7:00's Report

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

January 2nd, 2014

Pre 7:00 Look

- Futures and most global markets are starting 2014 off slightly lower after a relatively slow night of news. Europe is the laggard this morning as the global manufacturing PMIs were released, and the results were mixed.
- China slightly missed (51.0 vs. (E) 51.2) but the rest of Asia was strong and the PMI aren't really changing the outlook over there.
- Europe Manufacturing PMIS were largely in line, but the discrepancies between countries are causing a bit of concern. Germany was strong while France was v. weak, and the UK PMI declined.
- Econ Today: Weekly Jobless Claims (E: 338.5K), ISM Manufacturing PMI (E: 57.0).

Market	Level	Change	% Change
S&P 500 Futures	1840.50	-.50	-0.03%
U.S. Dollar (DXY)	80.650	.461	0.58%
Gold	1217.9	15.40	1.26%
WTI	98.19	-.23	-0.23%
10 Year	3.026	.050	1.68%

Equities

Market Recap

The stock market moved higher in very quiet trading Tuesday thanks to year end positioning and the better-than-expected Consumer Confidence report. Major U.S. stock indexes closed out just ticks off the highs of the year. The S&P 500 gained 0.4%, closing at yet another all-time high of 1,848.36.

Stocks spent the entire Tuesday session higher, as markets opened in the green and then rallied further after the Consumer Confidence data was released. Outside of the economic reports Tuesday morning, there wasn't any real market moving news, and even the economic reports really didn't effect trading all that much (again year end positioning really was the major "force" behind the rally Tuesday). Stocks closed quietly, as to be expected given the holiday, and just off the highs.

Trading Color

Volumes and participation were predictably very low Tuesday, and trading was dominated by day traders and algos. Thankfully, that dynamic, which has been in place basically since the December FOMC meeting, should end starting next Monday.

There was definitive cyclical outperformance Tuesday as the top-performing sectors were the railroads, semiconductors and homebuilders.

Homebuilders continued to trade well off the Case-Shiller Home Price Index, which showed prices have risen 13.6% year over year. Home builders remain the "canary in the coal mine" for when the absolute level of interest rates becomes a headwind on the market. And, given homebuilders were the best performing S&P 500 sub-sector in December, its safe to assume the higher rates aren't an equity market headwind, yet.

Transportation stocks were led higher by the airlines, as the dip in crude oil prices, which fell back below the $100/barrel level, supported the sector. Staying in the transports, it was interesting that the rails didn't really get hit despite the oil train accident in North Dakota, implying the market remains very confident in the continuation of the growth in WTI Crude oil being shipped by rail.

Once again "safety" and "bond proxy" stocks broadly underperformed, led lower by telecom, but utilities, REITs consumer staples also relatively lagged. Again

Market	Level	Change	% Change
Dow	16,576.66	72.37	0.44%
TSX	13,639.47	58.05	0.43%
Brazil	51,507.16	240.60	0.47%
FTSE	6724.86	24.14	0.36%
Nikkei	16291.31	112.37	0.69%
Hang Seng	23340.05	33.66	0.14%
ASX	5367.91	15.70	0.29%

Prices taken at previous day market close.

there was no real catalyst for the underperformance—just year end selling and re-allocations.

Market	Level	Change	% Change
DBC	25.64	-.06	-0.23%
Gold	1199.20	-4.60	-0.38%
Silver	19.385	-.23	-1.17%
Copper	3.394	.0115	0.34%
WTI	98.54	-.75	-0.76%
Brent	110.95	-.26	-0.23%
Nat Gas	4.253	-.174	-3.93%
RBOB	2.7858	-.0019	-0.07%
DBA (Grains)	24.26	-.11	-0.45%
Prices taken at previous day market close.			

On the charts the S&P 500 traded to a new high, and clearly remains in an uptrend. Initial support lies lower at the 20 day moving average.

A Look Back at 2013

Tuesday was a very slow trading day, and although we do get some important economic data, the rest of this week should be pretty quiet as well (Monday is when things will thankfully pick back up again).

Gold has been capped by a strong downtrend since late October, but appears to be trying to break out this morning.

But, that said, with 2013 in the books I wanted to just take a minute and review major market performance, so we can have that as context as we begin anew in 2014.

- Dow Jones Industrial Average: +26.5%
- S&P 500: +29.6%
- Nasdaq: +38.32%
- Russell 2000: +37%

Note: The DJIA, S&P 500, and Russell 2K collectively sit on all-time nominal highs. However, only the DJIA achieved an all-time real high. Meanwhile the Nasdaq failed to revisit all-time nominal highs.

- **10-year Treasuries began 2013 with a yield of 1.75% and closed the year at 3.02%.**
- **The 2- to 10-year Treasury spread widened more than a full percent from 1.51% to 2.65%.**
- Europe rallied 17.95% but clearly underperformed the U.S.
- The Japanese Nikkei finished the year as the world's best-performing index, + 56.7%.
- Brazil was the worst performer, with the Bovespa Index falling -15.5%.

Economics

There were a few economic reports released Tuesday but none of them really moved markets all that much and don't change the general market narrative. Bottom line is we only try and have you read things we think can actually move markets or provide an edge—none of the reports Tuesday will help do that, so we don't want to waste you time with a recap.

Commodities

Commodities were mostly lower on Tuesday, led down by natural gas. The benchmark commodity tracking ETF, DBC, lost 0.16%. Volumes were light on New Year's Eve and like equities the markets were driven by techincal traders and algos.

Price movement in gold was a perfect example of the technically dominated marketplace on Tuesday. Gold futures opened at just below $1,200/oz. and then sharply sold off, approaching the critical lows of the year at $1,179.40. Gold then abruptly turned around and rallied to $1,214/oz, filling two "gaps" in the chart on the way up. (Note this was a daily range of over $30, well above the recent average daily range.) After the dust settled, futures prices were essentially unchanged.

Speaking of technicals, the spot price of gold is coming to a crossroads on the daily chart. $1,200/oz has recently offered moderate support and the low of the year, $1179.40, is the critical level gold needs to hold in order for the downtrend to officially end. But, the trend line that dates back to late October is closing in on the spot price (see graph). Bottom line here is that one of those two technical levels has to give. We will either see the low of the year violated and the price breaking down to new lows, or gold closing above the dominant trend line.

It's a graphical representation of what anyone watching gold knows—that the market is at a tipping point, and we are either headed materially lower, or $1200ish is the bottom. Given the risk/reward on the trade ($20 of risk for 100+ of return), I continue to think buying on dips toward or below $1200 in gold makes sense, with a stop at 1179 (the old lows of last year).

The energy sector was largely unchanged Tuesday with the exception of natural gas futures. Natural gas sold off 3.93% as futures continue to consolidate and traders take profits following the 30% rally that started in early November. Weather remains the dominant factor in the short term, and although it is going to be very, very cold today and tomorrow in the northern parts of the country, the weather will warm up a bit next week.

Taken in the context of the huge run we've seen in natural gas lately, it was an excuse for weak handed longs to book profits. I would continue to advocate buying dips and building positions in XOP and FCG for medium term accounts, especially if their natural gas correction extends further, as the term structure remains bullish.

Finally, copper outperformed Tuesday, adding 0.34% on the session. Although the move was not a substantial jump, copper has been quietly been rallying now for several weeks, breaking through some key resistance levels and now trading well-above the 200-day moving average. That's interesting in the context of the Chinese market basically treading water, and if copper can continue to move higher, that might imply we're about to see the Chinese markets play catch up after last years underperformance. More broadly, copper has been trading "better" lately and that further supports my thesis on the global reflation trade..

Currencies & Bonds

Currency trading was quiet Tuesday as many foreign markets were closed. The dollar caught a modest bid, rising .25%, on positioning and a better-than-expected consumer confidence report.

Market	Level	Change	% Change
Dollar Index	80.325	.203	0.25%
EUR/USD	1.3749	-.0054	-0.39%
GBP/USD	1.6566	.0066	0.40%
USD/JPY	105.25	0.10	0.10%
USD/CAD	1.0625	-.002	-0.19%
AUD/USD	.8927	.0024	0.27%
USD/BRL	2.3618	-.0001	-0.01%
10 Year Yield	3.026	.050	1.68%
30 Year Yield	3.964	.057	1.46%
Prices taken at previous day market close.			

The euro was down 0.39%, giving back most of Monday's gains again mostly on year end positioning. This suggests the ECB will keep interest rates low as the Fed continues to steadily taper QE.

There was little movement in the yen as the Japanese equity markets will remain closed for the rest of the week. There was no political news or economic data released, so the sideways trading was generally expected.

In Canada, the Loonie rallied for the second day in a row as hedge funds and spec traders took profits from short positions. The Loonie is going to finish the year down more than 7% against the dollar, so it should come as no surprise that there were some pretty happy portfolio managers cashing out of their shorts.

More generally, as we start the new year, the trends of yen weakness and euro strength remain the two most important trends in the currency space.

Treasuries were lower Tuesday, as the 10 and 30 year declined close to .5% each. The bond market closed early Tuesday and trading was very, very quiet with no real catalysts. But, the ten year yield did manage to close above the 3% mark, and the key in the bond market remains how quickly the rise in yields will accelerate. So far, it's been slow enough that it hasn't been a worry for equities—but I'd be shocked if we get through 2014 without at least one scare from an acceleration higher in yields.

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 traded to new highs last week amidst thin, holiday trading. Sentiment towards the market 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.* *Stocks are at all time highs, while first support site at 1828 in the S&P 500.*

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.**

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).**

U.S. Dollar	**Neutral**	**Neutral**	**Neutral**	*The Dollar Index declined small last week, but mostly thanks to a strong euro. The Dollar Index should remain largely range bound, as a 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.**

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*

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.**