7:00's Report

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

November 8th, 2013

Pre 7:00 Look

- Futures are seeing a weak bounce after yesterday's steep declines, but foreign markets are solidly negative as they play catch up to the drop in stocks in the US yesterday. All eyes are on the jobs report.
- Economic data o/n was good as Chinese October exports rose 5.6%, handily beating estimates and implying we're seeing continued recovery in the global economy.
- Econ Today: Employment Situation (E: 120K). Personal Income & Outlays (E: 0.3%/0.2%). Fed Speak: Lockhart (12:00 P.M.), Bernanke (3:30 P.M.), Williams (4:00 P.M.).

Market	Level	Change	% Change
S&P 500 Futures	1748.25	3.00	.16%
U.S. Dollar (DXY)	80.94	.086	.11%
Gold	1308.30	-0.20	-.02%
WTI	94.12	-.08	-.08%
10 Year	2.613	-.027	-1.02%

Equities

Market Recap

Stocks had their worst day since early August as markets ignored Twitter (TWTR) euphoria and instead the growing theme of profit-taking led to sharp declines across the averages. The S&P 500 fell 1.32%.

Stocks started the day modestly lower ahead of the European Central Bank's interest-rate cut announcement, but turned positive on the action by the ECB and the stronger-than-expected GDP headline (more on that later). But, as has been the case lately, the gains were tentative, and markets started to roll over mid-morning.

The Russell 2000 is now more than 4% off the highs for the year, and 1070 is now an important level to watch.

Stocks traded methodically lower throughout the afternoon despite a total lack of news, and there was no single catalyst that accounted for the declines. Stocks sank all afternoon and ended just off the lows.

Other than a growing trend of investors looking to book profits, there wasn't any real "reason" for the sell-off yesterday, and most of what it was attributed to wasn't correct. The No. 1 reason I saw was "sooner than expected tapering of QE," but we know that isn't true because bonds wouldn't have rallied if that were the case. The other "reason" I saw often cited was the plunge in the yen (typically a "risk off" trade) but, as I'll get to later, there was no fundamental reason for the decline. If anything, I think it was mostly trading noise.

Trading Color

Internally, yesterday was relatively ugly. First, stocks went out basically at their lows. Second, the "growth oriented" indices (Russell 2000 and Nasdaq) badly underperformed, and the Russell is now 4% off its highs for the year. Finally, the "momentum stocks" continued to

Market	Level	Change	% Change
Dow	15593.98	-152.90	-.97%
TSX	13294.99	-85.42	-.64%
Brazil	52740.79	643.81	-1.21%
FTSE	6668.16	-29.06	-.43%
Nikkei	14086.80	-141.64	-1.00%
Hang Seng	22744.39	-136.64	-.60%
ASX	5400.66	-21.37	-.39%

Prices taken at previous day market close.

trade poorly. TSLA (another vehicle fire), PCLN, FB, CRM, and WRM (bad earnings) all fell multiple percentage points, which again implies profit-taking is the real reason behind the declines.

Market	Level	Change	% Change
Gold	1305.20	-12.60	-0.96%
Silver	21.58	-0.188	-0.86%
Copper	3.24	.003	0.09%
WTI	94.13	-0.67	-0.71%
Brent	103.44	-1.80	-1.71%
Nat Gas	3.529	.031	0.89%
Corn	421.25	0.0	0.0%
Wheat	653.25	0.0	0.0%
Soybean	1267.00	12.00	0.96%
Prices taken at previous day market close.			

From a sector standpoint, there was broad weakness and no real "outperformance" to speak of. Safety stocks didn't really offer any shelter from the selling yesterday, as utilities relatively outperformed but just barely (both were down close to 1%).

On the charts the S&P traded to a two-week low, and is just above support around the 1,730-1,740 level, although 1,729 is the first real area of support.

Jobs Report Preview

- Expectations are for 120K jobs added in October
- Unemployment Rate expected at 7.3%.

Scenarios

Expectations for this jobs report are already pretty low, but some of the better-than-expected data recently (PMIs) probably skews the risk to the downside.

The "Too Cold" Scenario: Around 60K jobs added. With expectations so low for this report, it would have to take a terrible number to really get people to react negatively. Even if it's a slight miss, people will likely blame the government shutdown. If we get a number this bad, expect stocks to decline, while gold, bonds and the dollar trade "dovishly" (so gold and bonds up, dollar down).

The "Just Right" Scenario: Given the levels of pessimism, it won't be hard for this number to somewhat "positively" surprise, and anything 150K-plus probably would get it done. In that case, expect a rally in stocks and a marginally "hawkish" trade (gold would get hit and bonds would likely trade down a bit, while the dollar would rally modestly).

The "Too Hot" Scenario: Although highly unlikely, a jobs print above 225K would likely put a December taper of QE on the table, which would send gold and bonds plunging and the dollar would take off. Stocks' reaction to this scenario would be tough to gauge – a sooner-than-expected taper would be a headwind, and even though the data would be good, I don't think we'd see any material rally (and stocks might even sell off a bit on the news).

Bottom line is this shouldn't be a big equity market mover unless it's way off the consensus, although we can expect gold, the dollar and bonds to trade with substantial volatility even on a small "miss" or "beat" vs. expectations.

Economics

3rd Quarter GDP

- 3rd Quarter GDP Rose 2.8% vs. (E) 2.0%.
- Personal Consumption Expenditures (PCE) rose 1.5%.

Takeaway

The third-quarter GDP report was a solid headline beat, but the devil was in the details and this GDP report wasn't nearly as good as advertised.

As always with GDP, it's important to look at the details, and the details weren't very strong. The reason GDP beat estimates was because of inventories, which contributed 0.8% to GDP. Final Sales of Domestic Product (which is GDP less inventories) rose at a 2.0% seasonally adjusted annual rate, exactly where headline GDP was forecast. Additionally, the positive contribution from inventories was mostly due to much higher than expected agricultural inventories (crop sizes are much bigger compared to last year's drought-affected crops).

Additionally, PCE (which is consumer spending and by far the largest part of the economy) rose at a 1.5% annual pace, which is down from Q2 1.8% and the lowest annual rate since 2Q '11.

Bottom line with the GDP report is it confirms we still are in a slow-growth economy, and if anything the core parts of the economy have softened a bit from Q2. Despite a fair bit of incorrect analysis by analysts on this report, nothing in it would pull tapering of QE forward, and that's part of the reason we saw bonds higher yesterday.

Jobless Claims

- Weekly claims fell to 336K, down 9K from 345K last week.
- 4 Week moving average fell to 348K.

Takeaway

Claims continue to tread water, and are at almost exactly the same level they were at the end of August (332K) before we had the California and Nevada data mistakes and the government shutdown. Bottom line is improvement in the labor market has stalled and we're basically at status quo (which equates to monthly job adds between 150K-180K, as we've seen since August). If we are looking for incremental improvement in the jobs market, we're not seeing it from weekly claims.

Commodities

Commodities were universally lower yesterday as the dollar saw substantial gains on both euro weakness and a strong headline GDP number. Precious metals responded with the biggest declines, which would be expected, but crude oil futures were also down 1% at one point during the trading day. The PowerShares DB Commodity Index Tracking Fund (DBC) was down 0.79% on the session.

The downtrend in oil seems to be intact following the "profit-taking pop" we saw Wednesday. WTI futures sold off with most other commodities in response to the initial move higher in the dollar after the GDP report was released and then, after a brief breather, continued lower into the close. The path of least resistance remains lower with some weak support around the $93/Bbl level while resistance has formed in the $98.50/Bbl area.

Market	Level	Change	% Change
Dollar Index	80.775	.216	0.27%
EUR/USD	1.3438	-.00791	-0.59%
GBP/USD	1.6098	.00152	0.10%
USD/JPY	97.80	-.825	-0.84%
USD/CAD	1.0451	.00325	0.31%
AUD/USD	.9448	-.00275	-0.28%
Brazilian Real	.4312	-.0415	-.95%
10 Year Yield	2.613	-.027	-1.02%
30 Year Yield	3.726	-.043	-1.14%

Prices taken at previous day market close.

Geopolitically, it appears that we may have some progress on the Iranian nuclear negotiations. There are reports this morning that Iran will receive temporary relief from international sanctions if they agree to halt uranium enrichment, and according to the Washington Post, there likely will be an announcement later today.

To a point this is already priced into Brent crude on a geo-political basis (it's collapsed this week), but the question now is "Does Iran return to the international oil markets and do they sell their oil at a discount to try and re-gain market share?" If they do, that will weigh on Brent prices further, so risks are mounting to the downside.

Precious metals declined the most in the commodity space yesterday due to the strength in the dollar. Initially when the ECB announcement was released, gold saw a spike higher that was more than likely due to algorithms trading off of the dovish European decision to reduce the benchmark interest rate by 25 basis points. But, the move was quickly corrected (by human traders) and gold traded back to flat.

However, when the GDP report was released, the dollar made a legitimate move higher and gold sold off substantially on the better-than-expected headline. But, gold held the $1300 level after briefly breaking below it after, as mentioned, the details of the GDP report weren't all that strong. Focus in the gold market now turns to the jobs report today. Watch yesterday's low of $1296—if the jobs report is better than expected, that's key near term support. A break of that level and we'll likely head straight to $1280.

Natural gas continued rallying for the third day in a row yesterday, making a high of $3.622. Futures gained in the pre-market and then drifted sideways until the EIA status report was released at 10:30 A.M. The EIA reported a build of 35 Bcf vs. estimates of a 27 Bcf build. After the report, natural gas came off the higher, but closed marginally positive and is trading more than 1% higher this morning. I'd continue to hold any natural gas longs that we put on around that $3.40 level as I think we've bought some "value" in gas, although given the quick 4% jump we've seen in gas prices, any traders looking to take a profit certainly could do so.

Currencies & Bonds

Currency markets had a wild ride yesterday, with the Euro and Dollar Index leading the way. The euro initially plunged following the surprise 25 basis point interest-rate cut by the ECB, and actually traded below 1.33, a level last seen in early September, for a short time following the U.S. GDP report (which came 45 minutes after the ECB rate announcement).

Conversely, the Dollar Index rallied hard after the ECB meeting mostly on euro weakness, but then shot higher following the GDP report to trade for a short time above 81.50—again, a level not seen since early September. At one time, both currencies were down and up well over 1% respectively, and that's some substantial volatility for the two biggest currencies in the world.

But, the gyrations of the algos and the day traders eventually gave way to actual fundamentals, and after reviewing the GDP report, markets realized it wasn't quite as good as it looked. After ECB chief Mario Draghi's presser, markets realized the ECB was likely done with incremental policy accommodation for a while, and both currencies spent the day retracing the earlier moves. The Dollar Index ended the day up 0.44% and the euro down 0.75% ahead of the jobs report this morning.

Although the euro and dollar were in focus yesterday, they weren't the only currencies to exhibit significant volatility. First, the Aussie traded down nearly 1% on dollar strength and after the October employment report missed estimates. The real fireworks, though, were in the yen. Immediately following the U.S. GDP report, the yen fell sharply versus the dollar, temporarily breaking through that 99 yen/dollar level I've been referencing.

But, again as investors realized the GDP report wasn't as good as it looked (and wouldn't pull tapering of QE forward), the yen began to retrace the decline, and then some weird stuff started happening.

Right before 11:15 and then from 1:25-1:50, the yen shot straight up in what almost looked like panic-buying. There was no fundamental reason for the rally (no one said anything in Japan) so I'm left to think this is simply trading-related. 11:30 is the European close and the period 1:30-1:50 is the close of precious metals trading, so I think that what most likely happened is some over-aggressive trade in Europe or in the U.S. made a big short bet on the yen and likely had to cover as those markets closed for fears of margin calls. It's just a guess at this point, but it does make some sense.

I point this out because, again, there's nothing fundamental to justify the yen falling nearly 1% vs. the dollar yesterday. So, I'd again look to use this bounce (or any further bounce out of the jobs report) as an opportunity to get short yen via YCS or futures.

Turning to Treasuries, they didn't really trade off the ECB rate cut, but did sell off initially on the perceived "hawkish" GDP report. But, once the algos got done gyrating the market and actual people got to read the GDP report, bonds arrested their declines and moved back to flat. In the afternoon, Treasuries rallied not because of Fed expectations, but because of an old-fashioned stock market sell-off. (It was a "Throwback Thursday" in that bonds actually traded in reaction to the equity market and declined as the declines in stocks accelerated.)

The near-term direction of both bonds and the dollar will likely be made clearer in a little over 90 minutes, but I'm still of the mindset that the market may have overshot its expectations of the possibility of Fed tapering any sooner than March, and even that isn't a sure thing in my opinion. But, we'll know a lot more later on today after the jobs report.

Have a good weekend,

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.**

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.**

U.S. Dollar	Neutral	Neutral	Neutral	*The ECB decision to cut interest rates by 25 basis points sent the dollar index to a multi-week high, but with the jobs report looming the trend remains unclear.*

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.**

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.**