7:00's Report

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

December 3rd, 2013

30 Year Treasuries have now totally "round tripped" the rally following the "no taper" surprise September FOMC meeting.

Pre 7:00 Look

- Futures and international markets are all moderately lower, as negative momentum from Monday's close carried over to international markets. News wise it was a largely uneventful night.
- Economic data o/n was light. The only release was UK Construction PMI, which beat expectations and sent the Pound near a two year high vs. the Dollar.
- The Reserve Bank of Australia held rates steady at 2.5%, as expected.
- Econ Today: No Reports Today.

Market	Level	Change	% Change
S&P 500 Futures	1793.75	-6.00	-.33%
U.S. Dollar (DXY)	80.705	-.237	-.29%
Gold	1222.70	0.70	.06%
WTI	94.10	.28	.30%
10 Year	2.801	.06	2.19%

Equities

Stocks declined to start the week during another quiet session, shrugging off positive economic data. The S&P 500 fell 0.3%.

Stocks started the day flat and traded higher following the better-than-expected November manufacturing PMI print. But despite the data point, trading largely echoed last week's directionless drift.

Importantly, stocks didn't decline on the strong data point, and that's important because it reinforces the fact that good economic data is "good" for the economy and the market. That, more than anything, was the big take-away from yesterday.

Attendance and participation remained thin, and stocks drifted in modestly positive territory before enduring another late-day sell-off into the close (this was a pattern last Monday and Tuesday). Like last Monday and Tuesday, though, the drop was as much a function of low volumes as it was convicted selling, and stocks bounced off their lows during the final 10 minutes of trading.

There wasn't any specific "reason" for the drop shortly before 3:30 p.m., but it virtually mirrored the same declines from last week. This makes me think it's likely a sell program or algorithm, given the consistent times of the catalyst less declines. (Also the Japan ETF, DXJ, and other macro-sensitive ETFs all randomly sold off at the exact same time, around 3:25 p.m. Eastern.) Such is a market dominated by electronic trading.

Trading Color

It was a pretty standard "risk off" day from an internals standpoint, although like last week the movements

Market	Level	Change	% Change
Dow	16008.77	-77.64	-.48%
TSX	13419.57	24.17	.18%
Brazil	51244.87	-1237.62	-2.36%
FTSE	6543.04	-52.29	-.79%
Nikkei	15749.66	94.59	.60%
Hang Seng	23910.47	-128.08	-.53%
ASX	5256.07	-23.45	-.44%

Prices taken at previous day market close.

came on very low volumes. The Russell 2000 was the big loser on the day – it traded poorly from the open, spent the entire day in negative territory, and finished down 1.2%. After the recent run-up, clearly we saw some profit-taking in the small caps yesterday.

Market	Level	Change	% Change
Gold	1222.10	-28.30	-2.26%
Silver	19.205	-.776	-3.88%
Copper	3.228	-.0025	-0.08%
WTI	94.03	1.31	1.41%
Brent	111.62	1.93	1.76%
Nat Gas	3.987	.033	0.84%
Corn	424.50	0.00	0.00%
Wheat	649.75	-5.25	-0.80%
Soybean	1321.25	-15.25	-1.14%
Prices taken at previous day market close.			

Looking at the sector trading, homebuilders also suffered from profit-taking, given their recent run, as the SPDR S&P Homebuilders ETF (XHB) dropped nearly 2%. Outside of the homebuilders, though, cyclicals were mixed. Energy, thanks to the big oil rally, and healthcare were the only two S&P sub-sectors to finish positive. Conversely, retail lagged, mostly thanks to somewhat-sanguine commentary on the shopping weekend. Meanwhile the most-consistent trend in sector trading, the underperformance of the "bond proxy" sectors, continued apace as utilities, REITs, telecom and consumer staples all underperformed the markets.

As mentioned, volumes and participation were basically at "holiday" levels, and again trading was dominated by hedge funds, algos and day traders. On the charts the outlook remains unchanged: Resistance sits at the all-time high of 1,813, while first support has crept up a bit to the 1,170-1,780 level.

Bottom Line—Is the "Pain Trade" Shifting?

The general market dynamic remains largely unchanged, in that the path of least resistance for stocks remains higher over medium term. **But, I'm getting the feeling that the short term "pain trade" may finally be turning lower**. I mention that because for the past two to three weeks, every miniscule dip in the averages has been covered as a sharp "sell-off" by the financial media, and people seem shocked and perplexed every time the S&P comes for sale.

For instance, if you were listening to the radio yesterday and couldn't see your screens, you would have thought the market dropped by 200 points at the lows based on the commentary, when in reality it was barely more than 90.

People seem very sensitive to any minute drop in the market and a rally into year end seems the overwhelming consensus.

And, while there remains a large degree of skepticism, in the very short term we may be setting up for a bit of a pullback (I mean a few percentage points, not the "this is it" correction everyone is looking for). For more than a year shorting or selling this market has been the wrong thing to do, and I'm not suggesting de-risking at these levels.

But, for those with a trading ilk, I'd imagine some puts on the broad market are pretty cheap right now, and perhaps may be worth a flier as a short term trade. Just something to think about.

Economics

The Institute for Supply Management's manufacturing index was released yesterday, beating analysts' expectations and indicating that the overall economy has been growing now for 54 consecutive months.

ISM Manufacturing Index

- November Manufacturing PMI was 57.3 vs. (E) 55.5
- New Orders grew to 63.6 vs. 60.6 in October

Takeaway

November manufacturing PMI was 57.3, showing an acceleration in the pace of activity in the manufacturing sector from October and beating analysts' estimates of 55.5. November's increase in the headline number was the sixth in a row and the highest reading for 2013, as 15 of the 18 manufacturing industries surveyed reported growth. Beyond the headline number, essentially all of the components of the report were strong—specifically new orders, which were up 3 percentage points to 63.3%, and the employment index, which registered a 3.3 percentage point increase to 56.5%.

Bottom line is that the positive trend in the manufacturing sector for the latter half of 2013 is ongoing. The employment index beating expectations agrees with the recent declines in weekly jobless claims and increases optimism for a strong ADP Employment Report scheduled to be released tomorrow morning.

Commodities

Commodities were broadly lower yesterday but, despite the weakness in the space, the PowerShares DB Commodity Index Tracking Fund (DBC) traded only slightly lower, down 0.12% due to strength in energy. The dollar was up 0.35%, adding to the general pressure on the sector.

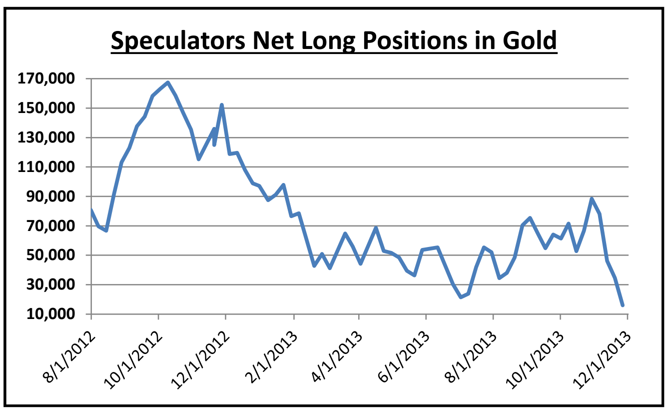
The only commodities that traded in the green yesterday were from the energy space. Brent and WTI crude oil rallied 1.76% and 1.41%, respectively. The strength began in Brent as the relatively good November manufacturing reports were released Sunday night/Monday morning in China and Europe, and WTI was quick to follow after we got the positive ISM Manufacturing PMI domestically.

Both grades of crude oil experienced solid gains but Brent outperformed WTI and widened the arbitrage spread to nearly $20 yesterday, approaching the highest levels since March. The arbitrage spread, along with the continued strength in economic data, has helped WTI to rally off last week's lows in the high $91 dollar range; however, both fundamentally and technically, crude prices still have some room to fall. Spot prices are up against the 23-day moving average at $94.73 (widely followed in the commodity markets) as well as the greater downtrend line that dates back to the August highs. I would prefer to be a buyer of oil in the low $90's or on a break out above $95.00—but at these levels.

Precious metals fell out of bed yesterday as gold was down 2.51% while silver was off by 4.21%. The move was part of a universally hawkish response to the ISM manufacturing report released yesterday morning. Gold crashed through the weak support levels around $1,226/oz. upon the ISM data being released and didn't look back as it made new lows I after hours trading.

There is little support between here and the July lows of $1180/oz, and as I said on CNBC Squawk Box Asia last night, the gold bulls had better be praying for a bad jobs number Friday, because if its better than expected, those lows will be tested.

Finally, I'm not trying to confuse the issue, but stepping back a bit from the short term noise, I do want to point out that the Commitment of Traders Report released by the U.S. Commodity Futures Trading Commission showed that the "Speculative Net Long" positions in gold are at the lowest level since I started collecting the data back in August 2011 (and maybe ever). The last time we saw the net longs this near this low was July 2nd. And, that low print marked the beginning of a $200 countertrend rally that lasted two months. I'm not saying the same thing is going to happen here, but if you're a contrarian, gold is about as "hated" of an asset as there is right now (just keep in mind there's good reason for that).



Currencies & Bonds

The dollar was universally stronger to start the week, as it rose against all of its major currency pairs. The Dollar Index ended the day up 0.35%, mostly as a result of the strong November ISM manufacturing PMIs and investors positioning ahead of what is generally expected to be a "hawkish" series of events this week. (There is growing positive sentiment toward the jobs report Friday.)

Market	Level	Change	% Change
Dollar Index	80.94	.283	0.65%
EUR/USD	1.3538	-.006755	-0.50%
GBP/USD	1.6350	-.00821	-0.50%
USD/JPY	103.06	.75	0.73%
USD/CAD	1.0632	.0015	0.14%
AUD/USD	.9100	-.0059	-0.64%
USD/BRL	2.3546	.0191	0.82%
10 Year Yield	2.801	.06	2.19%
30 Year Yield	3.86	.052	1.37%
Prices taken at previous day market close.			

Not surprisingly, the yen continued its recent downtrend, breaking through 103 yen to the dollar for the first time since May. Yesterday the catalyst for the 0.6% drop was a report that showed third-quarter capital spending came in well-below expectations, which will likely result in a slower third-quarter GDP print than expected. That is throwing more fuel on the fire that the Bank of Japan will unleash more accommodation in early '14, and this expectation is driving the yen lower. It's again very oversold in the short term, but I think it's only a matter of time before it challenges and breaks the low for the year.

In Europe, the euro dropped 0.33% yesterday despite better-than-expected November manufacturing PMIs. Most of the euro selling was due to positioning ahead of the European Central Bank later this week.

Keep in mind the euro has seen a nice run lately and is at a one-month high. If we want to be nit-picky, the Spanish PMI was surprisingly weak (48.6) and dropped below the 50 level (which is the difference between contraction and expansion) for the first time since May. That soft PMI is again reminding everyone of the "two-speed" EU economy that was, in part, a cause for the euro-zone debt crisis. But, while the soft PMI is a disappointment and did garner a lot of headlines, it seems more like an excuse for the selling than a reason.

Also keep in mind that other PIIGS November manufacturing PMIs were actually pretty good. Greek PMI rose to 49.2, a 51-month high, and Italian PMI rose to 51.4, a two-and-a-half-year high. So, Spain notwithstanding, I don't think that's enough to negate an overall strong European manufacturing PMI.

Bottom line with the euro is everyone is trying to figure out whether and what the ECB will do next to further ease policy, and right now there is a lot of uncertainty. And, given the looming ECB meeting Thursday, I'd expect the euro to drift today and tomorrow ahead of the decision.

Elsewhere in the currency markets things were quiet. The British pound finished flat despite a very strong manufacturing PMI (the case is starting to be made that the UK economy is recovering too quickly and the Bank of England may start to normalize policy sooner than expected). Finally, the "Aussie" was also flat vs. the dollar, and traded well off its highs of the day. From a trading standpoint, the Aussie should have been higher yesterday, given the good Chinese PMI print, and the fact that it couldn't hold gains isn't a good sign. Although it's very oversold, an ultimate trade down to 0.89 vs. the dollar isn't out of the question, although I don't like the risk/reward in the "short Aussie" trade at the moment.

Bonds dropped sharply yesterday, with the 30-year Treasury note falling 0.75% and the 10-year falling 0.41%, thanks to the aforementioned strong ISM manufacturing PMI and "hawkish" positioning. Interestingly, I think the latter was the major force in Treasury trading yesterday, as I mentioned in yesterday's e-mail that bonds were down very early (and before the ISM PMI). Of note, the 30-year has now totally "round tripped" the surprise "no-taper" rally that started after the Fed meeting and decision of Sept. 18. If I'm a money manager and I didn't take that September-November rally to readjust my bond holdings, right about now I'd be starting to get very, very nervous. And, as a result, I think it's not out of the question to see bonds test the lows of the year before the end of the month, depending on the jobs report. Regardless, the trend in the belly and long end of the yield curve is clearly down, and it's starting to accelerate.

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.**

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.**

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.**

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.**