7:00's Report

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

November 15th, 2013

Pre 7:00 Look

- Futures and European markets are trading slightly higher on follow through from yesterday's "Yellen" rally.
- The Nikkei continues to surge as the yen moves further above the 100 to the dollar level, rallying another 2% o/n and 7.6% this week!
- There was little econ data o/n: Final EU HICP (an inflation reading) confirmed the soft advance report of two weeks ago, reminding everyone dis-inflation is a threat in the EU.
- Econ Today: Empire State Manufacturing Survey (E: 5.5), Industrial Production (E: 0.1%).

Market	Level	Change	% Change
S&P 500 Futures	1791.50	3.75	.21%
U.S. Dollar (DXY)	81.125	.039	.05%
Gold	1281.70	-4.60	-.36%
WTI	93.81	.05	.05%
10 Year	2.702	-.023	-.84%

Equities

Market Recap

Stocks once again methodically grinded to new all-time highs Thursday, as "dovish enough" comments by Janet Yellen at her confirmation hearings helped push risk assets higher. The S&P 500 rose 0.48%.

Stocks opened the day flat but started to rally shortly after Yellen's confirmation hearings began. I cover it more later, but Yellen was predictably dovish and there weren't any surprises or bombshells, as she was almost a clone of Ben Bernanke. The dovish comments and lack

The Evolution of Tech: Enterprise-linked companies like CSCO and IBM have lagged badly, while Internet and "mobile" companies have prospered.

of any surprises removed any potential resistance to the rally. With the hearings out of the way, stocks resumed their grind higher and, just like on Wednesday, stocks spent the rest of the day drifting slowly and methodically higher in relatively quiet, news-less trading, and went out at the highs of the day.

Trading Color

Although stocks again hit new highs, it wasn't a typical cyclical-led rally. The Russell 2000 finished marginally negative on the day and oddly still is a ways from a new all-time high. The Nasdaq lagged as well, although Cisco Systems' (CSCO) 11% decline had a lot to do with that, so it can be somewhat discounted.

There was broad strength in the sub-sectors yesterday, although interest-rate-sensitive sectors (utilities, REITs, homebuilders) all outperformed off the "dovish" Yellen comments of the past 36 hours. But, strength was widespread as financials rallied nearly 1%, while consumer staples and basic materials stocks were also strong.

Market	Level	Change	% Change
Dow	15876.22	54.59	0.35%
TSX	13457.60	86.94	0.65%
Brazil	53451.60	1221.31	2.34%
FTSE	6702.63	36.50	.55%
Nikkei	15165.92	289.51	1.95%
Hang Seng	23032.15	383.00	1.69%
ASX	5401.67	46.24	.86%

Prices taken at previous day market close.

From an earnings standpoint, CSCO was obviously a disappointment and weighed on tech. But one interesting thing to point out is, while the commentary and outlook for the emerging markets was awful, there was some positive commentary on the recovery in Europe—which makes me feel a bit better about the "long Europe/ short SPY" spread trade.

Market	Level	Change	% Change
Gold	1284.20	15.80	1.25%
Silver	20.72	.278	1.36%
Copper	3.164	.0045	0.14%
WTI	93.78	-.10	-0.12%
Brent	108.51	1.39	1.30%
Nat Gas	3.597	.031	0.87%
Corn	426.50	-3.25	-0.76%
Wheat	644.75	-.75	-0.12%
Soybean	1313.50	-1.50	-0.11%
Prices taken at previous day market close.			

Wal-Mart (WMT) beat earnings but missed on revenues and same -store sales, but didn't really have any major commentary on the state of the consumer. Nordstrom (JWN) was also largely in-line, and both stocks finished flat on the day after recovering from early weakness. Generally, you get the feeling investors are starting to raise their projections for holiday spending.

Liquidity and volumes remain relatively light, and the intraday trading continues to be dominated by hedge funds and day traders. Vanilla funds are participating in pockets but mostly are content to sit on the sidelines at the moment. Volumes were a bit heavier than in recent a days but still not heavy. On the charts, things remain the same—the market is at new highs while support lies lower at 1,746.

Bottom Line

The melt up continues as buyers are being "pulled in" but skepticism remains and the "pain trade" is still higher. It feels like sentiment is changing slightly towards the more bullish camp, but not enough to say we're close to a material correction.

There's no way I'd add exposure at these levels to domestic equities, but if you're long, stay long. 1800 in the S&P seems a formality at this point, although that might end up being a "rest stop" on this relentless rally, as we're once again stretched short term.

Yellen Testimony Recap and What's Next For the Fed

Yellen was predictably vague and very "Bernanke-like" at her Senate confirmation hearing yesterday, and all in all it went smoothly. There's no need for me to re-hash the comments, as plenty of re-caps have been written about it. But the bottom line is she was expected to be "dovish" and defend the QE program, yet give no specifics about when it might end—and that's exactly what she did.

One thing I will point out is she was somewhat dismissive of the idea that the Fed, through its policies, is risking creating another asset bubble (or bubbles), and I was somewhat surprised by just how dismissive she was. Thinking much longer-term (I do have an 18-month-old son), that quick dismissal of the unintended consequences of the Fed's policies took me a bit by surprise.

Of course, I shouldn't be surprised, as academics and policy-makers rarely seem to consider the potentially negative effects of their actions. But, it only reinforces the nagging feeling that ultimately this doesn't all end very well (either by massive inflation or otherwise). But that's a problem for another day.

More importantly, the question we must address is "What's next for the Fed?" Currently the consensus expectation for the Fed is still for tapering to occur between January and March. (December remains a long shot.) But, more importantly, I want to make everyone aware of the subtle movement happening around the Fed that implies it is once again considering favoring "forward guidance" and zero-interest rate policies (ZIRP) over QE.

Put simply, there is building evidence that the Fed is looking to replace QE purchases with more direct "forward guidance" on ZIRP (saying rates will stay lower for longer). Over the past two weeks, Fed researchers released a paper stating that keeping ZIRP in place longer than currently estimated would do more to bring down unemployment than QE. And, yesterday Fed insider Jon Hilsenrath of the WSJ detailed the growing shift of Fed members toward extended ZIRP by lowering the unemployment threshold to 5.5% from the current 6.5%.

Longer-term clients are well-aware of this, because we discussed this at length back in the mid-summer when it because apparent the Fed would try to replace QE with forward guidance and extended ZIRP. And, back then I said that was going to be a mistake, as simply telling people you'll keep interest rates low for years into the future (when a lot can change economically during those years, especially now) isn't as effective as actually buying billions of dollars in bonds each month.

I certainly have no place challenging Fed governors on monetary policy, yet some anecdotal evidence so far says I'll be right. The Bank of England is on the leading edge of using "forward guidance" as a monetary policy tool, and so far it isn't really working. Despite assurances the BOE will keep rates low, the 10-year yield on gilts has risen from 2.38% on July 4, when forward guidance was formally announced, to a high of 3.02% in September, and is currently at 2.78%.

The reason yields have risen has been because of the rise in U.S. yields, and also because the UK economy is getting better. Regardless of what the BOE says, investors can see the economy getting better and are reacting accordingly. And, the fact that the BOE pulled forward by 18 months its estimated date when it would hit its 7% unemployment rate threshold this past week in its inflation report doesn't help its credibility on forward guidance.

From an investment standpoint, I think the shift away from QE and toward the use of "forward guidance" will remove the support QE has given the bond market and ultimately result in a sharper decline in the bond market than compared to keeping "QE Infinity" ongoing. Bottom line is this: If the Fed replaces QE with forward guidance, I think that only causes the acceleration of the bond market decline, so we should all be aware and positioned accordingly.

Market	Level	Change	% Change
Dollar Index	81.09	.107	0.13%
EUR/USD	1.3454	-.00135	-0.10%
GBP/USD	1.6056	.00244	0.15%
USD/JPY	100.06	.4065	0.41%
USD/CAD	1.0483	.001235	0.12%
AUD/USD	.9316	-.0031	-0.33%
Brazilian Real	.42950	.0026	.61%
10 Year Yield	2.702	-.023	-.84%
30 Year Yield	3.800	-.029	.76%
Prices taken at previous day market close.			

Economics

Weekly Claims

- Weekly Claims were 339K vs. (E) 330K.
- 4 week moving average dropped to 343K.

Takeaway

Jobless claims remained stubbornly high this week, again providing a non-confirmation signal of the shocking good monthly jobs report from last week.

Claims remain at basically the same levels they were in August, implying we are not seeing the incremental improvement in the labor market recent data suggest.

Normally, we see improvement in the jobs market in weekly claims first (they start to decline) but that hasn't happened here. This is going to continue to make people skeptical about the monthly jobs report and about the direction of the jobs market going forward. The claims report isn't going to affect expected tapering of QE by any means, but it is going to keep doubts alive about the validity of the recent jobs report and of the incremental improvement in the labor market.

Commodities

After a choppy and mixed morning of trading yesterday, commodities finished trading mostly higher with the exception of the grains, which were led lower by corn. The energy space outperformed for the second day in a row with RBOB gasoline futures gaining 2.15%. The benchmark PowerShares DB Commodity Index Tracking ETF (DBC) was up 0.44%.

RBOB gasoline futures increased for the 4th time in 5 sessions yesterday on yet another draw in supply. The EIA reported a draw of 800K barrels in gasoline inventories last week; however, this is a much lower drawdown than two weeks ago where we saw a 3.8 MM Bbl decline in supply levels. The "crack spread" I mentioned yesterday jumped higher by more than 10% due to weakness in crude. All indications are pointing to an increase in production of refined products in the coming weeks as the profit margins become more and more favorable, which likely will result in increased supplies of RBOB gasoline and heating oil. So, at this point it doesn't look like these rallies are sustainable.

Nymex crude oil futures opened the session almost a dollar lower than Wednesday's close and continued to trade down to a fresh 5 month low following the delayed EIA supply data release. The EIA reported a build of 2.6MM Bbl last week, beating estimates of just an 800K Bbl build.

The sentiment was lower in WTI until news broke of a natural gas pipeline exploding in Texas. The news pushed the price of crude futures into a technical gap between Wednesday's close and yesterday morning's open, and as they say on Wall Street, "all gaps will be filled sooner or later."

Shortly thereafter, the technicians and algorithms drove the price higher and followed through the technical price targets. Crude turned positive midday before losing steam and ending the session more or less unchanged. Bottom line: Movement in the oil market is primarily technical right now as the price is content where it is based on current supply and demand conditions while the geo-political risk premium remains relatively small.

Gold moved higher for the second day in a row following dovish commentary out of Fed chief nominee Janet Yellen. Gold rallied nearly $25 from Wednesday's lows, thanks to the "dovish" Yellen testimony.

In the short term, gold appears to have gotten a "life line" from Yellen, and it held support at $1260. But, lost in Fed chatter yesterday was the fact that the World Gold Council reported physical demand for gold is down 21% year-over-year, putting it at a 4-year low. Yellen's "dovishness" aside, gold will continue to have a hard time sustaining any material rally until inflation begins to tick higher and for now Gold is still range-bound at best, while the benefit of the doubt lies with the bears. $1260—$1340 remains the range.

Currencies & Bonds

The bond market was stronger yesterday (the 30-year note rose 0.28%) although a pretty bad 30-year auction saw the 30-year bond rally cut in half at midday and bonds finished well off their highs. The $16 billion auction of 30-year Treasuries saw the second-lowest bid to cover (a measure of demand) of the year, while the yield "tailed" 1.5 basis points above the "When Issued" yield, showing less-than-enthusiastic investor demand.

The soft 30-year auction followed two solid three- and 30-year Treasury auctions earlier in the week, and reflects the growing dynamic in the bond markets: Near-dated bonds are going to be just fine, but it's the long end of the curve that is at the most risk and will see some of the biggest declines as the bond bear market evolves.

What's more, the bond market basically called a "bluff" on the "dovish" interpretation of the Yellen testimony and comments. The outlook on Fed tapering (and for Fed policy) hasn't changed materially post-Yellen testimony, and likely all we've seen since Wednesday is an oversold bounce in bonds that likely should be further shorted at these levels.

Currency markets were relatively quiet yesterday, with the exception of the yen, which broke through the 100 yen/dollar level for the first time since September. The yen dropped on a combination of the Q3 GDP report (the headline was "OK" but the details were weak, prompting speculation for more stimulus) and comments by finance minister Taro Aso, who said that the Bank of Japan still had the capability to intervene in the currency markets to depress the value of the yen, if needed. The 100 level will likely be defended by the yen longs in the short term, but it appears the decline in the yen has resumed in earnest, and I'd expect the 103 yen to the dollar level to be challenged over the coming weeks.

Away from the yen, the euro was little-changed despite a slightly disappointing Q3 GDP report, while the "commodity currencies" were also flat. The pound was again the big winner vs. the dollar yesterday, as dip-buyers stepped in off initial weakness from an October retail sales report that missed expectations.

The one data point aside, though, the UK economy continues to recover, and despite the BOE's "forward guidance," the market is continuing to "pull forward" the date when the BOE will begin to remove accommodation.

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	*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.**