7:00's Report

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

January 13th, 2014

Pre 7:00 Look

- Futures are slightly weaker this morning and international markets are flat as the world digests Friday's jobs report. News flow was light over the weekend, and focused on the micro economic.
- European banks are extending the YTD rally as leverage ratios were reduced over the weekend.
- Base metals (especially nickel) are higher after Indonesia implemented an export ban on mineral ores.
- Econ Today: No Reports Today. Fed Speak: Lockhart (12:40 PM).

Market	Level	Change	% Change
S&P 500 Futures	1831.25	-6.50	-.35%
U.S. Dollar (DXY)	80.815	-.039	-.05%
Gold	1245.60	-1.20	-.10%
WTI	91.88	-.84	-.91%
10 Year	2.860	-.103	-3.48%

Equities

Market Recap

Stocks traded slightly lower last week as some soft economic data and a lack of any positive catalysts led to mild declines in the averages. The S&P 500 is down 0.32% year-to-date.

Stocks spent most of last week trading either side of unchanged. Markets were very quiet Monday and Tuesday as investors looked ahead to the Fed minutes, European Central Bank meeting and jobs report.

But, the "catalysts" of the week ended up being relative non-events, despite the fact that ECB President Mario Draghi was more "dovish" than expected and the jobs report was a big miss. Stocks closed quietly on Friday with small losses on the week.

Trading Color

The most-striking thing about last week, other than the headline jobs report miss, was that volumes haven't retuned to the market despite the start of the new year. "Cautionary" would be the best word to describe the current market, as vanilla mutual funds and large hedge funds remain on the sidelines, waiting for some sort of clue as to the next direction for stocks (it seems most view earnings as the next potential catalyst). As a result, volumes remain low and the intraday trading is still dominated by fast-money hedge funds, day traders and algos. This makes for volatile intraday trading, but keeps absolute moves relatively small.

That said, there were a few prevalent trends in the market last week: First, banks are the clear winners so far in 2014. The KBW Bank Index (BKX) is up 1.9% year-to-date, while the European banking index (the SXXP) is up even more. Conversely, retail seems to be the clear loser so far in 2014. Retail has lagged not just because of concerns about the weak consumer but also because of weather issues, margin compression and other core business issues. Third, interest rates on PIIGS' government debt plunged last week, and that's resulted in their respective stock markets being some of the best performers year-to-date. Spain, Portugal, Ireland, Greece and Italy are all up anywhere from 4% to 11% year-to-date (the 11% is Greece).

On the charts, the picture domestically remains the same. Short term the S&P 500 is sitting between re-

Market	Level	Change	% Change
Dow	16,437.05	-7.71	-0.05%
TSX	13,747.52	118.11	0.87%
Brazil	49,696.45	374.77	0.76%
FTSE	6737.25	-2.63	-.04%
Nikkei	15912.06	31.73	.20%
Hang Seng	22888.76	42.51	.19%
ASX	5292.08	-20.31	-.38%
Prices taken at previous day market close.			

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sistance at the all-time highs (1,849.44) and initial support at the 20-day moving average (1821.85), but the market remains in a well-defined uptrend.

Market	Level	Change	% Change
DBC	24.86	.16	0.65%
Gold	1246.90	17.50	1.42%
Silver	20.223	.54	2.74%
Copper	3.3415	.0425	1.29%
WTI	92.72	1.06	1.16%
Brent	107.52	1.13	1.06%
Nat Gas	4.053	.048	1.20%
RBOB	2.6691	.0265	1.00%
DBA (Grains)	24.24	.12	0.50%
Prices taken at previous day market close.			

Bottom Line

Investors have been frustrated by the fact that stocks haven't just resumed their rally early in 2014. But it's important to keep in mind that the S&P 500 rose more than 10% from September to December, so a period of consolidation shouldn't be surprising.

Despite the frustration that the market has gone nowhere so far in 2014, it's important to realize that nothing has really changed from late 2013: The macroeconomic horizon remains clear of crisis, valuations aren't cheap but they aren't extreme, interest rates are rising but the increase is orderly so far and there remains a high level of skepticism toward stocks in general. All that combines to make the path of least resistance still higher for equities and, as such, there's no reason to think this pause is anything more than just another period of consolidation, yet.

As mentioned, It seems earnings season will be the next major catalyst, and generally you can get the feeling that the market's focus is slowly turning from the "macro" to the "micro."

Although the volume of reports increases materially next week, there are several key bank earnings this week as well as important tech stocks and industrials' results. JPM, WFC, GS, C, PNC, BAC, COF and AXP all report this week, as does GE and tech names LLTC and INTC.

I'd say earnings season will be the key catalyst as to whether or not this flat start to 2014 is just another consolidation in an ongoing rally or the start of something more. Given the market's strength, though, the benefit of the doubt remains with the bulls, and although I could see hedging a bit into earnings season, I wouldn't be materially reducing any equity allocations at this point.

Economics

Last Week

Economic data last week was disappointing, highlighted by the big jobs report miss on Friday. But, the important takeaway is that the soft economic data did not change the general expectation that GDP in 2014 should be 3% or higher.

Starting with the jobs report, the right way to look at Friday's big miss (74K vs. estimates of 205K) is more confusing than outright negative. The miss was so big, and so divergent from all other recent economic data and employment indicators, that the market (rightly or not) is dismissing the jobs report as a statistical anomaly based on weather, seasonality, holiday hiring, etc.

The bulls will say that's the right way to look at the number, while the bears will view it as a classic example of investors "whistling past the graveyard" and simply dismissing numbers they don't like.

Time will tell who is right, and we'll get a good idea over the next few weeks as more data comes out, but for now the benefit of the doubt goes with the bulls. (The number is so far off that it makes more sense on the surface that this is an anomaly.)

While everyone focused on the miss, the more-important part of the jobs report was actually the 6.7% unemployment rate, down from 7%. I know the unemployment rate (UR) fell because the labor participation rate sank, making it not the positive it seems to be. But, the reason the number is important is because the UR rate is now within striking distance of the 6.5% UR threshold the Fed has cited as potentially warranting an increase in interest rates.

Now, no one thinks the Fed will raise rates when the UR hits 6.5%, but the point is that this may require the Fed to provide more clarity on its "Forward Guidance."

Remember, forward guidance is all a confidence game—it only works as long as the market believes it. If we hit 6.5% and the Fed doesn't clarify or lower the UR threshold (say from 6.5% to 6.0%), then it may serve to discredit "Forward Guidance," which may then result in a

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spike higher in interest rates. And, that would be bad for equities. So, what the Fed says about the UR threshold going forward will be important to watch.

Outside of the jobs report, the ECB meeting last Thursday was the next most "important" event. Draghi did his best to verbally "ease" policy by specifically pointing out that there is an increasing risk that the EU could suffer from an extended period of very low inflation, and he specifically clarified that the ECB mandate is for price stability both on the upside (inflation) and downside (deflation). He also tried to strengthen the ECB's forward guidance by further emphasizing that rates will be very low for very long.

But, while that did result in a temporary dip in the euro, the bottom line is nothing Draghi said made it any more likely that the ECB will actually act to combat the growing trend of dis-inflation. So from an investment standpoint, the major question facing all European investments (both equity and debt) remains: "Is Europe becoming Japan of the 2000s?" Despite Draghi's dovish tone, that question remains very much unresolved, and the answer remains the critical aspect of whether we're about to see a big bull market in European equities or European bonds (especially higher-yielding bonds).

The one other data point to note last week was that the ISM Non-Manufacturing PMI missed expectations. The important thing was that new orders, the leading indicator of the report, dropped below the 50 level for the first time in months. It was largely ignored by the market, but if that trend extends to January, stocks will notice.

This Week

Most of the reports this week are "second tier" economic indicators, so although there will be numerous reports, it's actually a relatively quiet week on the economics front, compared to last week.

Market	Level	Change	% Change
Dollar Index	80.585	-.169	-0.21%
EUR/USD	1.3667	.0061	0.45%
GBP/USD	1.648	.0001	0.01%
USD/JPY	104.12	-.70	-0.67%
USD/CAD	1.0887	-.0004	-0.04%
AUD/USD	.899	-.0003	-0.03%
USD/BRL	2.3595	.0013	0.06%
10 Year Yield	2.860	-.103	-3.48%
30 Year Yield	3.796	-.077	-1.99%
Prices taken at previous day market close.			

The two biggest reports will be the Empire State Manufacturing Survey (Wednesday) and Philly Fed Survey (Thursday), because they are the first two economic reports for January.

Also, a new round of housing data kicks off this week with the Housing Market Index (Thursday) and Housing Starts (Friday). Keep in mind that the recent housing data has implied the recovery is stabilizing, after slowing late last year in the face of higher interest rates. More evidence of that occurring will be welcomed by the market, as housing remains key to the economy.

Finally, December Industrial Production comes Friday and investors will be looking for further confirmation of strong manufacturing PMIs in December, further solidifying that manufacturing is seeing an uptick in activity.

Bottom line this week: None of the data releases will materially change the outlook for the economy. But, keep in mind the economy has seen several false starts over the past few years in the first quarter, and if the economic data for December and January starts to come in a bit weaker than expected, this will make the market a bit nervous that we may be seeing another "false start," and that's even more important in the context of Fed tapering. So, although none of the "big" economic reports are this week, it doesn't mean the data can be ignored, either.

Commodities

Commodities were mixed last week as we saw broad strength in the precious metals, while the decline in the energy sector accelerated. The broad-based commodity ETF DBC fell 1.31% on the week.

Gold continued to trade better last week, rallying to close near $1,250/oz. on a combination of increased inflation expectations and a weaker dollar, courtesy of the Friday jobs number. Inflation expectations, as measured by the TIPS (Treasury Inflation Protected Securities) spread, rose to a multi-month high. Additionally, although the ECB did its best to verbally "ease" policy, the dollar finished the week lower.

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Gold has traded with more resiliency for more than three weeks now, ever since it held $1,200/oz. on the tapering announcement in mid-December, and our call to buy gold at that level has so far proved out. And, I think longer term, we are starting to see the beginnings of the change in the outlook toward gold, where the focus turns to inflation. But, for now, in the mid-$1,200s, I'd prefer to stay an observer at these levels if you're not already long. A break of $1,270-ish would make me more bullish on a momentum basis.

While gold has been trading better, crude has been trading just plain terribly. WTI crude hit a multi-month low and is now close to breaking an uptrend that's been in place for over a year. And, the reason for the collapse remains relatively unknown. There wasn't any materially bearish news last week, and the EIA inventory data was more mixed than bearish, as there was a drop in oil inventories yet a big build in refined products (implying lower future demand for crude).

So, explanations for the drop have resorted to rumors of massive fund liquidations and lack of volumes combining to send WTI crude lower, and that could be the case. Oil got back above that uptrend thanks to a Friday rally, although whether that support can hold remains to be seen. If I had to trade energy I'd be a buyer today with a stop at last week's lows, but that's because I'm a bull on the economy, and if I'm right about that, then $90 oil is cheap. A break of the uptrend targets $87.50-ish.

Currencies & Bonds

Treasuries were volatile last week, as the stronger ADP jobs report led to yields on the 10-year briefly breaking back above 3%. But, that was followed by yields dropping sharply after the disappointing Friday jobs report, and the 10-year yield closed the week out just above 2.90%.

The bond market continues to be the most-reactive to changing economic data and Fed expectations, and that's a trend we can expect to continue now that we're seeing tapering of QE.

Going forward, the two most-important aspects of the bond market remain the fact that the rise in the 10-year yield remains orderly and that the yield curve continues to steepen, and particularly that the short end of the curve remains anchored. So, the iShares 1-3 Year Treasury Bond ETF (SHY) remains critical to the health of the bond market, because a spike higher in two-year yields or a drop in SHY would signal the market is losing faith in the Fed's "Forward Guidance." For now, though, the bond market is behaving well.

The Dollar Index was higher for the majority of last week due to a mostly to a weaker euro, although that reversed on Friday thanks to the jobs report, and the Dollar Index actually finished the week lower. Conversely, the euro was surprisingly buoyant despite the efforts by Mario Draghi to verbally ease policy at the ECB meeting last week. Both currencies remain largely stalemated in the current range as the market tries to gauge the pace of Fed tapering, and the willingness of the ECB to respond to the increasing threat of disinflation.

The yen rallied vs. the dollar last week after it failed to break above 105, and although nothing really "yen-bullish" happened, it feels like for now there's a period of consolidation upon us. Remember that additional easing by the Bank of Japan in Q1 is already priced into the yen at these levels, so there aren't a lot of near-term catalysts to further weaken the yen. That said, though, the longer-term trend remains firmly lower, and any rally in the yen toward the low-100s vs. the dollar should be shorted, as the ultimate target remains conservatively 110-115 yen to the dollar.

Finally, the commodity currencies (the Canadian dollar and Australian dollar) both sold off hard last week, thanks mostly to poor economic data (the trade balance for both countries showed lackluster growth in exports, and both economies rely heavily on exports for growth).

As I said last week, it looks like the "golden age" of the commodity currencies, where Canadian and Australian dollars were worth more than the U.S. dollar, has ended. And, for you currency traders, I'd be a seller of any decent rally in the Loonie or "Aussie" vs. the U.S. dollar, going forward.

Have a good week,

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 gone no where so far in 2014, but the market is cautious ahead of earnings rather than bearish.. Skeptical sentiment towards the rally 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.*

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 sold off last week on the soft jobs report, after an early week rally. The Dollar Index should remain largely range bound, as a stubbornly 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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