7:00's Report

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

December 6th, 2013

Pre 7:00 Look

- Futures and international markets are modestly higher, mostly due to positioning ahead of the jobs report. Overall it was a quiet night.
- Economically, the only data point was German Manufacturers' Orders, which missed expectations.
- Econ Today: Employment Situation Report (E: 185K). Personal Income and Outlays (E: 0.3%).
- Fed Speak: Plosser (10:15 A.M.), Evans (3:00 P.M.).

Market	Level	Change	% Change
S&P 500 Futures	1790.50	6.50	.36%
U.S. Dollar (DXY)	80.31	.069	.09%
Gold	1227.10	-4.80	-.39%
WTI	97.20	-.18	-.18%
10 Year	2.862	.021	.74%

Equities

Market Recap

Stocks drifted lower for the third-straight day Thursday during another low-volume session where trading was dominated more by positioning and sentiment than it was any fundamental news. The S&P 500 fell 0.43%.

Stocks opened flat Thursday amidst several catalysts. First, the economic releases (GDP and Jobless Claims) were strong on the headline but that was a bit misleading (more on that later). Meanwhile, Mario Draghi came off as modestly "hawkish" during his press conference following the ECB rate decision. But, despite all the headlines, the markets didn't really react all that much, and mostly followed the familiar script this week of gently drifting lower and spending most of the day in negative territory.

Stocks once again hit their lows in the late afternoon and bounced into the close to finish off the worst levels of the day. Support at 1,785-ish held for the second-straight day.

As far as "reasons" for the negative close, the usual suspects were rounded up: "Stocks fear tapering," "No fiscal deal in Washington," and "Draghi was hawkish" were all used to explain the drop in stocks. Also thrown in was concern about Q4 GDP (several firms on the Street dropped their estimates because of the negative effect of the inventory builds in Q3). But those are more excuses than reasons (stocks don't fear tapering, there will be some sort of a deal in Washington and Draghi wasn't "hawkish"—he just wasn't "dovish"). This market remains driven in the short term by sentiment and investor positioning (and the calendar, given we're close to year-end). For now, stocks are simply digesting and consolidating recent gains.

Trading Color

Activity and volumes remain very subdued in the markets, and day traders continue to dominate the intraday trading. There is little to no conviction to the moves we're seeing broadly in the averages, and most real money funds remain firmly on the sidelines, so both dips and rallies need to be taken with a grain of salt.

Profit-taking and positioning ahead of this morning's jobs report dominated sector trading yesterday. REITs, of all things, were the best-performing sub-sector despite higher yields, but we can chalk that up to short-

Market	Level	Change	% Change
Dow	15821.51	-68.26	-0.43%
TSX	13200.40	-104.52	-0.79%
Brazil	50787.63	571.84	1.14%
FTSE	6498.33	-11.64	-0.18%
Nikkei	15177.49	-230.45	-1.50%
Hang Seng	23712.57	-16.13	-0.07%
ASX	5197.96	-75.79	-1.44%
Prices taken at previous day market close.			

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covering going into the number this morning. Conversely, banks—which have seen a big run on expectations of tapering—relatively lagged after reports surfaced the "Volcker Rule" may be tougher than expected, and as people took pre-jobs-report profits.

Market	Level	Change	% Change
Gold	1230.60	-16.60	-1.33%
Silver	19.45	-0.38	-1.31%
Copper	3.257	-0.0145	-0.44%
WTI	97.43	.23	0.24%
Brent	111.00	-.88	-0.79%
Nat Gas	4.135	.175	4.42%
Corn	433.50	-3.00	-0.69%
Wheat	638.00	-9.25	-1.43%
Soybean	1328.00	-1.50	-0.11%

Prices taken at previous day market close.

More broadly, we did see cyclicals relatively outperform defensives, as industrials and consumer discretionary were the only other S&P sub-sectors to finish in the green. Consumer staples, utilities and telecom all lagged, and that makes sense if you think the jobs number is going to be good. Cyclicals will outperform going forward, while anything defensive or "bond proxy" will continue to lag the markets.

Things were quiet on a stock-specific basis—semiconductors rallied on the back of Avago Technologies' (AVGO) good quarterly report (and 7% rise), while Microsoft (MSFT) dropped 2.5% after reports surfaced that Ford (F) CEO Alan Mulally wasn't going to be the next MSFT CEO. Outside of that, things were quiet on a single-stock basis. On the charts, the S&P 500 is into first support at the 1,780-1,785 level, which held both Wednesday and Thursday. Resistance sits at 1,800 and then the old highs (1,813).

Watch How SHY Trades After the Jobs Report

I want to again point out that, although I've heard the opposite lately, both stocks and interest rates **can** rise together going forward. As I pointed out about two weeks ago, the key difference between this recent rise in yields and the May-August rise in yields is that this time, the "short end" of the yield curve hasn't sold off (its actually risen). And, that implies the market is more comfortable with the idea of higher interest rates, and that this recent rise in rates, and subsequent steepening of the yield curve, isn't a "rally killer" for stocks.

But, for stocks to keep rising amidst rising yields, that short end needs to stay anchored. So, watch how SHY (I-Shares 1-3 year Treasury ETF) reacts if the jobs number is better than expectations. If SHY doesn't sell off with other bonds, that's bullish for stocks. Conversely, if we start to see SHY drop over the coming days/weeks, that will be a signal that rising yields are becoming a headwind on equities, and a sign to get more cautious.

Economics

ECB Meeting

The ECB meeting was a mixed bag, but on balance the takeaway, as feared, was that Draghi and the ECB aren't in any hurry to do "more" to combat dis-inflation, and European stocks sold off as a result and the euro rallied.

On the positive, or dovish, side, the 2015 staff projections for growth and inflation weren't as high as feared. The ECB expects EU GDP to be 1.5% in '15, and inflation to be 1.3% in 2015. Both figures are lower than some feared, and in particular the 1.3% inflation reading is below 1.5%, which is what some were expecting. This is important because with such low growth and inflation expectations, the ECB certainly has room to ease further to stimulate the EU economy, because growth will be slow and inflation will be low.

But, just because the ECB has room to stimulate further, this doesn't mean it will stimulate further. Mario Draghi spent most of the presser saying current efforts to stimulate the economy "need time" to work through and people need to be patient. Additionally, he didn't seem particularly interested in another LTRO (Long Term Repurchase Operation), which is the likeliest next step in accommodative policy.

Bottom line is the ECB appears to be comfortable with current policy, despite very low inflation, and isn't in a hurry to do "more." And, I think that's a problem for European equities. So, given the ECB sluggishness, I'd be inclined to exit general European longs (and as a spread vs. the SPY), as I think we'll likely see a further correction. Longer term, I do still think there's money in owning European equities, but for now I'd prefer to move to the sidelines and wait for either lower prices or more urgency from the ECB.

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3rd Quarter GDP

- 3rd Quarter GDP Rose 3.6% vs. (E) 2.8% SAAR.

Takeaway

3Q GDP growth was revised much higher in yesterday's report from the initial release of 2.8% to 3.6%; however, the increase was mostly due to rising inventory levels. Inventories were revised higher by $31B to $117B, which accounted for essentially all of the adjustment in the headline number. The substantial accumulation of inventories seen in Q3 is expected to put a damper on Q4 growth, with early estimates only forecasting growth of around 1.5%.

Actually despite the temporary headline euphoria, the key metrics in in the report, PCE and Final Sales of Domestic Product, actually were both revised **down by .1%** from the initial readings, to 1.4% and 1.9%. So, on balance this GDP report wasn't good—it merely further confirms we were still in a "slow growth" economic during the 3rd quarter.

As far as market reaction, there was an very brief "hawkish" response in that bonds sold off and the dollar rallied, but it quickly lost momentum once people actually looked beyond the headlines.

Weekly Jobless Claims

- Claims fell to 298K vs. (E) 322K

Takeaway

Weekly jobless claims were lower than analysts' expectations, coming in at 298K. The claims number was below 300K for just the second time since I started collecting data back in 2008 (the other time was 294K on 9/12/13).

But, as we all know, when something looks too good to be true, it probably is, and The Department of Labor has indicated, however, that the drop of 23K claims was more than likely skewed by the Thanksgiving holiday. The general trend of declining claims remains in place, which is a good thing, but we'll likely see a big revision higher in claims next week.

Market	Level	Change	% Change
Dollar Index	80.275	-.353	-0.44%
EUR/USD	1.367	.0077	0.57%
GBP/USD	1.6328	-.0054	-0.33%
USD/JPY	101.76	-.59	-0.58%
USD/CAD	1.0644	-.0036	-0.34%
AUD/USD	.9066	.0041	0.45%
USD/BRL	2.3556	-.0356	-1.49%
10 Year Yield	2.862	.021	.74%
30 Year Yield	3.914	.009	.23%

Prices taken at previous day market close.

Commodities

Commodity markets in aggregate were unchanged Thursday, as DBC finished off just 0.12%. But, that flat aggregate finish underscored some big individual moves, as precious metals fell on more "hawkish" economic data and natural gas rallied to a seven-month high on a big drop in inventories.

Starting with natural gas, it rallied 4% yesterday and broke back through the $4.00/MMcf mark after the weekly inventory data showed a simply massive draw on supplies (162 Bcf vs. (E) 137 Bcf) due to the cold weather that descended on much of the country late last week. We've been saying for some time that natural gas is a weather-dominated commodity and that, if the weather turned cold, natural gas would rally up and through $4.00. That's what's happened. This early-winter cold spell has taken natural gas from an inventory surplus to a deficit compared to the five-year average, and now inventories are 2.8% below the five-year average, and 5% below last year's levels.

On the charts there is little resistance between current levels and the mid-$4.20s, so the case can certainly be made for more upside, especially seeing as there are frigid temperatures moving east as we speak. But, natural gas remains a weather-dominated market, and I'm much more comfortable being patient and buying dips into the high-$3.00s rather than chasing it at these levels. But, that's not to say it can't go higher first if cold weather is here to stay.

Interestingly, the natural gas equities haven't really followed the move higher in gas. FCG and XOP, two of the more "pure play" natural gas equity ETFs, aren't anywhere near seven-month highs, and actually look somewhat weak on the charts. But, if we are entering a period of prolonged elevated natural gas prices (high-$3.00/mid-$4.00), then

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these ETFs should play catch-up, as I am fairly certain there aren't a lot of analysts who have natural gas trading north of $4.00/MMcf in their models for Q1 2013. Given the volatility in natural gas and the weather-dominated nature of it, I'd prefer to wait to buy a dip, or if you can't be patient, then take a look at those two ETFs, as they may play catch-up.

The rest of the energy space was relatively quiet (WTI rallied small while Brent slid less than 1% on general angst surrounding the ECB) while the refined products were little-changed.

Precious metals were *not* little-changed yesterday, however, as the hawkish economic data (jobless claims in particular) led gold to give back the majority of Wednesday's gains, as it fell 1.5%. This sets up a rather precarious situation for the gold longs into this morning's jobs report. Bottom line is watch $1,210 and $1,250 (the recent low and high). It'll be especially interesting to see how gold reacts if we get a strong jobs report. Gold hasn't "broken" the way you would expect given the recent hawkish data, and it didn't really trade off the ADP report. So, if gold doesn't break down through $1,200 initially on a strong jobs report, for those who like to trade you might consider a long position or some March calls, as that will tell us a December/January tapering of QE is already priced into gold, and we aren't going to see material downside from here. Given the record number of shorts in gold, that is a recipe for short-covering, the type which we saw on Wednesday.

Currencies & Bonds

The dollar traded lower Thursday, falling 0.44% mostly due to the rally in the euro, which was higher after the market interpreted the ECB meeting as "not dovish." The dollar is rallying small this morning ahead of the jobs report in quiet trading.

Yesterday, though, the focus was on euro, which rallied 0.57% to six-week highs on Draghi's "not dovish" sentiment following the ECB meeting. Again, it wasn't that Draghi was "hawkish." He wasn't. And rates will stay low in Europe for the foreseeable future. But, the market discounts the future, and right now the market wants and expects the ECB to do "more" to stimulate the EU economy and combat disinflation. So, until the ECB actually does something more to ease policy, the Euro will drift steadily higher, because growing disinflation/deflation is currency bullish. And, the concerns that Europe is in danger of experiencing "Japan-like" deflation will become louder. From a currency standpoint, though, as long as the ECB is on the sidelines, the path of least resistance in the euro will be higher and I'd not be surprised to see the euro trade to higher for the year above 1.38 in the coming weeks.

The pullback in the yen continued for the third day in a row yesterday as it gained 0.58% against the dollar, closing at 101.76, and although the yen is weaker this morning, I'm not sure this counter trend rally is done. Again, I could see the yen trading near "par" versus the dollar on this bounce, but longer term the trend remains much, much lower and that would be a rally to short via YCS.

Bonds, specifically the long end of the curve, sold off on the stronger-than-expected jobless claims number. However, the move turned out to be a knee-jerk reaction, as 30-year bond futures (ZB) drifted higher as the trading day progressed.

This morning remember that the bond market is still the most-sensitive with regards to tapering expectations. For that reason, bond traders will be highly anticipating this morning's Employment Situation Report. The key levels to watch are 3% in the 10-year yield, which has held strong as resistance, and 128'12 in the 30-year note, which is the low for the year and could potentially serve as a tipping point in initiating an acceleration of the sell off.

Remember, as I said earlier, it's the pace and type of rise in yields, not the rise itself that's important. Stocks can rally amidst rising yields as long as that rise in yields is orderly, and focused on the "longer" end of the curve. So how bonds trade (specifically the 1-3 year Treasuries) if 128'12 is broken is important to watch.

Have a good weekend,

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 have consolidated recent gains, and worked off the short term overbought condition. A calm macro-economic horizon and still skeptical sentiment towards the rally remain tailwinds, and over the medium term the path of least resistance remains higher.* *Support in the S&P 500 lies in the 1780-1785 region, while resistance is 1800.*

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). Given the ECB's lack of desire to do "more" I think EU stocks face a headwind in the near term and would exit these positions and look for a better entry point in the coming weeks/months.**

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.**

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