7:00's Report

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

November 19th, 2013

Pre 7:00 Look

- Futures and international markets slightly lower as markets continue to digest recent gains.
- The OECD cut global economic growth forecasts for 2014 from 4.0% to 3.6%, primarily due to expected continued weakness in the emerging markets.
- Economically it was a quiet night. The German ZEW confidence index was a touch better than estimates (54.6 vs. (E) 54.0) but it's largely being ignored this morning.
- Econ Today: No Reports Today.
- Fed Speak: Evans (2:15 P.M.), Bernanke (7:00 P.M.).

Market	Level	Change	% Change
S&P 500 Futures	1787.00	-1.75	-.10%
U.S. Dollar (DXY)	80.835	.009	.01%
Gold	1270.50	-1.80	-.14%
WTI	92.83	-.20	-.21%
10 Year	2.678	-.031	-1.14%

Equities

Market Recap

Stocks hit new all-time highs again yesterday but ended modestly lower, mostly on verbiage, as comments by Fed officials (that were both anticipated and actual) and a warning on the market by Carl Icahn resulted in a late-day sell-off. The S&P 500 fell 0.37%%.

Stocks started the week slightly higher, in sympathy with foreign market who rallied off the positive Chinese economic reforms, and resumed their daily grind higher to new highs shortly after the open. Yesterday was devoid of any actual news to move markets, so instead the focus was on the anticipated speech by Bernanke tonight at 7 p.m., and the actual comments by N.Y. Fed President William Dudley, who said he was "more hopeful" on the economy. Those positive comments led to a brief sell-off around mid-day, but stocks recovered by the early afternoon and were comfortably positive until Carl Icahn made several negative comments about the market around 3 PM while speaking at a conference. (He's "very cautious" and thinks there could be a "big drop." As for earnings, he said they were a "mirage" fueled by low interest rates.)

After an initial dip lower, though, stocks steadied during the final half hour of trading and rallied a bit to go out well off their lows.

Trading Color

Monday was a quiet day and activity remains largely dominated by hedge funds, day traders and algos, as vanilla funds seems to have largely called it a year and aren't interested in adding substantial risk at these levels.

From an internals standpoint, the day was a bit worse than it appeared. Both the Nasdaq and Russell 2000 both fell close to 1%, while the Dow closed very slightly positive, but that outperformance was due to the big Boeing (BA) rally. Of note, the Russell 2000 continues to flash a non-confirmation signal, as it again failed to reach new highs.

Sector-wise it was a pretty defensive day, as eight of the 10 S&P 500 sub-sectors declined. Industrials (thanks to BA) and telecom were the only two sectors to finish higher (and both just barely). Utilities and staples relatively outperformed, while tech (AAPL dragged the sector down) and homebuilders (the Housing Market Index

Market	Level	Change	% Change
Dow	15976.02	14.32	.09%
TSX	13458.06	-24.51	-.18%
Brazil	54307.04	855.44	1.60%
FTSE	6682.30	-41.16	-.61%
Nikkei	15126.56	-37.74	-.25%
Hang Seng	23657.81	-2.25	-.01%
ASX	5352.90	-31.76	-.59%
Prices taken at previous day market close.			

for October slightly missed expectations) lagged.

Interestingly, the SPDR S&P Bank ETF (KBE) hit a new 52-week high yesterday. Banks (and financials more generally) have quietly taken a leadership role in this market over the past three weeks, which is historically been a positive. And, that's creating an odd dynamic, as I can't remember a market where small caps were lagging, but banks were at new 52 week highs. One of the two is "right" (and over the past few weeks its been the banks).

Market	Level	Change	% Change
Gold	1273.00	-14.40	-1.12%
Silver	20.38	-.347	-1.67%
Copper	3.1525	-.0185	-0.58%
WTI	92.97	-.87	-0.93%
Brent	108.47	-.03	-0.03%
Nat Gas	3.618	-.042	-1.15%
Corn	412.00	-10.00	-2.37%
Wheat	642.00	-2.50	-0.39%
Soybean	1287.75	7.25	0.57%
Prices taken at previous day market close.			

Volumes were very low again yesterday, as was activity, according to friends I spoke to on various trading desks. On the charts the S&P hit a new all time high at 1800, and the first level of support sits around 1760ish.

Bottom Line

Skeptical sentiment remains the key bullish driver for the market. Ichan's comments yesterday are obviously unnerving, but it's worth noting that stocks were already coming in when he spoke, and the total lack of volume yesterday made the declines look worse than they were (the drop in futures was as much the result of lack of bids as it was aggressive selling). But, between his cautious comments, the headline on CNBC.com this morning: "S&P 500 is 75% overvalued, says fund manager," and the Barron's "Bubble" cover story from the weekend, its safe to say sentiment remains very skeptical.

I'm certainly not a market cheerleader, and there are warnings signs to monitor, as we've discussed, but until the investment community "agrees" with this rally in stocks, the "pain trade" will remain higher and as a result I don't think its time to materially de-risk in the equity space.

From a "what to do now" if you've got money to put to work standpoint, I still like the idea of spreads (long EWU or VGK/Short SPY, Long EWA/Short SPY, Long DXJ/Short SPY) because there's no way one major equity market will decline without the entire global equity market falling with it, if we have a material correction. So, you stay exposed to the upside but are protected.

China Announces Reforms, But Is It a Buy?

Chinese shares were the big outperformers yesterday, as the iShares China Large-Cap ETF (FXI) rose more than 4% on positive sentiment surrounding details announced from last week's "Plenum" of the Communist Party. Interestingly, the initial reaction to the conclusion of the "Plenum" was one of disappointment, but we're seeing a reverse "devil in the details" effect. In other words, the more details we get, the more the market likes the reforms that are being enacted.

While there were several reforms announced, the two that were positive catalysts for Chinese shares were : 1. The relaxing of the one-child policy to allow couples where one person was an only child to have a second child, and 2. The loosening of regulations for private companies to offer IPOs in the Chinese stock market. (Currently it is very difficult for private Chinese companies to list on any Chinese exchanges, as the process takes a very, very long time and is extremely onerous. Public listings in China are dominated by majority state-owned companies.)

Both of these reforms contributed to a broad rally in Chinese shares. Specifically, anything childcare-related (for obvious reasons) led markets higher, as did Chinese investment banks (again for obvious reasons).

In total, the reforms announced have led to some pretty bullish calls on China, and many have called the economic reforms the biggest since the mid-1990s. But, the question remains "Is China a Buy Here?" and I'm not sure the answer is as clearly "yes," as the market seemed to imply yesterday.

Keep in mind that we've seen a big whipsaw in Chinese shares. Recall that, in the middle of last week, they were hammered after reports surfaced that the Chinese government will reduce the 2014 GDP expected growth rate to 7.0% from 7.5% this year. Additionally, let's not for-get that there is lots of concern about a property bubble in China. (Over the weekend, monthly stats showed housing prices up 9.6% over a year ago in October.) And, the People's Bank of China is still actively trying to drain liquidity form the system. (Remember SHIBOR rates spiked again at the end of October before the PBOC added liquidity.)

These reforms are a positive for China long term, but it's going to take a long time for these reforms to be implemented (meaning years). And, while ultimately more children and more IPOs are a positive for childcare product markets and investment banks, we're still a long way from that translating to the bottom line.

Longer term, does this make "China" a better place for capital than it was before? Yes, it does. So, maybe there's an argument for an IRA allocation, but I don't think the reforms from the "Plenum" are reason alone to get "bulled up" on China right now—not in the face of potentially slowing growth and a central bank trying to drain liquidity from the system.

As far as "what's next" for China, the official 2014 GDP growth rates should be released in the next few weeks (again, 7.0% GDP growth is the expectation) and also the results of a "debt audit" the Chinese government is conducting on local and federal debt. The debt estimate is around 60% of GDP, but the quality of that debt will also be scrutinized because many China "bears" think bad debt (specifically that which is tied to real estate) will be a major negative on the Chinese economy and market (although they've been saying this for a couple years now, too).

The results of the GDP growth estimates and debt audit over the coming weeks will be a lot more important to the near-term direction of Chinese shares than the reforms just announced. Bottom line is while there is a "value argument" to be made on China given FXI is down year-to-date and well off multi-year highs hit in late '10, the doesn't appear to be a clear, well-founded trend to capitalize on.

Market	Level	Change	% Change
Dollar Index	80.81	-.088	-0.11%
EUR/USD	1.3499	.00083	0.06%
GBP/USD	1.6101	-.00263	-0.16%
USD/JPY	99.92	-.143	-0.14%
USD/CAD	1.0435	.00018	0.02%
AUD/USD	.9369	-.00256	-0.27%
Brazilian Real	.4429	.011	2.55%
10 Year Yield	2.678	-.031	-1.14%
30 Year Yield	3.766	-.035	-.92%
Prices taken at previous day market close.			

Economics

No reports yesterday.

Commodities

Commodities started the week in the red with corn and silver futures leading the sector lower, down by 2.37% and 1.67% respectively. The only commodity that traded in positive territory was soybean futures, gaining 0.57%. The benchmark PowerShares DB Commodity Index Tracking Fund (DBC) was down 0.55%.

Gold futures began shuffling lower as soon as electronic trading opened Sunday evening. However, the real pressure for gold began at 11:15 a.m. when N.Y. Fed President William Dudley spoke. Dudley's comments were rather hawkish, causing the dollar to pare most of its morning losses. This sent the price of gold toward support around the $1,270/oz level.

The fact that gold couldn't rally despite a weaker dollar yesterday is disconcerting for the bulls. Gold may get another "life line" is Bernanke is dovish tonight, but the bottom line is gold will have a hard time rallying unless we see an uptick in inflation or a material delay in tapering expectations (both of which are very unlikely at the moment). Conversely, if Bernanke is marginally "hawkish" like Dudley was that will likely send gold through major support at $1260, at which point a run to $1200/oz. isn't out of the question.

Crude oil futures caught a bid during the first half of the trading yesterday, most of which was nothing more than an oversold bounce and a few speculative longs coming into the market. The spec buyers were enticed by the potential "value" in WTI after the big drops and the smaller builds in supply reported by the EIA that may actually reverse to a draw this week.

However, financial commentators scrambled to come up with a reason why WTI futures reversed and sold off so sharply when, in reality, the buyers just became exhausted. I read several articles about how the strengthening economy and possibility of a January taper were causing crude oil to sell off, but that's backwards. If the economy is so healthy that our very dovish Fed is considering a taper in the coming months, this would point to an increase in demand and an obvious rally in oil prices, not a sell-off. WTI Crude is not tied to tapering expectations the same way gold is.

Bottom line though is price action is still being dominated by technicians and trading software and, until we see a break below $92.50 or a rally through $95.50, futures contracts will remain range-bound.

Currencies & Bonds

Fed tapering expectations continued to be the dominant theme in currency markets yesterday, as both the dollar and bonds traded "dovishly" ahead of tonight's Bernanke comments on monetary policy. (Like the Yellen testimony, markets are assuming Bernanke will be dovish in his commentary.)

The Dollar Index finished down only marginally (-0.1%), though, after the aforementioned "more hopeful" comments from Dudley.

Dollar weakness was the main theme of the currency markets yesterday, as the euro and pound were both flat (there was no "new" news from Europe) while the "Aussie" and the yen both rallied small (peripheral buying on improving sentiment toward China in the former, and little more than an oversold bounce in the latter). Bottom line is yesterday was a "nothing" day in the currency markets.

The same can't be said, however, for the emerging markets, where most emerging currencies surged vs. the U.S. dollar. The Brazilian Real rose 2.55% and the Indian Rupee rallied 2.25% vs. the dollar yesterday mostly on optimism for emerging market economies on the back of the Chinese reforms. China is the main demand source for most of the emerging markets' raw materials, and you can make the case that the reforms are a positive for the Chinese economy long term. Couple that with a lot of shorts still in emerging currencies, and it was a recipe for a short-squeeze, which is exactly what we got.

Much like China, emerging markets are piquing people's interest because they are one of the few things that hasn't skyrocketed this year—and, as such, are being looked at as a potential "value play" in a market that is becoming increasingly overbought.

But, while I admit the "cheap" EMs are tempting, the bottom line is it still remains to be seen how the emerging markets survive in the environment of Fed tapering. Remember, earlier this summer, just the mention of Fed tapering nearly caused an emerging market debt and currency crisis. If global growth can continue to rebound, then it's possible emerging markets won't see the same debt crisis we saw last summer. But it's far from certain, and although EMs are attractive from a contrarian sense, buying the emerging markets into Fed tapering in early '14 doesn't make a lot of sense. At best, it's a very high-risk/high-potential-return investment.

Bonds echoed the "dovish" trade we saw in the currency markets yesterday, and rallied to a two-week high ahead of the Bernanke comments tonight. The bounce in bonds continues, although there's no real reason for it other than Fed tea-leaf reading (bond sold off a bit on the Dudley "more hopeful" remark, but rallied and closed not far from the highs of the day).

Interestingly, though, it seems that "tapering" expectations are starting to shift from March toward January, and Dudley's comments aren't worth overlooking. Dudley is vice chair of the committee that sets the Fed Funds rate, and one of the "Big Three" of Yellen, Bernanke and Dudley. So, if he's getting more hopeful, it's not a stretch to say Fed leadership is also getting more hopeful. As a result, we may see tapering earlier than '14 if the economic data doesn't backtrack. But, whether January or March, the Fed is tapering QE in Q1 '14, and that will result in lower bond prices, so this bounce in Treasuries remains a short.

Have a good day,

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 "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.**

Commodities	Bullish	Neutral	Neutral	*Commodities saw a mild oversold bounce last week, although the complex remains under pressure, despite the continued global economic recovery.*

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.**

U.S. Dollar	Neutral	Neutral	Neutral	*The dollar index rally stalled last week after the "dovish" Yellen testimony. At this point, unless expectations for Fed tapering change from the current Jan-March time frame,, I'd expect the dollar index to stay range bound*

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	*Bonds consolidated their declines last week on profit taking and the "dovish" Yellen testimony, but with tapering expectations set in Jan/March, the downtrend in bonds has resumed.*

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.**