7:00's Report

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

November 22nd, 2013

The Face of A Steepening Yield Curve: Unlike last summer, short term Treasuries are rallying while the long bond sells off, resulting in a steepening yield curve.

Pre 7:00 Look

- Futures are flat and most international markets are drifting slightly lower, as investors digest the week's news.
- Most international markets opened higher but have since come in, as no one wants to be very long into the weekend.
- The only economic release was the German IFO sentiment index, which beat expectations and rose to a 16 month high.
- Econ Today: No Reports Today. Fed Speak: George (8:40 A.M.), Tarullo (12:15 P.M.)

Market	Level	Change	% Change
S&P 500 Futures	1793.00	-0.75	-.04%
U.S. Dollar (DXY)	80.905	-.22	-.26%
Gold	1241.80	-2.00	-.15%
WTI	95.16	-.28	-.29%
10 Year	2.784	-.008	-.29%

Equities

Market Recap

Stocks rallied for the first time this week on Thursday, as positive economic data amidst "low for long" interest-rate promises from Fed officials saw the S&P 500 rally 0.81%. The Dow Industrials closed above 16,000 for the first time (but didn't hit a new intraday high).

Stocks opened Thursday in the green, as good domestic economic data (jobless claims and the flash manufacturing PMIs) trumped soft Chinese flash manufacturing PMIs and in-line EU flash PMIs. Stocks moved steadily higher throughout the day, as Fed speakers were generally "dovish" (or, at least, not hawkish). There was little news in the afternoon, but the steady rallied continued to "pull in" buyers, and I think yesterday investors began to contemplate the potential positives of a growing US economy in the context of low interest rates for a long time (more on this later). Stocks moved higher throughout the afternoon amidst little news, and stocks went out just off their highs.

Trading Color

It was a pretty standard "risk on" day. The Russell 2000 rallied 1.8% to lead all major averages, and went a long way toward correcting its recent underperformance. The Nasdaq also outperformed (up 1.22%) and the Dow relatively lagged.

From a sector standpoint, it was equally risk-on, although financials (and banks in particular) again handily outperformed. Both sectors hit new 52-week highs. Industrials, energy (thanks to the oil rally) and consumer discretionary (all traditional cyclical sectors) all outperformed, while "bond proxy stocks" continue to lag. Utilities and consumer staples were just barely higher, while

Market	Level	Change	% Change
Dow	16009.99	109.17	0.69%
TSX	13478.29	48.28	0.36%
Brazil	52688.02	-344.89	-0.65%
FTSE	6668.45	-12.88	-.19%
Nikkei	15381.72	16.12	.10%
Hang Seng	23696.28	115.99	.49%
ASX	5335.91	47.60	.90%
Prices taken at previous day market close.			

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telecom and healthcare also saw small rallies.

Unfortunately for the bulls, volumes yesterday were close to, if not the, lightest of the week. So, it's hard to say there was a lot of conviction to the rally (but then again, we've been rallying on low volume for some time). Buying certainly wasn't panicked, and stocks were able to lift mostly due to a lack of offers, not because of voracious buy demand. On the charts nothing changed: Resistance sits at the old highs (1,800) while support lies lower (1,775-1,760-ish).

Market	Level	Change	% Change
Gold	1243.70	-14.30	-1.14%
Silver	19.990	-.068	-0.34%
Copper	3.191	.0315	1.00%
WTI	95.23	1.38	1.47%
Brent	110.10	2.04	1.89%
Nat Gas	3.704	.03	0.82%
Corn	422.25	5.25	1.26%
Wheat	648.50	1.25	0.19%
Soybean	1292.50	18.75	1.47%

Prices taken at previous day market close.

Is the Steepening Yield Curve A Positive?

Very quietly, the yield curve has steepened substantially over the past month as 30-year Treasuries have declined sharply, 10-year Treasuries have declined but less so, and 2-year Treasureies have actually stayed relatively flat. The yield curve is about as "steep" as its been all year. This steepening yield curve is one of the reasons we're seeing such big outperformance from the banks—a steeper yield curve means higher net interest margins, which means more profitability.

But, more importantly, a steeper yield curve means that markets may finally be taking to heart the Fed's ZIRP (zero interest rate policy) pledge, in that short term interest rates may stay low for the next few years. This is in stark contrast to this summer, when the entire bond market came for sale on fears of Fed tapering (2 year Treasuries declined with long dated Treasuries as investors stampeded out of the sector).

I point this out **not because** I think the markets finally believing in ZIRP negates my "bond bear" opinion. I'm still a big bond bear, and longer dated interest rates will continue to rise, and eventually the yield curve will get so steep that it will force the Fed to move higher in the short end. But, that could be months or even a year away, and during that time period this rise in rates could be viewed as healthy and actually be supportive for stocks, as long as economic data continues to show the economy is expanding.

Point being, this recent rise we've seen in rates isn't the same as last summer, and if we continue to just see the longer end of the curve rise, then rising rates, by themselves, won't be a "rally killer" for stocks, and neither, potentially, will the removal of QE.

Sentiment remains very, very skeptical of this rally (the "pain trade" is still higher and yesterday there was no enthusiasm to the rally). A broad market expectation (for years now) was that the rally was just a factor of QE and that when QE ended, the rally would end (and that may very well end up being true). But, if the market does believe in "ZIRP" and the economy does continue to improve, then we have the potential dynamic of a growing economy amidst free money—and in that case, maybe the end of QE won't be the "Death knell" for the rally that everyone assumes it'll be. Again I'm not a perma-bull, but no one is really working out the positive scenario for all this resolving itself, so I thought it'd be useful to point out, if for nothing other than some contrarian food for thought.

Finally, as far as getting "pure play" exposure to a steepening yield curve, STPP is the best "pure play," although it's very much "trade by appointment," so buyer beware. But, it'll continue to rally as the yield curve steepens. "Peripheral" ways to profit from the steepening yield curve remain the banks (KBE) and obviously selling the long end of the curve (TBF, TBT).

Economics

Weekly jobless claims and the November Flash PMIs both beat estimates yesterday but stirred little reaction out of the markets, as "good data" was priced in.

Weekly Jobless Claims

- Weekly Jobless Claims were 323K vs. (E) 335K
- 4-week moving average fell to 338.5K

Takeaway

Weekly jobless claims fell 21K from last week's number to 323K, the lowest since the government shutdown.

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Last week's report was revised slightly higher to 344K, but the big drop in yesterday's report is more in line with the surprisingly strong October Employment Situation report released earlier this month.

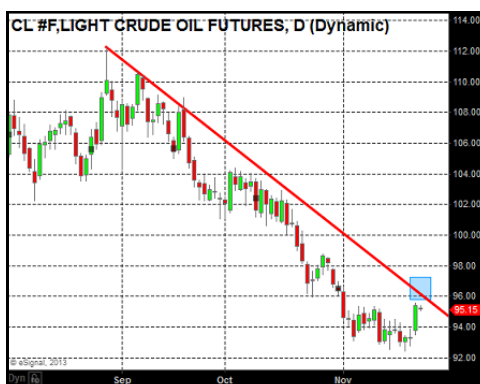
The four-month moving average fell for the third week in a row (showing some conviction to the trend lower) to 338.5K.

<u>November Flash PMIs</u>

- Manufacturing Index Flash 54.3 vs. (E) 53.0

<u>*Takeaway*</u>

The first look at November manufacturing activity via the Flash PMIs indicates the sector is picking up steam. The headline beat estimates and posted an eight-month high of 54.3 vs. a mediocre final reading for October of just 51.8. Within the report, both Output and New Orders were very strong, posting numbers of 57.1 and 54.9 respectively. The PMI index produced by Markit Economics is catching up to the ISM manufacturing PMI levels, which have been above 55 since July. As was the case with the Weekly Claims report, this news is a favorable indication for the state of the economy and reinforcing news for a QE taper coming sooner than later.



Commodities

Commodities were broadly higher yesterday with the exception of the precious metals markets. Generally, we saw industrial commodities solidly outperform yesterday, while metals (most precious) lagged. The dollar was flat and therefore had little effect on the commodities space. The PowerShares DB Commodity Index Tracking Fund (DBC) was up 1.19%.

Market	Level	Change	% Change
Dollar Index	81.12	-.052	-0.06%
EUR/USD	1.3462	.004635	0.35%
GBP/USD	1.6165	.00881	0.55%
USD/JPY	101.148	.7305	0.73%
USD/CAD	1.0525	.00586	0.56%
AUD/USD	.9224	-.00721	-0.78%
Brazilian Real	.4308	-.0019	-.44%
10 Year Yield	2.784	-.008	-.29%
30 Year Yield	3.883	-.022	-.56%
Prices taken at previous day market close.			

The outperformers in the commodity space were the refined products, RBOB gasoline and heating oil futures. The products rallied on reports out of two separate refineries. First, the largest oil refinery in the nation began routine maintenance work on Tuesday of this week but encountered some difficulties that resulted in a reduction of output from the 600K Bbl/day plant in Port Arthur, Texas. Second, Valero (VLO) reported flaring at their Texas City refinery. That added a little risk premium to RBOB gasoline, which in addition has seen substantial draws in supplies recently.

Crude oil prices rose amongst strong economic data and the re-introduction of some geo-political risk premium compliments of the Middle East. Brent Crude saw a big rally (nearly 2%) after reports surfaced that negotiations between Iran and the P5+1 regarding its nuclear program would, once again, yield no fruit and sanctions would stay in place.

WTI crude oil futures rose 1.47% Thursday mostly on dip buying and thanks to strong data from the Weekly Jobless Claims report and the Flash PMIs. With economic data improving some will make a "value" argument with WTI in the mid '90's, but given growing supply I remain skeptical. A break of the $96.50ish level in WTI would change my mind, but for now I wouldn't buy this recent rally (in the commodity or the energy equities).

Precious metals have gotten pounded over the past two sessions, down over $40 between Wednesday and Thursday's primary sessions. Gold fell another 1.14% yesterday while silver traded down most of the day, and closed in sub-$20/oz territory for the first time since the beginning of August.

Selling in precious metals was due to some follow-through trading after yesterday's hawkish Fed-speak combined with the generally strong economic data being released yesterday morning. The downtrend lower will almost certainly continue, barring any big news breaking. A consolidation in gold around the $1,240 level is a decent possibility but the

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next stop is $1,200.

Bottom line here is that with the economic recovery seemingly back on track, we can expect to see a broad increase in demand for industrial commodities, specifically energy, and an opposite move in precious metals for the foreseeable future (inflation remains the next catalyst for the metals, but it's not here—yet.)

Currencies & Bonds

Currency markets were relatively quiet Thursday, at least in the Western Hemisphere. The Dollar Index was little-changed despite the strong jobless claims and flash manufacturing PMIs, as good economic data has largely been "priced in" to the dollar and expectations for a Q1 '14 taper didn't really move that much ("good" economic data is largely priced into the Dollar Index at these levels).

In Europe there was broad currency strength, as the euro and pound rallied 0.4% and 0.5% respectively vs. the dollar. Trading in the euro continues to reflect the market trying to "game" what the ECB will do next, as the euro rallied despite the "in-line" EU flash manufacturing PMIs.

The main driver of the euro yesterday was ECB President Mario Draghi, who said in an interview that while the ECB did discuss negative deposit rates at the last meeting, there's been "no new news." He added, "Don't try to infer negative deposit rates," which basically refutes the Bloomberg article from Wednesday that implied the ECB was strongly considering negative deposit rates.

The truth, as usual, probably lies somewhere in-between, and the evolution of what the ECB can do to combat dis-inflation, amid a tricky political climate, will drive the euro in the near term. Given that, I'd expect a range-bound trade (between 1.33 and 1.36) until the course of action becomes clearer.

In UK, there's more clarity as to which direction the BOE will move next (they will remove accommodation) although the timing remains unknown. But, the "hawks" got a nice boost yesterday after the November CBI Industrial Trends Survey handily beat expectations, coming in at 11 vs. (E) 1. That reading is the highest since March of 1995! The pound rallied and is now closing in on the highs for the year at 1.6320. Fundamentally speaking, the pound remains one of the "strongest" currencies vs. the dollar in the global markets today.

While the moves in the European currencies were relatively muted, Asian currencies saw significant volatility, with both the "Aussie" and the yen dropping more than 1% each. The "Aussie" was weak thanks to the Chinese flash manufacturing PMIs (which missed expectations), and once the recent low of 0.9247 was broken, stops were elected and down "Aussie" went. There's some support around the 0.91 level in the "Aussie," but I don't think the bear case is as compelling as it was earlier this year, and I also don't think there a great risk/reward profile in a short position here. The Aussie in the 0.90 - 0.95 level vs. the dollar seems like it'sfairly valued.

I do not think, however, that the yen is fairly valued at 101 yen/dollar. The yen broke above 101 to the dollar yesterday as it declined more than 1% in heavy selling that lasted the entire day. The "reason" for the drop was apparently comments by BOJ Governor Haruhiko Kuroda, who said after the BOJ meeting that the Bank stood ready with more accommodation if the economy needed it.

That's nothing new (he's actually made that same statement many times before), but it was the excuse the yen bears needed, and the declines appear to be accelerating. The ProShares UltraShort Yen ETF (YCS) and the WisdomTree Japan Hedged Equity Fund (DXJ) both had nice days yesterday (up 2.3% and 1.7% respectively), and while we may see another short-term bounce, I'd expect the lows for the year at 103 will be tested sooner rather than later. There's still a lot more to go in this trade.

The Treasury market took a breather yesterday, as both the 30-year and 10-year Treasury notes were little-changed, following Wednesday's steep declines. Like the dollar, the good economic data from Thursday, which would normally be "hawkish," was mostly priced in thanks to Wednesday's declines. I'd expect another few days of consolidation in the bond market, but I'd continue to short any rally.

Have a good weekend, 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 "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.**

	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.**

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