7:00's Report

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

November 20th, 2013

Pre 7:00 Look

- Futures and most international markets are drifting lower in quiet trading.
- Chairman Bernanke's comments were a non-event last night. He did not echo Dudley's "hawkish" comments, gave no insight on when tapering would start, and repeated the "tapering isn't tightening" mantra.
- Econ Today: CPI (E: 0.0%), Retail Sales (E: 0.0%), Existing Home Sales (E: 5.13M), FOMC Minutes (2:00 P.M.)
- Fed Speak: William Dudley (10:00 A.M.), James Bullard (12:10 P.M.)

Market	Level	Change	% Change
S&P 500 Futures	1782.75	-2.50	-.14%
U.S. Dollar (DXY)	80.67	-.074	-.09%
Gold	1264.20	-9.80	-.77%
WTI	93.44	.10	.11%
10 Year	2.712	.034	1.27%

Equities

Stocks continued to tread water Tuesday ahead of Ben Bernanke's evening comments, and the S&P 500 finished slightly lower on the day, falling 0.20%.

Stocks opened flat Tuesday, and again followed a familiar pattern by grinding slowly higher right after the open and into the early afternoon. But, for the second straight day, verbiage from a prominent investor caused markets to turn negative. (As my friend Kenny Polcari says, a 20-point decline in the Dow is not a "sell-off.")

Yesterday it was BlackRock (BLK) CEO Larry Fink, who

Financials have very quietly been on a tear since the October jobs report, and just hit new 52 week highs.

made cautious comments on the near-term path of equities. (They weren't really bearish comments, but more "not bullish.")

Mr. Fink said he could see pension funds selling equities to rebalance their portfolios, given the large gains we've seen in stocks, and that he thought continued QE by the Fed wouldn't lead to a material improvement in the jobs market. The headlines surrounding those "cautious comments" were enough to cause the major averages to turn negative shortly after 1:30, and markets stayed in the red for the remainder of the day in slow trading. The Fink comments were the only main "driver" of stock prices yesterday, and even calling them a "driver" is a stretch.

Trading Color

All the major averages again finished lower yesterday (although barely), and again the "macro-sensitive" indices led the way down. The Russell 2000 was the laggard, falling more than 0.53%, while the Nasdaq dropped 0.44%. The Dow once again was the outperformer, falling just 0.06%. The Russell's inability to get to new highs remains a potential "caution" sign to watch – although in

Market	Level	Change	% Change
Dow	15966.90	-9.12	-0.06%
TSX	13443.30	-14.76	-0.11%
Brazil	53032.91	-1274.13	-2.35%
FTSE	6665.99	-32.02	-.48%
Nikkei	15076.08	-50.48	-.33%
Hang Seng	23700.86	43.05	.18%
ASX	5307.66	-45.24	-.85%
Prices taken at previous day market close.			

fairness, it's been going on for three-plus weeks now and it hasn't slowed the S&P 500.

Looking a bit into the "micro" yesterday, we had some bigger-name retailers report results. Home Depot (HD) and The TJX Companies (TJX) both beat on earnings and revenues, and upped 2014 guidance. Both stocks were up about 1% but finished well-off their respective highs.

Market	Level	Change	% Change
Gold	1274.20	1.90	0.15%
Silver	20.360	.003	0.01%
Copper	3.1545	.005	0.16%
WTI	93.93	.25	0.27%
Brent	107.00	-1.47	-1.35%
Nat Gas	3.557	-.061	-1.69%
Corn	418.50	6.50	1.58%
Wheat	650.00	7.75	1.21%
Soybean	1279.00	-8.50	-0.66%
Prices taken at previous day market close.			

Best Buy (BBY), however, dropped 11% after it cautioned that it was going to have to offer discounted promotional pricing to stay competitive this holiday season—to match Amazon (AMZN) and Wal-Mart's (WMT) discounts—which raised concerns about margin compression at the retailer. But, while BBY's stock got hit on margin concerns, overall the results from retailers during the past few weeks (from a sales perspective) were pretty upbeat (remember Macy's (M) blew out earnings). Hopefully that is a sign of positive progress in the economy on the consumer-spending front.

Looking at the sector trading, financials and banks again outperformed yesterday, while interest-rate-sensitive stocks took another hit on the move higher in bond yields. (The 10-year yield broke through 2.7% again yesterday.) The Financial Select Sector SPDR (XLF) was one of only three S&P 500 sub-sectors to trade in the green yesterday, while utilities and REITs were the two worst-performing sub-sectors (down nearly 1% each).

The recent financial and retail outperformance (retail was down yesterday but has seen a big run recently) I think is more-reflective of money looking for pockets of "value" in the market. While there has been positive news in the financials and retailers, really those were two of the "under-owned" sectors of the market before we got the positive jobs market report in early November. As such, money has flowed to them as opposed to the "momentum" stocks.

But, with financials and retailers at 52-week highs, there really aren't any pockets of "value" in the market at the moment other than the "bond proxy" stocks (utilities, telecom, healthcare, REITs). And, if you think rates are headed higher, as I do, then it doesn't make sense to buy them on the dip.

The one other "sector" that has lagged recently is small caps, which, as mentioned, haven't hit a new high like the other major indices. So, I suppose if you're looking for a pocket of value and are underinvested, and think this rally isn't over, perhaps small caps are a place to take a flyer on generating some outperformance if the rally continues.

Volumes remain anemic; so does participation. Day traders, hedge funds and algos are in total control of the market on an intraday basis. On the charts, 1,800 is now resistance while first support lies in the 1,775-1,760-ish region.

Bottom Line

Stocks are once again exhibiting some signs of short term fatigue, but given still persistent skepticism towards the rally, there's no reason to expect this short term overbought condition won't result in anything other than a side ways "churn" like we've seen so many other time this year.

The market dynamic remains the largely unchanged over the past week. Macro economic calm is giving way to multiple expansion (the S&P 500 has gone from trading at 12X '14 earnings at the start of the year to 15X currently) and there's no reason that can't grind higher still. And, there are still very few investors who "agree" with the rally, and every 5 point decline evokes comments along the lines of "this is it." So, the "pain trade" remains higher. I'm not sure how much farther this market can go, but given that context, the path of least resistance remains higher.

Where Are You Going to Go?

I wanted to touch upon Mr. Fink's comments about the pension fund re-balancing. With the S&P 500 up 25% year-to-date, funds rebalancing their equity exposure to get back in line with their respective allocations makes sense. But my question is, where are they going to go with the cash? Bonds?

If I'm a PM at a pension fund and I've got to reduce my equity exposure, am I going to sell those stocks and allocate that money to bonds, given the impending tapering? If I am, do I go into short-term bonds to protect myself but earn nothing in interest? If the funds can't sit in cash, and commodities aren't viable for the funds (nor do they look bullish at the moment), are other regions of the world (Europe, emerging markets, Japan, China) that much more attractive compared to the U.S.?

I'm not a fan of investing in something because "there's nowhere else to go." But in this 0%, Fed-engineered environment, I do have to admit that it's a tough question to answer. As a result, I'm not so sure that the rebalancing Mr. Fink is alluding to will be such a negative on stocks, although he's obviously more-knowledgeable in the area than I am. But, it is food for thought on why stocks can continue to grind higher. Capital flows are a powerful influence on markets in the short/medium term.

Economics

No reports yesterday.

Commodities

Commodities were mixed yesterday in a quiet, low-volatility trading session. Grains and natural gas were the only contracts to move more than 1%. The PowerShares benchmark commodity ETF (DBC) was down by just 0.1%. Commodities markets—specifically metals and energy—chopped sideways throughout the day while the dollar was essentially unchanged. All eyes were looking ahead to hear what Bernanke had to say last night.

Market	Level	Change	% Change
Dollar Index	80.750	-.76	-0.09%
EUR/USD	1.3528	.00206	0.15%
GBP/USD	1.6111	.000895	0.05%
USD/JPY	100.22	.412	0.41%
USD/CAD	1.0476	.00417	0.40%
AUD/USD	.9418	.00431	0.46%
Brazilian Real	.43965	.00025	.06%
10 Year Yield	2.712	.034	1.27%
30 Year Yield	3.804	.038	1.01%
Prices taken at previous day market close.			

Natural gas was the biggest underperformer yesterday, losing 1.69% on the session. Natural gas moved lower as traders closed long positions and secured profits after natural gas rallied nearly 5% in two weeks. The forecast for mild weather across the nation in the next 7-10 days is also putting some pressure on prices as nat gas is still primarily a weather-driven market.

Corn and wheat were the outperformers yesterday, logging gains of 1.58% and 1.21%. The pullback from the downtrend was mostly driven by technicals as shorts began to take profits (same concept as the longs taking profits in natural gas).

WTI crude oil futures saw modest gains yesterday, up 0.27%, while Brent contracts lost 1.35%. It feels like WTI is trying to put in a bottom somewhere here in the lows 90.00's, but its not safe to say the bottom is "in" because the supply/demand situation continues to lean bearish. Weekly inventories will now take on a greater role, as will economic data, in determining if the low from last week $92.50, holds.

Brent crude took a hit yesterday for several reasons: First, negotiations regarding Iran's nuclear program resume today and there is cautious optimism there will be a deal to at least partially relax some sanctions. So, we saw a bit of selling ahead of that potential outcome. Also, the OECD downgrade of global growth economic growth for '14 (and their specifically citing weakness in emerging market economies) also weighed on Brent (like WTI, implying potentially higher supply and lower demand). The trend in Brent, like in WTI, appears lower, and the next level of support sits around $105/bbl.

Finally, gold is threatening to break support at $1260 this morning after a quiet trading day yesterday. Chairman Bernanke's comments overnight were a non-event (he basically reiterated what he said before and stressed that even as the Fed eventually tapered QE, rates would remain low for a very long time after. So, the "tapering is not tightening" mantra). If gold breaks $1260 decisively, there isn't much to support it between that level at $1200, so the risk is to the downside as we head into the Fed minutes.

Currencies & Bonds

Like commodities, the currency markets didn't do a lot Tuesday either ahead of Bernanke's comments, economic data this morning and FOMC minutes later this afternoon. The Dollar Index traded almost unchanged (down 0.08%), while the pound was also flat. The euro caught a small bid (up 0.25%) thanks to a better-than-expected German ZEW business expectation index (54.6 vs. 54.0), and also after ECB Vice President Vitor Constancio stated that, while quantitative easing is still a possibility for the ECB, ECB members haven't discussed specifics or technical details of how such a program would work or be implemented.

Initially the euro dipped on the headline that it was a "possibility," but given his follow-up comments it appears this is a *remote* possibility. More broadly the question about whether the ECB is committed to "doing more" to help the EU economy remains largely unanswered (and it's starting to become a headwind for EU stocks).

The Australian dollar was the best performer vs. the dollar yesterday, rising 0.45% after the release of the minutes from the Reserve Bank of Australia's rate meeting last month. Much like the Constancio comments, the minutes were initially (incorrectly) interpreted as "dovish," due to the fact the RBA wouldn't remove the possibility of further rate cuts and also reiterated the Aussie dollar is "uncomfortably high."

While those are indeed "dovish" comments, they were already known to the markets. Instead, it was the fact that the RBA noted prior rate cuts are starting to filter through to the economy that was the real new "news" in the minutes (which implies the RBA will wait to see the full benefits of the prior cut, and as a result are on hold).

Bottom line with "Aussie," though, is any upside is largely capped but there's no real trend to follow either on the short or long side in the "Aussie." I'd say it's somewhat fairly valued vs. the greenback at these levels.

Looking at the bond market, there was some definite movement yesterday, as Treasuries dropped ahead of Bernanke (the 30-year gave back 0.4% yesterday). Ten-year bonds saw about half the declines the long bond did, but that likely was thanks to the Fed buying 3 billion worth of 7-10 year bonds as part of QE. There wasn't any specific catalyst for the bond decline, other than some profit-taking on this recent bounce, although the size of the moves were a bit larger than you'd expect given the impending Bernanke comments.

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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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.**