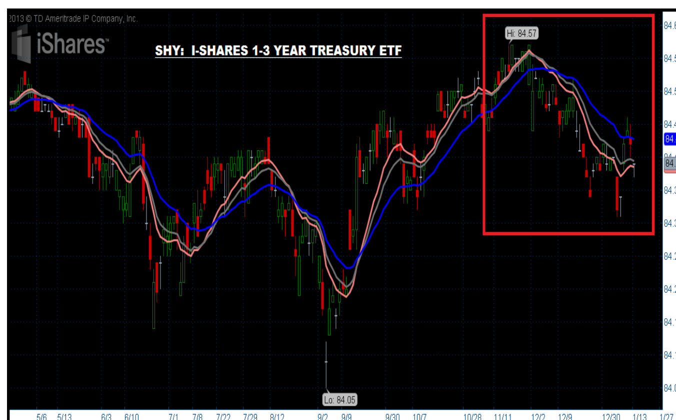
7:00's Report

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

January 16th, 2014



SHY: Short term Treasuries have sold off lately, and although it's not a major warning signal yet, SHY remains a key indicator of the "health" of the bond market.

Pre 7:00 Look

- Futures are slightly lower while international markets were mixed overnight.
- EU markets are little changed after a quiet night as most economic data released o/n was in line with expectations. One surprise was EU Dec. car sales which jumped 13% for the biggest gain in 4 years.
- Econ Today: CPI (E: 0.3%), Jobless Claims (E: 327K), Philly Fed Survey (E: 8.7), Housing Market Index (E: 57.5)
- Fed Speak: Williams (9:15 AM), Bernanke (11:10 AM)
- Earnings: GS (E: $4.14), C ($0.94), INTC (E: $0.52).

Market	Level	Change	% Change
S&P 500 Futures	1839.00	-2.50	-0.14%
U.S. Dollar (DXY)	81.15	.006	0.01%
Gold	1237.00	-1.30	-0.10%
WTI	94.65	.30	0.32%
10 Year	2.884	.015	0.52%

Equities

Market Recap

Stocks added to Tuesday's gains yesterday thanks to better-than-expected economic data as well as a well received earnings report from Bank of America (BAC). The S&P 500 rose 0.52%.

Stocks spent the entire session in the green, as markets initially rallied thanks to BAC earnings and the better than expected Empire Manufacturing Report. Like Tuesday, stocks slowly and methodically moved higher throughout the day, and caught a final boost into the close courtesy of an relatively upbeat Fed Beige Book (the commentary was more optimistic on the economy).

Lack of liquidity and offers continue to play a part in the magnitude of the move, although the market breaking to new highs did see some buyers "chasing" into the close, as markets went out near the highs.

Trading Color

The more "macro" sensitive indices either made new all-time highs (the S&P 500 and Russell 2000), or new multi-year highs (Nasdaq), as markets embraced good macro and micro data.

Sector wise, as to be expected, there was broad strength in most of the sectors of the S&P 500, and we saw the definitive outperformance of cyclical vs. defensive sectors, and that's really the first time all year we've seen that rotation re-emerge.

BAC was the big piece of "micro" news on the day, and while WFC and JPM earnings were "fine" on Tuesday, BAC's were generally perceived as "good." That helped

Market	Level	Change	% Change
Dow	16,481.94	108.08	0.66%
TSX	13,772.58	80.20	0.59%
Brazil	50,105.37	402.27	0.81%
FTSE	6,823.87	4.01	0.06%
Nikkei	15,747.20	-61.53	-0.39%
Hang Seng	22,986.41	84.41	0.37%
ASX	5,309.07	63.64	1.21%

Prices taken at previous day market close.

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led a big rally in the banks, as the BKX rose 1.7%, making it the best performing sector on the day.

Other than banks, tech was once again a standout (it seems there is "real" money moving into tech, ahead of earnings, especially in the semis and enterprise linked names). Specifically, LLTC earnings Tuesday after the close and the positive WSJ interview with AAPL CEO Tim Cook about China Mobile helped rally the space.

Market	Level	Change	% Change
DBC	24.95	.10	0.40%
Gold	1238.60	-6.80	-0.55%
Silver	20.12	-.162	-0.80%
Copper	3.355	.019	0.57%
WTI	94.35	1.76	1.90%
Brent	107.13	.74	0.70%
Nat Gas	4.346	-.023	-0.53%
RBOB	2.6258	.0034	0.13%
DBA (Grains)	24.24	-.09	-0.37%

Prices taken at previous day market close.

Conversely, utilities, healthcare and consumer staples lagged, while energy also fell despite higher oil prices. Energy weighed down by the refiners, which are selling off as the Brent/WTI spread (which can be thought of as a loose proxy for refiner margins) has contracted significantly over the past few days, and now sits at a multi-week low in the $12 dollar range.

On the charts the S&P 500 moved to a new high, and as I repeatedly say (because it works), the first rule of technical trading is you buy what's making new highs, and sell what's making new lows. The market made new highs, and although there is some resistance at 1850, the trend remains decidedly upward.

Bottom Line

Stocks have been volatile this week but beneath the surface the market dynamic has remained largely the same, and the gyrations by the averages remain more about a lack of liquidity and conviction ahead of earnings than anything else. At the moment, the macro economic horizon remains clear, valuations are stretched but if we see a good earnings season people will up estimates, Washington appears to be behaving, and sentiment remains skeptical and far from euphoric, making the short term "pain trade" higher. And, last Friday's jobs number aside, the economic data continues to imply the economy is accelerating.

The biggest risk to equities, other than a bad earnings season, remains that the markets lose confidence in the Fed's "Forward Guidance" and interest rates begin an unruly rise. And, that remains a real risk to watch (SHY is choppy but it looks like it's starting to trend down a bit, and that remains the key indicator as to whether or not the bond market is "behaving"). For now, though, the bond market is "behaving" and the path of least resistance for stocks remains higher as we move into the heart of earnings season.

Economics

Empire State Manufacturing Survey

- General Business Conditions Index surged to 12.51 vs. (E) 3.30
- New Orders for January jumped to 10.98 from -1.69 in December

Takeaway

The Empire State manufacturing index surprisingly surged in January, breaking a trend of sluggish readings and rising to a level last seen in 2012. This was a good number all the way around, as both the headline and details were stronger-than-expected.

The general business conditions index jumped to 12.51, far better than analysts' expectations of 3.30, while the December number was revised higher from an initial reading of 0.98 to 2.22. New orders, the leading indicator in the report, was also much-stronger, up 10.98 from -1.69 in December. The employment index also rose, leaping to 12.20 from a zero reading in December.

Markets reacted "hawkishly," with bonds and gold falling while the dollar and equity-market futures rose. Bonds moved the most off the number, as they continue to be the asset class most sensitive to shifting Fed "tapering" outlooks. (The retail sales data and Empire State survey, combined with Fed speak this week, have served to re-solidify expectations of another $10 billion taper in January.)

I've said in the past that the importance of both Empire State and Philly Fed has been somewhat diminished because of the new national "Flash" PMIs (they will come

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out next week). So, from a true economic-data standpoint, this report—despite the fact that it was surprisingly strong—really isn't that important. What is important, though, is that it joins Tuesday's retail sales report in helping to alleviate the anxiety caused by the weak jobs report. That jobs report shook the market's confidence in the economic recovery, and both retail sales and Empire State are helping to give the market a much-needed confidence boost. That, more than anything, is why Empire State was such a positive yesterday.

Commodities

Commodities were mixed yesterday as the better-than-expected Empire State manufacturing survey boosted the industrial commodities while the stronger dollar, up 0.51%, weighed on precious metals. The benchmark commodity tracking ETF, DBC, gained 0.4%

The energy sector broadly outperformed yesterday, led higher by a substantial rally in WTI crude oil futures, which rose 1.90%. WTI was higher early yesterday on short covering ahead of the inventory report, and expended the rally after the release of the Empire State manufacturing index.

The short squeeze intensified though when the EIA reported in its weekly inventory report, a draw of 7.7 million barrels last week vs. estimates of an 800K barrel draw. Futures peaked midday and drifted away from the highs as the session approached the close, a common thing to see happen as speculative day traders take profits towards the end of the trading day.

Finally, on the fundamental side of things, the parade of bank oil predictions rolled on yesterday. UBS was the latest, and they were decidedly more bullish than Duetsch Bank, with 2014 targets of $98.50 for WTI and $105 for Brent. As I said yesterday, trading off investment bank commodity price estimates is a really good way to go broke, but I do think that the fact that there is no "consensus" from the banks as to where oil prices will go this year (some are bullish, some are bearish), as a good reflection of the fact that we are at a "tipping" point in the oil markets. Bottom line is if the economy is going to return to 3% - 4% growth, WTI Crude is cheap. If it doesn't, with global supply rising, it's expensive. And, the move is going to big, one way or the other. I for one believe the former, but I want some more confirmation before getting blanket long oil and energy (excepting natural gas, of which I'm a well known bull).

Market	Level	Change	% Change
Dollar Index	81.145	.389	0.48%
EUR/USD	1.3602	-.0077	-0.56%
GBP/USD	1.6374	-.0064	-0.39%
USD/JPY	104.60	.40	0.38%
USD/CAD	1.0948	.0006	0.05%
AUD/USD	.8906	-.006	-0.67%
USD/BRL	2.3603	.0102	0.43%
10 Year Yield	2.884	.015	0.52%
30 Year Yield	3.806	.006	0.16%
Prices taken at previous day market close.			

Short term, though, we're in a no man's land. Oil is back above that multi-year uptrend line (which is encouraging), but all major short-term trends have been broken; and oil looks bracketed by the 50-day moving average ($95.46), while support lies down at the $93.00 area.

Precious metals were the worst performers yesterday as gold and silver traded down 0.55% and 0.80%, respectively. But, despite selling off, gold continues to trade "better." Upon release of the Empire State manufacturing data, the dollar began to rally, which it continued to do for the remainder of the day. And, although gold initially sold off in response to the dollar strength, it recovered soon after and closed essentially where it began the day. Point being, gold largely ignored the fact that the Dollar Index grinded higher the entire day.

The reason I point this out is because it is becoming apparent, through the price action in gold and its reaction to movement in the Dollar Index, that the market is beginning to realize that improving economic data is not only bullish for the dollar, but it will also eventually be bullish for inflation, which is bullish for gold. Short term gold remains in this "no man's land' in the mid-$1200's, and I'd continue to be a buyer on dips towards $1200, or on a momentum breakout above $1270.

Natural gas futures continued rallying yesterday morning, but found a top midday when weak longs started to head for the exits ahead of the EIA natural gas report due out later this morning (E: -297 bcf). Nat gas futures closed down 0.53% for the day.

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For some time now, natural gas has moved higher due to weather-driven demand expectations; however, because of this very cold winter, we are potentially seeing the market dynamics begin to shift. Point being, for the last several years, the only reason to be a "bull" on natural gas was because you believe in surging demand. You admitted supply was surging at the same time, which it is, but, you were a bull because you thought demand would surge more.

Well, thanks to the "Polar Vortex" and a cold winter (so far), the "given" of huge supply is starting to come into question. Analysts are expecting a near 300 BCF draw on natural gas supplies this year, which be a record and put inventories well below the 5 year average. Only Al Roker knows what the rest of winter weather will bring, but keep an eye on the 1200 BCF inventory level. If the winter stays cold, we could exit the winter heating season at or below that inventory level, and if we do, then not only is demand bullish for natural gas, but then so too would supply, as it would be at multi year lows.

I remain a medium and longer term bull on natural gas, and although the two natural gas equity ETFs (XOP and FCG) are trading more with oil prices in the short term, I believe they are two stores of "value" in the market, if my bullish call on natural gas is right.

Currencies & Bonds

The Dollar reigned supreme Wednesday, thanks mainly to the stronger than expected Empire Manufacturing Survey (as mentioned, it wasn't that Empire manufacturing is that important a number, but it's just helping to alleviate anxiety over the jobs report). The Dollar was stronger versus every other major currency Wednesday, although the moves weren't all that big (the Aussie Dollar was the biggest loser vs. the green back yesterday, dropping .4% ahead of the Labor market report).

News in most regions was quiet (again dollar strength was the main story), although there is an interesting development occurring in the euro. Since the ECB meeting last Thursday, the euro has been rising an uptrend that data back to the July '13 lows, and is has bounced off that trendline 4 times, including yesterday. I've said repeatedly that I don't think we'll see an extended period of euro weakness, because the ECB won't actually ease policy again in 2014 (they will continue to try and "verbally ease"), despite the growing threat of disinflation. So, if I were a currency trader, I'd be looking to buy euro on at these levels and expect a rally towards the 1.38 level. If that trend line is violated for a few trading days (in this age of algos, I don't trust one day moves in any market), I'll obviously have to re-think my position. But, for now the trend remains higher, and there's probably some money in a long FXE trade at these levels.

I pointed out in yesterday's Report that while the 30 year broke its downtrend trend line, implying we are seeing a short term pause in the downtrend in bonds. But, oddly, the 10 year Treasury hasn't broken it's downtrend, and I think that tells me two things:

First, the long end of the curve was more heavily shorted, and when Friday's jobs report came out, more shorts rushed to cover in the "long" end of the curve than they did in the "belly" of the curve. Second, I'll be a lot more confident that we are indeed seeing the start of a "counter trend rally" in bonds if the 10 year breaks through its downtrend line also. And, until we get that confirmation from the 10 year, I'd actually hold on to current levels of "bond shorts" in my portfolio, and would look to reduce them if/when the 10 year Treasury breaks through the downtrend line, confirming the move in the 30 year.

While the long end of the curve is more volatile and the place to profit most from a short standpoint, it seems the 10 year is now the focus of the bond market, and is perhaps a better gauge of the short term trend in bonds. Until the ten year breaks that downtrend, I'd say we're not in that counter trend rally just yet.

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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