7:00's Report

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

January 21st, 2014

Pre 7:00 Look

- Futures are slightly higher, as are most international markets, as Chinese short term lending rates have declined after spiking higher on Monday.
- The German ZEW Business Expectations Index was the only economic release o/n and it slightly missed estimates, which is weighing slightly on European shares.
- Econ Today: No Reports today.
- Earnings: BHI (E: $0.61), DAL (E: $0.63), HAL (E: $0.89), JNJ (E: $1.20), COL (E: $0.95), VZ (E: $0.65), TXN (E: $0.47).

Market	Level	Change	% Change
S&P 500 Futures	1839.25	5.00	0.27%
U.S. Dollar (DXY)	81.425	.063	0.08%
Gold	1248.00	-3.90	-0.31%
WTI	94.90	.32	0.34%
10 Year	2.827	-.016	-0.56%

Equities

Market Recap

While the US was closed yesterday, Asian markets traded modestly lower and Europe was flat as some news on China weighed on sentiment. First, the latest round of Chinese economic numbers hit Sunday night, and they were largely in-line with estimates. Q4 GDP (7.7% yoy growth vs. (E) 7.7%), December Industrial Production (9.7% vs. (E) 9.8%), and Retail Sales (13.6% vs (E) 13.6%), didn't provide any surprises.

But, what weighed on stocks yesterday was another uptick in short term lending rates in China. SHIBOR and shot term re-purchase rates rose sharply again and the Chinese central bank has stepped in to provide emergency liquidity, just like they did at the end of December. Part of this uptick in short term lending is again due to seasonal factors (the Chinese New Year is coming up and like the western New Year banks hoard cash to make year end liquidity ratios). But the actions by the central bank and tightening of liquidity is reminding everyone of the risk associated with the "shadow" banking system in China. Things are far from "crisis" levels and the PBOC injected more liquidity this morning and short term rates are falling, but this remains something to watch.

Last Week

Stocks closed flat last week as good economic data helped investors shrug off the weak December jobs report, while the market's focus turned decidedly to earnings as the week moved on. The S&P 500 is down .52% year to date.

It's very early in earnings season but generally speaking we have so far seen good bank earnings, and disappointment everywhere else (which is a bit disconcerting). Bank earnings were good (both in the large banks like WFC and BAC, as well as the regionals (STI, PNC, RF). But outside of the banks, the results were somewhat disappointing across several different sectors. INTC, GE, UNH and CSX were some of the big names that missed results and all traded down modestly, while retail continued to simply implode (GME, BBY and LULU were the latest retailers to "blow up," trading down between 10% and 30%).

On the charts last Monday's sell off caught people by surprise and saw the market trade temporarily through support at the 20 day moving average (1820ish), alt-

Market	Level	Change	% Change
Dow	16,458.56	41.55	0.25%
TSX	13,990.29	102.08	0.74%
Brazil	48,708.41	-473.45	-0.96%
FTSE	6,841.30	4.57	0.07%
Nikkei	15,795.96	154.28	0.99%
Hang Seng	23,033.12	104.17	0.45%
ASX	5,331.46	36.42	0.69%
Prices taken at previous day market close.			

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hough stocks recovered and briefly traded positive late in the week. That 20 day MA is again support, while the 1850 level is looking like some pretty decent resistance.

This Week

Focus this week will be on the one important piece of economic data on Thursday (January global Flash PMIs) but really this week is going to be all about earnings, as we enter the heart of reporting season.

From a "who's reporting" standpoint, bank earnings are largely over (at least the "systemically important" ones), and this week will be dominated by results from the tech sector, as well as health care, industrials and materials. Some widely held names that will report this week are: IBM, MSFT, JNJ, UTX and HON.

Bottom Line

Focus will continue to shift from the "macro" to the "micro," this week, as earnings are the most important near term catalyst for stocks (for now the market seems comfortable with global central bank policies). And, while macro risks remain (China, EU Deflation), overall the macro horizon remains as clear as its been in years, supporting risk assets.

Despite that, the market has largely gone no where in 2014, frustrating those who thought we'd see a continuation of the year end rally. But, the benefit of the doubt remains with the bulls as we enter the heart of earnings season, given the fact that central banks remain very accommodative, the macro horizon is clear, valuations are stretched but not expensive, and sentiment remains cautious/skeptical of stocks.

I would maintain equity market allocations into earnings, with a focus on cyclicals, and specifically the banks. And while the two biggest trends in the market (long Japanese stocks, short US bonds) have taken a breather, both DXJ and TBT/TBF will move higher over time as the fundamentals behind those trends remain very much in place and I would use this pause in both to add to positions.

Market	Level	Change	% Change
DBC	24.96	.08	0.32%
Gold	1252.00	11.80	0.95%
Silver	20.305	.251	1.25%
Copper	3.344	.0015	0.04%
WTI	94.18	.22	0.23%
Brent	106.43	.68	0.64%
Nat Gas	4.324	-.058	-1.32%
RBOB	2.6208	.0257	0.99%
DBA (Grains)	24.15	-.19	-0.78%
Prices taken at previous day market close.			

Economics

Last Week

Economic data last week was almost universally better than expected. This gave the market a needed "confidence boost" about the current state and trajectory of the economy following the disappointing December jobs report.

First, with regard to the current state of the economy, the first two January economic data points, Empire State manufacturing and Philly Fed, both beat expectations. Importantly, given the context of the jobs report, the employment indices in both reports saw strong gains from December to January (Philly jumped 5.6 points to 10.0 while Empire jumped from zero to 12).

Turning to the trajectory of the economy, several pieces of December data helped remind the market that we are seeing economic growth accelerate.

First, there was good news on the consumer front, which came amidst seemingly daily "blow ups" of retail stocks. December retail sales beat estimates, rising 0.2%. But more importantly, "control" retail sales—which exclude automobiles, gasoline and building materials, and serve as a better gauge of consumers' willingness to spend discretionary income—jumped 0.7%. This reading helped solidify the belief that Q4 GDP will be stronger than originally thought, and the terrible retail stock results are not due mainly to a sluggish consumer.

There was also some positive reinforcement in the housing market, after the December Housing Market Index and December Housing Starts largely met pretty high expectations, echoing recent data that implies that the housing market recovery is stabilizing after seeing it slow in the face of higher rates earlier in 2013. The key in housing now isn't so much that the market is accelerating, but instead that it's maintaining, and that's what the data said last week.

Bottom line is the December jobs report "spooked" markets, despite the fact that it was initially disregarded as a

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statistical anomaly. The 120-point drop in stocks last Monday proved that.

But, serendipitously, the data last week gave the market renewed confidence in the economy, and reinforced the belief that the December jobs report was just an anomaly that will be revised higher.

And, from an expectations standpoint, the market is still pricing in: 1) Another $10 billion taper of QE at the January meeting next week; 2) That QE ends completely in November; and 3) A minimum of 3% GDP growth in 2014, with risks to the upside.

This Week

The January global flash manufacturing PMIs, which are released Wednesday night (China) and Thursday morning (Europe and the U.S.) are the big (and pretty much only) numbers to watch this week. These PMIs remain very important because a continuation of the global economic recovery is a key pillar to a continued rally in risk assets, and the global PMIs give us the best "look" at the state of the global economy. China will be especially in focus, as concerns remain about whether economic growth is stable in that country (there are lingering concerns we will see economic growth slow further).

Domestically, we get more housing data (Existing Home Sales) on Thursday, and between that report and weekly jobless claims, that's pretty much it for domestic economic data, as it's a quiet week.

Finally, there are two central bank events worth watching. First, the Bank of Canada will have an interest rate meeting, and given the recent slowdown in their economic data, there is speculation that the BOC will cut interest rates. The market has already priced a cut in, to a point, as the "Loonie" is basically at a four-year low versus the dollar. The reason I point this out is because it could set up a "buy the news" bounce. Unless the BOC cuts rates and is very "dovish" in their commentary, we might see an oversold bounce in the "Loonie." If we do get that bounce, it may be a decent entry point for a short position via futures or the CurrencyShares Canadian Dollar Trust (FXC), as regardless the trend in CAD will remain lower.

Market	Level	Change	% Change
Dollar Index	81.365	.344	0.42%
EUR/USD	1.353	-.0089	-0.65%
GBP/USD	1.6414	.0061	0.37%
USD/JPY	104.26	-.08	-0.08%
USD/CAD	1.0972	.0043	0.39%
AUD/USD	.877	-.0049	-0.56%
USD/BRL	2.3423	-.021	-0.89%
10 Year Yield	2.827	-.016	-0.56%
30 Year Yield	3.757	-.016	-0.42%
Prices taken at previous day market close.			

The other central bank event to watch this week is the release of the Bank of England minutes from the December meeting. As I've detailed in this Report, the Bank of England may be a key leading indicator for how well "Forward Guidance" works as a policy tool for the Fed.

That's because the BOE's guidance, that it won't raise interest rates until well into the future, is being undermined by strong economic data out of the UK. And, it'll be very interesting to see how the BOE addresses this erosion of confidence in its "Forward Guidance," and very well could provide a blueprint for what will happen to the Fed, should our markets begin to lose confidence in their "Forward Guidance" and anticipate a sooner-than-expected increase in interest rates as the economy improves.

The market losing faith in the Fed's "Forward Guidance" because economic data is substantially improving remains the greatest peripheral risk to stocks and other risk assets. That's because, if that happens, we'll see interest rates embark on an unruly rise. The BOE is ahead of us on this path, though, so it's important to watch what they say, and more importantly, how the market reacts.

Commodities

There was broad strength in the commodity space last week despite the dollar moving higher by 0.77% in the same time frame. The rally in the commodities was largely a result of several economic reports being released that beat analysts' expectations and suggest the economy continues to grow at a moderate pace, thus easing some investors' concerns about growth slowing down a bit. The PowerShares DB Commodity Tracking Index ETF (DBC) gained 0.2% last week.

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The best-performing commodity last week was natural gas, as it added 4.3% to close at $4.299/MMBtu. Speculators bid the price up in anticipation of an expected record-breaking draw to natural gas supply levels to be reported Thursday morning. The EIA indeed reported a record-breaking draw in supplies of -287 Bcf, but that was less than the consensus analyst expectations calling for -297 Bcf. This resulted in a disappointment-fueled sell-off after the data was released.

On the charts, natural gas futures are in a broad technical range between $4.00 and the 52-week highs of $4.532. Until we get a larger-than-expected weekly draw to supply levels or some sort of bullish surprise in the news, we will likely remain there. However, over the medium term, both the technicals and fundaments in the natural gas market are pointing to higher prices.

Crude oil was one of the better-performing commodities last week, as it was able to bounce back from the nearly $10/Barrel sell-off it logged to start the year. WTI futures rallied 1.57% mostly due to shorts taking profits combined with speculative longs testing the market as WTI seems to have established a short-term bottom.

It is worth noting that several banks released their revised 2014 outlooks on oil prices last week, which traders normally only glance at to make sure there are no surprises from any of the major banks' analysts. Generally, the banks release estimates that are somewhat in-line with one another. However, last week there were several conflicting outlooks, some above and some below the current front-month spot price. All this really tells us is very few people are confident in their opinion as to which direction the price of oil is going to go.

In addition to the analysts' fundamental disagreement on the market's direction, the chart is a technical nightmare with all sorts of trendlines and moving averages being broken as if they weren't even there. Basically, until we get some more clarity on the fundamental supply and demand metrics within the crude market, and the charts clear up a bit, we are range-bound between $91.50 and $95.00/barrel.

Gold futures continued their recent trend of trading "better" last week, rallying 0.46% despite the stronger dollar (+0.77%). But, as we have been mentioning in the Report the past few weeks, gold has been trading in "no man's land" between two greater trendlines. As a general rule, the older the trendline, the stronger the supporting or resisting force it has.

Gold broke out through a downtrend dating back to late October on Jan. 2, but is now up against another trendline dating back to late August (therefore, we can expect it to be stronger). If gold prices are able to close above the trendline, which is sitting around the $1,255 area for 2-3 days in a row, then I would recommend adding to existing longs or opening new ones. If, however, the trend holds and prices head lower, I would look to the $1,220 area for support.

Currencies & Bonds

The Dollar Index grinded higher last week to hit a two month high thanks to the strong economic data, while the euro dropped to a two month low, as it was further pressured by the "dovish" commentary at the ECB meeting two weeks ago. The euro this week appears to have broken an uptrend dating back to July of last year, and if it doesn't trade back above it (say 1.3575ish) in the next few days, we may be seeing the start of a downtrend in the euro, despite the growing threat of deflation in the region. The yen was volatile last week but ended the week very slightly lower, thanks in part to the large Japanese trade deficit announced last week. A BOJ meeting started today, although nothing new is expected. The yen remains in a downtrend but seems capped, for now, at the 105 yen/dollar level.

Turning to bonds, last week was pretty quiet. The 30 year rallied while the "short end" of the curve sold off, causing the yield curve to flatten (that's not what we want to be happening). So, while the bond market is still largely "behaving," we are seeing some weakness in the short end of the curve, which bears watching (remember, the biggest risk to stocks is that the market loses faith in the Fed's "Forward Guidance" and that causes an unruly rise in rates). For now, though, the bond market appears to be consolidating the recent declines, and as long as SHY doesn't start to drop materially, then rising interest rates won't de-rail the rally.

Have a good short 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	*After a sluggish start to 2014, stocks once again moved to new all time highs last week. 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.* *Resistance appears to be forming at 1850, while support lies at the 20 day MA (1834).*

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 traded to a new 2 month high last week, while the euro looks to be breaking a 6 month long uptrend. Given the threat of dis-inflation in the EU, though, I remain skeptical we'll see material euro weakness in the near future.*

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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