7:00's Report

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

November 25th, 2013

Pre 7:00 Look

- Futures and international markets are trading modestly higher this morning, mostly on positive sentiment surrounding the Iran nuclear deal.
- Iran and the P5+1 agreed on a six month deal to ease sanctions in exchange for steps by Iran that will inhibit producing a nuclear bomb. Oil is down modestly (1.5%) on the news.
- Outside of Iranian geo-politics it was a relatively quiet weekend, and there was no economic data o/n.
- Econ Today: Pending Home Sales (E: 1.1%).

Market	Level	Change	% Change
S&P 500 Futures	1807.00	5.75	.32%
U.S. Dollar (DXY)	80.945	.203	.25%
Gold	1231.20	-12.90	-1.04%
WTI	93.61	-1.23	-1.30%
10 Year	2.752	-.032	-1.15%

Equities

Market Recap

Stocks saw mild gains last week but again traded to new all-time highs, thanks to a late-week rally that was fueled by strong economic data and increasing comfort with future Fed policy (specifically Fed tapering). The S&P 500 is now up 26.54%.

Stocks exhibited several signs of fatigue early last week (and to a point still do) as markets declined Monday-Wednesday, mostly in quiet trading that was driven by cautious sentiment. In particular, comments by Carl Icahn (who said he thought stocks could see a big drop) at a Reuters conference Monday, and also from BlackRock (BLK) CEO Larry Fink on Tuesday, resulted in mild sell-offs.

But, the economic data last week was better than expected. In particular, the weekly jobless claims and November Flash Manufacturing PMI beats on Thursday led to a nice rally that saw the markets recoup most of the week's losses. This momentum carried over to Friday as stocks continued their grind higher. The S&P 500 went out basically at the highs of the week on Friday, rising for the seventh week in a row.

Trading Color

Expected "hawkish" Fed policy continues to be a dominant driver of sector trading. Accordingly, last week saw financials, and banks in particular, further assume market leadership (they've been outperforming since early November) as both sectors hit 52-week highs. Conversely, any interest-rate-sensitive sectors badly underperformed: Utilities and REITs were down nearly 2% last week, while telecom also lagged.

Away from sectors being influenced by the rise in interest rates, retailers didn't have a good week last week, despite the strong retail sales report and rising expectations for the holiday spending. But, the weakness in retail was more a function of a lot of retail company earnings releases last week. In particular, Target (TGT) and Ross Stores' (ROST) soft results and guidance weighed on the entire sector. But, despite the weakness last week, the Market Vectors Retail ETF (RTH) isn't far off its 52-week highs. If we're seeing an economic recovery and improving labor market, retail stocks will move higher over the coming months as consumer spending will increase.

Market	Level	Change	% Change
Dow	16064.77	54.78	.34%
TSX	13478.34	3.01	.02%
Brazil	52800.74	112.72	.21%
FTSE	6691.76	17.50	.73%
Nikkei	15619.13	237.41	1.54%
Hang Seng	23684.45	-11.83	-.05%
ASX	5352.84	16.92	.32%
Prices taken at previous day market close.			

From an activity standpoint, last week was a pretty slow week. Intraday activity remained dominated by fast-money funds and algos, while vanilla mutual funds seem content to sit on the sidelines (this has been the case for weeks, though, and that hasn't stopped the market from rallying). On the charts the S&P 500 is at new all-time highs, while support lies between 1,760 and 1,775-ish.

Market	Level	Change	% Change
Gold	1242.90	-0.70	-.06%
Silver	19.81	-.124	-.62%
Copper	3.2205	.029	.91%
WTI	94.72	-.72	-.75%
Brent	110.72	.64	.58%
Nat Gas	3.782	.08	2.16%
Corn	4.22	-.01	-.18%
Wheat	6.49	.01	.12%
Soybean	7.02	.07	1.01%
Prices taken at previous day market close.			

Bottom Line

The most-important thing that happened last week (and really, it's been happening for a few weeks) was that the market seemed to "accept" that, although QE tapering will occur, the Fed is going to stay accommodative for a long time after it starts. (The Fed has been emphasizing this for months, but it seems that only now the market "believes" them.) The net effect has been a significant steepening of the yield curve, which is the reason we've seen banks and financials assume a leadership role in this market.

This is important because it's been widely assumed that once the Fed ended QE, the rally would end. That "no QE" headwind has kept many investors out of stocks. And if it proves not to be correct, then the risk for this market isn't for a sharp decline, but instead for a melt-up rally as money stampedes in. (To be clear, I'm not saying that's what I think is going to happen, but I'm pointing it out so everyone can consider it.)

More immediately, skeptical sentiment remains, still, an underappreciated tailwind on stocks, and the "pain trade" remains higher. Last week we had multiple high-profile investors and publications (Icahn, Fink, Barron's) all talking "bubbles," and Thursday and Friday's rallies were met with more disbelief than enthusiasm. As Ralph Acampora said this week (he's the godfather of technical analysis): "When a headline reads 'Bubble?' (Barron's) & a famous investor (Carl Icahn) talks about a bubble — there is no bubble. ... "

Stocks are once again short-term overbought and there are signs of short-term fatigue, and this week is going to be quiet. So, I'd not be surprised to see stocks tread water or come in a bit. But again, the pain trade remains higher, and so does the path of least resistance. I think that'll continue until such time as:

1. Sentiment becomes enthusiastic toward stocks.

2. The macro-economic horizon becomes less-calm.

3. Stocks get to heady valuations. (We're at 15X 2014 S&P 500 EPS; not cheap, but not "bubble" territory, either.)

I continue to like long Japan (DXJ), long Europe (VGK or EWU) and long cyclicals (SPHB or IWM) domestically, although I would prefer to hedge any new allocations with a SPY short, just because I'm cautious by nature. I would not, however, be de-risking at this point.

Economics

Last Week

Last week was highlighted by lots of "Fed-speak" and important economic data, and the net effect of both was to firmly solidify expectations for a Q1 '14 tapering of QE, and to incrementally increase the chances for a January taper (as opposed to March). Despite last week's good data and "hawkish" Fed-speak, a December taper is still remote (and it'll take a blowout jobs report next week to move those odds up significantly).

Starting with Fed-speak last week, there were multiple speakers (Chairman Ben Bernanke, Vice Chair William Dudley, James Bullard, etc.) and the result was a slightly "hawkish" tone. Bernanke's comments went largely as expected (he again stressed that "tapering is not tightening"), but it was Dudley and Bullard's comments—along with the FOMC minutes from the October meeting—that provided the hawkish tone. Dudley said he was "more hopeful" about the economy accelerating, while Bullard said a December taper isn't "off the table." And, although the minutes didn't reveal much, the market did focus on the FOMC saying tapering would likely occur "at one of the next few meetings."

Turning to the actual economic data, it continued the recent trend of being better than feared. Retail sales showed the consumer isn't quite as weak as was feared, as "core" retail sales (which exclude gasoline, cars and building materials) rose 0.52% from September. This was the biggest one-month increase since July (although September was revised lower, so the number wasn't quite as good as it seemed). But, against a pretty depressed outlook for the consumer, it was a positive surprise.

Jobless claims also dropped to multi-week lows, and the four-week moving average hit its lowest level in a month.

Finally, the most-anticipated number of last week, the November Flash Manufacturing PMIs, beat expectations at 54.3 vs. (E) 53.0, and rose to an eight-week high. Additionally, new orders, the leading indicator of the report, also rose.

Bottom line is the data again was better than feared, and it's becoming apparent that the government shutdown did not hamper economic growth, and the economy might just be stronger than we all thought. And, that good data is why the "hawkish" tone from the Fed didn't result in a sell-off in stocks. Keep this in mind over the coming week: The market can rally into Fed tapering as long as the economic data continues to get better (i.e., good economic news is good for the market).

This Week

It's a holiday week here in the States, so data-wise it's pretty slow (the next major catalyst domestically comes next Friday with the November jobs report). But, although we can expect a slower week, there are a few things to watch.

First, this week is heavy on housing data, and that's important because the one bad number from last week was existing home sales, which clearly shows the housing market recovery is slowing.

I've been saying this for months, but the housing recovery continuing is integral to the economic recovery. But, it's integral in that the recovery continues (it can be at a slower pace — we just can't have the housing market start to decline again. That is a big, big problem if it happens). So, given mortgage rates are rising again, housing data will be important to make sure the recovery is still ongoing (even at a slower pace).

Pending home sales (a leading indicator for existing home sales) are released this morning, and Tuesday we get both September and October Housing Starts (September's report was delayed by the government shutdown), and also the Case-Shiller Home Price Index. Those releases will be the most-watched of the week. The only way they result in a sell-off, though, is if they imply the housing recovery is stalling, not just slowing (and so far the data is implying the latter).

Also this week, October Durable Goods and jobless claims will be released Wednesday, and claims in particular will be watched to see if the downtrend in claims from last week continues.

Outside of a big negative surprise from the housing numbers, though, this week shouldn't really alter the current market narrative or Fed expectations. Again the next big catalyst is the jobs report on Dec. 6.

Internationally, it's a busy week in Japan. Wednesday night brings Retail Sales, and Thanksgiving Day we get CPI, household spending, unemployment and industrial production. I'm pointing this out because we've seen a big drop in the yen/rally in DXJ, and to a point I think any "good" economic data may already be priced in, in the short term. So, we could see a "sell the news" effect in Japanese stocks/rally in the yen, but I'd use that to add more long exposure to DXJ/short exposure to the yen (via YCS).

Finally, Friday we get EMU Flash HICP for October (HICP is Europe's version of CPI). I'm pointing that out because it was the weak September HICP that prompted the European Central Bank to cut rates. So, from a "What Will the ECB Do Next?" standpoint, this number will be important. (If it's still very low, like last month's 0.7%, expect euro weak-

Market	Level	Change	% Change
Dollar Index	80.69	-.43	-.53%
EUR/USD	1.3551	.009	.67%
GBP/USD	1.6204	.0044	.27%
USD/JPY	.9827	-.0044	-.45%
CAD/USD	.9491	-.0003	-.03%
AUD/USD	.9153	-.0052	-.56%
Brazilian Real	.43585	.00315	.73%
10 Year Yield	2.752	-.032	-1.15%
30 Year Yield	3.838	-.045	-1.16%
Prices taken at previous day market close.			

ness as calls for the ECB to do "more" will get a lot louder.)

Commodities

Commodities were mostly higher last week thanks to strength in the energy and industrial metals while precious metals plummeted on "hawkish" Fed-speak and good economic data. The PowerShares DB Commodity Index Tracking ETF (DBC) gained 0.82% last week.

The energy complex was led higher by the refined products, as RBOB gasoline and heating oil rose on a combination of strong economic data and cold weather and lower-than-expected supply. Two domestic refinery outages mid-week also contributed to the rally.

WTI crude was also higher, although only by 1.04%. WTI rallied thanks to some dip-buying early in the week and was also "pulled" higher by the rally in the products and in Brent, which rallied on an apparent breakdown in Iranian negotiations, although there was a deal struck over the weekend. Oil prices are about 1.5% weaker this morning on the Iranian deal.

With regards to the deal, it's a 6 month easing of some sanction in return for Iranian steps that will make it harder for them to build a bomb. But, the oil embargo and exclusion from the SWIFT system are still in place, so while this will be a mildly negative catalyst, don't expect it to result in a waterfall decline in oil prices.

Fundamentally oil prices are fairly content in this tight low- to mid-$90s range that has been established. Supply levels are still building, however, at a much-slower pace while refiner utilization levels continue to climb, indicating an increase in demand.

Copper was up 1.5% by Friday, closing on the high tick for the entire week, a very bullish sign. Strong manufacturing and general economic data around the globe supported the bulls in last week's rally. I'm a believer in the industrial metals and miners being a great potential "contrarian" play, based largely on the global economic recovery. But, frankly, the trade has been kicking my rear end. I'll hold it a bit more, though, as I think the industrials are one of the few corners of "value" in the market today. (Although that may be for a good reason ...)

Precious metals saw substantial selling pressure despite the lower dollar last week, as a "hawkish" Fed weighed on the metals. Gold and silver were down 3.6% and 4.6% respectively. The only bullish case gold has in this current environment is the potential risk of inflation ticking higher, and there is no sign of inflation at all (last week's CPI report was negative month-over-month).

The price of gold will trade off of tapering expectations. So, the path of least resistance remains lower toward $1,200/oz. At some point gold will be a buy because I believe inflation is coming, but I don't think it's here.

Currencies & Bonds

Yields on the long end and "belly" of the Treasury yield curve moved higher last week, as longer dated Treasury bonds fell thanks to "hawkish" Fed speak, good data, and further solidifying of Q1 tapering expectations. Both 30 year and 10 year Treasuries have clearly resumed their downtrends, although as I pointed out last week, this iteration of the bond market decline is different from last summer. Two year Treasuries aren't falling with the long bond, like they did last summer, and as a result the yield curve is steepening (it's the "steepest" it's been all year). That should continue, and the takeaway is to continue to focus on the long end of the curve for any bond shots (TBF/TBT).

Both the dollar index and euro were flat last week in choppy trading. A Q1 taper of QE is priced into the dollar at these levels, and the euro is still trying to figure out if, and what, the ECB will do next to ease policy. I'd expect range bound trading for both until the EMU HICP this Friday, and jobs report next Friday. Asian currencies were not flat, however. The yen moved through 101 dollar/yen last week on "dovish" comments by BOJ head Kuroda, and this morning is trading at a 6 month lows vs. the dollar. Taken in context of the steep declines we've seen in the yen, we could see a bounce later this week when a lot of data is released, but "short yen/long DXJ" remains one of the better trades in the market (point being you haven't missed it if you're not yet involved).

Have a good holiday shortened week, 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 the market gets more comfortable with the outlook for Fed policy (ZIRP) and tapering of QE. Skeptical sentiment towards this relentless rally remains a tail wind, and the "pain trade" is still higher.* *The S&P 500 is at new highs, while support sits between 1760-1775ish.*

Trade Ideas

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 yen has broken through 101 yen/dollar level, and DXJ is at multi-month highs. Although we could see a pause, that trend should continue over the coming months, and there remains more money in this trade.**

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 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). It's a bit of a contrarian idea, and over the past few weeks these sectors have lagged. But, they 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 was flat last week, as a Q1 '14 tapering of QE is priced in at these levels. The next major catalyst for the dollar will be the Jobs Report on 12/6.*

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 resumed their declines last week, but notably we are seeing the long end of the curve sell off while the short end rallies, creating a steep yield curve. Continue to focus on the long end if you short any bounce (which I think you should).*

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.**