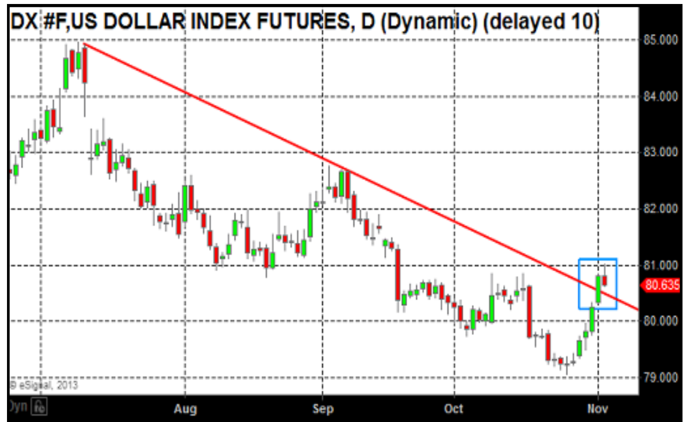
7:00's Report

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

November 5th, 2013



The Dollar Index broke a downtrend dating back to early July thanks to last week's rally.

Pre 7:00 Look

- Futures drifting very slightly lower this morning after an uneventful night.
- Chinese Premier Li Keqiang made comments on the economy, and while he said nothing new, he didn't pledge more stimulus, which is likely responsible for the mild global selling we're seeing this morning.
- Economically, UK service sector PMI beat expectations at 62.5 vs. (E) 59.8, sending the pound higher.
- Econ Today: ISM Non-Manufacturing Index (E: 54.5).
- Fed Speak: Lacker (12:30 P.M.), Williams (5:10 P.M.).

Market	Level	Change	% Change
S&P 500 Futures	1758.75	-4.25	-.24%
U.S. Dollar (DXY)	80.67	.03	.04%
Gold	1312.10	-2.60	-.20%
WTI	94.30	-.32	-.34%
10 Year	2.602	-.018	-.69%

Equities

Market Recap

Stocks drifted modestly higher to start the week in pretty quiet trading, as the market remains buoyant and resilient. The S&P 500 rose 0.46%.

Stocks started trading higher Monday thanks to better-than-expected international data (Chinese non-manufacturing Purchasing Managers' Indexes and EU and UK manufacturing PMIs), but really spent most of the rest of the day drifting. Stocks got a slight boost from "dovish" comments by St. Louis Fed President James Bullard, who said on CNBC the Fed was in "no hurry" to taper QE.

Stocks turned slightly negative into the European close shortly after 11 o'clock. But, there remain buyers on any dip, and the market gradually lifted into the close. Overall, it was a sleepy, pretty uneventful day in the equity markets, and the current market dynamic didn't really change of most people expecting a near-term pullback and higher prices in the longer term.

Trading Color

If last week's mild gains in the broader market were undermined by weak small-cap performance (as I pointed out in yesterday's issue), then yesterday's mild rally was bolstered by a small-cap recovery.

The Russell 2000 rallied 1.15%, strongly outperforming other major averages, and there was definitely a rotation in the market yesterday toward some of the recent laggards. The "momentum" stocks that had been beaten up lately (biotechs, GRPN, TSLA, NFLX, CRM) all bounced multiple percentage points, while homebuilders and energy stocks also outperformed. So, it's safe to

Market	Level	Change	% Change
Dow	15639.12	23.57	.15%
TSX	13361.78	24.32	.18%
Brazil	54436.92	423.68	.78%
FTSE	6722.43	-41.19	-.61%
Nikkei	14225.37	23.80	.17%
Hang Seng	23038.95	-150.67	-.65%
ASX	5431.96	41.43	.77%
Prices taken at previous day market close.			

assume we were seeing some dip-buying in these sectors (no one is really short those names).

Industrials and transports outperformed—the Dow Transports were up more than 1% and traded to a new all-time high, thanks to strength in the airlines (more on that below).

Market	Level	Change	% Change
Gold	1314.30	1.10	0.09%
Silver	21.655	-.182	-0.83%
Copper	3.255	-.0435	-1.32%
WTI	94.59	-.02	-0.02%
Brent	106.18	.27	0.25%
Nat Gas	3.445	-.068	-1.94%
Corn	426.25	-1.00	-0.23%
Wheat	662.75	-5.00	-0.75%
Soybean	1256.50	5.00	0.40%
Prices taken at previous day market close.			

Elsewhere, although yields declined marginally, consumer staples and utilities again lagged. So did financials, which were weighed down by bank stocks as the Fed's stress test parameters, which were released Friday afternoon, were tougher than expected.

Volumes were pretty lackluster and well-below recent averages yesterday, which makes sense given the catalysts later in the week. On the charts, not much changed: Support lies lower at 1,729 in the S&P 500 while resistance is at the old highs of 1,775.

<u>I'm Sure This Isn't True, But At the Same Time It Wouldn't Shock Me</u>

Yesterday both AMR Corp. (AAMRQ) and US Airways Group (LCC) were up sharply (as much as 2.1% and 5.7% respectively) on a WSJ article that implies they may be able to seek a settlement in the Department of Justice anti-trust lawsuit that is blocking the merger, obviously raising hope that ultimately the merger will be approved.

The progress, according to the article, centers around both LCC and AAMRQ being willing to divest certain assets, and the article specifically mentions assets at Reagan National Airport.

The reason I bring this up is because, when the DOJ lawsuit was announced, I had heard rumors that the real reason the DOJ went to block the merger (after allowing Delta/Northwest and Continental/United) was that members of Congress and other bureaucrats were nervous about the reduction of the availability of flights out of Reagan, should the merger be approved.

US Airways is the dominant carrier at that airport but American serves it, too. So, logically, after the merger they would almost certainly reduce capacity into Reagan National, thereby making it more difficult for members of Congress to catch convenient flights home.

Obviously that can't be the real reason for the lawsuit, but I'll just point out that if the airlines agree to divest the assets ahead of time, it'll allow for other airlines to pick up the routes, thereby ensuring plenty of availability and no interruption of flight schedules.

Again, I'm sure this is all hearsay and I'm just being super cynical, and the reason the DOJ is blocking the merger is because they want to preserve competition and fair pricing for the public. Sadly, though, it honestly wouldn't shock me if an ulterior motive proved to be true.

<u>It's Election Day</u>

It's an off year so not many people are aware of this, but it's Election Day and there a few races that will be decided today. I want to point out the Virginia Governor's race, between Democrat Terry McAuliffe and Republican Ken Cuccinelli. Obviously not all of you live in Virginia, but this race is being watched for insight into the voters' mindset ahead of the mid-terms next November.

First, Virginia is a battleground state and the results will likely be looked at anecdotally with regard to the mindset of the undecided electorate. Second, the Republican is a Tea Party favorite, so analysts will draw conclusions with regard to the state of the Tea Party and its effect (positive or negative) on Republican chances of capturing the Senate (and keeping the House).

Prior to the government shutdown, the expectation was that the Republicans would keep the House and likely take the Senate, but the results of this election will likely shift the expectations for the latter. It won't move markets today, but next year politics will be something we all have to watch. and I just wanted to start providing some context.

Economics

No reports yesterday.

Commodities

Commodities were mostly lower yesterday in quiet trading across the board. The weakest performers were natural gas and copper while crude oil caught a modest bid following the substantial sell-off we saw last week.

Gold futures were slightly higher in response to mild weakness in the dollar but the gains were tentative and we're already seeing gold lower this morning. Precious metals continue to trade inversely with the dollar and remain largely range-bound with neither the bulls nor bears holding the upper hand. $1280—$1340ish seems to be the dominant range, and likely will stay that way until we get some sort of inflation or Fed taper.

Copper was down 1.4% yesterday despite decent economic data out of China. The "good" economic data however was the Non-Manufacturing PMI, which is a service indicator and really doesn't affect the demand for copper. There are some supply worries but, for the most part, copper has been range-bound between $3.18 and $3.37 since early August and will remain that way for the near future. (On a technical basis, prices have been making lower highs and higher lows since early August, so look for a momentum-backed breakout one way or another when the pattern breaks.)

Natural gas opened lower and chopped back and forth in a very light volume session yesterday, ultimately declining 2.25% on the day. Movement in gas is still dominated by the weather and given forecasts are for a warm November, gas is under pressure. Natural gas is sitting on the $3.40 level this morning, and for those with some risk appetite, I continue to like a long trade in gas here (either via futures or UNG, the natural gas ETF). With a fairly tight stop in the $3.40-ish range, the risk is only 3 or 4 cents while your upside potential is 30-40 cents; food for thought.

WTI crude oil futures traded to a 4 month low yesterday before catching an oversold bounce shortly after the open. WTI zigzagged through the session and closed down just 2 cents. The move off the lows was driven by good economic data out of both China and Europe, giving the shorts a reason to take profit and a few brave spec longs the opportunity to buy.

Brent crude gained 0.3% on a similar "oversold bounce" after plummeting 2.5% on Friday. Both domestic and international oil prices are being driven by supply levels at this point; however, the Brent situation is slightly more complicated.

For the past several weeks, Brent crude has been supported by supply concerns emanating from Libya. But, after producing well below capacity for the last several weeks, Libya is expected to slowly ramp up exports next week, as the social protests that blocked exports are worked out by the government. Both the Mellitah and Hariga NW export terminals are expected to come back online over the next two weeks, which will increase production to about 400K Bbl/day for the country (from about 1/4 of that level over the past several weeks, but still well below the 1 million plus bbls/day capacity). So, as Libya comes back on line, I'd expect we'll see a contraction of the Brent/WTI spread over the next few weeks, especially if economic data in the US remains "ok."

Bottom line in the commodity markets is pretty much all commodities remain largely range bound, as they are looking for clues as to uncertain demand (WTI Crude and Natural Gas) or trading off the dollar (Gold and Silver), where the trend remains unclear. With the exception of a risk trade on natural gas, I don't think there are many clear trends in the commodity space right now.

Market	Level	Change	% Change
Dollar Index	80.625	-.185	-0.23%
EUR/USD	1.3518	.002605	0.19%
GBP/USD	1.5971	.004757	0.30%
USD/JPY	98.56	-.1555	-0.16%
USD/CAD	1.0422	.000485	0.05%
AUD/USD	.9507	.00399	0.42%
Brazilian Real	.4426	.00235	.53%
10 Year Yield	2.602	-.018	-.69%
30 Year Yield	3.691	-.005	-.14%

Prices taken at previous day market close.

Currencies & Bonds

Both currency and bond markets remain totally at the mercy of Fed and ECB expectations with regard to tapering of QE and rate cuts. Bond and currencies (and gold for that matter) continue to be much more reactive in the short term to the ever-changing expectations of central bank policies. Unfortunately for all of us, that's likely something that's here to stay.

We saw a bit of a reversal from last week's moves in the currency markets, as the Dollar Index declined modestly (-0.2%) while most major currencies rose vs. the greenback. There were "reasons" for the moves in the currency markets yesterday, as Fed President Bullard was slightly "dovish" in his commentary to CNBC (weighed on the dollar), while EMU PMIs largely met expectations and the UK Construction PMI was a solid beat at 59.4 vs. (E) 58.9.

But, while there were fundamental reasons for the moves in the currency markets, most of the trading yesterday was little more than a digestion of the huge rally in the Dollar Index and decline in the euro, both of which may have gotten a bit ahead of themselves in the very short term given the ECB meeting and jobs report.

As with the more important question of "Is the Dollar Index decline over?" we'll just have to wait and see, not only with regard to expected Fed tapering of QE (which I again think isn't as near as the market seems to have priced in from last week) but also with what happens with the euro. Because the euro is by far the largest component of the Dollar Index, a relentless decline will send the index up, even though the dollar may not be getting stronger against all currencies.

Instead of trying to guess whether the Dollar Index or euro is headed up or down, I instead try to focus on more-discernible trends, and again I'll come back to the yen. The yen has been supported by potential "macro crisis" over the past month (debt ceiling drama and spiking Shanghai Interbank Offered Rates) and also by universal weakness in the dollar.

Well, for now the macro horizon looks clear into year-end. While the Dollar Index could rise because the euro falls further, I don't see a lot of positive catalysts for the Japanese yen between now and year-end. I will again reiterate that shorting the yen (or getting long DXJ) remains one of the more fundamentally sound moves in the market. If the yen can get through 99/dollar, I think you could see an acceleration higher into year-end.

Bonds rallied to start the week, with Bullard's comments being the most-cited "reason" for the rally. But like currencies, I think we just saw a bit of book-squaring ahead of a potentially busy back half of the week.

I remain skeptical about just how "pulled forward" the tapering of QE is actually is vs. the expectations. And, because of that skepticism, and despite the fact that I'm a huge long-term bond bear, I'm not sure you want to add to any medium-/longer-term shorts at these levels, and would prefer to wait for higher prices before going all "in" on my bond short. It'll obviously be data-dependent, but I wouldn't be surprised if we saw one more bond rally before the market rolls over in earnest next year.

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**	*The S&P 500 traded to new all time highs last week despite shifting expectations of when the Fed will taper QE. While valuations are elevated, and there are "warning signs" in the market (small cap underperformance, loss of momentum stock leadership) cautious sentiment remains one of the bigger drivers of stocks, and until sentiment becomes much more enthusiastic, the path of least resistance for stocks remains higher.* *The S&P 500 support again sits at the old highs of 1729 while resentence is last weeks highs of 1775.*

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: **The "Long Japan" trade has stalled a bit thanks to a rising yen (which was a result of the debt ceiling drama) but long Japan remains one of the more fundamentally based trades in the market. DXJ remains the way to play it and I'd buy this dip for medium/longer term accounts.**

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 fell to multi-week lows last week as WTI Crude, gold and wheat all fell for various reasons (over supply, stronger dollar, etc.).*

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.**

Long Natural Gas around at these levels with a $3.40 stop: **The $3.40—$3.50 level in natural gas has held multiple tests of support over three months, and given we are heading into the winter seasons and inventories, while still elevated, are higher than they were last year, the case can be made for a good risk/reward set up.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	**Neutral**	**Neutral**	**Neutral**	*Euro weakness and the changing Fed expectations led to a massive rally in the dollar last week, but it remains to be seen if the Fed is actually more hawkish than we thought.*

Trade Ideas

Long: **Emerging market currencies (ETF is CEW) such as the Brazilian Real (BZF), Indian Rupee (ICN) or Mexican Peso, as those currencies should see further upside as Fed tapering has likely been delayed until early '14.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	**Neutral**	**Bearish**	**Bearish**	*Bonds declined last week on changing Fed tapering expectations, but at this point it's too early to tell if this counter trend rally in bonds is over, as it's not clear the Fed has actually turned more hawkish than the market previously thought.*

Trade Ideas

Buy on a significant dip: **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.**