7:00's Report

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

November 13th, 2013

Pre 7:00 Look

- Futures drifting marginally lower this morning along with most international markets, as global central bank expectations continue to dominate trading.
- Economically data o/n was mixed: the UK Labour market report was strong, while EU industrial production slightly missed estimates. But, UK shares are down on the good report, as it's seen as prompting a removal of stimulus (so good news is bad).
- The Hang Seng was the big laggard o/n, dropping nearly 2% on China growth concerns and appears to be breaking down.
- Econ Today: No Reports Today. Fed Speak: Pianalto (8:45 AM) Bernanke (7:00 P.M.)

Market	Level	Change	% Change
S&P 500 Futures	1761.75	-3.25	-.18%
U.S. Dollar (DXY)	81.26	.008	.01%
Gold	1272.60	1.40	.13%
WTI	93.25	.20	.21%
10 Year	2.768	.017	.62%

Equities

Market Recap

Stocks continued their struggle to make new highs Tuesday, as profit-taking again weighed on the averages. The S&P 500 failed to make a new high, and ultimately declined 0.24%.

Stocks started the day modestly lower, mostly in sympathy with international markets, and if there was one "reason" I could point to, it was the disappointing Chinese data (more on that later). As has been the case with the exception of last Thursday, stocks weren't able

Hang Seng: Chinese shares topped earlier in September, and now appear to be breaking down, which is a potentially worrying sign for the global recovery.

to generate any momentum to the downside. The markets traded either side of flat for the rest of the morning and early afternoon, in what was mostly a news vacuum.

Programs pushed stocks to the lows of the day during the mid-afternoon session (there were no fundamental reasons for the sell-off). But like the morning session, there was no follow-through and the markets lifted into the close to finish marginally weaker but well off the lows.

Trading Color

There wasn't a ton of insight from the market internals yesterday, as most averages finished close to unchanged (the Nasdaq eked out a small gain on the close). The sector trading mirrors the general drift we're seeing in the averages, and there's no definitive theme in the sub-sectors other than pretty consistent underperformance of the "bond proxy" sectors, which is an offshoot of higher interest rates. Utilities again lagged, falling 0.8%, and REITs dropped 0.45%, but banks didn't catch a bounce. (Financials were actually the worst-performing S&P subsector.) So, we can't say there was a "higher yield" rotation trade at work yesterday.

Market	Level	Change	% Change
Dow	15750.67	-32.43	-.21%
TSX	13326.04	-32.35	-.24%
Brazil	51804.33	-819.54	-1.56%
FTSE	6653.94	-72.85	-1.08%
Nikkei	14567.16	-21.52	-.15%
Hang Seng	22463.83	-437.58	-1.91%
ASX	5319.18	-73.92	-1.37%

Prices taken at previous day market close.

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Looking at some of the specific news of the day, homebuilders actually rallied despite the tick higher in rates, but that was mostly due to the D.R. Horton (DHI) earnings beat. Transports rallied off the US Airways (LCC)/AMR Corp. (AAMRQ) announcement of the settlement that will allow the airlines to merge. Apparently the Department of Justice was confident there wouldn't be a significant reduction in flight availability from Reagan National Airport for congressmen and bureaucrats (I mean, for the public at strategic airports).

Market	Level	Change	% Change
Gold	1263.00	-18.10	-1.41%
Silver	20.625	-.657	-3.09%
Copper	3.2215	-.038	-1.17%
WTI	92.99	-2.15	-2.26%
Brent	105.87	-.53	-0.50%
Nat Gas	3.621	.047	1.29%
Corn	432.25	-2.50	-0.57%
Wheat	645.25	-1.00	-0.15%
Soybean	1314.50	13.50	1.04%

Prices taken at previous day market close.

Refiners also caught a bid yesterday thanks to an article stating the EPA might actually reduce the renewable fuels mandate for this year back to 2012 levels, which would help increase refiner margins, yet be a big negative on corn prices.

Volumes remained subdued yesterday and were well below recent averages, as a state of paralysis seems to have gripped the market (no one wants to lose their year by doing anything overly aggressive). On the charts the picture remains the same: The S&P continues to fail at resistance at the old highs 1,775, while support lies at last week's lows (1,746).

Bottom Line

The market continues to show some signs of fatigue (S&P can't break through 1775) but really all we're doing is running in place. The calendar is starting to play a bigger role in the market as liquidity has totally dried up. Big money funds are content to largely call it a year, and aren't interested in adding exposure at these levels or buying the slight dips (as they've been doing). So, the result is a stalemated market that is totally dominated intra-day by programs, hedge funds and day traders.

Stepping back the narrative remains largely the same: Valuations are stretched but not crazy, and the macro horizon is as clear as its been in years, yet the "pain trade" remains higher thanks to continued high levels of skepticism (every 5 ticks down in the S&P brings cries of "this is it"), although there are some subtle signs this is changing—slightly.

For now, though, I'd maintain equity allocations and ride the trend, and the best areas of new opportunity remain either outright foreign longs or as spreads: Long DXJ or a long DXJ/Short SPY spread, Long VGK/Short SPY or anything "short bond" related (TBF/TBT on any dip).

Are Chinese Officials "OK" With Slower Growth?

There was a lot of news out from China yesterday, and generally speaking it wasn't very encouraging from a global growth perspective, because it implied the Chinese government is becoming comfortable with a slower pace of economic growth. Obviously, if that happens, it's a problem for the global economy, as China remains a big driver of global GDP growth.

First, there were more signs of monetary tightening in China yesterday, as October loan growth missed estimates (increasing by 506 billion yuan vs. (E) 580 billion yuan). This matters because, more so than any developed nation, the Chinese government really controls how much loan growth there is, and not the private sector (mainly because all the big banks are state-owned). So, slower loan growth reflects the government's lack of a desire to provide liquidity, which obviously isn't pro-growth.

Second, I noted in yesterday's Report that there is some fear Chinese authorities may cut their GDP growth target to 7.0% from 7.5% this year (2013). Well, on cue the FT released an article postulating that's exactly what Chinese officials will announce in the coming days, and that's one of the reasons for the deep industrial commodity and "China related" weakness in the markets yesterday. (Australian shares got hit as well.)

The third event people were watching in China yesterday was the results of the "Third Plenary Session of the 18th CPC Central Committee." Basically that's a very odd term for a meeting between all the leaders of the Chinese government and ruling Communist Party, where they craft the general direction of policy for the economy over the next 10 years. There was hope that some substantial, growth-enhancing reforms might emerge

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from the "Plenum" but instead there were just broad generalizations about when results of the meetings would be announced. So, there wasn't anything concretely positive to counter the concerns about growth.

But, while the announcement from the "Plenum" was disappointing in the short term, there were interesting takeaways about the longer-term future of the Chinese economy. First, Chinese officials promised a "decisive" role of the markets in the allocation of resources to the economy in the next decade (up from a previous "basic" role of the markets). So, we can take that as a mild positive.

More importantly, though, there were some strong hints at reforms designed to help further balance and mature the Chinese economy from an export-driven economy (meaning the world's factory) to one that also has a strong consumer demand element to it (similar to what happened in the U.S. in the years following the Industrial Revolution in the late 19th and early 20th centuries).

For instance, one of the bigger reforms that is expected to be announced soon is the removal of the two-tiered real estate system. Currently farmers moving into the cities cannot sell their farms to help fund their urban lifestyles, so they are stuck with the asset while living in the cities. With that obstacle removed, obviously those farmers will have more disposable income and it'll encourage more migration into the cities.

That real estate reform underscores the future (and I mean long-term future) of the Chinese investment landscape, where you no longer want to profit from China by "buying what China buys" (like industrial metals), but instead "buying what the Chinese consumer buys." Over the next decade, that's where the money will be made by investing in China – through finding companies that can tap into the rising "middle" class of the Chinese consumer. It's something to consider for an IRA or other long-term account, but that's where the opportunity is.

Market	Level	Change	% Change
Dollar Index	81.24	.04	0.05%
EUR/USD	1.3429	.003525	0.26%
GBP/USD	1.5894	-.00873	-0.55%
USD/JPY	99.62	.0885	0.09%
USD/CAD	1.0492	.00087	0.08%
AUD/USD	.9301	-.0034	-0.36%
Brazilian Real	.4296	.0033	.77%
10 Year Yield	2.768	.017	.62%
30 Year Yield	3.855	.007	.18%

Prices taken at previous day market close.

Economics

No economic reports yesterday.

Commodities

After a pretty quiet trading day on Monday, commodities experienced broad weakness in yesterday's session. Weak economic data and forecasts out of China weighed on industrials while the energy space was hit because of both supply data and an announcement by the IEA that the United States would be the largest oil producer by 2015. The PowerShares DB Commodity Index Tracking Fund (DBC) was down 0.67%.

The sole outperformer yesterday was natural gas, seeing its 5th move higher in 6 sessions that pushed it up by 6% in just a week. Snowfall across the Northeast helped natural gas accelerate higher in yesterday's session. However, it was unable to close above the 50-day moving average, which remains the ceiling for now.

It has become a trend recently for nat gas to make a weather-driven rally but then fail to hold onto gains. So, as weather warms back up later this week, look for prices to come back in. Anyone with long trading positions should take this opportunity to close out or at least take some profits.

Crude oil was one of the worst performers in the commodity space yesterday, falling 2.26%. WTI crude oil finally broke out of a five-day consolidation pattern and continued its two-month downtrend, making a new low of $92.86/Bbl into yesterday's close. Crude moved lower on technical and lingering supply concerns (the IEA article just mentioned).

Gold and silver both sold off considerably yesterday, down 1.41% and 3.09% respectively. Confusion about when to expect a taper of QE out of the Fed has made long positions unappealing to most investors and even to spec traders, as technical support levels continue to be broken. The key catalyst for yesterday's declines was the Lockhart comments,

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that a taper in December is not completely off the table; this added to the already-abundant selling pressure in precious metals.

Gold is now approaching its last thread of support at the Oct. 15 low of $1,251. Beyond that it looks like a pretty straight shot down to the $1,200 level.

Copper lost 1.17% in yesterday's primary session as Chinese growth fears weighed on outlooks for demand (the expected reduction in growth from 7.5% this year to 7.0% next. Copper, like crude oil, broke down out of a narrowing range, a rather bearish technical move. Copper has limited support where it is currently trading and, if it violates $3.19, look for a follow-through reaction with the next stop down around $3.00.

Currencies & Bonds

The Dollar Index saw a small rally Tuesday (up 0.08%) but that understates the strength in the dollar yesterday, as it was higher vs. every major currency except for the euro (hence the mild gains in the Dollar Index). Helping the dollar were marginally "hawkish" comments by Fed Presidents Lockhart and Richard Fisher, who respectively said "QE Can't Go On Forever" and a December taper is still on the table.

But, the effects of these comments were somewhat muted because neither man is a voting member of the FOMC this year (although Fisher will be a voting member in 2014). The pound, yen and Aussie all declined about 0.5% vs. the dollar, and each hit lows last seen in early September. So, again there was some broad dollar strength yesterday even though it didn't reflect in the Dollar Index.

As for the euro, it didn't really rally on any news. (Actually the only "news" in the euro was somewhat bearish, as German ECB member Jorg Asmussen said in an interview with the Dow Jones that the ECB has more tools at its disposal—again vague, but somewhat noteworthy coming from a German.) But, really what we saw yesterday was a continued bounce in the euro after last week's sharp declines, as the broad questions of "Will the Fed Do Less?" (meaning taper) and "Will the ECB Do More?" (meaning ease further) remain the two most-important questions in the currency markets. Until we have some more clarity on both, I don't expect really substantial moves in either currency from current levels.

Turning to bonds, Treasuries were slightly weaker in quiet trading and the 10-year yield crept a few ticks higher toward 2.80%, but overall it was a quiet day. Of note, though, was the fact that the bond market didn't react to the equity market sell-off. (Bonds didn't really catch a bid when stocks were at their lows of the day, reflecting the pressure on bonds at the moment.) Support in the 30-year Treasury basically lies at the "big figures" of 131'00 and then 130'00, so there's not much to hold bonds up right now other than dovish Fed commentary or soft economic data.

Fundamentally, there was a three-year Treasury bill auction that was well-received. That's not surprising, because we should expect the short end of the curve (under five years) to continue to see strong demand. It's the long end of the curve (seven to 30 years) that will get hit the hardest in continued bond market decline.

Looking at the auction results, the bid to cover for the $30 billion offering was 3.46, the highest since March, and the yield on the offering met the "when issued" yield (both signs of strong demand). So, although the "long" end of the yield curve appears to have rolled over and is declining, the "short" end remains well-bid, and as a result we're seeing the yield curve continue to steepen—a trend I expect to continue (with fits and starts depending on QE expectations).

One of the key takeaways from yesterday's auction is to realize that if the duration of your bond holdings is in the longer end of the curve, one way to protect yourself is to "shorten" that duration, although obviously you'll earn less interest. But, it's better than seeing the value of the bonds decline.

Have a good day,

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.**

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.**

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.**

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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