7:00's Report

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

December 24th, 2013

Pre 7:00 Look

- Futures are flattish while most international markets, ex-China, rallied off continued momentum from the US. Economically and news wise it was a quiet night. Markets close at 1:00 PM today.
- Chinese shares fell as concerns about short term liquidity remain despite the Chinese central bank injecting cash into the system Tuesday. It should be a temporary problem, though, as Chinese banks are hording cash to try and meet year end liquidity requirements.
- Econ Today: Durable Goods Orders (E: 1.5%), New Home Sales (E: 450K).

Market	Level	Change	% Change
S&P 500 Futures	1823.25	0.50	.03%
U.S. Dollar (DXY)	80.67	.053	.07%
Gold	1198.40	-1.40	-.12%
WTI	99.18	.27	.27%
10 Year	2.929	.042	1.45%

Equities

Market Recap

Stocks moved higher yesterday despite rather light liquidity (obviously expected the week of Christmas). The S&P 500 closed up .48% while the Dow logged its 48th record close of the year.

Stocks were higher pre-market on mostly on continued follow through from Friday's strong GDP report, but the strong Personal Income and Outlays report also helped, and stocks spent the entire day in positive territory.

STPP: This is one ETF everyone should have on their screens, as it is one of the easiest ways to view whether the yield curve is flattening or steepening. A new uptrend started back in May, and as long as that continues, stocks can rally despite tapering of QE and higher rates.

The move higher in the stocks was more a product of thin supply than convicted buying. However, the fact that the post-Federal Open Market Committee announcement gains are holding (as opposed to initiating a correction) further confirms that the Street is comfortable with the Fed's decision to taper QE.

Trading Color

As mentioned, volumes and participation were very low yesterday, and it really was a day trader's market.

From a sector standpoint, money again moved out of safety stocks, specifically utilities and consumer staples, and into cyclicals, primarily tech and the financials. So, we are seeing a continuation of the "higher interest rate trade" that's resulting in "bond proxy' underperformance, and cyclical (specifically banks) outperformance.

Financials were the biggest outperformers yesterday, mostly thanks to the steepening yield curve. The Financial Select Sector SDR (XLF) was up 0.50%, establishing a new 52-week high. Since the banks are largely benefiting from the steepening yield curve.

Market	Level	Change	% Change
Dow	16,294.61	73.47	0.45%
TSX	13,447.70	48.10	0.36%
Brazil	51,356.10	170.36	0.33%
FTSE	6642.22	35.64	.54%
Nikkei	15870.42	11.20	.07%
Hang Seng	22921.56	109.38	-1.42%
ASX	5291.95	26.73	2.76%
Prices taken at previous day market close.			

On the "micro-economic front," the tech sector also outperformed yesterday mostly because of strength in Facebook (FB) and Apple (AAPL). Facebook, up 4.81% on the session, caught a bid on reports of strong mobile user data after some analysts stirred up some concerns that the social media giant was losing its edge in the mobile space. Apple gained 3.84% in yesterday's session, after rumors were confirmed over the weekend that Chinese mobile phone network operator China Mobile Ltd. (CHL) will begin to carry the iPhone next month. The breakthrough deal is expected to boost Q1 profits as Apple will offer both its latest edition hand sets, the iPhone 5S and the cheaper edition the 5C, to Chinese consumers.

Market	Level	Change	% Change
Gold	1197.80	-5.90	-0.49%
Silver	19.39	-.063	-0.32%
Copper	3.308	.00	0.00%
WTI	98.89	-.43	-0.43%
Brent	111.56	-.21	-0.19%
Nat Gas	4.463	.045	1.02%
Corn	434.25	1.00	0.23%
Wheat	609.50	-4.00	-0.65%
Soybean	1319.75	-11.25	-0.85%
Prices taken at previous day market close.			

Homebuilders also continued to rally yesterday, in large part due to an upgrade of KB Home (KBH) by Citibank (C). But, the more broad point is that homebuilders aren't breaking down in the face of higher interest rates, and that helps confirm the market is comfortable with the level of interest rates and the pace of the move higher. Home builders remain the "canary in the coal mine" with regards to any negative effect on the market from higher rates, as they will break down first if high interest rates start to become a headwind.

Consumer staples largely underperformed thanks to weakness out of Walgreen (WAG), down 2.54%. Walgreen announced a slight earnings beat vs. analysts' expectations on Friday; however, most of those gains were given back yesterday. The selling in WAG was presumably a result of investors rotating out of Walgreen and into CVS Caremark (CVS).

Bottom line in the equity market is that the "post-taper" grind higher is further confirming that markets are comfortable with the QE taper and continue to believe in ZIRP. But, continue to keep a close eye on the 10-year Treasury yield, emerging-market currencies and bonds, and movement in the yield curve itself, as these indicators are all vital to the continuation of the equity rally. Having said that, for now, the path of the least resistance remains higher.

Economics

Personal Income and Outlays

- Nov. Personal Income rose 0.2% M/M vs. (E) 0.5%
- Nov. Consumer Spending rose 0.5% vs. (E) 0.5%
- Core PCE was unchanged at 1.1% yoy vs. (E) 1.1%

Takeaway

The personal incomes and outlays (which is a fancy term for spending) data improved last month. But it was a mixed bag, as incomes rose less than expected but did reverse a decline in October. Meanwhile, November consumer spending met estimates.

The market "liked" the release, though, and focused on the fact that consumer spending met estimates and was revised higher for both September and October. And, while the uptick in spending in November was in large part thanks to a big increase in car sales, it doesn't negate the fact that, over the past few months, we've seen consumer spending increase (which is obviously a positive for the economy). This report will help to boost the chances that we see a bit better Q4 GDP than is currently being forecast (most estimates are around 2% GDP growth for Q4).

The other important part of this release is the "Core PCE Price Index," which is the Fed's preferred measure of inflation. Year-over-year, core PCE was unchanged from October to November, at a 1.1% yearly increase. That, obviously, is well-below the Fed target of 2.0%, and inflation remains simply too low.

Bottom line is the Personal Income and Outlays report reflects the "sweet spot" we're in economically. Data shows the economy is getting better (e.g., the consumer spending numbers), but inflation remains very low. This gives the Fed plenty of leeway to keep policy very accommodative, and that dynamic likely means higher stock prices.

Commodities

Commodities were mostly lower yesterday in a very quiet trading session. The PowerShares DB Commodity Tracking Index ETF, DBC, was down 0.12% despite a slightly weaker dollar. It is worth noting that every product in the space traded in a tight range and the only commodity to move more than 1% was natural gas, which continued to grind higher and closed up 1.02%.

The biggest underperformers on the day were the precious metals, with gold down 0.54% and silver down 0.40%. Gold spent most of the day below the $1,200/oz. level, which most bulls were hoping would hold as support again. However, for now support lies at $1,190.

Fundamentally, the newest Commitment of Traders report, released Friday, showed little had changed from the week before. Net longs in gold fell slightly from 15,803 to 13,762 while net longs in silver increased from 1,149 to 3,709. The net long positions for both, however, are well-above where they were two weeks ago, and precious metals are no longer as susceptible to a short-squeeze.

Trading action in precious metals was "choppy" yesterday, dictated by day traders scalping for ticks and algos making the market. We can expect to see more of the same today as the markets are expected to remain very quiet before they close at 1 p.m.

The only commodity to trade in the green yesterday was natural gas, which again added to its impressive six-week rally, closing up 1.02%. Once again, the jump higher was thanks to expectations of more cold weather lined up to sweep across the nation.

Natural gas has made a new high in each of the last three trading sessions and remains comfortably above the former resistance level of $4.444. That level has now become the first line of technical support. Resistance is now hovering between $4.55 and $4.60.

A well respected trading axiom is that when something doesn't decline in the face of bearish news, that's bullish. Well, over the weekend I heard it was near 70 degrees in the Northeast, yet last week natural gas barely declined, exhibiting strength. To boot, the first rule of technical analysis is you "Buy what's making new highs." And, natural gas is consistently making new highs.

So, while natural gas is very overbought in the short term and we likely will see a pullback of some sort over the coming week so, both the technicals and fundamentals appear bullish and I'd continue to accumulate the natural gas equities in here (XOP and FCG) and look to buy the commodity on a dip back towards the support levels mentioned earlier.

Currencies & Bonds

As expected, trading was very quiet in both the currency and the bond markets yesterday.

The dollar drifted slightly lower yesterday, mostly due to some short-term profit-taking after last week's "Fed-fueled" rally, after which some consolidation can be expected.

Looking overseas, Europe was very quiet with the euro and the pound both little-changed. Trading in the yen and the Aussie was even quiet, as both currencies seem to be taking a slight breather from their greater downtrends.

The one notable mover yesterday was the Loonie, which rallied 0.5% vs. the dollar. Canadian GDP rose more than expected in October, with the headline number increasing 0.3% vs. expectations of 0.2%. The strong data is ratcheting up expectations for better-than-expected Q4 growth. The Loonie has been weak lately on concerns about raw materials prices and the general condition of the economy. The Loonie has been trending lower since establishing highs back in January of last year when it was well-above par vs. the dollar. Since those highs it has traded lower by nearly 10%.

Market	Level	Change	% Change
Dollar Index	80.57	-.18	-0.22%
EUR/USD	1.3693	.0022	0.16%
GBP/USD	1.6348	.0015	0.09%
USD/JPY	104.08	.01	0.01%
USD/CAD	1.0604	-.003	-0.28%
AUD/USD	.8932	.0011	0.12%
USD/BRL	2.358	-.0294	-1.23%
10 Year Yield	2.929	.042	1.45%
30 Year Yield	3.844	.020	0.52%

Prices taken at previous day market close.

I remember trading and investing in the Loonie when it was 60 cents and 70 cents to the dollar back in the mid-2000s and riding it all the way past "parity" vs. the greenback, but I think those days have passed—at least for a long while. And, although the decline in the Loonie may be over, it's not something I'm particularly bullish on, considering the Fed is tapering QE and I don't see any sort of multi-year commodity bull market forming, like the one we saw in the mid-2000s.

Yesterday was a good day for our friends to the north, but I'd prefer to keep my money in American dollars, as opposed to Canadian or Australian.

Turning to the bond market, it behaved a bit more the way you would expect yesterday, as the 30-year declined nearly 0.5% and the 10-year note fell a more modest 0.2% while short-term Treasuries were flat. The reason for the weakness, other than further digestion of the Fed's tapering, was the personal spending data in the income and outlays report (they trumped the low inflation reading, as the market already knows we have low inflation). Importantly, the yield curve steepened yesterday, reversing the "flattish" trend of late last week.

Finally looking at "taper sensitive" assets, emerging-market currencies and bonds both saw small rallies yesterday, recovering some of last week's losses. Key take-away being, emerging markets continue to hold up relatively well amidst the reality of tapering, and as long as that persists, it won't cause a stock market correction.

Have a good day and a Merry Christmas.

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 traded to new highs last week after the FOMC began tapering QE and 3Q GDP was stronger than expected. Skeptical sentiment towards the market and a strengthening economy remain tailwinds on the market, and as long as the short end of the yield curve remains anchored, the path of least resistance remains higher.* *Stocks are at all time highs, while first support site at 1813 in the S&P 500.*

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 104 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.**

Commodities	Bullish	Neutral	Neutral	*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.**

Long Gold: **I'm dipping back into the well here with the gold trade. The near term outlook is mixed to negative, but medium term I think $1200 represents a fair risk/reward set up on an acceleration of inflation. I would initiate a small long position around the $1200 level with a stop at the old lows ($1179).**

U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index traded an outside reversal following the Fed decision to taper, and the multi-month downtrend in the Dollar Index is likely over.*

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.**

Treasuries	Bearish	Bearish	Bearish	*With the Fed tapering QE and shift to "forward guidance" as the main policy tool, the case for the bond bears has gotten stronger. Continue to short any rallies in the bond*

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.**