7:00's Report

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

November 11th, 2013

Pre 7:00 Look

- Futures are slightly higher and international markets are playing catch up to Friday's rally, as economic data over the weekend beat expectations.
- Chinese CPI was under estimates (3.2% vs. 3.3%) and industrial production, retail sales and fixed asset investment largely met expectations.
- No deal was reached to ease sanctions on Iran, although the tone remains optimistic. Crude isn't really reacting.
- Econ Today: No reports today, and banks are closed for Veteran's Day.

Market	Level	Change	% Change
S&P 500 Futures	1767.00	1.00	.06%
U.S. Dollar (DXY)	81.23	-.157	-.19%
Gold	1285.40	0.80	.05%
WTI	94.30	-.30	-.31%
10 Year	2.746	.133	5.09%

Equities

Market Recap

Stocks closed fractionally positive last week despite increased volatility as surprisingly strong economic data trumped increased profit-taking. The S&P 500 gained 0.5% and is now up 24.5% for the year.

Stocks exhibited more signs of fatigue early in the week, as Monday-Wednesday, the market basically gyrated around flat in quiet trading. But, Thursday brought the biggest sell-off in months, as the S&P fell by more than 1% and traded close to a one-month low.

Despite multiple cited "reasons" for the decline in stocks Thursday, the truth is it was more about end-of-year profit-taking and an unwillingness of buyers to "buy on the dip" creating an air pocket in the market. There wasn't any specific "reason" the market fell as hard as it did, other than nervous longs and relatively light liquidity.

But, Friday's surprise payroll number caught the market off-guard. Stocks methodically rose throughout the day to recoup almost all of Thursday's losses and brought the S&P 500 back positive on the week, despite being down more than 1.5% at the lows.

As far as market internals go, it was a mixed picture last week. On one hand, the Dow hit a new all-time high last week. But on the other, more "growth"-oriented indices like the Russell 2000, Dow Transports and Nasdaq all underperformed, despite big bounces on Friday. And, momentum stocks like Tesla (TSLA), Facebook (FB), Salesforce.com (CRM) and Groupon (GRPN) all continued to see heavy selling (which is the main reason we know a lot of the selling is profit-taking).

From a sector standpoint, bonds were down pretty consistently all week, so "bond proxy" stocks got hit last week, and especially on Friday. Utilities fell last week, as did REITs, while homebuilders and consumer staples stocks were little changed.

Conversely, as the market re-priced in the date of the expected Fed taper, financials (and especially the banks) saw a big rally Friday—the Financial Select Sector SPDR (XLF) alone rose 2.3% on Friday. That's thanks to the expectation of a sooner tapering of QE and the positive impact that will have on Net Interest Margins for banks. (If that happens, it's especially good for regionals.)

Financials have been one of the big laggards on a combi-

Market	Level	Change	% Change
Dow	15761.78	167.80	1.08%
TSX	13378.33	84.13	.63%
Brazil	52248.86	-491.93	-.93%
FTSE	6724.81	16.39	.24%
Nikkei	14269.84	183.04	1.30%
Hang Seng	23069.85	325.46	1.43%
ASX	5387.14	-13.52	-.25%

Prices taken at previous day market close.

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nation of concerns about litigation risk and of a delayed Fed taper. So, it'll be interesting to see if that sector can bounce back (and if it can, that'll be an anecdotal positive for the market).

Materials (economic data out of China) and large-cap tech, mostly thanks to the big Microsoft (MSFT) rally early in the week on new CEO rumors, also outperformed.

Market	Level	Change	% Change
Gold	1289.00	-19.50	-1.49%
Silver	21.50	-.16	-.72%
Copper	3.26	.011	.34%
WTI	94.35	.15	.16%
Brent	104.90	1.44	1.39%
Nat Gas	3.55	.03	.85%
Corn	4.27	.06	1.49%
Wheat	6.50	-.03	-.50%
Soybean	12.96	.30	2.33%
Prices taken at previous day market close.			

Overall, though, the sector trading wasn't definitively "bullish," as the market wasn't led universally higher by cyclicals. However, there certainly were pockets of outperformance, as the rise in rates generally weighed on safety sectors.

On the charts the S&P 500 failed to break the all-time highs of two weeks ago, so the 1,775 level remains resistance as we start the week, while the lows of last week (1,746) remains support.

Looking at volumes, Friday was busy. But other than that, there's little participation in this market right now. It seems like investors are more in the mindset to stay on the sidelines and protect performance into year-end than they are looking to put on more risk. If volumes are a sign of conviction (and that's debatable in today's electronic, high-frequency-trading world), then there's not a ton of conviction with the bulls.

This Week

Focus this week will be on China's "3rd Plenary Meeting of the Central Committee," which is basically a government policy-making conference. The market cares about this because it wants to see some pro-growth policy reforms come out of the conference, although at this point nothing major is expected to be announced. But, headlines may affect sentiment toward China (depending on what's enacted).

Domestically, we'll be watching the start of the Janet Yellen confirmation hearings (more on this later, but her confirmation is expected), and also on some October-end earnings. Of particular note is Cisco's (CSCO) earnings report Wednesday night, and as always the market will be watching the comments of CEO John Chambers regarding the state of the economy and business spending in general. Also, Wal-Mart (WMT) reports Thursday morning, so obviously that will be watched as we approach the holiday shopping season.

Bottom Line

I believe the path of least resistance for stocks remains higher, and for several reason. First, sentiment remains very, very far from enthusiastic, and despite the market showing resiliency yet again, most investors agree that stocks will likely head higher, but not for "real" reasons and as such there is a huge market correction looming in the future (and that opinion probably isn't wrong, but I've learned in this business it's very seldom what you expect that causes corrections). Point being, no on "believes" in this market.

Second, the macro horizon remains as clear as its been in years (no financial or Eurozone crisis). Third, economic data appears to be in a "sweet spot" in that it's good, but not good enough to have the Fed remove any accommodation. Finally, valuations (S&P at a little over 14.75X 2014 $120 EPS estimate) aren't cheap, but they aren't rich either, and if the economy can accelerate over the coming quarters to above 3% GDP than somewhere between 15X—16X (so 1800—1920) is reasonable.

That said I wouldn't be aggressively adding exposure here given where we are in the calendar, as I think we could see a few more bouts of profit taking selloffs given no one wants to loose a good year of performance, but the benefit of the doubt remains with the bulls, and I'd certainly wouldn't be de-risking here.

Economics

Last Week

Economic data last week were stronger than their relatively low expectations, as concerns about the negative effects of the government shutdown had resulted in pretty low expectations for most of October's economic

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releases.

And, it would appear that those concerns have been misplaced, because we're not seeing the drop in economic activity you would think we would have. At the same time though, while the data is better than depressed expectations, it's not clear we're seeing an acceleration of activity, either.

Certainly the highlight last week was the jobs report Friday, which was a solid "beat" vs. pretty depressed expectations. October payrolls grew by 204K, much more than the 120K expectation, and the revisions to September and August were a positive 60K. (The direction of revisions to prior months can often be a good signal of the overall trend in hiring.)

But, the jobs report was just the highlight of consistently "good" data last week. Third-quarter GDP was 2.8%, higher than the 2.0% expectation, although that number was a bit deceiving as inventories added 0.8% to the report. (So, in reality, real economic growth in Q3 met expectations.) October Non-Manufacturing (or service sector) PMI rose to 55.4, beating expectations, although the new orders component (the leading indicator of the report) declined. Finally jobless claims declined marginally to the 330K level, which is pretty much where they were in August.

Internationally, last week was also busy. The highlight overseas was the "surprise" 25-basis-point cut in interest rates by the European Central Bank, which led to a plunge in the euro and a rally in the Dollar Index. The cut was in response to currently very low inflation across the European Union, which some are fearing might turn into "dis-inflation" if allowed to persist.

Somewhat lost in the ECB and jobs report hysteria was strong economic data from China. October composite PMIs beat estimates early last week and exports rose more than forecast Friday morning. (Strong exports to Europe are an encouraging sign of a continued economic recovery, not only in Europe but also globally).

Market	Level	Change	% Change
Dollar Index	81.28	.43	.53%
EUR/USD	1.3356	-.0072	-.54%
GBP/USD	1.5997	-.0087	-.54%
USD/JPY	1.0087	-.0131	-1.28%
USD/CAD	.9525	-.0039	-.41%
AUD/USD	.9353	-.0083	-.88%
Brazilian Real	.42985	-.00185	-.43%
10 Year Yield	2.746	-.0133	5.09%
30 Year Yield	3.842	.116	3.11%
Prices taken at previous day market close.			

The economic data remains very important mainly because of WWFD (What Will the Fed Do?). In an absolute sense, while last week's data beat low expectations, it's still a long way from achieving "escape velocity" for the economy, where we no longer need QE or very, very low interest rates.

But, from a WWFD standpoint, last week's better-than-expected data furthered the shifting expectations for when the Fed will taper QE, which seems to be the dominant theme in markets these days and the single-biggest influence on the bond market. Although I don't think the Fed will taper QE in December, the strong jobs report from Friday did result in January now becoming a strong contender for the first tapering. But, at this point we need to see follow-through on this stronger-than-expected economic data in November before the consensus shifts from the current March expectation of the first tapering.

This Week

This should be a relatively quiet week on the economic front, especially compared to last week. The most important event of the week will be the confirmation hearings for presumptive Fed Chair Janet Yellen, which begin Thursday. There will be plenty of grandstanding and some tough questions and obstacles (in particular from Rand Paul). Despite this, she is widely expected to be confirmed (it would be a shock to the market if she wasn't).

Looking at the actual hard data coming this week, we get our first look at November data with the Empire State Manufacturing Index on Friday. (Although it's just one region, markets will be looking for any signs of follow-through from October's surprisingly strong data.)

Jobless claims and October industrial production will also be watched. In particular, markets would like to see the weekly claims start to decline and confirm the surprisingly good October jobs report. (Right now it's a bit of a contradiction, in that claims are at the same level

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as in August while the monthly jobs report has improved.)

It's actually a busier week in Europe from a data perspective, and given the ECB's rate cut last week and growing concerns about dis-inflation, data there will be watched closely to see if the fledgling economic recovery is still intact. HICP (the EU equivalent to our CPI) will be released Friday, and markets will be looking to see if there is any uptick in this final reading from the "flash" reading of two weeks ago. It was the very low "flash" HICP reading that was really the big catalyst behind the ECB cutting rates, as it's starting to flash a "deflation" warning sign.

Commodities

Most major commodity indices traded to their lows of the year last week, as US Dollar strength and individual supply/demand concerns weighed on the complex.

WTI Crude traded to a 4 month low below $94/bbl early last week before bouncing thanks to short covering after some "less bad" inventory data and strong economic reports. Also weighing on both WTI and Brent Crude last week were reports of potential removal of sanctions on Iran by the west, although that appears to have broken down a bit over the weekend. Nonetheless, both supply/demand and geo-politics continue to weigh on the energy space. The lows from last week ($93.37) in WTI are now key support.

Precious metals also got hit last week, as gold fell to a one month low thanks to a stronger US Dollar. Gold got hit initially Thursday after the better than expected GDP Report, and then support gave way on Friday after the jobs data. Gold remains at the mercy of the US dollar, and with little to no inflation evident, its hard to make a case for a sustained rally. $1268 (the closing low from last month) is now key support).

Currencies & Bonds

The Dollar Index surged last week to 2 month highs on a "perfect storm" of a weaker euro (thanks to the rate cut) and shifting tapering expectations (now split between January and March). Conversely, the euro plunged to a 2 month low, although the currency stabilized a bit in the 1.33—1.34 range at the end of the week. Since October 25th, the euro has declined more than 3% and the dollar has rallied nearly 3%, huge moves for the two world's two largest currencies.

Dollar strength was pretty universal last week, as the strong jobs data resulted in a higher dollar virtually across the globe. In particular, the yen dropped nearly 1% on Friday and importantly broke through the 99 yen/dollar level, which has been support. If it stays above 99 for another close or two, I think that signals the resumption of the downtrend in the yen. And, Instead of playing the guessing game of "Dec. vs. Jan. vs. March taper or no taper," I think one best ways to play the current environment is to refocus on the long Japanese stocks/Short Yen trade. Regardless of whether the Fed tapers in Jan or March, we likely won't see any material US Dollar weakness over the coming weeks or months, and that should mean a resumption of the downtrend in the yen, and a rise in Japanese stocks.

Turning to bonds, it appears that I was too aggressive on my target for the bond market "counter trend rally." Treasuries plunged last week on shifting tapering expectations, and the 30 year Treasury fell 1.5% while the yield on the 10 year Treasury broke through 2.70% for the first time in nearly a month.

So, it would appear that the resumption of the bond market decline has begun, although I continue to be stubbornly skeptical of how quickly the expectations of tapering of QE are shifting (if two weeks ago tapering was expected in June and that was too pessimistic, then now tapering in January seems a bit aggressive to me - but that's just an opinion). If you didn't use the two month plus rally to get "more short" or "less long" of bonds, I'd look to do so on any further bounce, as the downtrend in bonds appears to have once again resumed.

Have a good week and Thank You Veterans.

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	*While valuations are elevated, and there are "warning signs" in the market (small cap underperformance, loss of momentum stock leadership) 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 lows of last week (1746) while resentence is last weeks highs of 1775.*

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: **With Fed tapering expectations shifting to early 2014, the dollar should be supported over the coming months, which likely will result in the resumption of the decline in the yen. The weaker yen (and higher Japanese stocks) appears to be the clear winner from last week.**

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	*Commodities fell to multi-week lows last week as WTI Crude, gold and wheat all fell for various reasons (over supply, stronger dollar, etc.).*

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 Natural Gas around at these levels with a $3.40 stop: **The $3.40—$3.50 level in natural gas has held multiple tests of support over three months, and given we are heading into the winter seasons and inventories, while still elevated, are higher than they were last year, the case can be made for a good risk/reward set up.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Neutral	Neutral	Neutral	*It was a "perfect storm" for US Dollar Index strength last week, as a 25 basis cut in rates by the ECB and a strong jobs report pushed the Dollar Index to a multi-month high.*

Trade Ideas

Short: **Japanese Yen. The yen has been supported mostly by extreme dollar weakness, and with tapering expectations being pulled forward, the yen should resume its decline vs the dollar. YCS remains the best non-futures way to play the trade.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	Bearish	Bearish	Bearish	*The "counter trend rally" in bonds appears to have ended, thanks to strong economic data last week and shifting Fed tapering expectations. Once again the trend in the bond market appears to be lower.*

Trade Ideas

Buy: **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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