7:00's Report

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

January 27th, 2014

Pre 7:00 Look

- Futures are slightly higher this morning, bucking a trend of international market declines.
- Asian shares were sharply lower as they caught up to Friday's declines in the US, while European markets are being weighed down by EM concerns and a 5% drop in VOD.
- The weekend was quiet news wise, and the only econ data this morning was the German IFO Business Climate Index, which rose to a multi-year high.
- Econ Today: New Home Sales (E: 450K).
- Earnings Today: CAT ($1.29), AAPL ($14.04), STX ($1.40).

Market	Level	Change	% Change
S&P 500 Futures	1785.00	3.00	0.17%
U.S. Dollar (DXY)	80.56	.019	0.02%
Gold	1267.80	3.50	0.28%
WTI	96.82	.18	0.19%
10 Year	2.735	-.038	-1.37%

Equities

Market Recap

Stocks fell more than 2% last week as fears of slowing economic growth combined with renewed concerns about emerging markets pushed stocks to multi-week lows. The S&P 500 is down 3.14% year-to-date.

Stocks spent the early part of last week basically flat, as investors focused on specific earnings results. But, the macroeconomic influence on markets returned with a vengeance Thursday, as soft global and domestic economic data helped spark a sell-off across risk assets.

There were two main "reasons" cited for the drop in stocks: First and foremost was China (i.e., fears of an economic slowdown plus liquidity concerns thanks to an elevated repurchase rate and default fears about a wealth-management product). Second was emerging market turmoil, specifically worries about another Argentine default, as well as political turmoil in Turkey, Thailand and the Ukraine.

Stocks traded sharply lower Thursday and the selling accelerated Friday as stocks finished the week on the lows.

Trading Color

I'll be discussing the global sell off on Squawk Box on CNBC Asia at 5:40 PM EST today.

Selling Thursday and Friday was different from what we've seen so far this year, as there were signs of real "de-risking" and some capitulation selling late Friday by long-only mutual funds as well as hedge funds. Volumes were elevated both Thursday and Friday.

From an internals standpoint, earnings largely dominated sector trading until Friday when we saw a typical "risk off" pattern emerge as cyclical indices and sectors led on the downside (that was not the case Thursday, where the Nasdaq and Russell 2000 actually outperformed the S&P 500). So, that switch on Friday further confirms investors were trying to "de-risk." And, further confirming that point was the fact that some of the best-performing sectors of the market recently (i.e., regional banks, biotechs, Internet stocks) all got hit hard both Thursday and Friday, implying profit-taking was the main motivation for the selling.

On the charts the S&P 500 broke through the 50-day moving average (1,812) for the first time since early October, and next support lies at 1,775-1,785 range. If that

Market	Level	Change	% Change
Dow	15,876.11	-318.24	-1.96%
TSX	13,717.76	-215.21	-1.54%
Brazil	47,787.38	-533.26	-1.10%
FTSE	6,570.36	-93.38	-1.40%
Nikkei	15,005.73	-385.83	-2.51%
Hang Seng	21,976.10	-473.96	-2.11%
ASX	5,240.93	-22.06	-0.42%

Prices taken at previous day market close.

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support is broken decisively, expect people's outlooks to turn decidedly more negative, as that was an area of strong buyer interest in early December.

Market	Level	Change	% Change
DBC	25.08	.01	0.04%
Gold	1264.30	2.00	0.16%
Silver	19.765	-0.245	-1.22%
Copper	3.2715	-.014	-0.43%
WTI	96.64	-.68	-0.70%
Brent	107.89	0.00	0.00%
Nat Gas	5.182	.452	9.56%
RBOB	2.6632	.0014	0.05%
DBA (Grains)	24.25	-.02	-0.08%
Prices taken at previous day market close.			

Earnings Season Update

Although it was overshadowed by macro concerns late last week, earnings season continues to roll on. Overall, the season is "OK" to "slightly better" than expected, although it's still early. Banks and tech have been the standout sectors so far.

122 of the S&P 500 have reported earnings so far, with 73% beating and, more importantly, 67% topping revenue estimates. This would be an uptick if that revenue percentage holds throughout the rest of earnings season. Management commentary on conference calls is also being regarded as more-positive than last quarter. Finally, consensus 2014 EPS for the S&P 500 remains largely unchanged at $120/share.

This Week

Macro risks centered around China and the emerging markets will be watched this week, but it's also one of the busiest weeks of earnings—with numerous large, systemically important companies reporting. Some "widely helds" that give results this week are: CAT/AAPL (today), CMCSA/F/PFE/T/YHOO (Tuesday), BA/DOW/FB (Wednesday), MMM/MO/UPS/V/XOM/AMZN/GOOG (Thursday) and CVX (Friday).

Politics will also be in focus this week. President Obama gives his State of the Union address tomorrow night, although it isn't expected to influence trading that much. Also, House Republicans have their annual retreat 1/29-1/31, and that's important because they are expected to craft their debt ceiling strategy during that retreat. Concern about the debt ceiling quietly re-emerged last week, and that's another potential headwind on the market, although it's highly, highly unlikely that the Republicans would cause too much commotion over it during an election year, although with this Congress anything is possible.

Bottom Line

Last week was a nasty sell-off, to be sure, but it seemed more out of frustration than legitimate fear. Investors came into 2014 decidedly "long," anticipating a continuation of the December rally. And, the longer the market has stayed flat, the more frustration has built. So, last week's "reasons" for the market declines seemed more like excuses to de-risk and get "less long" given the market's inability to rally in January.

Now, I'm not trying to downplay the risks presented last week. If Chinese economic growth collapses, and/or we see another emerging market capital crisis, that's a game-changing negative. But, we didn't see those last week. I'll cover this more in the Econ section, but Chinese growth appears to be cooling (as expected) but not collapsing. And while the EM headlines last week were scary, the truth is concerns about capital flows are, for now, isolated to Argentina—and political unrest in Turkey, Thailand and the Ukraine has been ongoing for months.

I'm not trying to sound like a perma-bull, because I'm not. But, right now I don't think the risks from last week materially altered the macro backdrop, which remains relatively clear. **In fact, it's worth noting that China, the epicenter of last week's turmoil, was actually the best-performing market last week (up 2.47%). Meanwhile Europe, which had the best economic data last week, was the worst performer (down 4%).**

The risks are there, like always, but for now I don't think there has been a material change in the market narrative. The macro horizon remains relatively clear, valuations are not cheap but not overvalued, and high degrees of skepticism toward this rally remain. As a result, the benefit of the doubt remains with the bulls, and I'd be more inclined to buy this dip than sell it here. Preference remains toward cyclicals (especially banks), industrials, "long Japan" via DXJ, short bonds via TBT/TBF, and long natural gas equities via FCG or XOP.

Economics

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Last Week

The key economic data point last week was the Chinese flash manufacturing PMI for January, which missed expectations and, more importantly dropped below the 50 level for the first time in 6 months—signaling contraction and stoking fears that the Chinese economy is slowing materially.

The U.S. flash manufacturing PMIs for January also missed expectations, although the drop was more modest and the index remains comfortably above the 50 level at 53.7.

Both reports helped spark a sell-off across risk assets, and although much was made of the two "misses," the actual data last week wasn't really as bad as the market reaction.

First, the Chinese PMIs was a disappointment, but at 49.6, the index is implying Chinese growth is moderating, not collapsing, and that's an important distinction to make going forward. Chinese growth is *expected* to moderate as the country implements various reforms. But, if growth looks like it's starting to collapse, that is a game-changing macro headwind. But, the data last week doesn't imply that is happening.

In the U.S., growth was also expected to slow from the very high levels of activity in December 2013, and while no one ever likes to see economic indicators decline, the dip in January in the flash manufacturing PMI isn't near enough to raise concerns about the economic recovery in the U.S.

The bottom line, and the proper context in which to consider last week's data, is that it was one of the catalysts for the market sell-off. But, more importantly, it wasn't that bad in aggregate, and the hard data does not imply we are seeing a slowdown in economic activity domestically or globally that would be a bearish game-changer.

Market	Level	Change	% Change
Dollar Index	80.55	.025	0.03%
EUR/USD	1.3674	-.0001	-0.01%
GBP/USD	1.6476	-.0005	-0.03%
USD/JPY	102.37	.09	0.09%
USD/CAD	1.1073	-.0014	-0.13%
AUD/USD	.8689	.0008	0.09%
USD/BRL	2.3983	.0006	0.03%
10 Year Yield	2.735	-.038	-1.37%
30 Year Yield	3.651	-.030	-0.82%
Prices taken at previous day market close.			

This Week

The FOMC meeting and official Chinese manufacturing PMI for January are the two key events to watch this week. Starting with the former, despite some upset in the emerging markets and the broader markets' drop last week, the Fed is still expected to further taper QE by an additional $10 billion this week while at the same time further strengthening its forward guidance and "ZIRP" pledge.

In China, the official government manufacturing PMIs for January are released Wednesday night, and it'll be very important to see if the official government number confirms the weakness we saw in the Markit "flash" PMI of last week. The China perma-bears will scoff if the official PMIs are better and declare the numbers as rigged, which they may be. Regardless, though, if the official PMIs are better than last week's "flash," it'll help alleviate concerns about Chinese growth.

This report is particularly important seeing as the Chinese New Year starts on Friday the 31st, and the Chinese markets will be closed for the subsequent week.

Switching to Europe, the "flash" HICP for January is released Friday. HICP is the euro version of our CPI, and it's key because dis-inflation remains the biggest threat to the European economy. If HICP comes in below expectations, Europe and the euro will trade sharply lower.

Domestically, besides the FOMC meeting there are several ancillary pieces of economic data: new home sales (today), durable goods (Tuesday), Q1 GDP (Thursday), and personal income and outlays (Friday). While none will shift people's opinion of the economy on their own, there is some doubt creeping into minds of investors (justified or not) about the economy, so these readings will help to reinforce or contradict that fear.

Commodities

Commodities were among the best performers last week, as the commodity ETF DBC rose 0.2%, led higher by energy and gold.

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Natural gas was the star performer last week, rallying 18% on expectations of continued frigid weather through the end of the month. Growing demand for natural gas has always been in the bulls' favor in natural gas, but this latest rally is about supply concerns—particularly that if the cold weather continues, we could exit the winter season well-below recent averages for natural gas supplies.

Natural gas has obviously spiked and it's a runaway market, and no one knows how high it can go before it breaks. I wouldn't buy the commodity here, but beyond the short term, this is more bullish for the natural gas equities. Although FCG and XOP got hit by general stock selling last week, I'd use this dip to get long for medium-term accounts.

Staying in energy, WTI crude rallied 1.8% last week on expectations of increased demand thanks to the southern leg of the Keystone Pipeline starting to move 270K barrels per day from Cushing, Okla., to refineries in the Gulf. Also helping was the absolutely parabolic move higher in cash natural gas and heating oil, which helped pull up crude prices. Despite the rally, though, WTI remains range-bound between $92-$100/bbl, a range that's been intact for months. A break above the $98 level would pique my interest on the long side, although that $100 level remains stiff resistance.

Finally, turning to the metals, gold hit a multi-month high near $1,270/oz. on a combination of a "risk off" bid centered on Chinese liquidity and emerging market worries, and thanks to a weaker U.S. dollar. Gold appears to have broken a multi-month downtrend line, but I'd like to see a few more closes above the $1,260 level before getting too enthusiastically bullish.

Finally, the one commodity to badly lag last week was copper, which dropped 2% last week off the Chinese PMI miss. Copper appears to be breaking down, and unless it stabilizes and rallies this week, it looks as though a new downtrend will have begun. That's an anecdotally negative sign for the global economy and something to watch going forward.

Currencies & Bonds

The Dollar Index declined last week, although the greenback wasn't universally weak. The dollar fell substantially against most developed market currencies last week (the euro, pound and yen).

The euro and British pound were stronger thanks to general worries about U.S. growth and strong economic data from Europe. The euro and dollar remain largely range-bound against each other, as investors try to figure out whether the ECB will further ease policy this year. The "flash" HICP this Thursday will be the next key catalyst with regard to the euro. The yen rallied thanks to the aforementioned concerns about growth and also benefited from a '"risk off" bid as concerns about China and the emerging markets grew.

The U.S. dollar was stronger vs. the commodity currencies last week, though. The Aussie and Canadian dollar both hit new multi-year lows vs. the U.S. dollar, as both central banks signaled their desire for their respective currencies to decline further. And, they will achieve that goal. Shorting the commodity currencies remains one of the most well founded currency trades out there.

Finally, the big loser in the currency markets last week was the Argentine peso, which dropped 13% as fears grew that the Argentine government would default, as their supply of pesos is getting dangerously low. On Friday the country lifted capital controls that have been in place for some time and that helped the peso stabilize, but risks obviously remain.

Turning to bonds, we saw a big rally in Treasuries last week thanks to a big "risk off" bid given the plunge in the stock market. While the outlook for Fed policy remains unchanged (tapering will continue on schedule), the yield on the 10-year Treasury has hit a multi-month low (2.73%) and it's looking more possible that we're entering a counter-trend rally amidst a longer-term bond decline. But, given the outlook for policy and the economy remains largely unchanged, I will stress that this rally, whether it lasts for another few days or a few weeks, is nothing other than an opportunity to get more "short" bonds, because the bigger downtrend remains very much in place.

Have a good 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	*The market got hit last week on concerns about Chinese growth and emerging markets, and stocks suffered their worst weekly declines in over a year. But, the positive fundamental back drop remains largely in place, and so far none of the events of last week are bearish "game changers."* *Important support sits at the 1780ish range, while 1812 (the 50 day MA) is resistance.*

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: **Gold is now threatening to break out of a months long downtrend, but given gold has rallied as a "crisis" hedge, I'm skeptical the move can last. A few more closes above the $1260 level would make me more bullish in the short term.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index largely range bound as the market has priced in Fed tapering, while the question of what, if anything, the ECB will do to combat rising dis-inflation remains unanswered.*

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, including the one we are seeing now thanks to emerging market concerns.*

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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