7:00's Report

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

November 21st, 2013

Pre 7:00 Look

- Futures are drifting slightly higher this morning amidst mixed economic data o/n while most foreign markets are lower.
- November Flash PMIs were mixed but generally "ok." Chinese PMIs missed expectations (50.4 vs. (E) 50.8) but still remain above the 50 level, signaling expansion. EU PMIs basically met expectations but Germany beat estimates (a positive).
- The Nikkei was the big outperformer o/n, rallying 2% after the BOJ reiterated its commitment to accommodation at their rate meeting (but they didn't say anything new).
- Econ Today: Jobless Claims (E: 335K), Flash PMIs (E: 52.5), Philly Fed Survey (E: 15.5).

Market	Level	Change	% Change
S&P 500 Futures	1783.25	3.50	.20%
U.S. Dollar (DXY)	81.165	-.007	-.01%
Gold	1247.10	-10.90	-.87%
WTI	93.94	.08	.09%
10 Year	2.792	.08	2.95%

Equities

Market Recap

Stocks fell for a third-straight day Wednesday as this market continues to act "tired" in the short term. The S&P 500 fell 0.36%.

Stocks opened modestly stronger yesterday morning, mostly thanks to the better-than-expected October retail sales report. They spent the majority of the day in positive territory, despite a soft existing home sales number. Data aside, though, yesterday's trading was once again driven by Fed rhetoric (speakers and the minutes). Although equity markets shrugged off relatively "hawkish" comments by St. Louis Fed President Jim Bullard, who said that a December taper of QE was still on the table, they couldn't ignore the somewhat-confusing and marginally hawkish Fed minutes.

Inverse bond ETFs like TBT broke out to new highs yesterday as long dated Treasuries declined sharply.

Stocks declined off the initial release, as algos sold immediately, but then rebounded back into positive territory before finally declining during the final hour of trading (which is becoming a bit of a trend). But, activity remains driven by fast-money funds, and the declines were once again due just as much to a lack of bids as aggressive selling. Stocks steadied and rallied a bit into the close to finish off the lows of the day .

Trading Color

Despite the losses being the biggest so far this week, there wasn't a lot more activity in the market yesterday. Trading is still dominated by hedge funds, day traders and algos. Vanilla funds remain on the sidelines, and I continue to think they are content to largely call it a year from an exposure standpoint.

Looking at the internals, given the recent weakness in

Market	Level	Change	% Change
Dow	15900.82	-66.21	-0.41%
TSX	13430.01	-12.76	-0.09%
Brazil	53032.91	-1274.13	-2.35%
FTSE	6686.46	5.38	.08%
Nikkei	15365.60	289.52	1.92%
Hang Seng	23580.29	-120.57	-.51%
ASX	5288.32	-19.35	-.36%

Prices taken at previous day market close.

the "macro-sensitive" indices, you'd expect yesterday's declines to have been led by small caps and the Nasdaq, but the exact opposite happened. The Russell 2000 and Nasdaq relatively outperformed (down just 0.14% and 0.26% respectively) while the Dow was the laggard, falling 0.41%.

Market	Level	Change	% Change
Gold	1245.00	-28.50	-2.24%
Silver	19.860	-.474	-2.33%
Copper	3.1495	-.008	-0.28%
WTI	93.77	-.12	-0.13%
Brent	107.96	1.04	0.97%
Nat Gas	3.672	.116	3.26%
Corn	417.00	-.75	-0.18%
Wheat	647.25	-3.00	-0.46%
Soybean	1273.75	-2.50	-0.20%
Prices taken at previous day market close.			

From a sector standpoint, the themes we've been talking about for a while now remained largely in place. Increased tapering expectations were the main driver of asset prices yesterday, so it's not surprising that "bond proxy" stocks continued to underperform. Utilities (down 1.2%), REITs (down 1.2%), and telecom were the worst-performing S&P 500 sub-sectors, while banks finished positive (so, a textbook "higher rates" sector rotation).

Volumes were the heaviest they've been all week, although overall activity remains pretty spotty, as volumes and activity aren't anywhere near "conviction" levels. On the charts resistance remains at 1,800, while support lies in the 1,775-1,760 range.

Bottom Line

Ostensibly yesterday stocks fell because tapering is becoming more of a reality and that's "bad." But really, that's not what happened with the markets, and a more-certain taper isn't, by itself, a rally-killer.

As I said yesterday, stocks are acting "tired" and whether it was Carl Icahn Monday, Larry Fink Tuesday or the Fed minutes yesterday, reactions to their comments are excuses rather than reasons for the declines. But, at this point, there's no reason to suggest this isn't just another consolidation/chop.

Why IOER Matters to You

One of the main drivers of trading yesterday in the euro (and, to a point, the dollar and U.S. equities) was the concept of negative interest on excess reserves (IOER). Not only did the euro drop nearly 1% on a Bloomberg story that they were considering an negative IOER, but Fed President Bullard said he wanted to commission a study on the potential effects of a negative IOER.

IOER, or "Interest On Excess Reserves," refers to the interest the Fed and other central banks pay banks on their excess money (reserves) they keep in those central banks. So, if I'm a large bank, and I deposit more money than is required at any Fed bank, I get paid 25 basis points on that money. As of the latest Fed release, in October there was more than $2 trillion in "excess reserves" on the Fed's balance sheet, earning 0.25% annual interest.

One of the big problems the Fed, and other central banks, has is getting money off the banks' balance sheets and into the "real economy" via lending. Well, one of the theoretical ways to "force" banks to lend money would be for the Fed to push the IOER negative. So, instead of the banks *earning* 0.25% annually on the $2 trillion at the Fed, they would have to start *paying* interest on those balances, which theoretically should compel them to lend the money out.

A negative IOER is one of the few remaining "bullets" the Fed has in its arsenal to help stimulate the economy. And, while it becoming reality is likely still a long shot here in the U.S. or in Europe, a negative IOER would be, theoretically, a stimulative move by the Fed (so, dovish and likely equity-positive). I wanted to make sure everyone knew exactly what it was, because it's a topic I think will come up a lot more in the coming weeks/months.

Economics

Retail Sales

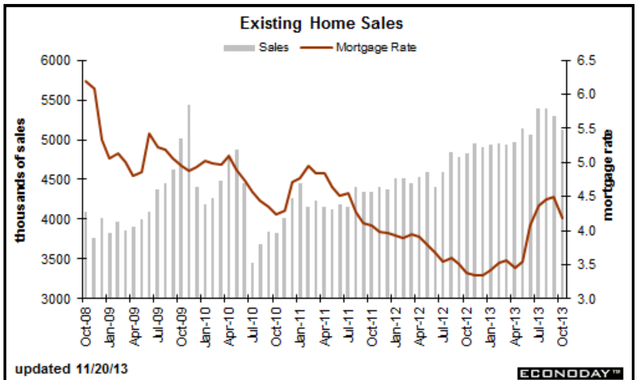
- October retail sales rose 0.4% vs. (E) 0.0%.
- Retail Sales ex-Gas & Autos rose 0.3% vs. (E) 0.3%.

Takeaway

Retail sales were stronger-than-expected and implied the consumer wasn't materially negatively affected by the government shutdown in early October. More importantly, the "control group"—which excludes cars, gasoline and building materials, and gives us the best picture of the strength of the consumer—rose 0.52% from September, Although the September data was revised slightly lower, that month-over-month change was the biggest since July.

This retail sales report echoes the other surprisingly strong data we've seen since October, and also confirms some of the strong results we've seen from retailers in recent earnings. Bottom line is a slowdown in consumer spending has been a concern for markets for the past several months. But this report, along with the "micro" anecdotes from retailers, is raising expectations heading into the holiday season.

From a WWFD (What will the Fed do) standpoint, this report was taken as marginally "hawkish" even though, by itself, it won't pull forward tapering into December. But, this retail spending report does imply we may see an upward surprise in PCE (consumer spending) in the Q4 GDP report, which would be a positive for the economy.



Existing Home Sales declined further in October, confirming we are seeing a slowdown in the housing recovery.

FOMC Minutes

On balance the minutes from the October meeting were taken as slightly "hawkish," mainly thanks to the sentence that stated the FOMC was looking to cut back asset purchases "at one of the next few meetings." But, despite the "hawkish" interpretation, there wasn't much new revealed in the minutes that we didn't already know from recent economic data and Fed speak. The Fed is getting progressively more uncomfortable with its QE program, and given the uptick in the data seems intent on reducing it, but is very concerned about tapering of QE not resulting in substantially higher interest rates, and much of the minutes details discussions on how the Fed can avoid that outcome ("forward guidance" remains the strategy).

Market	Level	Change	% Change
Dollar Index	81.135	.391	0.48%
EUR/USD	1.3423	-.0131	-0.97%
GBP/USD	1.6104	-.000455	-0.03%
USD/JPY	100.05	.04	0.04%
USD/CAD	1.0450	-.0017	-0.17%
AUD/USD	.9334	-.0079	-0.85%
Brazilian Real	.43490	-.0034	-.78%
10 Year Yield	2.792	.08	2.95%
30 Year Yield	3.905	.101	2.66%
Prices taken at previous day market close.			

Bottom line is given the minutes, the consensus first tapering of QE is still in Q1 '14, but expectations seem to be drifting from March to January. A December or "Santa-taper" remains a low probability.

Commodities

Commodities were mixed yesterday, with precious metals selling off substantially on the hawkish Fed-speak while most of the energy space posted solid gains on supply data and weather forecasts. The dollar was up 0.5%, helping send gold and silver lower but having little effect on the rest of the sector. DBC, the benchmark commodity index ETF, was up 0.12%.

All of the major markets were dominated by Fed chatter and the FOMC meeting minutes released at 2 p.m. yesterday. The hawkish comments from Bullard as well as the Fed minutes mentioning a December taper not only still being in the cards but almost-probable (pending strong economic data) sent the dollar higher and literally took the bottom out of precious metals.

Substantial selling pressure came into gold futures following the release of the FOMC minutes. There is really no case for the bulls at these levels. Technically, gold prices have developed a near-textbook head-and-shoulders pattern (bearish) since prices bottomed back in late June.

With the timeline of tapering QE being moved forward, the only thing that will fuel a rally in gold back toward the $1,400 level is rising inflation, which isn't even a speck on the horizon yet. In the near term, there is a slight chance that another announcement out of the Fed—saying they will again push back the taper (toward March or June, which wouldn't surprise me)—could cause a short-lived gold rally. But $1,300 will likely be the ceiling on that rally.

The EIA released weekly inventory data yesterday, stirring little reaction from crude prices. Nymex crude oil futures closed down 0.13%. According to the EIA, crude inventories rose by a less-than-expected 400K Bbls last week vs. a build of 2.6MM Bbls the week before. Heating oil, reported a much-bigger-than-expected draw of 4.8MM Bbls last week compared to a decrease in supplies of just 500K the week prior. This unexpected move sent prices higher by 1.57%, closing the day near the highs at $2.95.

Natural gas was the largest-outperforming commodity yesterday, rallying back strong after two days of posting losses. In what appeared to be a "short-squeeze style" pop in the primary session, natural gas moved higher by 3.26%. News of colder weather on the back end of the 10-day forecast sent spec shorts looking for the door while welcoming longs into the market. This helped send natural gas up for the biggest single-session gain since July 18.

There is some mild resistance on the chart between Monday's open price and the high of that session (between $3.68 and $3.70) but as the winter season sets in, there is room to move higher as demand rises. The EIA natural gas report being printed this morning at 10:30 a.m. will be closely watched by "spec-techs" and physicals traders alike.

Currencies & Bonds

It was a definitive "hawkish" trade in the currency and bond markets yesterday, as the stronger-than-expected retail sales, Bullard comments and FOMC minutes all contributed to send bonds sharply lower and the Dollar Index higher.

Bonds were the big movers yesterday, though, so we'll start with them. The 30-year collapsed more than 1% on a combination of the aforementioned hawkish events and, importantly, broke through support at the November lows. Unless the economic data turns bad, it should move somewhat quickly toward the September lows at the 129'01 level.

Expectations for Fed and ECB moves once again dominated the currency markets yesterday. While most of the focus was on the Dollar Index rally (up 0.45%), really the euro's plunge (-0.80%) was the most-important story of the day.

The euro dropped sharply yesterday, almost entirely on a report from Bloomberg that ECB officials are considering a negative deposit rate (similar to the negative IOER we covered earlier). The reason the market reacted so violently to that is because the ECB bringing deposit rates negative is a lot more credible (and feasible) from a logistics and political standpoint than a QE program. (It's not even clear if the ECB can actually do QE, given its charter.) So, the fact that the ECB is considering it caught traders somewhat off-guard, and the euro dropped sharply in reaction. The potential for a negative deposit rate aside, though, the question remains largely unanswered as far as whether the ECB will actually do *more* to stimulate growth and ward off dis-inflation, although clearly this Bloomberg report, if true, implies they are closer than people initially thought.

Turning to the Dollar Index, as mentioned it enjoyed a strong rally yesterday, but much of the gain was the result of euro weakness, and the dollar wasn't universally stronger against all currencies. The pound was flat vs. the greenback after the BOE minutes from last month's interest rate meeting offered nothing new; this reflects much of the somewhat "hawkish" tone in last week's inflation report, where the BOE pulled forward by 18 months the date when it thought the unemployment rate would dip below 7%.

The yen actually finished the day fractionally higher after very strong export data from October (implying a stronger Japanese economy than initially expected). But, while the data was good, nothing really changed in the yen narrative yesterday, and the trend remains lower, especially with the dollar apparently catching more of a "tapering" tailwind.

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.* *Resistance is 1800 in the S&P 500 while support is 1775-1760 range.*

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.**