7:00's Report

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

December 5th, 2013

Pre 7:00 Look

- Futures and international markets are almost perfectly flat ahead of the ECB rate decision later this morning.
- The Nikkei was again the laggard o/n, dropping another 1.5% on yen strength, despite the headlines of a large stimulus package being passed. But, that was expected by the market.
- There was no economic data o/n.
- Econ Today: BOE & ECB Rate Decisions (No Policy Changes Expected), GDP (E: 3.1%), Weekly Jobless Claims (E: 322K). Fed Speak: Fisher (1:15 P.M.)

Market	Level	Change	% Change
S&P 500 Futures	1790.25	-1.50	-.08%
U.S. Dollar (DXY)	80.605	-.023	-.03%
Gold	1232.30	-15.00	-1.20%
WTI	97.51	.31	.32%
10 Year	2.841	.066	2.38%

Equities

Market Recap

Stocks drifted slightly higher Wednesday before closing with modest losses. The S&P 500 gave back 0.13%.

Stocks continued to act "tired" Wednesday morning, as markets failed to rally on a much stronger-than-anticipated ADP jobs report. But, stocks did catch a bid and traded to the highs of the day mid-morning on reports that congressional leaders are close to a budget deal. But, that temporary lift faded, and by 12:30 markets traded down to the lows of the day. But, the sell-off

The Nikkei is down more than 3% in two days, and looks to have started a short term correction. This is a correction that should be bought, however.

couldn't gain momentum. By the close, markets had rallied back to flat, completing a whipsaw day.

Trading Color

Most major averages finished close to flat yesterday so there wasn't any material difference between the more-cyclical indices (Russell 2000 and Nasdaq) and the more-defensive Dow Industrials. From a sector standpoint, it was a bit of a mixed bag. On one hand, "bond proxy" sectors continued their bounce from Tuesday, as utilities and REITs finished in the green. But as I said yesterday, I imagine that's as much profit-taking by shorts into the jobs report as it is anything else.

Banks traded well yesterday despite news that the "Volcker Rule," which will prohibit banks from prop trading, might be approved by mid-December (earlier than expected). The SPDR S&P Bank ETF (KBE) rose 0.62%.

Also, the strength in commodities led to a bounce in the basic materials index, which rallied 0.5%. Overall, there wasn't much to read into the sector trading. Although we're seeing a pause in the recent trends of cyclical outperformance and "bond proxy" underperformance,

Market	Level	Change	% Change
Dow	15889.77	-24.85	-0.16%
TSX	13304.92	-14.95	-0.11%
Brazil	50215.79	-133.10	-0.26%
FTSE	6509.97	-22.46	-0.34%
Nikkei	15407.94	-341.72	-2.17%
Hang Seng	23728.70	-181.77	-0.76%
ASX	5273.75	17.68	0.34%
Prices taken at previous day market close.			

nothing material has changed and I'd expect those trends to re-emerge sooner rather than later.

Volumes and participation remain slow. In fact, it's so quiet that I'm starting to wonder about trading revenues at the major IBs, but that's a thought for another day. The midday dip in stocks came as much because of a lack of interest from buyers as it did aggressive selling, and really this market largely continues to simply tread water at current levels.

Market	Level	Change	% Change
Gold	1246.90	26.10	2.14%
Silver	19.83	.765	4.01%
Copper	3.2575	.0565	1.76%
WTI	97.10	1.06	1.10%
Brent	111.65	-.97	-0.86%
Nat Gas	3.961	-.015	-0.38%
Corn	436.50	5.25	5.25%
Wheat	647.25	-6.50	-.99%
Soybean	1329.50	9.75	0.74%
Prices taken at previous day market close.			

On the charts, support at the 20-day moving average (1,785) was temporarily violated yesterday, although the market closed just above it at 1,792.81.

Bottom Line

Even though stocks were resilient yesterday, in the short term, I still think investors are a touch too sensitive to any minuscule sell-off. (At the lows yesterday, the market wasn't even down close to 1% and people seemed nervous.) So, the short-term "pain trade" remains lower. But, longer term the market narrative remains the same, and beyond a potential small correction, I think the path of least resistance is still higher. I'll look to be a buyer of cyclicals on any material dip toward the 50-day MA (1,756) if we get it.

Keep in mind the lack of volumes and participation by real money funds remains an underappreciated factor in intraday trading. Despite media reports, stocks didn't falter yesterday morning or afternoon because of "tapering fears" or anything else fundamental. This market has basically gone nowhere since mid- to late-November, and it looks like we are witnessing another period of digestion/consolidation, similar to what we've seen multiple times this year.

Finally, for all the angst over the near-term direction of stocks, keep in mind that the strongest trend in the markets is that of lower bond prices/higher yields. Regardless of what the jobs report says this Friday, that trend is going to continue. So, I continue to advocate methodically adding to "bond short" positions via TBT, TBF or STPP on any bounce we may get in bonds if the jobs report surprises.

A Reversal in Japan?

Headlines today are focused on a 182 billion dollar stimulus package being released in Japan, but really we're seeing a "buy the rumor/sell the news" reaction as that was largely expected and priced in.

More broadly, the chart of page 1 highlights the reversal we saw in the Nikkei Wednesday, and that selling continued overnight (Nikkei down 1.5%). The Nikkei is falling because the yen is rising, and while the bull case for rising Japanese stocks remains firmly in place over the medium term, it feels like we're getting a short term correction after the market simply got too overbought (which is actually healthy). If you're a trader or have short term profits I'd take them in DXJ, and if you're a long term holder in DXJ I'd look to add on a dip starting around 47.50ish.

Jobs Report Preview

Since not everyone reads the Report by 8:30 each morning, I'm putting Friday's jobs report preview in this issue, so that everyone has an idea of what's expected.

The "consensus" expectation is for 185K jobs added in November, although given yesterday's ADP report, the "whisper number" is somewhere closer to 200K. I'm going to give the "Goldilocks" scenarios, but first keep these couple things in mind ... First, the current "consensus" for Fed tapering of QE is Q1 2014. March is the favored month, although many think it'll be January. So, markets will trade off those expectations. Second, bonds, the dollar and gold are much more reactive to tapering expectations than stocks, so expect more volatility from those asset classes. Finally, and perhaps the most-important thing to realize about this jobs report, is there isn't really a "too hot" reading, at least with regard to stocks.

Good data is good for the market, so if the jobs number is a blowout, expect cyclical stocks to rally, even if there is an initial dip on the headline.

The "Too Cold" Scenario: < 140K. Given ADP, this would be a very disappointing print and likely push QE tapering expectations beyond Q1 2014. If the number is below 140K, expect a "dovish" response, in that gold and bonds will rally very hard, the dollar will fall, and stocks likely will fall too. (Again, good news is good news.)

The "Just Right" Scenario: 170K – 200K. This is the "sweet spot" and if the jobs number is in this range, don't expect too much of a reaction. Bonds may get hit the hardest on a number in this range, but really this is currently priced into stocks, bonds, gold and the dollar.

The "Too Hot" Scenario: > 225K. A number above 225K would probably significantly increase the odds of a December taper to better than 50/50, and we would see a "hawkish" response from markets in that bonds and gold would sell off, and the dollar would rally. The wildcard is stocks – but I think that in this scenario, stocks would also rally. If there is a knee-jerk decline off a strong headline print, I'd be a buyer of cyclicals on that dip.

Economics

November ADP Jobs Report

- November Payrolls increased 215K vs. (E) 185K

Takeaway

The ADP Employment Report is the latest set of data suggesting the job market is steadily improving. The number was much higher than analysts' expectations. In fact, November's payroll growth was the highest since November 2012, confirming the recent trend lower in weekly jobless claims.

This report obviously adds upside expectations to tomorrow's government report, whose whisper number for Friday almost certainly moved higher yesterday.

Market	Level	Change	% Change
Dollar Index	80.64	.022	0.03%
EUR/USD	1.3587	-.0002	-0.01%
GBP/USD	1.6378	-.0013	-0.08%
USD/JPY	102.20	-.29	-0.28%
USD/CAD	1.0682	.0036	0.34%
AUD/USD	.9028	-.0108	-1.18%
USD/BRL	2.3903	.0147	0.62%
10 Year Yield	2.841	.066	2.38%
30 Year Yield	3.905	.068	1.77%
Prices taken at previous day market close.			

ISM Non-Manufacturing PMI

- Nov. Non-Manufacturing PMI was 53.9 vs. (E) 55.5.

Takeaway

The non-manufacturing, or service sector, PMI missed expectations, but it's still a decent number and the service sector has shown growth (above 50) for 47 consecutive months now. The headline number missed analysts' expectations; however, the data within the release was rather mixed. The widely followed New Orders component fell slightly by 0.4 to 56.4. While that is the third-consecutive monthly decline, it's still at a very high level on an absolute basis. The one real disappointment was that the employment index dropped 3.7 points to 52.5, the lowest print since May.

Bottom line is that, although we're seeing some moderation in the service sector of the economy, overall activity is still steadily expanding. There isn't anything in this report that would make people think the economy is starting to slow.

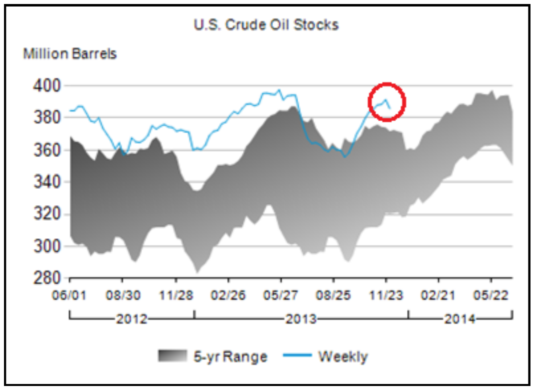
Commodities

Commodities rallied yesterday on a combination of continued strength in energy and short-covering in the metals. The commodity ETF DBC rallied 0.2%.

Precious metals led the way higher, mostly on short-covering. Interestingly, gold and silver were able to rally in spite of a stronger U.S. dollar and generally "hawkish" economic data (the ADP report). But, to understand why gold rallied (when, logically, it should have sold off further), we have to realize that, as I mentioned in Tuesday's report, spec net longs are at multiyear lows while short interest is at the highest level it's been since I started keep track 3+ years ago**.**

So, when the "hawkish" data came out and gold didn't decline, you saw shorts start to cover for two main reasons. *First*, everyone who wants to short gold is already in, and all the weak longs are already out. So, who is left to sell? *Second*, the fact that gold didn't decline in the face of the ADP report implies a strong November jobs report is already priced into gold at these levels.

Gold is soft this morning ahead of more data, but we could easily see this short-covering rally continue into Friday's report. Even after yesterday, I'm sure there are a lot of gold shorts still in the market. But, I don't think the fundamental case for gold has improved. As I've said, gold needs inflation to trade materially higher, and there is just no hint of that right now, and if you're buying gold here for anything other than a trade, make sure you have a long term time horizon.



Turning to WTI crude, it extended its rally, rising 1.4% and moving through \$97/bbl. thanks to the first drop in inventories in 11 weeks. Oil inventories fell 5.6 million barrels according to the EIA, and that helped further squeeze remaining oil shorts and embolden recent longs. Much like gold, I'm not sure the fundamental story for oil is that much more bullish, even after the big run. First, the big draw in inventories has a lot to do with the calendar, as oil companies "de-stock" to avoid being taxed. We can expect inventories to continue to drop throughout December as de-stocking continues. But, even with that, inventories remain elevated, and unless we see a material increase in demand, I'm not sure we're headed materially above \$100/bbl.

Interestingly, Brent crude declined nearly 1% yesterday, but that was as much a reaction to the OPEC meeting and comments by the Iranian Oil Minister as it was anything fundamental. OPEC left its "quota" at 30 million barrels per day, but Iran's oil minister shook things up a bit when he said "Under any circumstances we will reach 4m b/d even if the price of oil falls to \$20 per barrel." Obviously that's not going to happen anytime soon, but it does underscore the growing challenges facing OPEC.

Currencies & Bonds

Western currency markets were muted yesterday and remain so this morning, which makes sense ahead of the ECB decision. The most interesting currency action yesterday (and for the past few days) came out of Asia.

The yen continued it's rally versus the dollar yesterday, and that strength is continuing this morning, and it looks like we may be seeing a short term pause in the yen decline versus the dollar. As far as "why" the yen reversed, there are two main reasons being cited: First, BOJ board member Takehiro Sato downplayed the idea of more stimulus from the BOJ (the thought of more stimulus has pushed the yen to recent lows vs. the dollar). Second, Japan's largest pension fund expressed doubts about the BOJ being able to meet its 2% inflation target, which basically calls into question the effectiveness of BOJ policy.

In truth, though, the yen simply got too short term oversold and was in need of a correction. So, while nothing fundamental has changed to make the case for the yen any "less bearish" than it has been, we may have seen some short term exhaustion (keep in mind the yen went from 100 yen/dollar to 103.50 in just a few trading days). I could easily see the yen rallying back to 101—100 yen to the dollar on a correction, but the important thing here is that would be a rally to short, as the larger trend in the yen remains down.

The other big mover in Asia yesterday was "Aussie," which declined 1.3% yesterday and traded to fresh 3 month lows after the nation's GDP report showed the economy grew at 2.3% yoy vs. expectations of 2.6%. Aussie briefly broke through support at the 0.90 level but rebounded back to close slightly above it. Aussie remains under pressure here, I would expect the .90 level to hold vs. the dollar, as given the state of global currency markets, that seems close to fair value.

Bonds continued their declines yesterday, falling after the "hawkish" ADP report, and the bond market continues to be the most sensitive asset class to "tapering" expectations (much more so than equities or currencies). The 30 year traded to a new three month low ahead of the jobs report tomorrow. We're seeing a small bounce in bonds this morning, but that's as much trading noise as anything else, and given the big release tomorrow, I'd expect a flat day in the bond market today. Have a good day, Tom.

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.**