7:00's Report

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

December 16th, 2013

Pre 7:00 Look

- Futures and European markets are solidly higher after "Flash" manufacturing PMIs beat expectations, while Asian shares dropped on disappointing data.
- EU December "Flash" Manufacturing PMIs were surprisingly strong at 52.7 vs. (E) 51.9. German readings were also stronger than expected at 54.2 vs. (E) 53.0.
- Conversely, data from Asia was weak. Chinese flash PMIs missed expectations at 50.5 and the Tankan Survey in Japan disappointed.
- Econ Today: Empire State Manufacturing Survey (E: 4.50), Flash Manufacturing PMI (E: 55.0), Industrial Production (E: 0.6%).

Market	Level	Change	% Change
S&P 500 Futures	1777.00	8.50	.48%
U.S. Dollar (DXY)	79.99	-.22	-.28%
Gold	1230.10	-4.50	-.36%
WTI	97.12	.52	.54%
10 Year	2.85	-.018	.-.62%

Equities

Market Recap

Stocks dropped 1.6% last week as the level of anxiety increased among money managers and they moved to preserve gains ahead of the FOMC meeting this week and into year end. The S&P 500 is up 24.48% year to date.

Stocks were heavy all of last week, as the S&P declined each day from Tuesday through Friday. News wise, the Fed and Washington dominated the wires last week, and most of the markets' declines were blamed on one of those two factors. The declines Tues/Wed were attributed to the fear of no budget deal in Washington, and the Thurs/Fri drop was blamed on anxiety over Stanley Fischer's apparent appointment to be Fed Vice-Chair (the concern is he isn't a big supporter of "forward guidance").

Really, though, general anxiety over potential Fed tapering of QE was the most cited "reason" for the market declines last week, but the truth is the market isn't as concerned about actual tapering of QE as the financial media is making it out to be. Although odds of actual tapering of QE at this week's FOMC meeting did rise a bit last week, the market remains largely "ok" with tapering, as long as the economic data continues to improve and the short tend of the yield curve doesn't drop like it did in May.

More broadly, the larger market dynamic didn't really change last week. Last week's declines were more the result of growing skittishness among money managers, who view the FOMC meeting this week as the last potential "land mine" of 2013. Given there are only three trading weeks left in the year, they are more focused on preserving gains and hedging up than they are missing a year end rally.

Put more simply, no one wants to be a hero and buy this market before the Fed, so as a result any mild selling creates an outsized effect. That dynamic, more than anything else, is the reason stocks fell last week.

Trading Color

Volumes remained low and participation from real money funds is virtually non-existent, so intra-day trading remains dominated by hedge funds, day traders and algos, so a lot of the intra-day moves we saw in the market last week (and for the past few weeks) can be

Market	Level	Change	% Change
Dow	15755.36	15.93	0.10%
TSX	13125.70	11.31	0.09%
Brazil	50051.18	-70.43	-0.14%
FTSE	6439.96	-5.29	-0.08%
Nikkei	15152.91	-250.20	-1.62%
Hang Seng	23114.66	131.30	-.56%
ASX	5089.63	-8.79	-.17%
Prices taken at previous day market close.			

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chalked up to random trading "noise." There are no big moves being made in the market right now by vanilla mutual funds or large hedge funds.

Sector wise last week was a mixed bag, although the most notable occurrence was that late in the week we saw a resumption in the underperformance of the "bond proxy" stocks.

Market	Level	Change	% Change
Gold	1235.10	10.20	0.83%
Silver	19.655	.202	1.04%
Copper	3.35	.018	0.54%
WTI	96.58	-0.92	-0.94%
Brent	108.80	.13	0.12%
Nat Gas	4.353	-.056	-1.27%
Corn	425.50	-8.75	-2.01%
Wheat	628.75	-5.00	-0.79%
Soybean	1327.50	3.75	0.28%
Prices taken at previous day market close.			

Utilities, consumer staples, healthcare and telecom all underperformed the market last week, as investors sold anything "bond proxy" late in the week in anticipation of potential Fed tapering this week.

Conversely, although there was broad weakness in the market, "macro-sensitive" sectors relatively outperformed, as banks, materials stocks, and homebuilders traded better than the market (although still finished lower on the week). Specifically, banks caught a "sell the rumor buy the news" reaction to the details of the Volker Rule finally being announced, materials rallied on "ok" China data, and homebuilders rallied thanks to a earnings beat by HOV.

Importantly, the sector trading of last week reminds us that in a world of tapering of QE, the traditional "safety" sectors may not be so safe, relatively speaking, if the declines in the market are the result of rising rates. So, keep in mind "safety" in this market may be in the macro-sensitive sectors, which is counter intuitive to the past.

On the charts, the week wasn't a particularly strong one. The S&P 500 broke down through support in the 1780-1785 range (it had been support since late November), although given the low volumes, I'm not quite sure that support range has been decisively broken, yet, and wouldn't be surprised if the S&P trades back into that range as we approach the Fed announcement Wednesday.

<u>This Week</u>

The Fed will dominate the week, but there's actually a fair bit of other stuff going on. First, there are several November quarter end earnings releases this week. In particular, watch FDX (Wed morning), ORCL (Wed night) and NKE (Thurs night). Second, Yellen's confirmation vote is expected at some point this week (probably after FOMC meeting). Third, HON and GE give business outlooks for 2014 on Tues/Wed, and finally there is an EU Leader's Summit on Thursday/Friday where we should see final agreement on the EU banking union.

Economics

<u>Last Week</u>

There was very little economic data released last week, and economically the focus was on trying to "game" the chances of the Federal Open Market Committee announcing a plan to taper QE after their meeting this week.

The two major pieces of data (retail sales and jobless claims) we received last week generated mixed signals. Positively, retail sales beat expectations, and the important "control" group—which excludes automobile, gasoline and building-material purchases—continued to advance, rising 0.53% in November.

This uptick in retail sales came at a good time, as concerns about the consumer linger, especially given many retailers' unenthusiastic commentary on the holiday shopping season. In fact, the resilient consumer (and stronger retail sales) resulted in many analysts and strategists upping their Q4 GDP estimates, as Personal Consumption Expenditures (i.e., consumer spending) are now expected to be stronger than originally thought.

The retail sales beat was the economic "highlight" of the week, and from a WWFD (What Will the Fed Do) standpoint, it very slightly upped the chances of a taper this week. However, it certainly won't be the deciding factor.

On the flipside, jobless claims saw a jump of 68K, to 368K, as statistical errors thanks to Thanksgiving and other factors were worked out. That number was obviously a disappointment vs. expectations, but weekly

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claims have been so volatile lately that many people are discounting the adjustment. And, most (including me) expect claims to move south toward the lower-300K range, where it's been since August.

However, the most-important economic news of last week (both for the economy and with regard to WWFD) came from Washington, where a two-year budget deal was struck and passed by the House.

From a market standpoint, the budget agreement provides some much-needed clarity for the market, and helps remove another potential macroeconomic risk from the horizon (there won't be another budget battle or threat of shutdown).

Finally, the agreement is being viewed (correctly) as incrementally increasing the chances of a December taper—although like retail sales, it won't be the deciding factor.

Bottom line, last week's retail sales data was positive and confirms the overall feeling that the economy is improving. From a WWFD standpoint, the odds of a "Santa taper" this week did increase, although it remains somewhat of a long shot.

This Week

The FOMC announcement Wednesday is the most-important event this week and, for the next few days, Wall Street will be focused squarely on its outcome. I'll preview what to expect in Wednesday's Report, but as of right now the "consensus" expectation is for no tapering at this meeting, although it is certainly possible. Keep in mind this meeting also brings the FOMC's forecasts for growth, inflation and interest rate policy expectations (so it'll be an opportunity for the FOMC to further emphasize its zero-interest-rate policy). We also have the Chairman's press conference, which will be the last with Ben Bernanke at the podium.

Market	Level	Change	% Change
Dollar Index	80.38	.027	0.03%
EUR/USD	1.3733	-.0021	-0.15%
GBP/USD	1.6291	-.0057	-0.35%
USD/JPY	103.21	-.15	-0.15%
USD/CAD	1.0589	-.0049	-0.46%
AUD/USD	.8958	.0025	0.28%
USD/BRL	2.3275	-.0045	-0.19%
10 Year Yield	2.85	-.018	.-.62%
30 Year Yield	3.855	-.02	-.52%
Prices taken at previous day market close.			

Away from the FOMC, there is also a lot of data coming out this week about the real economy. While the FOMC will dominate the conversation all week, keep this in mind: The only reason the market isn't throwing a "taper tantrum" is because the economy looks to be improving. If that changes and the data turns south, the market won't be as receptive to tapering as it currently is. Point being—the Fed is watching the data and everyone else, in turn, is watching the Fed for clues about where the numbers are heading next.

Later this morning we'll get the "flash" manufacturing PMI for December, which will be closely watched. We also get Empire State Manufacturing (today) and the Philly Fed Manufacturing Index Thursday (they are usually the first economic data from the current month), although those two indices will have their thunder stolen this week given the "flash" PMI comes out before them.

This week also brings a bevy of housing data (Housing Market Index tomorrow, Housing Starts Wednesday and Existing Home Sales Thursday). The housing recovery remains the key lynchpin in the broader economic recovery. We saw over the summer that the housing market is sensitive to rising interest rates, so how the housing market is reacting to this recent uptick in rates will be important to see, both from a "real" economy and FOMC perspective. As I've been saying, the housing recovery can lose some momentum, but it needs to keep going so the economy can continue to accelerate.

Finally, jobless claims will reveal whether that big jump from last week starts to get reversed, and on Friday we get our last look at Q3 GDP. (Don't expect any big revisions; they usually happen between the first and second revisions.)

Bottom line is it's a big week from a policy and real economy perspective.

Commodities

Commodities were mixed last week; however, the weakness in the energy sector led to the largest weekly sell-off in the commodity benchmark ETF, DBC, in six weeks. DBC closed the week down 1.55%.

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The correlation between the commodity space and the Dollar Index remains intact as the dollar logged its first weekly gain in a month while DBC posted its first weekly loss in a month.

Natural gas was the big outperformer again last week, further extending its recent gains and approaching the highs of the year. Natural gas futures have rallied for six weeks in a row now, moving higher by just more than 25%. The rally has been impressive; however, the sellers were able to defend the high of the year (by one-tenth of a cent) that was established in late April. The $4.444 high has now become a short-term resistance and the "level to beat" for this nat-gas rally. On the charts, support lies between $4.20 and $4.22.

Nymex crude oil futures weighed on the commodities complex, losing 1.2% last week. The move lower suggests WTI crude simply became overbought in the short term, which was confirmed by the lack of a buyer response to Wednesday's EIA announcement about the substantial draw of over 10 million barrels in supply. (That big of a draw would have obviously spurred a solid rally otherwise.) Front-month futures ran into some technical resistance between $98.00 and $99.00 earlier in the week, including the 200-day moving average which has clearly held. It looks like we may be falling into a new range, with this week's highs becoming resistance and support forming in the $95.00-$95.50 area.

Gold and silver both closed the week modestly higher despite the strength in the dollar. Gold and silver futures were higher by 0.65% and 0.53%, respectively. With a Dec/Jan/March taper largely priced into the precious metals markets at these levels, it will take a surprise out of the coming FOMC meeting such as talk of a later taper (June), or a larger-than-expected taper this month to materially move the metals one way or another. In gold, $1,200/oz. is still the level to watch while $19.00/oz. in silver is the first level of support.

Currencies & Bonds

The dollar index finished a volatile week very slightly higher. The Dollar Index was weak through Wednesday of last week, due mostly to strength in euro. But, the good retail sales report Thursday increased tapering expectations, and the dollar rallied hard Thursday to recoup most of the weeks' losses. Obviously this week the Fed decision will have an impact on the dollar and at this point, a small tapering of QE in January or March is largely priced in. But, a December taper is not, so there is some modest upside risk for the Dollar Index into the meeting.

Turning to the euro, it rallied last week and broke temporarily above 1.38 vs. the dollar after ECB Governing Council member Benoit Coeure made multiple comments implying the ECB doesn't intend to do "more" to stimulate the EU economy. Given the threat of disinflation in the EMU, doing nothing more from a policy standpoint is, by default, euro bullish, and as long as the ECB resists more stimulus, the euro will grind steadily higher.

Turning to Asia, both the yen and Aussie Dollar traded sharply lower last week. Starting with the later, "Aussie" plunged Thursday after RBA member Stevens said he thought the Aussie Dollar should be .85 vs. the US Dollar. Obviously that's pretty "dovish" and Aussie crashed through support at .90 in response to the comments. If Stevens and the RBA want .85 Aussie to US Dollars, I'm no one to argue, so that's a good target! With regards to any investment opportunities in 'Oz, Australian stocks, which have gotten beaten unmercifully lately, now are appearing interesting to me again, and this week I plan to do some work into trying to figure out if EWA is a "buy" around here.

The yen traded above 103 yen/dollar on expectations of continued stimulus from the BOJ. The yen is challenging its lows for the year vs. the dollar, but regardless of whether it breaks those lows or pauses (it'll depend on the FOMC), the overall point remains that the "Short yen" trade remains on of the best ideas in the market, and there's still a long way to go in the trade.

Finally, the Treasury market largely churned last week ahead of the FOMC (bonds were higher early in the week but then sold off on the strong retail sales data). Like the Dollar, at this point a small January or March tapering of QE is priced into Treasuries, but a December taper is not.

Have a good week—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 1780-1800 level. A calm macroeconomic 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.**

Long Natural Gas E&Ps: **Term structure in the natural gas markets has turned bullish, as its in backwardation out nearly a year, implying a structural increase in demand. But, natural gas equities remain under pressure, and could potentially offer some value in the market over the medium/longer term. FCG and XOP are the two "pure play" ETFs in the natural gas E&P space.**

	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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