seng	23249.79	43.42	.19%
ASX	5411.13	-14.37	-.26%
Prices taken at previous day market close.			

middle of the day before selling off rather badly into the close (as if all the bids in the market were suddenly pulled, which is exactly what would happen when the program finished).

Market	Level	Change	% Change
Gold	1324.20	-25.10	-1.86%
Silver	21.93	-1.053	-4.58%
Copper	3.30	-.0255	-0.77%
WTI	96.30	-.47	-0.49%
Brent	109.20	-.67	-0.61%
Nat Gas	3.586	-.034	-0.94%
Corn	428.00	-2.25	-0.52%
Wheat	667.75	-7.25	-1.07%
Soybean	1279.50	-8.00	-0.62%
Prices taken at previous day market close.			

Regardless of that program trading, a CNN headline about an Israeli military strike in Syria probably contributed to the downward pressure into the close, although that speaks more to the lack of participation in the afternoon than anything else. (The headline isn't that material and oil didn't move off it.)

Bottom line is both the open and the close yesterday were kind of ugly, and the market declined for a second day in a row—something that hasn't happened since October 7—and more and more this looks like the "pause" everyone has been expecting.

Trading Color

Looking at the sector trading, we saw a continuation of the unwind of the two-week move into the "bond-proxy" stocks, as utilities, consumer staples, telecom, REITs and healthcare underperformed. And, even though earnings season is mostly "over" from a market-influence standpoint, good results by Comcast (CMCSA) helped consumer discretionary actually be the best-performing S&P 500 sub-sector yesterday. Outside of consumer discretionary, there was continued weakness in the cyclicals (and that has become pretty consistent lately). In the context of slowing economic growth, this remains something to keep an eye on. Financials badly underperformed yesterday, as did homebuilders (rates fell) and energy.

Overall it's confused trading taking place. The "bond-proxy" sectors are getting hit as rates tick back up, but at the same time we're not seeing any sort of cyclical outperformance because the economic data is showing the economy was slowing before the government shutdown. Really, the sectors are signaling stagflation (higher rates with no growth) and although it's still early, that was a scary thought on a Halloween trading day.

As an aside, the unwind of that "bond proxy" trade has been surprisingly violent over the past two days, given that I don't think anything material changed at all with the Fed statement. I get that some complacency with regard to Fed tapering QE in mid-2014 has come out of the market. But just because the market is complacent, doesn't mean it's wrong.

Perhaps I'm in the big minority, but I'm not really sure that a mid-'14 taper is totally off the table, given the trend in economic data and another round of political dysfunction looming in March/April of next year (when the next debt ceiling fight will be). I agree with the consensus that Jan/March are the likely tapering dates, but unless the data turns around, mid-'14 will be very much in play again.

Volumes were heavy in the morning but quieted throughout the afternoon as focus turned to kids' trick-or-treating schedules (it's like a *de facto* holiday). On the charts, resistance is now the old highs of 1,775, while there is light support at 1,740 and then 1,729 (the old all-time highs).

Economics

Yesterday that "market moving" report was the Chicago PMI, which measures manufacturing activity in the Chicago region. No one really pays attention to this number normally, but it was a huge blow out: 65.9 vs. (E) 55.0 (and the largest monthly gain in over 30 years!) and New Orders rose to 74.3, the highest level in 9 years. The report as so much better than expected it had some questioning the validity of it, but given the index is constructed from a survey of purchasing managers, it's kind of hard to argue with the results. And, although the strong report contributed to the "hawkish" trade in markets yesterday, all eyes now turn to the national PMI coming at 10 AM this morning.

Jobless Claims

- Weekly Claims declined to 340K vs. (E) 335K
- 4 Week Moving Average ticked higher to 356.25K

Takeaway

Jobless claims fell by 10K to 340K compared to last week's figure, which was unrevised at 350K. Initial claims were however slightly higher than analysts' estimates of just 335K. The four-week moving average made a substantial move higher for the fourth week in a row following the spike in claims due to the government shutdown.

The Department of Labor declared that California has finally sorted through the pile of backlogged claims that have been skewing data for weeks now, and the effect of the government shutdown has fizzled out as well.

So, this is the first relatively "clean" print we have seen since August and it tells us that we are more or less in the same employment environment that we were in back then, as claims at the end of August were very close to where they are now (332k). And, it confirms we've seen at best a stagnant labor market, if not slight deterioration.

Commodities

Precious metals saw their steepest declines in several weeks thanks to a big surge in the dollar, as the market continues to knock some complacency out of the "delayed tapering of QE" camp. Gold closed down nearly 2% and silver plunged more than 4.5% in heavy selling as the day wore on. Both gold and silver started trading Thursday decisively in the red, but really it was the Chicago PMI that led to a big Dollar Index rally and pushed gold and silver materially lower.

Gold held the $1,320 level (barely) on a closing basis yesterday, but whether it can hold that support later today depends on what the dollar does and the outlook for the Fed. The expectation of when tapering will begin, whether it's Jan/March/June, will decide if gold can rally further from current levels.

Market	Level	Change	% Change
Dollar Index	80.29	.453	+0.57%
Euro	1.3579	-.01501	-1.09%
Pound	1.6061	.00271	0.17%
Yen	.010171	.000025	0.25%
CAD $	.9590	.0058	0.61%
AUD $	.9446	.0008	0.08%
Brazilian Real	.44465	-.00935	-2.06%
10 Year Yield	2.542	.015	.59%
30 Year Yield	3.631	-.001	-.03%
Prices taken at previous day market close.			

But, there is something a bit disconcerting in the way gold traded yesterday. Based on how the market reacted to the "hawkish" Fed, it appears the market has largely priced in a "mid-2014" taper and is now adjusting to an "early 2014" taper expectation. But, here's the troubling part – if the market was pricing in a mid-2014 taper and all gold did was rally to $1,350, then that's not very bullish.

Gold stabilized over night although its trading just below $1320. If it can't get back above that level in the next few days or moves lower from here I'd exit any recently added trading longs. More generally, this week's price action only furthers the point that—for gold to head materially higher from here (and I mean several hundred dollars)—it will have to be because of inflation concerns, not QE tapering delays. Inflation, which still has yet to appear, remains the next major catalyst in the gold market, not dollar weakness.

Although all major commodities were lower yesterday, there was relative outperformance by the industrial commodities, thanks in part to the Chicago PMI. WTI crude started trading yesterday down nearly 1%, but it held support at the $96.00 level and actually managed to trade close to flat thanks to the Chicago PMI. Copper was also a relative outperformer, rallying 0.8% partially on comments from copper miner Codelco, which said it would be raising premiums for copper shipped to China due to increased demand (which is nice to hear from a global macro-standpoint).

Natural gas was one of the few commodities yesterday with some actual fundamentals to consider. Weekly inventory data was slightly above expectations (38 Bcf build vs. (E) 37 Bcf), and, predictably natural gas declined on the news, trading down 1%. Natural gas will remain a weather-driven commodity, but at these levels perhaps it's worth taking a look at—regardless of whether temps stay warm or not.

Inventory levels, while still above the 5 year average, are now 120 Bcf below the levels of last year, when natural gas was still trading around the $3.50/Bcf level – so, less supply yet the price remains basically at the same level. From a weather perspective, that implies that we don't need the same degree of cold that we did last year to lead to higher prices, as don't have near the same level of surplus.

Additionally, natural gas has largely "held" the $3.50-ish level three separate times over the past month, implying there is a large buyer willing to get long natural gas at those levels. Point being, natural gas seems a bit attractive here with a stop about $0.10 below current levels. Weather will be the main factor in the short term, but there seems to be support at the $3.50 level and a rally should take us close to $3.90, so you're looking at 10 cents of risk for 30+ cents of reward, not a bad set-up.

Fill 'er up—With Natural Gas?

Finally, this is more a longer-term observation, but anecdotally it seems the world is intent on finding new and different ways to use natural gas as a fuel. CNG (compressed natural gas) use as a transportation fuel isn't exactly new; it's been in use for a long time in "closed loop" transportation systems like at the Port of Long Beach and on certain bus routes in Tulsa, OK, and other cities. But, there was an interesting story in the WSJ yesterday (link here) about rising interest in CNG from some of the nation's largest truck fleets, including Con-way, Swift, Lowe's and UPS. And, while each company plans to convert only part of their fleet to CNG trucks, it underscores how the market is inventing new ways to use natural gas, given its cheap price.

Now, obviously this isn't a reason to buy natural gas today, but it is worth pointing out that, anecdotally speaking, the ways we are "using" natural gas seems to be trending upward. Incidentally, from a "how to play this" perspective, the primary beneficiary of a rollout of CNG, which the article explains, is CLNE—a compressed natural gas distributor owned by T. Boone Pickens. (As an aside, I used to trade CLNE back in the late '00s when I worked at the hedge fund, and for those of you who remember the "Pickens Plan"—which was a plan to do a national conversion to use natural gas as a transportation fuel—it was conveniently launched not long after he acquired a controlling interest in CLNE!)

Currencies & Bonds

Trading was hawkish in the currency and bond markets yesterday. The dollar was up 0.57% and closed just shy of the highs of the day, comfortably above the 80 level. The dollar has been trending higher since the end of last week but saw additional buying pressure at the release of the much higher-than-expected Chicago PMI. The dollar also experienced some follow-through trading after Wednesday's FOMC announcement, which was quasi-hawkish and caused a revaluation as to when to expect a taper out of the Fed.

Importantly, the strength in the dollar was not universal. Both the pound and the yen rallied against the dollar and the Aussie was flat on the day. It was primarily the weakness in the euro that allowed the dollar to make such a strong move yesterday.

The big loser vs. the dollar was the euro, which plunged 1% (that's a huge move for the euro) thanks to a soft German Retail Sales Report, which printed at –0.4% vs. (E) 0.4%. Additionally, the EMU HICP, which is the European equivalent of our CPI, rose just 0.7% year-over-year in October. This was the slowest pace since November 2009 and implies an impending whiff of disinflation—a potential negative for the EU economy. As a result, the soft inflation report raised questions over whether or not the ECB will ease policy further to spur inflation back to the desired levels. Combine that with an overcrowded long, and down it went.

The yen bounced a little bit after the BOJ left monetary policy unchanged (which was broadly expected), and at the same time upgraded its assessment of the domestic economy.

Treasuries drifted marginally lower after the large moves in the space yesterday. Longer maturities moved lower on the combination of the overall "hawkish" trade (potential for earlier-than-expected taper) in the market and the strong Chicago PMI. We are seeing some complacency coming out of the market; however the rally more than likely remains intact.

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 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).**

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.**