7:00's Report

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

January 15th, 2014

While the broad market is just off the highs, the retail sector has gotten hammered lately, and has been hurt by slowing consumer demand and margin compression.

Pre 7:00 Look

- Futures are modestly higher as are most international markets, as they rose thanks to the rally in the US yesterday.
- China was the one laggard, as that market was flat following data that showed Chinese bank loan growth missed expectations.
- Econ Today: Producer Price Index (E: 0.4%), Empire State Manufacturing Survey (E: 3.30), Beige Book (2:00 PM)
- Fed Speak: Evans (12:50 PM), Lockhart (5:20 PM)
- Earnings: BAC (E: $0.27), CSX (E: $0.42).

Market	Level	Change	% Change
S&P 500 Futures	1836.50	3.50	.19%
U.S. Dollar (DXY)	80.99	.234	.29%
Gold	1238.50	-6.90	-.55%
WTI	93.04	.46	.50%
10 Year	2.869	.042	1.49%

Equities

Market Recap

Stocks rebounded Tuesday as the S&P 500 recouped most of Monday's losses, helped by economic data and a benign start to earnings season. The S&P 500 closed up 1.08%.

Stocks opened higher thanks to a stronger-than-expected retail sales report, which helped alleviate some of the anxiety caused by Friday's jobs report, and on JPM/WFC earnings, which were in-line to better-than-expected and importantly showed strong loan growth figures—a good macro indicator for the economy.

Like Monday, though, the real reason that we saw stocks trade sharply higher was liquidity, or lack thereof. In what was the mirror image of trading Monday, stocks rallied not so much because of increased buying interest, but instead because of a total lack of offers. And, as the market grinded higher throughout the day, it fed on itself, causing buyers to chase, and stocks closed basically at their highs.

Trading Color

Tuesday there was broad strength in the market, as all 10 S&P sub-sectors rose, led by cyclicals and tech. Tech, and particularly the semi-conductors, were the big outperformers, as the semi-conductor index rose 2.3% and the Nasdaq was the best-performing major index. There was no single catalyst to account for the strength, and really the rally was more a reflection of optimism heading into earnings (INTC, which reports later this week, rose 4%). Other cyclicals like materials, energy and basic materials also outperformed and traded up almost 2%.

Market	Level	Change	% Change
Dow	16373.86	115.92	.71%
TSX	13692.38	10.90	.08%
Brazil	49703.10	276.20	.56%
FTSE	6790.31	23.45	.35%
Nikkei	15808.73	386.33	2.50%
Hang Seng	22902.00	110.72	.49%
ASX	5245.43	33.38	.64%
Prices taken at previous day market close.			

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Healthcare also outperformed for the second straight day, again led higher by biotech, as there was more positive sentiment/news emanating from the JPM Healthcare Conference.

As far as the laggards go, retail managed to close positive, but barely, as the sector remains under pressure. GameStop (GME) was the latest retail "blow-up" yesterday, as the stock traded down 20%.

Market	Level	Change	% Change
DBC	24.845	-.005	-0.02%
Gold	1242.00	-9.10	-0.73%
Silver	20.17	-.215	-1.05%
Copper	3.3325	-.014	-0.42%
WTI	92.47	.67	0.73%
Brent	106.25	-.50	-0.47%
Nat Gas	4.356	.082	1.92%
RBOB	2.615	-.0191	-0.73%
DBA (Grains)	24.32	.06	0.25%
Prices taken at previous day market close.			

Sticking with retail for a second, we've got to be close to some seller exhaustion in the space given the beating that's occurred over the past few weeks. And, while it doesn't mean that the sector is a "buy" today, from a contrarian point of view, in the context of rising retail sales data and consumer spending, at some point down here retail is worth a shot. Let's say my interest is piqued, but I've got to do a bit more investigation.

Finally, financials also relatively lagged the market yesterday ahead of a lot more earnings over the rest of the week, although the sector finished solidly positive. The JPM/WFC earnings were fine, and both stocks finished slightly higher. But, as mentioned, the loan growth for both companies was better-than-expected, and that's being taken as a positive macro sign, and was really the key takeaway from the reports.

Looking at the charts, the S&P 500 bounced and is now back above support at the 20-day MA (1,827), while resistance remains at the all-time high (1,849).

Bottom Line

Yesterday's rally was a nice response to the Monday sell-off, but it's simply not fair to discount the Monday drop because of low liquidity and participation and not do the same to the Tuesday rally.

Lack of volumes and participation remain the key influence on the markets on a day-to-day basis, and until we get some sort of clarity from earnings season (which will start to happen next week), I expect a range-bound, but likely volatile, market.

Interestingly, though, as I mentioned yesterday, the market does seem to be constructing a "Wall of Worry" around earnings. And, I read several places yesterday that most traders expect a "17" handle on the S&P before 1,850. So, sentiment is again cautious.

I'm by no means a perma-bull, and if earnings season isn't good, then we're in for some trouble. But, the relentless skepticism toward this rally remains an underappreciated tail wind. Until we see otherwise, the path of least resistance remains higher, and I wouldn't be de-risking ahead of earnings.

Not All Fed Commentary Will Move Markets

There were two Fed speakers yesterday (Charles Plosser and Richard Fisher), and both made "hawkish" comments. Plosser said Friday's jobs report won't de-rail tapering of QE, while Fisher said he wanted to taper QE by $20 billion in January, as opposed to $10 billion. Both comments made great headlines, but generated little market reaction, as Plosser and Fisher are two of the most "hawkish" Fed presidents out there, and their stance against QE is well-known.

With regard to "Fed speak," hawks will be hawks and doves will be doves, but it's the centrists like John Williams and the leadership like Janet Yellen and Vice Chair Stanley Fischer, whose comments will move markets. Both Plosser and Fisher do have votes on the FOMC this year, as we've covered, but that's just 2 of 11, so don't expect them to alter the course of Ms. Yellen's Fed anytime soon.

Economics

Retail Sales

- December Retail Sales rose 0.2% vs (E) 0.0%

Takeaway

Yesterday's retail sales report was stronger-than-expected and showed a month-to-month increase of 0.2%, beating analysts' expectations for a flat reading. More importantly than the headline number, the

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"control" group (retail sales ex-autos, building materials and gasoline) which we find to be the best way to get a true reading of the consumer, rose 0.7% month-over-month, the largest single-month increase since 2012. But, the report wasn't all good as November and October "core" retail sales were revised slightly lower (by 0.3% and 0.1% respectively).

Bottom line, though, is the stronger-than-expected retail sales data suggest that consumer spending remains healthy (the awful retail results are about more than the consumer) and the good number yesterday helped to offset some of the concern investors have been feeling because of the abysmal jobs number. Bottom line is the consumer ended 2013 on a relatively strong note.

Commodities

Commodities were mixed yesterday in mostly technical trading, with energy catching a bounce while precious metals fell slightly. The PowerShares DB Commodity Tracking Index ETF (DBC) was again unchanged at 24.845 despite a slightly stronger dollar (+0.14%).

Natural gas rallied for the third session in a row, moving higher by 2.2%. Nat gas futures gained for two main reasons. First, some early analyst estimates for tomorrow's EIA supply data release are calling for a record-breaking 300 Bcf draw in supplies as a result of the substantial spike in heating demand due to the "Polar Vortex" of week.

Second, the market remains focused on the extended weather forecast, which is calling for more below-average temperatures. The spot price in natural gas reclaimed the $4.20 level, which is again the first line of support while the December high of $4.532 is still resistance. We remain bullish natural gas based on several fundamental factors including the term structure while the technicals continue to support the trade.

Market	Level	Change	% Change
Dollar Index	80.745	.134	0.17%
EUR/USD	1.3675	.0004	0.03%
GBP/USD	1.6438	.0056	0.34%
USD/JPY	104.17	1.19	1.16%
USD/CAD	1.0948	.0087	0.80%
AUD/USD	.8958	-.0094	-1.04%
USD/BRL	2.3499	-.0096	-0.41%
10 Year Yield	2.869	.042	1.49%
30 Year Yield	3.800	.033	0.88%
Prices taken at previous day market close.			

After seeing solid gains on Friday and Monday, precious metals futures took a breather yesterday, with gold and silver falling .73% and 1.05%, respectively. Most of the declines occurred around 10:30 a.m. when we saw gold futures abruptly begin selling off, which continued through 11:15. Because there was a lack of breaking news, the drop was most likely a result of algos "fishing for stops" placed by new, weak speculative longs. And, apparently they "caught" a lot of them, as the price moved through Monday's lows before finding support in the low-$1,240s.

Bottom line is yesterday's move was nothing more than trading noise, and both major precious metals remain in a technical "no man's" land, above major support at $1200, but below a multi-month downtrend at $1270. The outlook for gold is improving, but I'd still prefer to buy dips towards $1200, rather than get long in the mid 1200's.

Oil futures caught an oversold bounce yesterday, with futures contracts for February delivery gaining .73% on the session. Like trading in the precious metals market, the move was largely just "noise." On a technical note, the spot price stopped in its tracks at $92.88, which was Monday's high (to the tick). This suggests that the market yesterday was controlled by algos and day traders who were simply fishing for stops. In fundamental news, we're starting to see the banks roll out their annual price expectations for oil, and yesterday Deutsch Bank lowered its price targets for WTI from $98.75 to $88.75 and Brent from $106.25 to $97.50, not exactly a small adjustment. But, its worth pointing out that banks price forecasts are notoriously in accurate, so don't take it as quite the negative it appears to be. If we all traded off bank's price forecasts for commodities, we'd be broke.

Currencies & Bonds

Like Monday, the real action in the commodity markets was in Asia, where we saw the yen and Aussie dollar plunge and give back the entire Monday rally, while the "Loonie" hit a new four-year low vs. the dollar.

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Starting with the yen, it dropped more than 1% vs. the dollar yesterday after the Ministry of Finance reported that Japan's current account deficit hit the highest level since 1985 (592.8 billion yen vs. (E) 368.9 billion yen). The bottom line is that Japan usually runs a current account surplus, meaning that each month there are more yen coming into Japan than there are yen leaving Japan, because exports are usually greater than imports.

Japan is one of the few large, developed economies to have a current account surplus, and that's one of the main reasons the yen is considered a "safe haven" currency. But, with the yen plunging, investment managers in Japan are starting to buy dollar-denominated investments to hedge against the falling yen. That's partially leading to a current account deficit, so more yen are leaving Japan each month than are coming in. So, with the current account deficit so unexpectedly large, that chips away at the yen's status as a "safe haven" currency, which is the reason the yen fell so sharply yesterday.

Bottom line with the yen is there are multiple reasons to be short yen, and the current account deficit is yet another. I don't know why this is, but experience has shown me that in strong trends like this one, unexpected news always seems to benefit trend, and that's exactly what happened yesterday. And, perhaps I'm giving the yen too much credit in expecting to see some sort of a bounce – but it's just years of experience that tells me we should see one. But, as I keep saying, the trend is clearly lower in the yen, and whether the rally is to 103 or 101, it's a rally that should be shorted.

Commodity currencies were also very weak yesterday, as the Aussie gave back the entire Monday rally, while the Loonie hit a new four-year low. Starting with the Aussie, it declined as investors got positioned ahead of a critical Labour Market Report out Wednesday night, while the Loonie sold off as speculation rose that the Bank of Canada will cut rates at their meeting next week. Both currencies remain under pressure, and I'd continue to short any decent rallies that come out of those data points. As I said last week, the "Golden Age" of the commodity currencies is over, and it's just a question of how far they fall vs. the dollar.

The Dollar Index bounced back a bit on Tuesday, rallying 0.15% thanks to the better-than-expected retail sales report and "hawkish" comments by Fed presidents Plosser and Fisher. In Europe, the euro was flat for the second straight day, as it largely ignored the better-than-expected November Industrial Production data (and that was a pretty good report, up 3.0% yoy vs. (E) 1.8%).

Looking beyond intraday trading, both the Dollar Index and the euro will likely be range-bound for some time, until there's more clarity on the path of both the Fed and the ECB. Generally, we know the Fed is moving forward with QE tapering, while the ECB remains uninterested in providing more monetary accommodation, despite the growing risk of dis-inflation. But, both courses of action are data-dependent, and right now the data is simply too inconclusive to have a high degree of confidence that either path won't change (so, that the Fed won't waver on tapering, and the ECB won't ease further). As a result, expect range-bound trading in the dollar and euro until the data become more conclusive.

Turning to the bond market, Treasuries predictably sold off in reaction to the retail sales report and the "hawkish" comments by the Fed governors (although the retail sales report was the real catalyst). Despite the declines, the 30 year remains above the downtrend line dating back to last May, implying we may be seeing the start of a counter trend rally in the bond market. It's not definitive yet as the ten year still hasn't broken above it's downtrend line, but it something to monitor, as there's a chance we may be seeing a temporary pause in the downtrend in bonds.

10 Year Treasury: Unlike the 30 year, the 10 year hasn't yet broken its downtrend. If/when it does, it'll confirm that we're entering a "Counter Trend Rally" in the bond market. Until then, though, I wouldn't reduce my bond shorts.

Have a good day—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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