7:00's Report

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

December 10th, 2013

Pre 7:00 Look

- Futures and European markets are slightly higher after economic data largely beat expectations o/n.
- Chinese Industrial Production met expectations (up 10% yoy) and November retail sales beat estimates, helping to spur a rally in commodities this morning.
- In Europe, the data was mixed: UK and Italian Industrial Production beat, while French IP missed. But, the data isn't causing any major moves in Euro area markets.
- Econ Today: No Reports Today.

Market	Level	Change	% Change
S&P 500 Futures	1810.75	1.75	.10%
U.S. Dollar (DXY)	80.098	-.05	-.06%
Gold	1245.30	11.20	.91%
WTI	98.47	1.13	1.16%
10 Year	2.857	-.026	-.90%

Equities

Market Recap

After one day of excitement Friday, stocks resumed the familiar pattern of consolidation on Monday in very quiet trading. The S&P rose 0.18%.

Stocks opened basically flat and drifted modestly higher in rather aimless trading. As far as catalysts yesterday, there really weren't any. The usual suspects were dragged up again, this time to explain the small rally: The rise in stocks was attributed to "Optimism surrounding a budget deal," and "The Fed tapering QE because the economy is finally strong enough." I make light of those "reasons" only because last week they were used to explain the declines in stocks, and to make the point that they are excuses, not reasons, for the market's intraday movements.

The one piece of news yesterday worth noting was commentary by St. Louis Fed President James Bullard, who said a small December taper may be appropriate given the strong jobs report. But, truth is the media is a lot more focused on when tapering will occur (Dec/Jan/March) than stocks are. At this point tapering is being viewed as a positive, given economic data strength.

Stocks hit their highs slightly before midday before selling off a touch into the afternoon and closing slightly positive. The afternoon was very, very quiet.

Trading Color

Lack of volumes and activity, in many ways, continues to be the most consistent theme in the market over the past few weeks. It seems as though "real money" has largely called it a year, and everyone is now sitting nervously idle, hoping the year ends quietly and with strong gains. Volumes remain low as does participation, and intra-day activity was again dominated by hedge funds, algos and day traders. There remains little to no conviction in either direction from large "vanilla" funds, and really the intra-day swings are little more than trading "noise" at this point.

Sector wise it was a mixed bag and there was no real discernable patter, other than continued underperformance of retail. The Morgan Stanley Retail Index closed slightly lower yesterday, as we are half way through the holiday shopping season. There wasn't any more "bad" news yesterday, but the space remains heavy and some earnings this week from COST and LULU among others

Market	Level	Change	% Change
Dow	16025.72	5.52	0.03%
TSX	13310.30	29.58	0.22%
Brazil	51165.38	221.11	0.43%
FTSE	6559.48	7.49	0.11%
Nikkei	15650.21	350.35	2.29%
Hang Seng	23811.17	68.07	0.29%
ASX	5144.42	-41.60	-0.80%
Prices taken at previous day market close.			

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are on the horizon.

Elsewhere financials and banks traded "ok" ahead of the release of the Volker Rule (presumably today), although a lot of the negativity associated with that event is probably priced in.

On the charts the situation remains the same: Support in the S&P at 1785ish, resistance at 1813 the old highs).

Market	Level	Change	% Change
Gold	1236.90	7.90	0.64%
Silver	19.825	.302	1.55%
Copper	3.285	.0155	0.47%
WTI	97.48	-.17	-0.17%
Brent	109.45	-2.16	-1.94%
Nat Gas	4.233	.119	2.89%
Corn	438.00	3.75	0.86%
Wheat	639.00	1.75	0.27%
Soybean	1343.25	17.75	1.34%

Prices taken at previous day market close.

Clarity From Washington On Friday the 13th? How Apropos!

Yesterday, I came across multiple headlines warning of the "Budget Deadline" looming this Friday the 13th. So, I wanted to spend a minute making sure everyone knows what's really going on.

First, as I said in yesterday's Report, the "deadline" of Friday is self-imposed by the budget committee—it has nothing to do with the finances of the country. It also happens to coincide with the date most members of Congress want to leave for the holidays—so we know they will be properly motivated!

As far as what the deal looks like, it's widely expected that later this week there will be a two-year budget agreement that will be voted on by both chambers of Congress prior to adjourning for the holidays. Based on tentative details of the deal, passage is expected, although with this Congress you never know.

First, the particulars of what's expected: The budget for government spending is expected to be set somewhere between $1 trillion and $1.015 trillion, a modest increase from the current $967 billion annual budget. The increase in spending comes largely from the undoing of "sequester" cuts at the Pentagon and other domestic agencies. Importantly, though, while the sequester and reduction in government spending this year has been a drag on GDP, don't expect next year's increase to result in a big bump in economic activity. The increase in spending in the budget, by itself, isn't a reason to get materially bullish, although it will be somewhat positive economically in the short term (although people will debate the negative implications on the deficit and budget medium/longer term).

More importantly, though, this will be the first multi-year budget deal since 2011 (the one that resulted in the "Fiscal Cliff" in late '12) and the clarity from Washington, more so than anything else, is a positive. And, this removes the possibility of yet another macro-economically de-stabilizing budget battle over the coming quarters.

I often say in this Report that markets crave clarity above all else, so over the medium term this is a positive from that standpoint.

Finally, many of the articles describing the budget deal also mention the debt ceiling, which looms early in 2014. But, it's very, very unlikely that Republicans will pick another fight on the debt ceiling for two reasons. First, it's an election year, and neither party wants to take the risk of getting a lot of negative press. Second, the Republicans want to keep the focus on the "Affordable Care Act" into the mid-terms, and likely won't want to muddy the waters. Bottom line is there is very little chance of a debt ceiling fight in 2014, so don't get spooked by headlines to the contrary unless something material changes.

Bottom line is it looks like Washington will finally remove itself as a headwind from the markets in 2014, which is a good thing.

Economics

No reports yesterday.

Commodities

Commodities were broadly higher yesterday with the exception of the energy sector. The PowerShares DB Commodity Tracking Index ETF (DBC) was slightly lower due to the weakness in energy, which carries a heavier weight in the index. The dollar slipped 0.21%, closing down for the 5th session in a row, which again offered modest support to the space.

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With cold temperatures still lingering across much of the country, it was no surprise that natural gas rallied yet again, closing higher by 2.89% yesterday. The reason for the rally is the obvious increase in demand required to meet heating needs. At this point it's a momentum market in the short term, and who knows how far the rally can go if the weather stays cold, but I would not be a buyer up here after this run. For the technicians, there is some mild resistance around $4.30 while support lies down at the psychological level of $4.

WTI crude oil futures were down by -0.17% yesterday after prices rose for six sessions in a row. There wasn't much fundamental news in the market yesterday, although WTI is higher this morning and has broken through the 200 day moving average for the first time in nearly 3 months thanks to decent global economic data.

Gold and silver futures traded higher yesterday, marking the third rally in four days for both of the precious metals. Fundamentally, the Commitment of Traders report released by the CFTC on Friday continues to show just how hated the precious metals are right now. The number of "Speculative net long" positions in gold made another multi-year low at just 9,941, while net long positions in silver (the historically more-volatile of the two) actually turned negative for the second time this year.

The COTs aren't a an absolute leading indicator of a rally, and there are plenty of reasons to not like gold right now (Fed tapering of QE and no inflation being the primary reasons). But, there are few sectors in the market that are as loathed as the precious metals, and historically speaking, when sentiment turns this negative, it usually predicts some sort of a rally. I'm not saying get long gold here, but if you do have some risk capital you're looking to take a "flier" on, there are few assets in the market today as hated as the precious metals.

Market	Level	Change	% Change
Dollar Index	80.155	-.16	-0.20%
EUR/USD	1.3740	.0034	0.25%
GBP/USD	1.6430	.0081	0.50%
USD/JPY	103.28	.3700	0.36%
USD/CAD	1.0636	-.0004	-0.04%
AUD/USD	.9106	.0004	0.04%
USD/BRL	2.3178	-.0142	-0.61%
10 Year Yield	2.857	-.026	-.90%
30 Year Yield	3.889	-.028	-.71%
Prices taken at previous day market close.			

Currencies & Bonds

The recent trend of strength in European currencies and weakness in Asian currencies (particularly the yen) continued yesterday, while the Dollar Index saw a small decline (down 0.21%) mostly in reaction to euro strength. There was no material news that was dollar-specific yesterday.

Starting with Europe, the euro continued its rally, rising 0.3% vs. the dollar and inching closer to the high of the year, above 1.38. The catalyst for yesterday's rally actually wasn't central bank-related—it was Finance Minister-related. Although we don't pay attention to them as much as we did when Europe teetered on the brink of collapse, there was a European Finance Ministers meeting yesterday. For the first time in a while, something appears to actually have happened at it (I describe why the banking union is EU-positive below).

Staying in Europe, the best performer versus the dollar yesterday was the pound, which made a new, multi-year closing high and is now just shy of making a new intraday high for the year, something that will likely happen this week. The rally in the pound yesterday was central bank-related, as Bank of England head Marc Carney made a speech in New York. The pound rallied after Carney acknowledged the UK economy is recovering (something that is evident to anyone watching the data). And, the currency markets continued to say "nuts" to Carney's "forward guidance," as he spent most of the speech focusing on why the UK will need low rates well into the future. But, as has been the case for months now, the currency markets are saying "nuts" to Mr. Carney. We can all see the data, and if the economy improves and housing prices in the UK continue skyward, eventually the BOE will have to move rates higher, and hence is the problem with "Forward Guidance."

Both the euro and the pound remain in solid uptrends vs. the dollar, as the pace of acceleration in the UK economy (and the growing housing bubble there), along with the ECB's "comfort" with current policy in the face of a growing deflation threat, are trumping the Fed's ex-

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pected tapering of QE. And, as long as either one of those facts change, the pound and euro will rally vs. the dollar.

One currency that didn't rally vs. the dollar yesterday was the yen, which fell 0.33% and gave up early gains as momentum sellers piled on, pushing the yen very close to new lows for the year. Despite media reports to the contrary, selling in the yen yesterday was due to carry-over from Friday's collapse vs. the dollar and technical trading. The drop in the yen yesterday was not, as reported, in reaction to a "weak" Q3 GDP print. It's true that Monday night, the revised look at Q3 GDP in Japan missed expectations (it was revised to 1.1% from 1.9%), but it was the opposite of last week's U.S. Q3 GDP print. The Japanese number was revised lower thanks to a drop in inventories, which is actually a positive for Q4. And, personal spending in Japan was revised higher in Q3, from 0.4% to 0.8%. So, while the headline was weak, the underlying data was fine, and implies a tailwind on GDP in Q4 as companies need to re-stock inventories (again, the opposite of what we're seeing here in the U.S.).

I'd expect the lows of the year in the yen, 103.73, will provide some support, and I'd be surprised to see them decisively broken before year-end given how short-term oversold the yen is. But, that's taking a guess on short-term timing, and the bottom line is the trend in the yen remains decidedly lower. Whether it breaks to new lows this week or next month, ultimately the yen is heading much lower vs. the dollar.

Turning to the bond market, the long bond rallied 0.44% yesterday, and clearly there is ample evidence that a Dec/Jan/March tapering of QE is priced into bonds at these levels. When something doesn't go down on bearish news (as was the case for bonds Friday with the jobs report) then that's usually a sign that the short-term downtrend is over. So, I'd not be surprised to see bonds start another "counter-trend rally" at least into the Fed meeting of next week. But, like the yen, that rally should be shorted and viewed as "healthy" with regard to the longer-term downtrend in bonds, which is where real money is going to be made over the coming months and quarters.

<u>Why a Banking Union is Bullish For Europe, Longer Term</u>

European finance ministers are close to agreeing on a banking union framework that would once and for all remove the potential for individual banks (like Irish or Spanish banks) to bankrupt an entire EU country (as happened in Ireland, and nearly happened in Spain).

Without getting too far into the details, the link between "bad" banks and sovereign governments was one of the key causes of the euro-zone crisis, and one of the main pillars of that crisis abating was the declaration by EU leaders that they would form a banking union, which would create a pan-European regulator to close troubled banks, and also create a centralized European fund to recapitalize banks and make depositors whole (think of it similarly to a pan-European FDIC). Well, it looks as though the Germans, who were against it (because, if a bank needed to be saved, it'd be them writing the checks), have either finally been ground down to agreeing or got something they wanted, because it looks as though a framework is imminent.

From an investment implication standpoint, this is a foundational positive for the EU and further solidifies that we won't see a repeat of the financial crisis of the past few years. It's not a reason to run out and buy EU banks now (in fact, the resolution fund will likely be funded through taxes on the banks), but longer term it is a positive for European equities in general and European banks. In particular, this is a foundational positive for the PIIGS (EIRL, EWP, EWI, GREK) and they all rallied partially on the news yesterday. Again, it's not a reason to buy them today, but over the medium/longer term, this is supportive of an eventual return to "normal" in the EU economy, which will benefit the PIIGS markets the most. And, it is a reason to buy them for longer term accounts on any material dip in Europe over the coming weeks.

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	*Stocks continue to consolidate recent gains around the 1800 level. A calm macro-economic horizon and still skeptical sentiment towards the rally remain tailwinds, and over the medium term the path of least resistance remains higher.* *Support in the S&P 500 lies in the 1780-1785 region, while resistance is 18013 (the old highs).*

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 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 bounced last week thanks to the big rally in the energy space. But, the outlook for commodities remains mixed, as the global economy remains mired in stagnant growth. Given the severe underperformance of commodities this year, though, the asset class remains on of the last corners of value in the market, if the global recovery can accelerate.*

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 traded down last week mostly off euro strength, as a Dec/Jan/March tapering of QE is largely priced in. With the euro in a clear uptrend, it'll be tough for the Dollar Index to trade materially higher, despite the Fed starting to dial back policy.*

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.**

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