7:00's Report

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

November 14th, 2013

Is "Dr. Copper" sick? Copper broke below three month support yesterday on Chinese growth concerns. That shouldn't happen if the "global recovery" remains intact.

Pre 7:00 Look

- Futures and international markets slightly higher on hopes for continued global stimulus.
- Economic data o/n wasn't very good. Japanese Q3 GDP and EU Q3 GDP generally met expectations, but the details of both reports were weak, arguing for more stimulus from the BOJ and ECB. Also, UK Oct. retail sales unexpectedly declined, missing expectations.
- Yellen confirmation hearings begin at 10 AM.
- Econ Today: Weekly Jobless Claims (E: 330K). Fed Speak: Plosser (9:00 A.M.), Yellen (10:00 A.M.)

Market	Level	Change	% Change
S&P 500 Futures	1782.75	4.00	.22%
U.S. Dollar (DXY)	81.24	.262	.32%
Gold	1283.40	15.00	1.20%
WTI	93.70	-.17	-.18%
10 Year	2.725	-.043	-1.55%

Equities

Market Recap

Stocks managed to grind their way to new all-time highs Wednesday, as the S&P 500 broke through resistance at 1,775 in quiet trading. The S&P 500 closed up 0.81%.

The resiliency of this market remains its hallmark. Stocks opened lower Wednesday in sympathy with most international markets. And, shortly after the open it looked as though we were going to see an acceleration to the downside, despite the lack of news to account for the declines. But, as it has done so many times before, the market halted its declines and began a methodical rally —one that caused shorts to cover and "pulled in" longs as the market broke through the old all-time high at 1,775. As far as "why" stocks reversed, there wasn't any concrete reason but certainly M (Macy's) great earnings, and anticipation of a "dovish" Yellen at her confirmation hearing, both helped. Stocks climbed steadily throughout the afternoon session and went out basically at their highs of the day.

Despite the "reasons" for the rally yesterday, In the short term, this market remains driven more by sentiment and positioning (with investors scared to screw up a good year but at the same time also afraid to miss a year-end rally) than it is by news or fundamentals, as the investment landscape remains largely the same as it has been for the past week or two.

Point being, there hasn't been any "new" fundamental news in the markets over the past two weeks, and the while whole world is still trying to "game" what's next for the Federal Open Market Committee (when will it taper) and the European Central Bank (when will it ease further), stocks simply continue to grind steadily higher.

Market	Level	Change	% Change
Dow	15821.63	70.96	.45%
TSX	13377.11	51.07	.38%
Brazil	52230.29	425.96	.82%
FTSE	6658.30	28.17	.42%
Nikkei	14876.41	309.25	2.12%
Hang Seng	22649.15	185.32	.82%
ASX	5355.43	36.25	.68%
Prices taken at previous day market close.			

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Simply, stocks care a lot less about when the Fed tapers than the bond or currency markets, and while there are daily gyrations, the outlook for both central banks remains largely static, resulting in sentiment and positioning being the main drivers of stocks heading higher.

There were a few events that moved markets after hours yesterday. First, on the negative side, CSCO missed earnings last night and the stock is down more than 10% after hours, which is going to weigh on tech and the Nasdaq this morning. From a commentary perspective, CEO John Chambers didn't really say much on the global macro-economy, but he was very, very negative on the emerging markets, and blamed underperformance there for the soft results and weak outlook. So, although some are looking for a "buy the dip" play in EM, between Chambers comments and the prospects of Fed tapering putting downward pressure on EM bonds and currencies, I'd resist the urge to "buy the dip" and stay in the more developed markets right now, as I simply don't think the risk is worth the reward at the moment.

Market	Level	Change	% Change
Gold	1268.5	-2.70	-0.21%
Silver	20.56	-.218	-1.05%
Copper	3.163	-.071	-2.23%
WTI	93.83	.79	0.85%
Brent	107.20	1.39	1.31%
Nat Gas	3.561	-.056	-1.55%
Corn	429.75	-2.50	-0.58%
Wheat	645.50	.25	0.04%
Soybean	1315.00	.50	0.04%
Prices taken at previous day market close.			

Also, Janet Yellen's testimony to the Senate today was leaked after the close. It was taken as "dovish" in that she defends QE, and it did cause gold and bonds to rally, although I think that was more a function of nervous shorts more than anything else. Bottom line is Yellen is a "dove" and will talk like a "dove." There wasn't anything new in the remarks, and her confirmation is widely expected.

Trading Color

It was a typical "pro-cyclical" rally to new highs yesterday, which is what you want to see. The Russell 2000 and Nasdaq both led markets to the upside, while from a sector standpoint consumer discretionary, tech, energy, financials, and home builders outperformed, while traditional "defensive" sectors like utilities, telecom and healthcare lagged.

Macy's (M) earnings were the big "micro" headline yesterday, and they were surprisingly strong as earnings, revenues and same store sales all beat expectations. That has led to some optimism towards the holiday shopping season, and the results lifted the Morgan Stanley Retail Index to new all time highs.

Volumes remain relatively light, as large investors remain on the sidelines, but that's been the case for months. On the charts the S&P 500 is at new all time highs, and rule #1 in techincal trading is "You buy what's making new highs, and sell what's making new lows." Support remains last week's lows (1784).

Economics

No reports yesterday.

Commodities

Commodities were mixed yesterday, with crude oil and refined products outperforming while metals traded lower for much of the day before getting a bounce on the Yellen testimony. The PowerShares DB Commodity Index Tracking Fund (DBC) was up 0.4% as the energy space carries a heavier weight in the index.

Crude oil bounced higher yesterday after seeing the largest sell-off in over a month on Tuesday. Crude was drawn higher by strength in both RBOB gasoline and heating oil prices, which rallied 1.65% and 1.50% respectively, while crude logged gains of just 0.8%.

The rally in refined products was largely due to speculation on another draw in gasoline and distillate supplies in today's inventory report, which will in turn spark higher refiner utilization levels and more demand for oil. This is supported by a move higher in the so-called "crack spread" that compares ratios of RBOB gas, heating oil and crude oil futures prices, painting a general picture of what current profit margin levels are for refiners.

With the crack spread near a three-month high, demand for crude oil can be expected to jump as refiners take advantage of the price ratio between refined products and crude oil. However, this is not necessarily a reason to buy WTI futures at these levels. Crude inventories

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remain above the five-year range and, until we see a substantial downtrend in oil reserves, prices are expected to be range-bound in the mid- to low-$90/Bbl area.

Gold "pinballed" through most of the trading session until sellers took control and the price began to break down in the last hour of the primary session, closing down 0.21%. But, gold caught a life preserver from the "dovish" Yellen prepared text and rallied 1% after hours. Gold and silver remain totally at the mercy of tapering expectations, and I don't think this downtrend is over.

Natural gas futures retreated as the cooler weather we saw earlier in the week has passed through most of the Northeast. As I mentioned in yesterday's Report, it has become routine for natural gas to rally on weather-related news and then fail to sustain the gains as temperatures warm back up (or cool back down in the summer). Barring a big, unexpected change in inventory levels out of the EIA this morning, we can expect to see more of the same weather-directed price action and I'd look to re-but natural gas on a dip back towards $3.40, but not at these levels.

Copper was the worst performer of the day yesterday, trading down to its lowest levels in three months amid fears that China's of slower growth in China. Copper was down 2.23% to $3.16/lb. The chart for copper is downright ugly, with the spot price crashing through the last level of support without hesitation. Right now we can chalk up coppers declines to China concerns, but given it's a pretty good indicator for the global economy, this persistent weakness in copper will need to be monitored.

Currencies & Bonds

Yesterday ECB chief economist Peter Praet personified the confusion and mixed messages investors are getting from the world's central banks. In an interview with Dow Jones, Praet said first that the ECB would consider using QE or paying negative interest on excess reserves if the economy needed it. The comment followed similarly dovish messages by other ECB members this week and resulted in the euro selling off and the Dollar Index rallying. But, in the same interview, Praet later said that no further easing was needed at the moment, which sparked a rally in the euro (which ended the day up 0.3%) and a drop in the Dollar Index (which fell 0.34% on the headline-inducing whiplash).

Market	Level	Change	% Change
Dollar Index	80.97	-.282	-0.35%
EUR/USD	1.3465	.00152	0.11%
GBP/USD	1.6028	.01338	0.84%
USD/JPY	99.35	-.125	-0.13%
USD/CAD	1.0465	-.00194	-0.19%
AUD/USD	.9327	.002125	0.23%
Brazilian Real	.42710	.0002	.05%
10 Year Yield	2.725	-.043	-1.55%
30 Year Yield	3.829	-.026	-.67%
Prices taken at previous day market close.			

The big winner of the day in the currency space yesterday, though, was the British pound, which rose 0.9% and closed back above 1.60 vs. the dollar on a combination of factors. First, it was a strong labor market report. Then, the Bank of England pulled forward the date it thinks the unemployment rate will drop to 7% to the fourth quarter of 2014—a full 18 months earlier than previously thought.

That change, contained in the BOE's inflation report, was obviously taken as hawkish, although the BOE was quick to note that a sub-7% unemployment rate wouldn't directly result in a rise in interest rates. It tried (unsuccessfully) to use "forward guidance" to reassure markets that rates would stay low for a long time into the future. But, regardless of their efforts, for now the trend in the pound remains higher.

The yen was the big mover overnight, as it plunged .6%, basically to 100/dollar on the weak Japanese GDP report (which argues for more stimulus). The downtrend in the yen is accelerating, although by no means has anyone missed this trade. YCS and DCY remain two of the more fundamentally sound trades in the market (we don't have to guess about the BOJ's intentions) and there's much more to go on both.

The Treasury market bounced yesterday, with the 30-year note rallying 0.29% and the 10-year yield moving back down toward 2.70% (closed at 2.725%). Mostly the rally was just an oversold bounce, which is to be expected. But the 10-year auction yesterday was well-received, which provided an extra boost to Treasuries in the early afternoon.

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The Treasury auctioned $24 billion worth of 10-year bonds, and the bid to cover (a measure of demand) was the second-highest since May at 2.70, where the yield was half a basis point below the "When Issued" yield—again signaling good demand.

This strong 10-year auction comes on the heels of Tuesday's good three-year auction, and reflects a still-decent appetite for U.S. debt (and some doubt about just how committed the Fed is to tapering QE). Today's 30-year auction will be interesting to see if the demand for the near-dated issues extends to the long bond. Certainly the issue won't "bomb," but I'd be surprised if demand is as strong as it has been for the two previous auctions this week.

Are Higher Yield European Bonds the Answer to ECB Indecision?

The ECB seems intent on challenging the Fed as the central bank with the most conflicting messages each week. Last week the market was both disappointed by the extension of the main refinancing operation, which many took to signal that the ECB was "done" for a while and won't unleash any greater policy measures to combat dis-inflation. But, just this week we've had three ECB officials come out and imply that it stands ready to "do more" and would even consider QE or negative interest on excess reserves.

Further complicating the matter is the politics of the ECB. When there is a dis-inflation scare in the U.S., we can rely on the Fed to unleash stimulus, as they've done many, many times. But, with ECB, it's not so causal. The German (and, really, Northern European) factions on the ECB are anti- inflation, and as such are generally hesitant to take extraordinary measures unless it's to avoid a total catastrophe (like the breakup of the euro).

From an investing standpoint, that makes analyzing the growing opportunities in Europe very difficult, because we're basically forced with a binary outcome: Either the ECB does nothing further, and we worry about the euro zone slipping into Japanese-style deflation, or the ECB acts like the Fed or BOJ and the European markets react like the U.S. markets did when QE programs were unleashed. But, perhaps there is one way to be a relative winner in both scenarios.

Higher-yielding European bonds (and I'm not necessarily talking about junk bonds, but something with a bit more yield than German bunds), theoretically speaking, should do well in either scenario.

On one hand, if the ECB fails to act, or is slow to react, we'll see dis-inflation start to morph into deflation—which will be good for bonds (as long as they aren't too high-risk). On the other, if the ECB does act forcefully and adopts a QE program (or institutes a negative rate on excess reserves), then that should result in a big bond rally—the likes of which we saw when the Fed started its QE program—as investors stretch for yield in a perennially low-yield environment.

Even if the ECB is successful in stoking inflation, it'll be a long time before it materializes (as we've seen with our own QE program). One way or another, the coming environment in Europe, as long as it doesn't devolve into another recession (which is shouldn't) should be good for higher-yielding European bonds, especially on a bit of a pullback.

The issue with this, of course, is getting easy access to the asset class. There are two "foreign" high-yield ETFs (IHY and HYXU) and, although they are foreign, the vast majority of holdings are European debt. Both yield over 5%, but you've got currency risk in both (possibility of a declining euro) and they trade by appointment only and not very good options. Additionally, they both seem to trade in lockstep with the European equity market.

I'm going to look into mutual funds today to see what viable options there are, but if we're looking at a scenario where we have either 1) a bout of deflation or 2) extraordinary amounts of stimulus, European bonds (specifically, higher-yielding bonds) could be the winner, in stark contrast to the U.S., where the bond market clearly appears to be rolling over. So, for those needing to maintain bond allocations for clients (and that's pretty much everyone in some fashion), perhaps European bonds are a place to look for opportunity, as their outlook seems a lot better than domestics. I'll investigate further.

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	*Stocks moved to new all time highs this week as sentiment and expanding multiples continues to drive stocks higher. There are warning signs out there, but for now the the "pain trade" remains higher.* *Markets are at all time highs while support lies at the lows of last week (1748).*

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.**

	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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