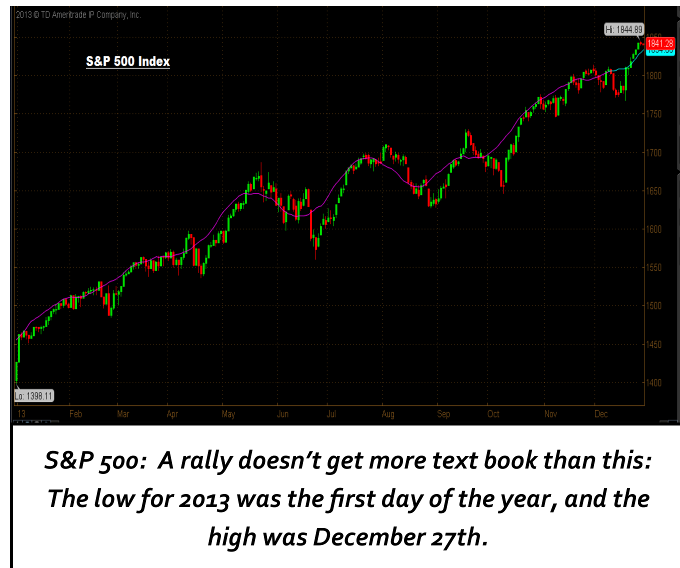
7:00's Report

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

December 31st, 2013



S&P 500: A rally doesn't get more text book than this: The low for 2013 was the first day of the year, and the high was December 27th.

Pre 7:00 Look

- Futures and international markets are little changed this morning, as trading is predictably quiet on the last day of the year. There was no economic data released o/n.
- China released its much anticipated audit of national and government debt, and it largely met expectations and didn't really change anyone's outlook on China.
- Expect very quiet trading today, as Japan and many European markets are closed.
- Econ Today: Case-Shiller HPI (E: 1.0%).

Market	Level	Change	% Change
S&P 500 Futures	1835.50	.75	0.04%
U.S. Dollar (DXY)	80.235	.113	0.14%
Gold	1203.10	-.70	-0.06%
WTI	98.93	-.36	-0.36%
10 Year	2.974	-.032	-1.06%

Equities

Market Recap

Stocks were effectively unchanged Monday during a very quiet and uneventful session. The S&P 500 closed down .02%.

Stocks spent basically the entire trading day Monday sitting at the unchanged level. The only real "event" yesterday was the Pending Home Sales report, and that was largely ignored by the markets. Stocks drifted throughout the morning and afternoon and closed flat during a very quiet and low volume session.

Trading Color

All the major averages closed flat yesterday, and as you'd expect volumes, participation and activity were all very low, leaving day traders and algos to trade the market for ticks here and there.

Looking at the internals, the most interesting thing that happened yesterday was that the VIX spiked 9%, but while that caught people by surprise, it was likely due to year end positioning (maybe people buying VIX because they think we'll see a sell off early in 2014).

Some of the year's best performing "momentum" stocks were under pressure yesterday, as FB, PCLN, AMZN all got hit, but again that's probably due to year end positioning as well.

Sector wise it was pretty uneventful given the low volumes, although homebuilders rallied again, shrugging off the soft Pending Home Sales report and trading almost to a new 52 week high. Semi conductors also rallied for the sixth straight day, while banks lagged a bit on year end profit taking.

Market	Level	Change	% Change
Dow	16,502.14	23.73	0.14%
TSX	13,586.51	-1.47	-0.01%
Brazil	51,507.16	240.60	0.47%
FTSE	6,749.58	18.31	0.27%
Nikkei	16,291.31	112.37	0.69%
Hang Seng	23,306.39	61.52	0.26%
ASX	5,352.21	-4.59	0.09%
Prices taken at previous day market close.			

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With major averages unchanged the outlook on the charts remains the same: The S&P 500 is in a clear uptrend, with little resistance overhead and support at the 20 day moving average (1834).

Market	Level	Change	% Change
Gold	1203.50	-10.50	-0.86%
Silver	19.66	-.39	-1.97%
Copper	3.3815	-.0035	-0.10%
WTI	99.35	-.97	-0.97%
Brent	111.25	-.93	-0.83%
Nat Gas	4.43	.06	1.47%
Corn	4.2350	-.0400	-0.94%
Wheat	6.0050	-.0850	-1.40%
Soybean	13.0950	-.0425	-0.32%
Prices taken at previous day market close.			

Another Positive Sign for the "Long Japan" Trade.

Japan (and Asia more generally) has been the main source of news in the markets during the past week and a half, as Western markets have slowed during the holiday season. And, despite the fact that the Nikkei will be closed through Friday, there was still notable news from Japan yesterday.

On December 12th I noted in the Report that we may be seeing, at long last, the start of "Wage-Push Inflation" in Japan, after the All Toyota Workers Union in Japan said it will push for higher wages next year. I wrote:

"This seems relatively boring, but it's important—because if other unions in Japan follow this push for higher wages, it could finally start the process of "wage-push" inflation.

Wage-push inflation is basically a fancy term for explaining that, as people get paid more (higher wages), they spend more and prices rise for goods and services, because more money chases the same amount of goods. Normally, economies don't want "wage-push" inflation, but in the case of Japan, where the administration is trying to manufacture inflation, this could be a very positive sign.

One of the main reasons Japan hasn't been able to break the cycle of deflation is because companies have been reluctant to increase wages (Toyota hasn't increased wages since '08), so the fact that incomes are stagnant acts as a deflationary force, especially in a world of rising costs.

But, if Japanese companies finally move and wages start to increase, it'll be a big positive for the potential of inflation restarting in Japan. From an investment standpoint, that would be very bullish for the WisdomTree Japan Hedged Equity Fund (DXJ), as stock prices would inflate along with everything else, and the yen would decline."

Well, as we thought, it looks like that move by the All Toyota Workers Union has started to generate momentum , because earlier this month the Keidanren business lobby, the top big business lobby in Japan with over 1200 companies as members, will encourage its member companies to increase wages during the spring salary negotiations. This will be the first time in six years the Keidanren will allow base wage increases, and represents growing momentum for wage increases across Japan.

With the Nikkei up 57% in 2013, there are a lot of questions about whether or not the run is over. I believe it is not, but that's not because I'm "married" to what has been a very successful trade. If the facts and outlook for the Japanese market had changed, I'd change my opinion. But, they have not.

Instead, I believe we are merely entering the next stage of this rally, one that is fueled by rising inflation and a reallocation of money into Japanese equities (and out of Japanese bonds). The arrival of "wage-push" inflation is central to that investment thesis, and the fact that you are seeing very large corporate and labor organization starting to raise wages again for the first time in years implies we should start to see that "wage-push" inflation, and that's a big reason why I think the rally in DXJ isn't done, regardless of how good the returns have been this year.

Economics

Pending Home Sales

- Pending Home Sales Index rose 0.2% vs. (E) 1.5%
- October reading revised lower to –1.2% from –0.6%

Takeaway

The Pending Home Sales Index released by the National Association of Realtors rose slightly in November, gaining 0.2%, but missed analyst expectations for an increase of 1.5%. Although the number missed expectations, the

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data did bump up into positive territory for the first time in 6 months. Year over year however, the index which tracks signed contracts to buy existing homes, is down 1.6%.

The key takeaway from yesterday's report on Pending Home Sales is that after declining for 5 straight months, the report turned positive in November. And, although Pending Home Sales largely missed expectations the report suggests that at the very least, the housing market recovery appears to be stabilizing after showing signs of slowing earlier in the year. This report along with other recent housing data indicates broad stabilization in the housing market despite rising mortgage rates, and while it doesn't mean his doesn't mean the slow down in the recovery is necessarily over, but it is potentially an encouraging sign.

Commodities

Commodities were mostly lower yesterday despite the fact that the dollar was down 0.50%. The PowerShares DB Commodity Tracking Index ETF (DBC) fell 0.56%.

The only commodity that rallied yesterday was Natural Gas, which gained 1.47%. Natural Gas futures continue to trade independently from the rest of the commodities space, still dictated primarily by weather. Forecasters are expecting a cold start to the year with temperatures below average through January 8th for the Mid West and Northeast and that helped Natural Gas to rally for the first time in 6 sessions yesterday. On the charts, major support remains at $4.20 BCF while resistance is last weeks high of $4.532.

I've said for the past few weeks that I believe we are seeing a fundamental bullish shift in the natural gas market, due mostly to the term structure shifting to backwardation. I'm not a big options trader, but It is worth noting that the most active options traded on NG futures yesterday were the May $6 calls. Whether the transactions were physical traders hedging bets or speculators getting into the game, the volume in $6 calls adds to the bullish sentiment in Natural Gas.

Market	Level	Change	% Change
Dollar Index	80.135	-.403	-0.50%
EUR/USD	1.3800	.006	0.44%
GBP/USD	1.6514	.0036	0.22%
USD/JPY	105.12	-.0500	-0.05%
USD/CAD	1.0644	-.0059	-0.55%
AUD/USD	.8905	.0037	0.42%
USD/BRL	2.3598	.0216	0.92%
10 Year Yield	2.974	-.032	-1.06%
30 Year Yield	3.908	-.035	-0.89%

Prices taken at previous day market close.

Precious metals were the biggest underperformers yesterday, as silver fell 1.97% while gold was off 0.86%. With yesterday being one of the last trading days of the year, and gold and silver being two of the worst performing investments in 2013, yesterday's selling was undoubtedly influenced by investors booking losses for tax purposes. Otherwise trading was largely technical with the price action being determined by algos and spec traders. $1200/oz. remains key support in gold, and I would continue to peck away on the long side at that level.

The Commitment of Traders Report was released yesterday (delayed from Friday because of the shortened week last week), and net longs in both gold and silver declined from last week. Net long positions in Gold fell for the 3rd week in a row by 2,569 to 11,193 while net longs in silver fell 384 to 3325, both near historic lows (which, typically, is a bullish contrarian indicator).

It is worth noting that WTI Crude Oil futures dipped down below $100 per barrel and closed at $99.35 after closing above $100 on Friday for the first time since mid October. The 1% selloff in WTI was a result of many oil traders believing the rally up and over $100 was a little too much a little too soon as inventories remain near a record high for this time of year. Over the medium term however, sentiment remains bullish though as most economic indicators continue to print positive data which will lead to an uptick in demand.

Finally, there is news of a big accident this morning in North Dakota, where there was a train collision that resulted in an oil spill. It isn't having an effect on oil prices, and likely won't, although it'll keep the debate alive about how safe shipping "crude by rail" is, as the accident is the latest in a series involving trains carrying oil.

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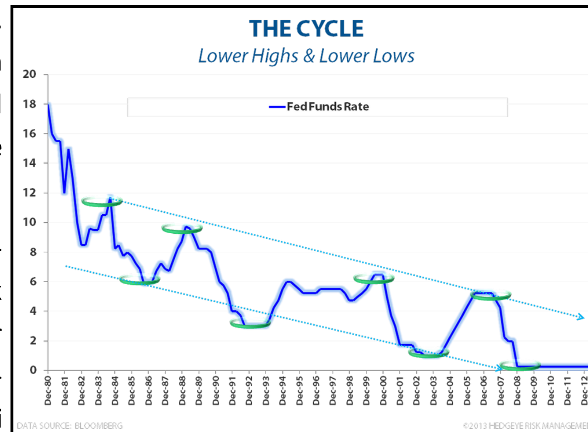
Currencies & Bonds

Monday was a mixed day in the currency and bond markets, as the Dollar saw decent declines (down .5%), and was universally lower against its major trading partners, while Treasuries saw a mild rally. Year-end positioning was the main influence in the currency and bond markets, as there was little in the way of news out yesterday.



The one exception was in the euro, which rallied .5% to close back above 1.38 vs. the dollar. Other than year end positioning, the euro caught on the Mario Draghi comments over the weekend, mentioned in yesterday's Report, that there wasn't any current need to further reduce interest rates. Obviously that re-enforces the growing perception that the ECB is satisfied with current policy, and as I've said many times lately, that's by default euro bullish.

Elsewhere in currencies, the Aussie and Canadian Dollars rallied .5%, while the Pound continued it march higher vs. the greenback, rallying .33% to close just off the highs for the year. Again, though, most of this was random trading "noise" and year end positioning. Nothing materially "dollar bearish" happened yesterday.

Turning to the bond market, to 30 and 10 year Treasuries rallied .44% and .22% respectively in quiet trading. Like currencies, year-end positioning and thin markets are the real "reasons" behind the oversold bounce in bonds. Given the decline in bonds over the past three weeks, this low volumes bounce might last into the first few days of the new year, but that's just a bounce in an otherwise steadily down trending market.

The ten year yields initial stint about 3% was relatively short lived, as the ten year yield closed yesterday at 2.76%. But, I think everyone knows by now it's a matter of "if," not "when" the ten year yield trades with a 3% handle for good. And, I for one hope that sometime in the first few weeks of 2014 I see a sub 3% en year yield for the last time in my life – because I would much rather have a stronger economy with higher interest rates, than I would the mess of the past 5 years along with "free" money.

A Trend Shift of Enormous Proportions

Finally, I've included a chart I saw on twitter yesterday that was produced by the group over at Hedge Eye Research that shows the unrelenting downward trend in the Fed Funds rate starting in 1980, some 33 years ago. Context is a critical thing to keep in this business, and it's interesting to see the consistent drop in the price of money over the past three decades. And, it's pretty clear that unless we can go below zero (and in this era of financial engineering, who knows) this three plus decade downtrend is over. Now, how soon the next uptrend begins is anyone's guess (It hasn't started in earnest yet, but I'm bettering its sooner than most think), but clearly that's direction we should all be preparing for.

Tectonic shifts in the markets like this throw off all sorts of opportunities beyond just the primary trend, and I learned that lesson well trading the commodity market shift back in '04 and '05. In other words, there are going to be a lot of different ways to make money off this huge trend change in the coming quarters and years.

I've said it before multiple times and I'll say it again – this shift in the direction of rates will be the defining factor of markets not just in 2014, but for years to come. And, making sure you're on the right side of it and recognizing and seizing opportunities associated with this shift will be the key to outperforming not just in 2014, but also over the coming years. And, it's our job to help you do it – and we will. I'm proud that we were able to recognize this shift early and help clients get positioned for it, but this is merely the end of the beginning.

Happy New Year's Eve, Stay Safe, and We Will See you in 2014.

Best,

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 traded to new highs last week amidst thin, holiday trading. 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 1828 in the S&P 500.*

Trade Ideas

Long Japan: **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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
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).**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index declined small last week, but mostly thanks to a strong euro. The Dollar Index should remain largely range bound, as a strong euro caps any material upside.*

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	*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 market.*

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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