7:00's Report

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

January 23rd, 2014

Pre 7:00 Look

- Futures are slightly weaker this morning as disappointing Chinese economic data offsets good data from Europe.
- Chinese flash manufacturing PMIs for January dropped to 49.6, missing expectations and hitting a 6 week low.
- In Europe, however, the numbers were good. The EU PMI rose to 53.2 vs. (E) 52.5, and both Germany and France saw activity rise compared to December.
- Econ Today: Jobless Claims (E: 330K), Flash Manufacturing PMI (E: 55.0), Existing Home Sales (E: 4.90M SAAR).
- Earnings Today: JCI (E: 0.69), LMT (E: 2.00), MSFT (E: 0.67).

Market	Level	Change	% Change
S&P 500 Futures	1832.50	-6.00	-.33%
U.S. Dollar (DXY)	80.965	-.34	-.42%
Gold	1246.00	7.40	.60%
WTI	96.83	.10	.10%
10 Year	2.860	.035	1.24%

Equities

Market Recap

Stocks were flat again Wednesday during another boring session outside of some specific earnings situations. The S&P 500 was up 0.06%.

Stocks opened Wednesday very slightly lower, hit their lows of the day around 10 AM, and then drifted higher throughout the remainder of the session to close just in the green. The entire trading range on the S&P 500 yesterday was barely over 5 points, so that tells you how slow things were.

FCG has broken the downtrend in place since October, and now both the technicals and fundamentals for the natural gas producer ETF are tuning positive.

Trading Color

The Dow Industrials once again was the big laggard yesterday, falling 0.25%. Meanwhile the Dow Transports rose over 1% and hit another new all-time high, while the Russell also made new highs (up 0.47%) and the Nasdaq hit another new 52-week high (up 0.41%).

I read a few people who noted the recent divergence of the Dow Industrials and implied it could be a warning sign for the market, but I don't think that's correct. The Dow is lagging because of its index composition and bad earnings results by heavily weighted components, not because investors are negative on industrials (IBM was the reason the Dow dropped yesterday).

From a sector standpoint, obviously transports were one of the outperformers, helped by good NSC earnings, while tech also outperformed partially due to the AAPL rally off Carl Icahn tweeting he added to his position while touting the stock on CNBC. Semiconductors also saw a nice rally and the SOX hit a new all-time high this week.

On the flipside, materials were the only S&P 500 sub-

Market	Level	Change	% Change
Dow	16373.34	-41.10	-.25%
TSX	13988.20	36.43	.26%
Brazil	49299.66	757.59	1.56%
FTSE	6813.01	-13.32	-.20%
Nikkei	15595.89	-125.07	-.79%
Hang Seng	22733.90	-348.35	-1.51%
ASX	5262.99	-56.78	-1.07%
Prices taken at previous day market close.			

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sector to finish negative, as earnings misses by FCX and ATI as well as weakness in the gold miners weighed on the space. Retail also continued to lag, although the sector finished very slightly positive on the day.

Market	Level	Change	% Change
DBC	25.09	.12	.48%
Gold	1239.10	-2.70	-.22%
Silver	19.86	-.01	-.05%
Copper	3.33	-.02	-.70%
WTI	96.77	1.80	1.90%
Brent	107.20	.11	.10%
Nat Gas	4.72	.29	6.54%
RBOB	2.68	.06	2.14%
DBA (Grains)	2.17	.05	.23%
Prices taken at previous day market close.			

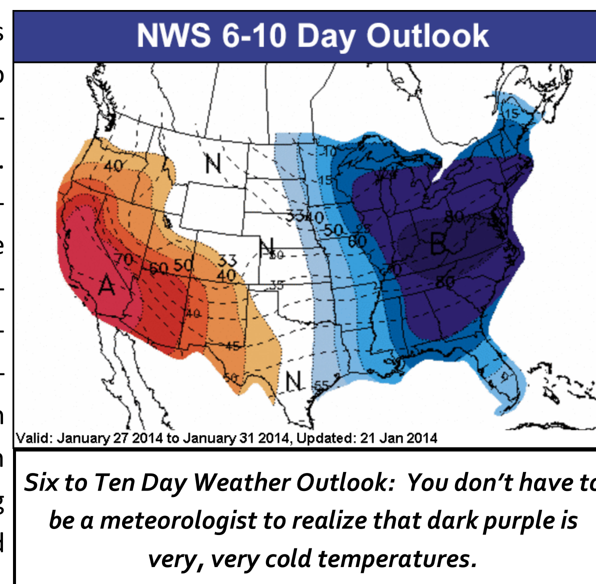
Volumes and activity remain subdued away from specific earnings situations, and it seems most investors remain in a "wait and see" mode into earnings.

On the charts 1,850 remains key resistance in the S&P 500, while initial support remains lower at the 20 day moving average at 18.38.

Bottom Line

It remains a relatively boring year to date. Earnings season is rolling along and while there are certainly some positives and negatives to focus on, overall the season is being viewed as "OK" so far.

The macro-economic back drop remains very quiet and static (something I don't think will last too long), but for now that is allowing investors to continue to focus more on the individual sectors vs. the market as a whole. That has resulted in a drop in correlations amongst sectors of the market (regional banks and airlines are up 6% and 10% respectively, while materials and consumer discretionary and down year to date). And, that drop in correlations is likely something that will continue (so we should expect continued significant cyclical outperformance as long as the macro back drop remains quiet).



Six to Ten Day Weather Outlook: You don't have to be a meteorologist to realize that dark purple is very, very cold temperatures.

Bottom line is this: You don't sell a market where the Russell 2000, Nasdaq, Dow Transports and semiconductor index are all making new or multi-year highs.

Economics

No economic reports yesterday.

Commodities

Commodity markets Wednesday were all about energy. Natural gas exploded higher, breaking through resistance at $4.53 to trade to a 2 1/2 year high, rallying more than 6% on the day. And, it's continuing this morning as natural gas us up another 3.5% as of this writing. Given where a lot of you live, you know the reason for the rally. Frigid weather has once again descended on the Midwest and Northeast, and it is expected to stay around for a while, as most weather forecasts call for cold weather into the end of the month.

That, in turn, is causing demand for natural gas to spike as heaters stay cranked up. Supplies are so constrained in the northeast corridor that the price for natural gas for immediate delivery, referred to as the "cash" market, spiked 1,030% yesterday to trade above $110.50/MMBtu (those are not typos).

At this point the market is in runaway mode and no one knows how high it can go before it breaks, as it'll largely depend on the weather. Short term, those who like to gamble will take their shots on the long side in the commodity itself, or in the U.S. Natural Gas Fund (UNG). But I'm viewing this with a longer-term lens, as this extended cold snap is going to put more pressure on supplies, which is fundamentally bullish for natural gas (and not just some temporary extreme weather spike).

The bullish case for natural gas is getting stronger over the medium term, and as a result, this spike furthers the bullish scenario for XOP and FCG. I continue to think that's the best way, from a volatility and return potential standpoint, to play this evolving market.

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Natural gas wasn't the only big mover in the energy space yesterday. WTI crude rallied 1.8%, thanks in part to news that the southern leg of the Keystone Pipeline, which will run from Cushing, Okla., to Nederland, Texas, will open today, and begin carrying 700K barrels of oil per day from tanks in Cushing to refineries on the Gulf. That is obviously bullish for WTI crude, as it further relieves the bottleneck that has occurred in Cushing, where oil had become "trapped" with no ability to move it south to refineries.

WTI is now in the middle of the range that it has traded in since mid-October ($92-$100), and it would take a break of $98.50-ish and then $100 to turn the short-term trend bullish. So, for now I'd wait to buy another dip (if we get one) or a breakout above those two resistance areas. Bottom line: While crude supply is surging, the simple fact is that, if we get a strong economy (say close to 4% GDP growth), then WTI is cheap sub-$100/bbl.

Elsewhere in the commodity space, things were relatively quiet as markets looked ahead to the flash PMIs released overnight and later this morning. Both gold and silver traded basically flat, while copper saw some decent selling ahead of the Chinese flash PMIs (copper has seen a nice run and, with some nervousness surrounding China, some traders booked short-term profits into the number).

The commodity markets are behaving more as a market of commodities rather than a commodity market, as individual supply/demand fundamentals and outlooks dominate the price action. But, commodities in aggregate remain "cheap," if you think, like I do, that we will see a meaningful acceleration in global growth and an uptick in inflation.

Market	Level	Change	% Change
Dollar Index	81.30	.074	.09%
EUR/USD	1.3545	-.0014	-.10%
GBP/USD	1.6571	.0099	.60%
USD/JPY	104.48	.18	.17%
USD/CAD	1.1088	.0123	1.12%
AUD/USD	.8818	.0048	.55%
USD/BRL	2.3758	.0026	.11%
10 Year Yield	2.860	.035	1.24%
30 Year Yield	3.759	.020	.53%
Prices taken at previous day market close.			

Currencies & Bonds

By far the most interesting market yesterday was the currency market, and I say this despite the fact that the Dollar Index and euro were both flat on the day.

Starting first with the pound, it rallied 0.6% vs. the dollar and traded to a new 17-month high after the December Labour market report showed the unemployment rate dropped to 7.1%, vs. (E) 7.3%. On the surface this is obviously a good sign for the UK economy, but that's not the reason the pound rallied.

Instead, the pound off because the minutes from the January Monetary Policy Committee (MPC). The MPC admitted that the unemployment rate was falling much faster than they anticipated, and said it would likely soon cross the 7.0% "threshold" they established as a point where they may need to start to raise interest rates.

But, they hedged that statement by saying that, even if the unemployment rate dropped below 7% in the near future, given contained inflation there was "no immediate need to raise rates." And, by saying that, they reinforced their "Forward Guidance" to keep interest rates at zero well into the future.

But, the market isn't buying the story. As mentioned, the pound rallied to a new high and the yield on 10-year "Gilts" rose 5 basis points to 2.90%, despite the MPC saying there was no need to raise rates.

Again, this is important because the UK is ahead of us and the Fed in the evolution of "Forward Guidance" as a policy tool. And, with unemployment dropping close to the 7.0% threshold, the market's confidence in the BOE's "Forward Guidance" is eroding. And, it'll be very interesting to watch how the FTSE trades if that confidence erodes further, because as I've been saying, it'll be a roadmap for us (yesterday the FTSE was down small, but the next few weeks will be critical).

The Aussie dollar was a big mover yesterday vs. the Greenback, rallying 0.6% after December CPI showed a bigger jump in inflation than anticipated. Quarter-over-quarter, Australian CPI rose 0.8% vs. (E) 0.5%, and year-over-year CPI rose 2.7% vs. 2.2%. That jump likely puts the RBA "on hold" from a policy standpoint for a

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few months, and we may indeed see the start of the counter-trend rally we've been looking for in the Aussie, and that's a rally that should shorted. Unfortunately the soft Chinese flash PMIs have "Aussie" giving back most of yesterday's rally, that rally may have only lasted one day.

In Canada, the "Loonie" fell 0.88% and was by far the worst performer vs. the dollar, and the drop came despite the fact that the Bank of Canada held interest rates steady (there was some expectation of a cut). But, in its statement, the BOC highlighted the fact that inflation was falling, and that it appeared it would be well below their target for the foreseeable future. This implies policy will remain very, very accommodative.

Additionally, the BOC said:

"Stronger U.S. demand, as well as the recent depreciation of the Canadian dollar, should help to boost exports and, in turn, business confidence and investment."

Translated, this means:

"*A weaker Loonie is one way to jumpstart the economy, so let the thing fall."*

And, in turn, they have joined the Australians in seeking a weaker currency to help spur economic activity. As I've been saying with Australia, when a central bank wants to devalue its currency, it will succeed, so you know how you should be positioned.

The Loonie came close to breaking the $0.90 level yesterday (the low was $0.9003), but it's just a matter of time until we see something we haven't seen since late 2009—a Canadian dollar with an "8" handle. Condos in Vancouver are coming our way!

Treasuries saw decent declines yesterday (30 and 10 year down .3% each), although there was no "reason" for the drop, and if anything I'd attribute it to late longs booking some profits ahead of the PMIs this morning. Bonds continue to consolidate the recent declines ahead of another round of key macro catalysts beginning today, and ending in two weeks with the jobs report.

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	*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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