7:00's Report

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

December 2nd, 2013

Pre 7:00 Look

- Futures are flat to start the week while international markets are mixed, despite almost universally better data o/n.
- Chinese November Manufacturing PMI beat expectation, rising to 50.8 vs. (E) 50.4, further implying the pace of economic growth has stabilized.
- European November Manufacturing PMIs also largely beat expectations: German, EMU and UK November PMIs beat expectations and rose from November levels.
- Econ Today: November ISM Manufacturing PMI (E: 55.5).

Market	Level	Change	% Change
S&P 500 Futures	1803.25	-0.75	-.04%
U.S. Dollar (DXY)	80.955	.293	.36%
Gold	1237.40	-12.90	-1.03%
WTI	92.66	-.04	-.04%
10 Year	2.741	.005	.18%

Equities

Market Recap

Stocks continued their methodical rally last week, climbing to new highs in very quiet, low-volume "holiday trading." The S&P 500 is now up 26.62%.

Stocks spent most of the holiday-shortened week drifting, as the week was devoid of any material catalysts. Given the low volumes and participation, intraday movements were dominated by fast-money funds and algos. Stocks never closed very far from flat, and there weren't any real "reasons" for the market's movements last week. Despite hitting new intraday highs, the S&P 500 went out basically unchanged on the week.

Trading Color

Volumes, desk attendance and participation from real money were all very low last week, and as mentioned the intraday trading was dominated by day traders, hedge funds and algos. So, it's tough to read too much into the sector trading last week.

But, despite the lack of volumes and catalysts last week and the near-flat finish, market internals continue to be bullish. First, cyclicals continued to outperform "safety" last week, as banks continued their rally off higher interest rates, while retailers also outperformed thanks to good earnings like Tiffany & Co. (TIF) and positive initial comments on holiday sales Friday. The latter continued over the weekend as Wal-Mart (WMT), Macy's (M) and Target (TGT) all said they were pleased with initial results.

I'll be discussing the outlook for the commodity markets tonight at 5:40 PM EST on CNBC Asia Squawk Box.

More broadly, the Russell 2000 hit a new all-time high, as small caps continue to play catch-up from their previous underperformance. Tech was also strong—the Nasdaq hit 4K for the first time since the early 2000s, thanks in part to Apple (AAPL) rallying on expectations of a deal with China Mobile (CHL) and better-than-expected Hewlett-Packard (HPQ) earnings.

On the negative side, anything "bond proxy" continues to get hit, as rates moved up again last week and utilities, REITs, telecom, consumer staples and healthcare all lagged. Interestingly, while the leadership of this rally has shifted from tech/Internet stocks to banks over the

Market	Level	Change	% Change
Dow	16086.41	-10.92	-0.07%
TSX	13395.40	24.57	0.18%
Brazil	52482.49	635.66	1.23%
FTSE	6650.57	-3.90	-0.06%
Nikkei	15661.87	-65.25	-0.41%
Hang Seng	23881.29	92.20	0.39%
ASX	5320.05	-14.29	-0.27%

Prices taken at previous day market close.

past month, the most-consistent trend among the various sectors since May has been the underperformance of anything "bond proxy." This trend will likely continue even if there is a market correction.

On the charts, the S&P 500 hit yet another new all-time high, so minimal resistance sits at 1,813, while support lies in the 1,775-ish area.

Market	Level	Change	% Change
Gold	1250.60	12.80	1.03%
Silver	19.981	.348	1.77%
Copper	3.2305	.03	0.94%
WTI	92.72	.42	0.46%
Brent	110.11	.00	0.00%
Nat Gas	3.954	.059	1.51%
Corn	424.50	-2.00	-0.47%
Wheat	655.00	3.75	0.58%
Soybean	1336.50	16.50	1.25%
Prices taken at previous day market close.			

Bottom Line

Not much changed with regard to the market dynamic last week. The macro-economic horizon remains as clear as it's been in four-plus years, and that coupled with continued skepticism of this rally in stocks means the path of least resistance for equities is higher.

The calm macro horizon has allowed multiples to expand across various markets, and although we've seen a huge rally in the S&P 500, we're still only trading at 15X 2014 $120/EPS. So, not "cheap" but not "rich" either—unless you think that $120 figure is going to decline.

Additionally, there were more signs last week that the market is finally taking to heart the Fed's "Zero Interest Rate Policy" (ZIRP).

The first clue that the markets were finally believing the Fed about low rates for the longer haul was the recent steepening in the yield curve. The yield curve is as steep as it's been all year, and the short end of the curve (two-year Treasuries) isn't selling off with the long end.

Second, homebuilders traded to new highs last week, despite mixed housing data and higher rates. Homebuilders have acted as a "litmus test" for the market's sensitivity to higher rates. The fact that the SPDR S&P Homebuilders ETF (XHB) can rally despite higher rates might also reflect growing comfort with a steepening yield curve.

The point here is that everyone assumes this entire stock market rally is nothing more than a result of QE, and the widespread belief is that when QE goes away, so too will the market rally. And, that may prove to be true. But if it isn't and the promise of ZIRP replaces QE as an accommodative force, then a "melt up" rally—not a nasty correction—is the risk.

Bottom line, though, is the SPDR S&P 500 (SPY) is stretched short term, and although I wouldn't de-risk here, I continue to favor international exposure over U.S. on a valuation basis for any additional capital. ("Japan" is trading around 14X 2014 earnings while "Europe" is trading at around 12.5X, and both those regions still have central banks looking to do "more.") I'd continue to favor any new money going into the WisdomTree Japan Hedged Equity Fund (DXJ), iShares MSCI United Kingdom ETF (EWU) or Vanguard FTSE Europe ETF (VGK) outright or on a spread vs. an SPY short.

Economics

Last Week

Economic data was pretty light last week, even despite the holiday, but there were a few takeaways worth noting.

Generally speaking, the data was mixed. In particular, one of the main takeaways from last week was that the slowdown in the housing recovery is still ongoing. Both Pending Home Sales and permits contained in the housing starts number missed expectations. Technically, permits beat the headline expectation, although that was due to an increase in permits for multi-family structures. The more-important single-family permits continued to be soft.

The key here isn't so much that we need to be worried about the housing market (prices are still holding up, which is the most-important part). But clearly the higher mortgage rates are biting, and I think collectively the market will breathe a sigh of relief when the housing data stabilizes.

The other main takeaway from economic data last week was the continued improvement in jobless claims. Weekly claims dropped to a multi-week low at 316K (vs. estimates of 330K), and the four-week moving average also dropped to a multi-week low. This is important because if this drop in claims is accurate (there's some concern the Columbus Day holiday may be positively skewing the data), then claims will "confirm" the improvement we've seen in the monthly Employment Situation Report. This would in turn strongly imply we're seeing positive momentum again in the jobs market, which obviously is important because it further solidifies the Fed will taper.

Finally, Durable Goods was a bit of a disappointment. New Orders of Non-Defense Capital Goods ex-Aircraft (NDCGXA) fell for the third-straight month, and it's now at its lowest level since March. Part of this could be seasonal, but it does raise some concern we're seeing business pull back on investment (buying machinery, etc.) and that could be a drag on GDP in Q4. But, we're not seeing a dip in the manufacturing PMIs, so until we do, the market will largely shrug off the drop in NDCGXA, although it is something to watch.

Bottom line: Nothing materially changed last week. The housing recovery is still ongoing but momentum is slowing, and that's something we need to continue to watch. The drop in claims will make people cautiously optimistic that the good October jobs report is legitimate, and if it is, expectations for Fed tapering will be further solidified. But, nothing last week changed the market's expectation on the economy (still slow growth) or toward the Fed (a Q1 taper remains the expectation, with March slightly ahead of January as the consensus month, although expectations have been shifting to January).

This Week

This is a busy week, and it is especially important because it's basically the last big week of data for 2013.

First, it's "jobs week." So, we will get the ADP Employment Report Wednesday, jobless claims Thursday and the Employment Situation Report (the big jobs report) Friday.

Market	Level	Change	% Change
Dollar Index	80.685	-.062	-0.08%
EUR/USD	1.3589	-.0015	-0.11%
GBP/USD	1.6365	.00	0.00%
USD/JPY	102.41	0.12	0.12%
USD/CAD	1.0613	-.0001	-0.01%
AUD/USD	.9110	.0014	0.15%
USD/BRL	2.336	.0005	0.02%
10 Year Yield	2.741	.005	.18%
30 Year Yield	3.808	-.004	-.10%

Prices taken at previous day market close.

This report is probably a bit more important than normal because if it's very strong, then the prospects of a December taper of QE will rise substantially. (As mentioned, that is **not** priced into the equity or bond market.) And, I'm not sure anyone knows exactly how the stock market would react to a December taper announcement (it could rally because of the good data or sell off because tapering may be too "early," in what would be a "taper tantrum").

In addition to jobs week, it's also Purchasing Managers' Indexes week. We've already gotten the final look at Chinese and EU manufacturing PMIs, and will see the U.S. number at 10 this morning. But, Tuesday night/ Wednesday morning we also get Composite PMIs for China and Europe, respectively, and the Institute for Supply Management's Non-Manufacturing PMI for the U.S.

These numbers are obviously important because the pace of the global economic recovery appears to have slowed a bit, and if we see a soft number in China or Europe, that could present a new headwind on risk assets.

In addition to the global PMIs, we also get rate decisions from the Reserve Bank of Australia (tonight) and the Bank of England and European Central Bank Thursday. None of the banks are expected to change policy, but the ECB press conference will be scrutinized to see what, if anything, Mario Draghi says about what "more" the ECB is prepared to do to help combat dis-inflation. (If he disappoints and doesn't imply they are ready to do anything, European stocks could get hit.)

Finally, domestically we also get the second look at Q3 GDP, as well as September and October New Home Sales. (Like Housing Starts, the data was delayed because of the government shutdown.)

Bottom line is this is an important week because:

1) It should definitively tell us whether a December taper of QE is possible, and

2) We get the latest look at the pace of the global eco-

nomic recovery, and specifically whether the ECB remains committed to "doing more" to help the EU economy gather steam.

Commodities

Commodities were largely mixed last week as volumes and participation were down due to Thanksgiving. The PowerShares DB Commodity Index Tracking Fund (DBC) was up 0.19% while the dollar was essentially unchanged.

The major news in the commodity space last week was the announcement of an agreement between the P5 +1 and Iran on relaxing some of the economic sanctions. Although the agreement doesn't allow Iran to return to the international oil markets or again participate in the SWIFT international banking system, the fact that some progress was made was notable. Interestingly, though, Brent Crude didn't really decline sharply off the news, other than a knee jerk reaction, and that implies the "deal" was already priced in. Nonetheless, it does set the stage for the return of Iran to the global oil markets in the coming quarters, and that additional supply will obviously act as a headwind on Brent prices.

Sentiment and supply increases also resulted in WTI Crude oil hitting a new six-month low last week, dropping temporarily below $92/bbl. last Wednesday. The WTI crude oil futures for January delivery dropped 2.2%, making them the worst performing commodity on the screen. WTI continues to suffer from supply increases and consistently more bearish sentiment, and until we get material upside in economic data, implying we are seeing an uptick in demand, WTI Crude will remain under pressure.

Staying in energy, the big outperformer last week was natural gas, which rose 3.67% as cold weather moved across the nation. Natural gas has rallied four weeks in a row now as a colder than expected start to winter is resulting in increased demand. Natural Gas is now overbought and remains weather dominated, so if temperatures turn warm we'll see a sharp correction, but I'd look to be a buyer on any material dip back into the 3.70ish region.

Gold surprisingly finished the week in the green, finding support just below $1,230/oz. as the dollar index was flat on the week. But, with key catalysts looming later this week and the risk of an earlier than expected taper, I think the path of least resistance for gold remains lower in the near term.

Currencies & Bonds

Last week was generally a quiet week in the currency markets, although that was more a factor of holiday trading than a lack of news. The dollar index was basically flat on the week.

In Europe, there were several peripherally "positive" developments. First, in Italy, PM Letta survived a confidence vote, which was centered on his proposed 2014 budget and Silvio Berlusconi was officially kicked out of the Senate. In Germany, a coalition government was formed, and finally Greek bonds were upgraded.

But, the "good" news didn't result in a significant jump in the euro, because the major market concern is when, and if, the ECB will do "more" to combat dis-inflation. The ECB meeting this week should be a non-event from a policy standpoint, but Draghi's comments about what the ECB is thinking of doing will be watched.

The yen continued its declines last week, as economic data was largely "ok" and the market continues to expect the BOJ to do "more" on the accommodation front early in '14. The yen rose through 102 and is challenging the May lows this year.

Bond markets were largely unchanged last week in very quiet trading, although a series of Treasury auctions offered some insight into the Treasury market. The two year and five year auctions saw strong demand, but the seven year auction on Wednesday saw soft demand, and that again reinforces that the bond market is starting to "believe" the Fed with regards to ZIRP, and as a result the belly and long end of the curve are most vulnerable to material declines (and as a result, that's where short positions should be).

Have a good day,

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	*Stocks moved to new all time highs this week the market gets more comfortable with the outlook for Fed policy (ZIRP) and tapering of QE. Skeptical sentiment towards this relentless rally remains a tail wind, and the "pain trade" is still higher.* *The S&P 500 is at new highs, while support sits between 1760-1775ish.*

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 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 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 saw a mild oversold bounce last week, although the complex remains under pressure, despite the continued global economic recovery.*

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 was flat last week, as a Q1 '14 tapering of QE is priced in at these levels. The next major catalyst for the dollar will be the Jobs Report on 12/6.*

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.**