7:00's Report

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

November 7th, 2013

Pre 7:00 Look

- Futures flat and the global markets are quiet ahead of the ECB later this morning.
- News was light o/n but on balance what data we got wasn't very strong. German industrial production missed expectations, and the Australian employment survey also disappointed.
- Econ Today: BOE Meeting (E: No change in rates or QE). ECB Meeting (E: No change in rates), Press Conference 8:30 EST. Q3 GDP (E: 2.0%), Jobless Claims (E: 335K).
- Fed Speak: Stein (9:10 A.M.), Dudley (1:30 P.M.).

Market	Level	Change	% Change
S&P 500 Futures	1762.25	-3.25	-.18%
U.S. Dollar (DXY)	80.565	.006	.01%
Gold	1313.30	-4.50	-.34%
WTI	95.14	.36	.36%
10 Year	2.64	-.022	-.83%

Equities

Market Recap

Stocks finished trading Wednesday modestly higher on a combination of good global economic data and a potentially more "dovish" Fed. The S&P 500 rose 0.43%.

In a lot of ways, trading yesterday was the mirror opposite of Tuesday. Stocks sprinted out of the gate thanks mostly to good global economic data and the WSJ article that Fed policy might shift toward extending the Zero Interest Rate Policy beyond the current consensus, and shift away from the benefits of quantitative easing (link to the article here). That was seen as incrementally "dovish" by the markets yesterday, and was responsible for a large part of the bullish sentiment in markets yesterday.

But, as has been the case for over a week now, there was no follow-through to the early rally. Stocks came in hard after the first hour of trading, before rallying off the lows before lunch. Then they spent the afternoon drifting to close solidly positive, but well off the highs.

There was little in the way of news during the trading session yesterday, and mostly stocks continue to tread water—no one wants to chase the market higher, but dips are viewed as buying opportunities for fear of missing a Santa Claus rally. Until that dynamic is resolved, stocks will keep running in place.

Trading Color

The S&P 500 finished higher, but yesterday was far from a "strong" day for a number of reasons. First, while the Dow and S&P 500 closed higher, the Nasdaq, Russell 2000 and Transports (all economic growth-oriented sectors) all closed solidly lower. And, the huge rally in MSFT alone contributed more than 1 point to the 7.5 points the S&P 500 gained yesterday, so the rally looked a bit better than it actually was.

Additionally, we saw a resumption of weakness in the "momentum" stocks, as the TSLA declines (close to 15%) reminded everyone who owns those stocks just how much they've run and was a not so gentle reminder to lock in gains.

From a sector standpoint we continue to see violent gyrations in the "bond proxy" and safety stocks. Utilities, telecom, and RETIS were down sharply Tuesday, but then were the big outperformers yesterday thanks to the article implying the Fed could lower its unemploy-

Market	Level	Change	% Change
Dow	15746.88	128.66	.82%
TSX	13380.41	18.70	.14%
Brazil	53384.60	-447.25	-.83%
FTSE	6729.50	-12.19	-.18%
Nikkei	14228.44	-108.87	-.76%
Hang Seng	22881.03	-155.91	-.68%
ASX	5422.04	-11.77	-.22%
Prices taken at previous day market close.			

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ment threshold and extend ZIRP.

Bottom line with "bond proxy" stocks is they are totally at the mercy of Fed expectations, and we should continue to see volatility going forward. Given I'm a long term bond bear, I'd be hesitant to allocate capital to any of these sectors except consumer staples (XLP) on a decent dip (as I said last week) because I think the group will underperform as a whole regardless of short term gyrations in tapering expectations. Whether it's a month or a quarter away, the Fed will taper and rates will rise, and I'd prefer to be in sectors with more of a "growth" attribute to them.

Market	Level	Change	% Change
Gold	1317.40	9.30	0.71%
Silver	21.81	.174	0.80%
Copper	3.235	-.0235	-0.72%
WTI	94.84	1.47	1.57%
Brent	105.13	-.20	-0.20%
Nat Gas	3.499	.033	0.95%
Corn	421.00	-4.00	-0.94%
Wheat	653.75	-2.25	-0.34%
Soybean	1256.25	6.00	0.48%
Prices taken at previous day market close.			

On the charts the S&P failed to make a new high (it got to 1773, two points shy of the all time highs of 1775) and volumes, predictably, were pretty light. The techincal picture remains largely unchanged this morning (resistance at 1775, support well below current levels around the 1720's).

Economics

There were no significant reports yesterday, but I've provided a preview of today's European Central Bank meeting, as it's one of the most-anticipated events of the week.

ECB Meeting

- Consensus expectation is for no change in rates or other policies.

Preview

Although the "consensus" is for no change to rates, there is certainly a chance that we could see a 25-basis-point cut by the ECB, based on the very low inflation reading of last week.

This kind of cut would be a "dovish" surprise. But if the ECB doesn't cut rates, then at a minimum the market will be looking for ECB President Mario Draghi, at the press conference that begins at 8:30 a.m. Eastern, to say the ECB governing council extensively discussed at least one of the following:

1) Cutting interest rates (which means they'll do it in December).

2) A plan offering a new LTRO (not announcing it, but acknowledging it was discussed).

3) Potentially cutting banks' reserve requirements.

Again, the market isn't anticipating the later two policies being announced, but instead is looking for evidence that they were at least considered. These central bank interactions with the market remain, at heart, a confidence game, and the market is looking for reassurance that the ECB is worried about dis-inflation and is thinking on how it will ease policy further in the coming months.

Now, a logical question is "Why Do We Care What the ECB Does?" Beyond the obvious answer that it affects my "bullish Europe" investment thesis, more importantly, if the ECB doesn't cut rates or provide more clarity on how they plan to ease policy further in the coming months, you'll see the European stock market sell off hard— and most likely that will drag the U.S. markets down, too.

So, if the ECB is "hawkish," expect lower stock prices around the globe. That's because we are still in a global equity market that is being buoyed by multiple central banks continued support and accommodation. If one large central bank all of a sudden appears uncommitted to more accommodation, we'll see the effects across all markets.

Think of it like pontoons on a boat—if one starts to deflate it won't sink the boat, but it's sure going to make it start listing. In an era of unprecedented central bank liquidity and interlinked financial markets, if "dis-inflation" is allowed to creep into the EU financial system and the ECB is perceived as not responding, it's bad for risk assets globally.

Commodities

Commodities were broadly higher yesterday on generally strong global economic data. Both the EU Composite

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PMIs and the German Manufacturers' Orders were stronger than expected. The PowerShares DB Commodity Tracking Fund (DBC) was up 0.08%.

The commodity space as a whole has been getting hit pretty hard in the past few sessions, so most of the move higher yesterday was due to an oversold bounce, rather than any actual bullish news or long-term buyers coming into the market. Generally commodities are going to remain range-bound with a bias to the downside in the near future, until we get more clarity on the economy and the Fed.

WTI crude oil was the largest outperformer yesterday following six straight losing sessions. Buyers took control right away when the primary session opened and prices rallied consistently throughout the day and oil closed more than 2% higher.

The EIA released its weekly inventory report that was "not as bad as feared" and that was enough for shorts to begin covering and protecting profits while some speculative longs also entered the market.

The EIA reported a build of 1.6M Bbls last week, which was very close to the analyst consensus but much lower than last week's build of 4.1M Bbls. The fact that the data was in line with estimates was "good enough" news to send the price of WTI higher throughout the day.

There was a draw in both gasoline and distillate inventories as well, which is indicative of future crude demand out of refineries. This also helped elevate crude.

The low-risk trade in natural gas I mentioned last week is working nicely. Nat gas is on a two-day rally, up as high as 3.2% since Monday's close. It didn't take long for the "gap" I noted in yesterday's report to be filled during the primary session. Natural gas does, however, remain largely range-bound and primarily weather-driven, so it is necessary to keep a close eye on any storm systems that begin to develop across the country.

Gold and silver both rallied yesterday as the dollar traded lower throughout the session. Staying in line with the recent trend, the moves in both gold and silver showed strong inverse correlation with the dollar. The greenback was down due to an article that "close friend of the Fed" Jon Hilsenrath released in the WSJ regarding the possibility that the Fed will lower the level the unemployment rate needs to reach in order to begin tapering (from 6.5% to as low as 5.5%). This would further delay any chances of a taper in QE. For now, gold and silver both remain "handcuffed" until the ECB announcement today and the U.S. employment situation statistics are released Friday.

Copper was the only commodity that really saw any decline yesterday, and frankly there wasn't much of a reason for it. Some analysts were quoted as saying the price of copper fell on concerns about the Chinese economy, but that seems like a stretch and a somewhat-forced commentary. The truth is copper is trading on technicals as the market waits for more fundamental data to direct futures prices one way or another.

Despite the decent bump higher in the commodity space yesterday the sector, and most every market for that matter, remains range-bound ahead of the jobs report due out tomorrow.

Currencies & Bonds

We saw reversals of this week's trends yesterday, as the euro strengthened and the dollar fell, mostly on position squaring ahead of the ECB and jobs report—although there were some fundamental forces at work in currencies yesterday.

Market	Level	Change	% Change
Dollar Index	80.57	.011	.01%
Euro	1.3516	-.0006	-.04%
Pound	1.6078	0.00	0.0%
Yen	1.0134	-.0001	-.01%
CAD $	.9597	.001	.10%
AUD $	.9468	-.004	-.42%
Brazilian Real	.4345	-.00085	-.20%
10 Year Yield	2.64	-.022	-.83%
30 Year Yield	3.769	.011	.29%

Prices taken at previous day market close.

The euro rallied 0.35% yesterday ahead of the ECB meeting thanks to a combination of good economic data (composite PMI, German manufacturing) as well as short-covering into the meeting this morning.

Yesterday, the Dollar Index declined almost an identical 0.31% thanks to euro strength but also because of speculation the FOMC may lower its unemployment thresh-

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old for raising interest rates (currently at 6.5%). Speculation, emanating from a Fed paper that was presented at an International Monetary Fund meeting yesterday, is that the FOMC may lower the unemployment rate threshold that would warrant a increase in interest rates to 6.0% or 5.5% from the current 6.5%, which would obviously mean that we would have ZIRP for a longer period than thought.

Weakness in the dollar was almost universal (the pound rallied another 0.2% vs. the dollar after better-than-expected service sector PMI data, and the "Aussie" bounced off recent lows after the September trade balance showed a smaller deficit than expected), and exports were increased and revised higher in August.

Australia, like Canada, is a commodity-export-driven economy, so an increase in exports is economically positive for the country, which is why we saw the "Aussie" tick higher on the release. The strong export data reinforces my continued bullish stance on Aussie shares (via EWA), given that the Reserve Bank of Australia will keep the Aussie dollar low. (Again, the RBA referred to it as "uncomfortably high" in this week's statement.) Growing exports, a recovering economy and downward pressure on the currency from the central bank is a good recipe for higher Australian equity prices.

Staying in Asia, yesterday the yen was actually the only major currency to fall vs. the dollar, despite stronger-than-expected composite PMIs and Bank of Japan meeting minutes that met expectations. 99 yen/dollar remains a key level and the yen continues to inch closer to it. Once it's violated, I think we could see an acceleration to the downside.

Finally, turning to bonds, treasuries were flat yesterday, as the market digested Tuesday's steep declines and looked forward to the ECB and jobs Report.

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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