7:00's Report

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

January 28th, 2014

S&P 500: Stocks held support at the December lows around 1775-1785. If that level is violated, though, look for the bulls to make a stand at 1764 (the 100 day MA).

Pre 7:00 Look

- Futures are bouncing this morning as emerging markets have temporarily stabilized, thanks to Indian and Turkish central banks taking steps to defend their currencies.
- The Reserve Bank of India somewhat surprisingly hiked rates by 25 basis point and the Turkish central bank is expected to rise rates by 200 basis points later today.
- Econ data was light o/n, as UK GDP met expectations.
- Econ Today: Durable Goods Orders (E: 1.6%).
- Earnings Today: F ($0.28), PFE ($0.53), T ($0.50), YHOO ($0.38).

Market	Level	Change	% Change
S&P 500 Futures	1783.50	7.75	.44%
U.S. Dollar (DXY)	80.745	.133	.16%
Gold	1255.30	-8.20	-.65%
WTI	96.23	.51	.53%
10 Year	2.766	.031	1.13%

Equities

Market Recap

Stocks stabilized and showed some signs of life Monday, but a lack of truly positive catalysts resulted in markets again closing negative on the day. The S&P 500 fell 0.49%.

Stocks opened the week higher, bouncing from Friday's beating but the bounce was never really very strong and by 11:30 stocks were once again negative and losing ground rapidly.

Just when it looked like things might get ugly again though, stocks bottomed midday as sellers became short-term exhausted and support held in the 1,775-1,785 range. The S&P 500 actually turned positive in the late afternoon, but there was no real conviction behind the rally and stocks eventually gave way during the last hour of trading to close modestly weaker.

As far as "reasons" for the rally, there were several listed: CAT's earnings were better than feared and their China commentary was fine, news of an emergency Turkish central bank meeting today helped support emerging market currencies, and news circulated that the Chinese wealth-management product would be bailed out.

But, as mentioned, none of these events were really that "positive," and really they were more excuses for the bounce in stocks, not reasons for it.

Trading Color

This sell off has been more about hedge funds and mutual funds getting "less long" and re-adjusting their portfo-

Market	Level	Change	% Change
Dow	15837.88	-41.23	-.26%
TSX	13582.29	-135.47	-.99%
Brazil	47701.05	-86.33	-.18%
FTSE	6575.42	24.76	.38%
Nikkei	14980.16	-25.57	-.17%
Hang Seng	21960.64	-15.46	-.07%
ASX	5175.11	-65.82	-1.26%

Prices taken at previous day market close.

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lios, and that continued yesterday, although not with the intensity of Thursday and Friday (leading some to hope that we may be near an end of the "re-positioning" phase).

Cyclical sectors continued to badly underperform, as the Russell 2000, Nasdaq and Dow Transports all dropped by more than 1% yesterday compared to much more modest drops in the S&P 500 and Dow Industrials.

Market	Level	Change	% Change
DBC	24.88	-.20	-0.80%
Gold	1252.80	-11.50	-0.91%
Silver	19.635	-.13	-0.63%
Copper	3.2575	-.014	-0.43%
WTI	95.67	-.97	-1.00%
Brent	106.67	-1.21	-1.12%
Nat Gas	4.877	-.305	-5.89%
RBOB	2.6255	-.0377	-1.42%
DBA (Grains)	24.26	.01	0.04%
Prices taken at previous day market close.			

Sector wise, there remains ample evidence that we are seeing investors book profits and get "less long," as opposed to being outright negative. Some of the recent best performing stock sectors continued to get hit yesterday, with tech (specifically internet stocks like GOOG, FB, TWTR), bio-techs, semi-conductors and airlines all seeing steep drops. Conversely, typically "defensive" sectors outperformed, and utilities (which have been the surprise sector of 2014) finished the day slightly in the green (up .24%).

On the charts it was encouraging to see the 1775-1785 area of support hold in the S&P 500 yesterday, although may technicians I talk to are pointing to the 100 day moving average (1764) as the next critical area of support.

Bottom Line

This sell off remains more about re-positioning than it does a massive change in sentiment, so now it's just a question of how much more re-positioning is left by hedge funds and mutual funds that found themselves too "long" early in 2014.

Activity was heavy from hedge funds over the past three trading days so the hope is they are close to "done," although the state of mutual funds remains the bigger unknown.

Regardless, the point is this decline, so far, is more about positioning than it is fundamentals, and although yesterday's bounce was pretty pathetic, implying we haven't seen the lows yet, I believe the fundamentals remain positive and the benefit of the doubt with the bulls. I would not materially de-risk at these levels.

Economics

FOMC Preview

Clients have asked in the past for previews of the FOMC meetings a day early because they get calls from their clients early, so here it is.

The broad consensus expectation is for:

- Another taper of $10 billion per month, reducing the QE program to $65 billion/month.
- Like in December, the taper will be split evenly between Treasuries and MBS (Mortgage-Backed Securities).

With regard to "Forward Guidance," expect the Fed to again emphasize its ZIRP (zero interest rate policy) but specifically look for the Fed to focus more on the risk of low inflation, and downplay the 6.5% unemployment rate threshold. That will most likely be the way the Fed tries to make the statement "dovish."

Finally I've heard some chatter that the weak December jobs report or the recent turmoil in the emerging markets may cause the Fed to "taper" the taper. At the risk of making myself look foolish, that has almost zero chance of happening. It would be a huge (and upsetting) shock to the system, as the Fed will have confused everyone just like they did in September .

Bottom line is this meeting has been pretty well-telegraphed, so unless there's a huge surprise it could wind up being a non-event.

Commodities

Commodities were broadly lower yesterday as we saw some profit-taking in some of last week's big gainers, specifically in the energy space. The commodity tracking ETF, DBC, fell 0.52%.

Natural gas traded in a huge range yesterday, rallying more than 5% early Monday morning then reversing and closing down nearly 6%.

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Natural gas futures rallied up to $5.442 overnight Sunday evening, which was the highest level since February 2010. Then natural gas began to sell off on the release of a revised extended weather forecast that called for warmer weather than initially expected through February 10th. As to be expected in any market this overbought, the selling accelerated throughout the day as weak longs exited positions and stops were hit.

Given it's totally weather-dominated in the short term, we can expect natural gas to remain one of the most volatile of all commodities. But swings aside, expect prices to stay elevated as supplies are now well-below the five-year average. I remain very bullish FCG and XOP over the medium term.

On the charts, our first line of support lies around $4.70/MMBtu while the level to break to the upside is yesterday's multi-year high of $5.442.

There was also some profit-taking in Nymex crude oil futures yesterday as traders continue to preserve gains after the decent rally we saw last week. News flow was slow in oil yesterday, but certainly one of the reasons for the 1% drop was the drop in the refined products, thanks to the warmer weather forecasts (WTI followed the products higher last week, and then again followed them lower yesterday).

Bottom line for crude is that the market continues to look for fundamental direction so the technicals are the commanding force for the time being. We do have potentially market-moving data due out today and through the end of the week in the form of durable goods orders, the FOMC announcement, and more economic data from China, not to mention the EIA inventory data tomorrow morning.

Gold pulled back slightly yesterday, falling 0.91%, after seeing a breakout late last week as part of a fear trade.

Gold is basically traded inverse to stocks yesterday, as the $30 dollar run last week was predicated on a fear trade, and as fear comes out of the market, and stocks rally, gold will give back ground. Profit-taking was also responsible for some of that sell-off, as traders closed long positions ahead of the FOMC announcement tomorrow. Today I would expect both precious metals and the dollar to largely tread water ahead of the FOMC announcement—that is, barring any surprises in the durable goods report or bad news out of emerging markets.

More broadly, I remain skeptical of gold at these levels because the rally above $1250 has been based on "fear," not fundamentals. Rising inflation remains the next major positive catalyst for gold, and that is still down the road a ways. I discussed the outlook for gold and some early signs of rising inflation in my interview with CNBC Asia yesterday (link here for those interested in viewing).

Currencies & Bonds

Focus remains on the emerging markets, and specifically Argentina, Turkey, Thailand and the Ukraine.

There were a few pieces of news out o/n: First, the Ukrainian Prime Minister, Mykola Azarov, has offered to resign, in an effort to "help end the conflict." In reality he was forced out by Ukrainian President Viktor Yanukovych, but regardless of how it happened this is a positive development in the political situation in the Ukraine, as protestors have wanted the PM out for some time.

Turkey is the emerging market most in focus this morning, though. As mentioned, the Turkish central bank has called an emergency meeting, and is largely expected to hike interest rates by 200 basis points in an effort to arrest the declines in the Lira.

This move by the central bank is now widely expected, and both the Lira and the Turkish stock market have stabilized this morning in anticipation of that announcement. If the Turkish Central Bank doesn't hike rates, or take some other action to defend the Lira, look for the markets to sell off on disappointment. TUR (the Turkey ETF), will be a good leading indicator to watch today.

Market	Level	Change	% Change
Dollar Index	80.605	.064	0.08%
EUR/USD	1.3666	-.0009	-0.07%
GBP/USD	1.6573	.0092	0.56%
USD/JPY	102.72	.44	0.43%
USD/CAD	1.1092	.0005	0.05%
AUD/USD	.8747	.0066	0.76%
USD/BRL	2.4205	.0228	0.95%
10 Year Yield	2.766	.031	1.13%
30 Year Yield	3.680	.29	0.79%
Prices taken at previous day market close.			

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The situation in Turkey has bumped Argentina as the current "epicenter" of the emerging market crisis, so that's the market to watch today. There's no ETF for the Lira, but just google "Turkish Lira Bloomberg" and click the "US Dollar—Turkish Lira" link for updated prices if you don't have a Bloomberg Terminal .

More broadly, the WisdomTree Emerging Currency Strategy ETF (CEW) remains the easiest way to see what's happening with the rest of the emerging markets, as it heavily weights to the Indian rupee, Thai bhat, South African rand and Turkish lira.

Like most risk assets, CEW traded lower yesterday before rallying with the market, and that ETF remains one of the better barometers of the emerging market "crisis" everyone is talking about.

A key level to watch with CEW is $19.25. That's the low from August (which was the last bout of EM angst and centered on the Indian rupee). If that level is broken decisively on a closing basis, then things may be legitimately deteriorating.

Turing to developed currencies, Monday was a pretty boring day. The Dollar Index was unchanged and the euro was also flat, while the pound bounced back from Friday's declines.

In Asia, the Aussie caught a mild bounce thanks to the official word that the Chinese "Wealth Management Product" (surprise!) won't default. And, as I said in last Tuesday's Report, it looks like investors will be bailed out by a combination of the issuing company (China Credit Trust), the Industrial & Commercial Bank of China (ICBC) and the local Chinese government. So, the Aussie caught an oversold bid on the "news," but the rally was just an oversold bounce, following the absolute drubbing the currency took last week.

The yen finished modestly lower vs. the dollar (down 0.35%), as there was actually some negative fundamental news in the market yesterday. The December trade balance showed a bigger trade deficit than expected at 1.3 trillion yen vs. (E) 1.26 trillion yen. I covered this a few weeks ago in the Report, but a growing trade deficit erodes the yen's status as a "safe haven" currency over the medium and longer term, as currency traders prefer to "hide" in currencies with large account surpluses, not deficits.

But, while that is another fundamental reason to be bearish yen (the trade deficits will get bigger as Abenomics continues to be implemented), yesterday was a good example of the old trading axiom: Fundamentals rule in the long term, but money flows rule in the short term. And, yesterday, we saw that as the yen continued to trade inversely with U.S. equities (risk on/risk off).

The yen was lower Monday morning as futures were at the highs of the day; the yen traded to flat as stocks hit their lows mid-morning, and then it sold off again as stocks rallied into the afternoon. And, that's a trading pattern (yen inverse to stocks) we can expect to see as long as the market remains nervous, especially about anything Asia-centric.

But, given my opinion that we are not quite in the "crisis" that the financial media would have us believe, selling yen in the low-100s to the dollar at these levels via the ProShares UltraShort Yen ETF (YCS) could be a good idea for investors who can stomach some potential volatility and who have a greater-than-short-term outlook.

Interestingly, Treasuries spent the entire day in the red, with the 10- and 30-year bonds declining 0.2% and 0.35%, respectively. And, even when the market was at its lows and threatening to collapse, bonds never materially rallied, and that was a clue that we weren't seeing another "risk off" sell-off in equities yesterday. As to "why" bonds fell, the reason is likely recent new longs selling ahead of the Fed tomorrow, and bond bears like me using this bounce to lay out shorts. Although, I generally don't like trading ahead of any FOMC meetings, as I view that as guessing, and guessing in this market is a good way to go broke. Look for bonds to be flat today ahead of the FOMC meeting tomorrow.

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	*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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