7:00's Report

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

November 6th, 2013

Global industrial mining stocks have been in a solid uptrend since bottoming in July.

Pre 7:00 Look

- Futures and global markets are higher as economic data o/n was good.
- EU service sector PMIs, UK Industrial Production and German manufacturers' orders all beat estimates. EU retail sales was the one disappointment, as it slightly missed expectations.
- The strong data extended beyond Europe, as Japanese composite PMIs beat estimates (56.0 vs. (E) 53.2).
- Econ Today: No Reports Today. Fed Speak: Pianalto (1:10 P.M.)

Market	Level	Change	% Change
S&P 500 Futures	1765.50	9.00	.51%
U.S. Dollar (DXY)	80.565	-.22	-27%
Gold	1318.30	10.00	.76%
WTI	94.14	.77	.82%
10 Year	2.662	.06	2.31%

Equities

Market Recap

Stocks drifted modestly lower yesterday as the market continues to tread water ahead of the week's big catalysts Thursday/Friday. The S&P 500 fell 0.28%.

Stocks started trading Tuesday lower on general profit-taking and some less-than-enthusiastic comments from China Premier Wen Jiabao regarding more economic stimulus. Equities hit their lows for the day shortly before 10 AM with the Dow down nearly 100 points, but really the declines were more about positioning and trading noise than any real negativity, and stocks recovered throughout the day to close down slightly.

Stocks traded off their lows following more dovish comments by a Fed governor on CNBC. (This time it was Boston's Eric Rosengren saying economic growth was "substantially slower than I'd like to see.") The ISM Non-Manufacturing PMI beat also helped stocks trade back to flat by midday. But, given the events looming later in the week and also for the rest of the year, there doesn't appear to be any great desire to chase stocks higher and add additional risk.

As a result, stocks spent the afternoon drifting near flat in hedge-fund- and fast-money-dominated trading, before selling off a bit into the close (but again well off the early morning lows).

Trading Color

It was another quiet day in the markets, as most of the "real money" is sitting on the sidelines and trading is dominated by fast-money/day-trading types.

As such, the only discernible trend in the sector trading Tuesday was the weakness in the "bond proxy" stocks,

Market	Level	Change	% Change
Dow	15618.22	-20.90	-.13%
TSX	13361.71	-0.07	-0.01%
Brazil	53831.85	-605.07	-1.11%
FTSE	6754.43	7.59	.11%
Nikkei	14337.31	111.94	.79%
Hang Seng	23036.94	-2.01	-.01%
ASX	5433.81	1.84	.03%
Prices taken at previous day market close.			

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as rising interest rates were the dominant theme in markets yesterday (and are now at multi-week highs).

Homebuilders (they aren't a bond proxy but they are rate-sensitive), utilities, and REITs all badly underperformed. (REITs in particular got hit hard as the Vanguard REIT ETF (VNQ) was down 1.7%.)

Market	Level	Change	% Change
Gold	1310.00	-4.70	-0.36%
Silver	21.685	-.015	-0.07%
Copper	3.2645	.0115	0.35%
WTI	93.44	-1.18	-1.25%
Brent	105.42	-.81	-0.76%
Nat Gas	3.477	.032	0.93%
Corn	425.00	-1.25	-0.29%
Wheat	656.00	-6.75	-1.02%
Soybean	1250.25	-6.25	-0.50%
Prices taken at previous day market close.			

Other defensive sectors held up "OK" though, as healthcare was little-changed and consumer staples actually finished positive on the day. But, it's not enough to say there was a "safety" bid in the markets, as tech was the only other sector to finish in the green and consumer discretionary was flat on the day.

With earnings season ending and the market looking forward to events later in the week, volumes continue to dry up and are well-below recent averages. On the charts the S&P 500 was little-changed, so the technical picture remains the same.

Bottom Line

The market overall continues to feel "tired" but, at the same time, that doesn't necessarily mean an impending correction. (The market has traded sideways many times this year before moving higher.) And, I continue to read multiple articles about how stocks are "whistling past the graveyard" given recent sluggishness in Europe, plunging oil prices, stubbornly low inflation, small-cap underperformance and now emerging market weakness. (EMs were sharply lower yesterday.)

But, all these warnings, while legitimate, don't necessarily mean an impending correction. At best it seems the market is running in place, as investors don't want to lay out more capital given that it's late in the year. But at the same time, they don't want to materially de-risk if we get a Santa Claus rally. So, for now, the market dynamic remains largely the same—treading water until we get a better picture on the economy and Fed expectations (via the jobs report).

Finally, if I had to say what this market's kryptonite would be, it's a surprise earlier-than-expected tapering of QE without strong economic data. All other "warnings" aside, that's the bearish game-changer that I'm watching for.

More Anecdotal Positives on Global Miners/Mining

In the Oct. 15th 7:00's Report, I made the case that the multinational, industrial miners offered a "value play on the global recovery" given their massive YTD underperformance and washed-out valuations.

Since then, what I think is the preferred ETF for this idea, the iShares MSCI Global Metals & Mining Producers ETF (PICK), has hit a 7 month high and, after a pullback at the end of last week, is up 2.5% since Oct. 15th.

Despite the run and the fact that PICK is well off the lows of the year, I think this is a trade that still makes sense, and lately I've had some agreement around the Street.

Earlier last week, Codelco reported it is increasing premiums for copper shipments to China, citing strong demand. And, earlier this week Goldman Sachs upgraded the steel sector from "cautious" to "neutral." And, yesterday Jefferies had a positive report on Q4 iron ore demand emanating from China.

While the GS report cited valuation (all the bad news is priced in) and improving fundamentals (pretty standard stuff), the Jefferies bullish call on iron ore is more nuanced.

Jefferies is bullish on iron ore because of impending construction of affordable housing in China. The report postulates that recent surging Chinese property prices aren't so much the result of a speculative bubble as they are the reflection of a lack of housing capacity. This results in inflation for existing housing. One way to cure that (and the housing inflation) is to build more "affordable units," and upward of 70K price-capped housing units are scheduled to be built in major cities in 2014, potentially alleviating the supply issue.

This increased demand comes at a time when iron ore supply usually dips. (We are entering a seasonally weak period for iron ore production. Over the last three years,

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iron ore production has declined 15% in the first quarter of the year.) Bottom line is we're seeing more anecdotal evidence of a "turn" in the industrial metals and for industrial metal miners, and the space still remains a "value." PICK is still down 7% on the year, compared to the 23%-plus gain for the S&P 500. If you're looking for a sector that has badly underperformed, this is it!

Finally, I prefer PICK over the higher-volume alternative, the SPDR S&P Metals and Mining (XME). XME has a higher concentration of coal names (17%) and precious metals (another 17%). I'm more interested in a "pure play" on some of the industrial metals and mining companies. As a result, I'll tolerate the lower volume (PICK isn't heavily traded) because I would prefer to leave the domestic coal and gold names out of this trade.

Economics

ISM Non-Manufacturing PMI

- Oct. Non-Manufacturing PMI was 55.4 vs. (E) 54.5.

Takeaway

The non-manufacturing (or service sector) PMI continued the trend of surprisingly "not as bad as feared" economic data in October. (It'd be a stretch to call the October data "strong" at this point.)

The headline beat estimates of a small decline, while the business activity index (which is the non-manufacturing PMI equivalent of the production index in the manufacturing report) jumped to 59.7 from 55.1 in September, although it still remains below the July and August readings.

The one disappointment there was the decline in new orders, which is the leading indicator in the report.

Bottom line is the service sector, like pretty much every other sector in the economy, has seen some slowing of momentum since the summer. Although, given the low expectations for data in October because of the government shutdown, this report was definitely better than expected. From a Fed policy aspect, although the market traded slightly "hawkish" in the release, this report won't pull forward any tapering of QE from current expectations (which appear to be coalescing around March '14).

Market	Level	Change	% Change
Dollar Index	80.775	.135	0.17%
EUR/USD	1.3477	-.00198	-0.14%
GBP/USD	1.6050	.0086	0.54%
USD/JPY	98.54	.107	0.11%
USD/CAD	1.0459	.00176	0.17%
AUD $	.9493	.002695	0.28%
Brazilian Real	.43495	-.00055	-.13%
10 Year Yield	2.662	.06	2.31%
30 Year Yield	3.758	.067	1.82%

Prices taken at previous day market close.

Commodities

Commodities were broadly lower in yesterday's trading session. Nymex crude oil futures again led the way lower as traders anticipate yet another weekly build in supply. WTI futures expiring in December closed lower by 1.25%. The two outperformers were natural gas and copper, which saw gains of 0.93% and 0.35%, respectively. In addition to technical trading and supply anticipation, strength in the dollar put pressure on the general commodities space.

Gold closed modestly lower as it continues toward the magnetic $1,300 level while silver finished the session essentially flat. Precious metals again traded in almost perfect negative correlation to dollar movement, which obviously applied some pressure. Copper, on the other hand, moved a few ticks higher on the ISM Non-Manufacturing data, which was pretty positive, indicating a possible bump in demand. This would be in line with a report from Codelco stating that they were increasing premiums.

Natural gas held the $3.40 level as I had anticipated and moved higher throughout the day. The move was close to establishing an "outside reversal" on a daily candle chart, which is a textbook long entry for technical traders. Fundamentally there wasn't a whole lot driving the market, which leads me to believe I was not the only one who saw Nat Gas as a value in the $3.40 range.

In addition to the "outside reversal" I just mentioned, there is a pretty sizeable gap on the daily chart. As the age old Wall Street saying goes: "All gaps get filled sooner or later." I anticipate this one filling soon, with an initial price target to Friday's low, $3.508, but I also see the

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potential for the follow-through up to the $3.70 and $3.80 levels in the coming weeks. Of course this is a weather-driven market, so we will need to see a little bit of a catalyst in the form of a cold snap pushing across the country, which is pretty much inevitable.

WTI continues to implode, reaching a 5 month low in yesterday's primary session. The selling was a product of continued fundamental weakness due to rising supply and technical trading that is working prices lower as the downtrend continues. It appeared as though many market participants were either closing their spec longs or opening spec shorts as the day went on in anticipation of the afternoon API number. The EIA report coming out this morning at 10:30 A.M. will have a substantial influence on the future direction of WTI contracts.

Currencies & Bonds

The euro continues to "drive the bus" in the currency markets, falling another 0.33% on a combination of positioning ahead of the ECB meeting Thursday (where actual or verbal easing is expected) and after the European Commission reduced expected EMU GDP growth in 2014 to 1.1% from 1.2%. That's obviously not a huge move, but in the context of mounting pressure on Mario Draghi and the ECB to do "something" in the face of falling inflation, it did add to downward pressure on the euro yesterday.

With the euro weaker, the Dollar Index was stronger, although it finished off its best levels of the day and rose less than 0.2%. The weaker euro wasn't the only influence on the Dollar Index yesterday, but it did turn out to be the deciding factor as a second-straight day of "dovish" commentary on CNBC by a Fed president (this time Eric Rosengren) offset the better-than-expected October Non-Manufacturing PMI.

Turning to currencies that trade off actual economic fundamentals, the Reserve Bank of Australia had an interest rate meeting Tuesday, and as expected kept rates steady at 2.5% and its commentary on the economy largely unchanged from the previous meeting. Importantly, though, the RBA said the Aussie remains "uncomfortably high" and, like I said last week with regard to Japan, it always pays to be investing on the same side as the country's Reserve Bank. The RBA won't let the Aussie appreciate much higher than it already has, and in a slow global recovery and steady Chinese/Asian economic growth, that should continue to be beneficial to the resources-rich Aussie economy. Throw in a relatively "pro-business" government, and EWA continues to be attractive, especially given the dip over the past week or so.

Treasuries dropped to three-week lows yesterday on a combination of technical trading and a "hawkish" response to the ISM Non-Manufacturing Report. The 30-year bond broke Friday's low of 133'20 prior to the ISM Report, and then accelerated downward after the release to trade down 1% on the day before bouncing a bit to finish down 0.7%. The 10-year yield, meanwhile, has quietly crept higher and is now at 2.66%. On the charts things turned a bit bearish for bonds yesterday, as the 30-year Treasury note broke the uptrend in place since the September "no tapering" lows, and appears to potentially be rolling over. I continue to think the bond market is overreacting to the potential for a "sooner than expected" tapering of QE, and definitely don't think a good ISM Non-Manufacturing report is worth a 1% decline in the Treasury market. So, like in the dollar and euro, if investment sentiment had shifted too far one way two weeks ago, it appears to me to be shifting too far to the other into the big events later this week.

But, as a staunch bond bear, I'd welcome this countertrend rally breaking down and the decline resuming in earnest, because that's much more profitable than this continued rally. But at this point I just don't see the fundamentals supporting it. Perhaps a blowout jobs number awaits Friday would force me to change my tune, but I just don't think this countertrend rally is done yet.

Have a good day — 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	*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.**

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