# 7:00's Report

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

***January 31st, 2014***

## Pre 7:00 Look

- Futures are lower this morning as the Turkish lira resumed its declines and economic data from Europe disappointed.
- There was no real news o/n but the lira is off 1% versus the dollar, weighing on sentiment.
- In Europe, German December retail sales surprisingly declined 2.5%, while EU flash HICP dropped to 0.7% yoy vs. (E) 0.9%, although the decline was due to energy. Regardless, HICP shows disinflation in Europe remains a major concern.
- Econ Today: Personal Income and Outlays (E: 0.2%), Consumer Sentiment (E: 81.0). Fed Speak: Fisher (1:15 PM).

| Market | Level | Change | % Change |
|---|---|---|---|
| S&P 500 Futures | 1770.25 | -11.00 | -0.62% |
| U.S. Dollar (DXY) | 81.225 | .032 | 0.04% |
| Gold | 1245.30 | 2.80 | 0.23% |
| WTI | 97.82 | -.41 | -0.42% |
| 10 Year | 2.693 | .018 | 0.67% |

# Equities

*Market Recap*

Stocks surged Thursday to turn positive on the week as a rally in the emerging markets provided a tailwind to equities. The S&P 500 rose 1.13%.

Stocks were modestly higher early Thursday as a stabilization in the Turkish lira and South African rand helped risk assets, and then took another leg higher after the Q4 GDP report basically met expectations (it was in-line with estimates but, given the rash of econ data "misses" this month, it was taken as better than feared).

After the open, pretty much everyone (including me) expected equities to come back in, but that didn't happen—and it resulted in buyers "chasing" the market higher and stocks hitting their highs of the day right around 1 o'clock just below the 1,800 level.

Stocks dipped a bit during the afternoon session, but recovered during the last hour of trading to go out not far off the highs.

*Trading Color*

Technically speaking we did see a "risk on" day yesterday, as the Russell 2000 and Nasdaq both outperformed the S&P 500, but you still got the feeling that the gains were tentative and there wasn't much conviction behind the move (volumes were also light compared to earlier in the week).

It was not a textbook "risk on" day in the sector trading. Tech led the markets higher (up nearly 2%) thanks mostly to strength in Internet stocks (courtesy of FB earnings) and semiconductors. But, other market leaders were utilities and REITs, both up 1.5%, so not exactly the cyclical leadership you want to see.

Healthcare and financials were also higher on a combination of earnings, while industrials, energy (courtesy of the XOM miss) and homebuilders all lagged (homebuilders finished negative on the back of pending home sales).

On the charts the S&P 500 broke above the 1,794-ish resistance level that had capped stocks all week, and now 1,800 and 1,812 (the 50-day MA) are the next resistance levels. Support lies lower at that 1,775-1,785 range, with the 100-day MA (1,767) critical support.

*Bottom Line*

Yesterday saw a nice bounce from stocks, and there was

| Market | Level | Change | % Change |
|---|---|---|---|
| Dow | 15,848.61 | 109.82 | 0.70% |
| TSX | 13,735.28 | 92.06 | 0.67% |
| Brazil | 47,244.26 | -312.52 | -0.66% |
| FTSE | 6,486.72 | -51.73 | -0.79% |
| Nikkei | 14,914.53 | -92.53 | -0.62% |
| Hang Seng | 22,035.42 | -106.19 | -0.48% |
| ASX | 5,190.00 | 1.94 | 0.04% |
| Prices taken at previous day market close. | | | |

definitely some "long" buying as opposed to just short covering, but I think it's a bit early to say that this sell off is over (although I think we are getting close to the end unless emerging markets really blow up or economic data next week is bad). Ideally I would have liked to see the S&P trade down to the 100 day MA (which has been support for over a year), hold that level, and then begin to rally back, but perhaps I'm being a bit nit-picky as the S&P 500 did get down to 1770, which may be close enough.

| Market | Level | Change | % Change |
|---|---|---|---|
| DBC | 24.91 | -.10 | -0.40% |
| Gold | 1243.00 | -19.20 | -1.52% |
| Silver | 19.135 | -.417 | -2.13% |
| Copper | 3.225 | -.0155 | -0.48% |
| WTI | 98.06 | .70 | 0.72% |
| Brent | 107.92 | .07 | 0.06% |
| Nat Gas | 4.905 | -.56 | -10.28% |
| RBOB | 2.6626 | .0017 | 0.06% |
| DBA (Grains) | 24.38 | .11 | 0.45% |
| Prices taken at previous day market close. | | | |

Things look a bit messy again this morning, as the lira is once again falling versus the dollar and Europe is down on economic data, but as long as 1767 holds (the 100 day MA) I would maintain equity allocations and be more inclined to add more than de-risk.

# Economics

GDP

- Q4 Real GDP rose 3.2% SAAR vs. (E) 3.0%

*Takeaway*

The first look at Q4 GDP showed an economy that continues to gain momentum, as GDP slightly beat estimates and the pace of economic growth in the 2nd half of 2013 was the highest in 10 years. Not only was the headline good, but so too were the details of the report. PCE (consumer spending) rose 3.3%, while final sales of domestic product (which is GDP excluding inventories) rose 2.8%, up from 2.5% in Q3. The pace of growth is being taken as especially impressive given the negative effect of the government shutdown.

But, before we get too excited, remember that 3% GDP isn't exactly breakneck speed, and it appears the inventory-building that helped make Q3 GDP so strong continued in Q4. This will likely be a headwind on growth in this current quarter, as we can just keep building inventories forever and it'll have to take a pause at some point.

But, that aside, the GDP report confirms what we knew – the economy was building momentum into the end of the year, and taken in the context of Fed "tapering" of QE, this made the decision earlier this week to further taper a pretty easy one. But, the price indices remain very low, as the core PCE price deflator remains well-below the Fed 2.0% target, at 1.1%. That should exert some anecdotally "dovish" influences over the Fed with regard to their "forward guidance."

Finally, it's important to remember that GDP is the equivalent of taking a picture of the speedometer in your car – it tells you how fast you were going at that second, but doesn't tell you a thing about what to expect in the future. So, while the GDP was good, it won't allay concerns about the pace of growth in January.

Jobless Claims

- Weekly Claims rose to 348K vs. (E) 327K
- 4 Week Moving Average moved higher by 750 to 332.5K

*Takeaway*

Weekly jobless claims surprisingly jumped last week to 348K from a revised reading of 329K the week prior. The 4-week moving average moved higher for the first time in a month, albeit by less than 1K. The smoother 4-week average now sits at 332.5K, essentially the same level as August 2013, implying that we have basically seen neither improvement nor deterioration in the labor market since then. As a result, we should still be in a 200K-plus monthly job addition environment. Despite being a "miss," the market did not react to the report as the number was largely written off because of a combination of bad weather and the MLK holiday skewing results. Growth in the labor market remains status quo.

Pending Home Sales

- Pending Home Sales Index fell 8.7% m/m in Dec. to 92.4

*Takeaway*

Pending home sales plummeted in December to 92.4

from a negatively revised November reading of 101.2. The dip of 8.7% was much lower than the lowest estimate of -2.5%. Luckily for the bulls, this miss, like new home sales earlier in the week, was given a pass because most think the frigid temperatures in December dissuaded homebuyers from venturing out. But, it's safe to say that if it wasn't for the cold weather excuse, the markets would have hated the number.

On the fundamental side of things, though, there were some cautious comments by the National Association of Realtors (which released the report) that rising home prices amidst flat income levels, combined with a lack of existing home inventory, did weigh on results, regardless of the weather.

Bottom line this week with housing is that the soft data got a pass because of the cold weather. But after showing some signs of the recovery stabilizing, concerns about the housing recovery will remain until we get some "clean" data next month.

## Commodities

Commodities were mixed yesterday as there was broad weakness in metals and strength in the energy sector with the exception of natural gas. The benchmark commodity tracking index ETF, DBC, fell 0.4%

Natural gas was the worst-performing commodity and remains by far the most volatile of all commodities, as it has moved between 5% and 10% per session numerous times this week. The catalyst for yesterday's 8% sell-off was the smaller-than-expected draw in supply reported by the EIA. The report showed natural gas inventories fell by 230 Bcf, which is a substantial draw, but less than analyst expectations of for a draw of 239 Bcf. As we speculated in yesterday's Report, the miss sent longs for the doors as a 240-ish Bcf draw was largely priced in.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dollar Index | 81.16 | .579 | 0.72% |
| EUR/USD | 1.3553 | -.0108 | -0.79% |
| GBP/USD | 1.6483 | -.0077 | -0.46% |
| USD/JPY | 102.70 | .43 | 0.42% |
| USD/CAD | 1.1155 | -.0013 | -0.12% |
| AUD/USD | .8792 | .0056 | 0.64% |
| USD/BRL | 2.4244 | .0131 | 0.54% |
| 10 Year Yield | 2.693 | .018 | 0.67% |
| 30 Year Yield | 3.635 | .013 | 0.36% |
| Prices taken at previous day market close. | | | |

While most of the trading world is busy trying to catch the next 5% - 10% move in natural gas — an effort that is very difficult and dangerous due to the fact that natural gas is totally weather-dominated in the short term — I want to reiterate that these elevated prices for natural gas remain bullish for gas E&Ps.

I'm not sure of much, but I am pretty sure that most E&P analysts didn't model natural gas prices north of $4.50 this year, and the longer natural gas prices stay elevated (whether it's $4.50, $4.75 or $5.00), the higher the probability sell-side analysts will have to raise their price targets as the realized prices for the gas moves higher. As a result, I remain very bullish natural gas E&Ps, and will let others smarter and more brave than I try to figure out the where the next 25-cent move will be in the commodity.


Staying in energy, WTI crude oil futures rallied 0.74% yesterday, mostly due to the bullish influence of rising heating oil prices, but also in sympathy with stronger risk assets like stocks. Importantly, Nymex crude broke through several layers of technical resistance, including a longstanding downtrend line, to close above resistance at the $98/bbl. level.

Crude oil futures have been resilient through the global turmoil this week, mostly as a result of the recent colder-than-average weather boosting demand for refined products like heating oil. It's also worth pointing out that WTI futures failed to sell off on the much larger-than-expected build in crude supplies earlier this week. When something should sell off based on fundamentals and doesn't, that's a bullish clue. While I'm not ready to jump into the crude pool just yet, the market is turning more bullish. I'd prefer to see a break of resistance just below the December highs of $100.75 per barrel.

Precious metals traded lower yesterday with gold futures falling 1.38% while silver was down 1.85%. The dollar was up almost 1%, which put a fair amount of pressure on precious metals. But, as we mentioned earlier in the week, gold has been trading inversely with the stock market as part of the global "fear trade." And, with the stock market up over 1%, gold began to fall as the "risk bid" continued to leave the market.

This is exactly why I suggested to subscribers earlier in the week to refrain from buying gold, as the recent rally wasn't anything more than a "crisis bid" fueled by emerging market turmoil. Now that EMs are settling down, there isn't really any other bullish catalyst for gold in the very short term. On the charts the first line of support lies in the $1,240/oz area while resistance hovers above at $1,270. If we see a dip toward the $1,200-$1,220 area, I recommend taking a shot on the long side with a stop just below $1,180.

## Currencies & Bonds

We'll start again with emerging market currencies, as they remain the No. 1 macro driver at the moment. Emerging market currencies stabilized yesterday after seeing wild swings earlier in the week following Turkey and South Africa's benchmark interest rate hikes. There was no specific news that influenced the stabilization, and really it was more market digestion than anything (meaning this angst probably isn't over). The Turkish lira has rallied back to pre-rate hike levels, which has had a calming effect on the broader currency markets. If the lira can hold current levels, that will be a positive for emerging markets and likely most risk assets.

The dollar was much stronger yesterday, adding 0.74%. The move higher was a result of two things: First, the market continued to digest the Fed's decision Wednesday to further taper QE by another $10 billion, which is fundamentally bullish for the dollar. Second, the euro traded lower, down 0.82%. The move lower came after the German CPI report missed analyst expectations, declining 0.6% in January and falling to just a 1.3% increase year-over-year vs. December's 1.4%. Based on the weaker-than-expected German inflation reading, currency traders lowered expectations for this morning's EU HICP report.

Moving to Asia, the yen fell yesterday as fear left the global markets and the greater "risk-off" trade fizzled out. Additionally, Japanese retail sales missed expectations, but that had much less of an influence on the selling.

Bonds traded lower all day yesterday as the week-long "risk off" trade temporarily subsided. The 30-year Treasury was down about 50 basis points early in the session but then caught a bid after a strong 7-year treasury note auction. The bid to cover was 2.65 vs. the 2013 average of 2.56, indicating a larger-than-average number of bids and therefore strong demand. Another indication of strong demand was that the actual yield on the auction was a half basis point lower than the "when-issued" yield. The 30 year Treasury closed the day down just .2%.

Despite the dip, the near-term outlook for bonds remains mixed, as I'm not sure we've seen the last of this latest bout of EM angst. If we haven't, that will be supportive (short term) of Treasuries. But, again, it's a rally that should be shorted.

Have a good weekend,

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** | *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."*<br>*I remain bullish above the 100 day MA (1767) while 1800 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.**

| | | | | |
|---|---|---|---|---|
| **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.**

| | | | | |
|---|---|---|---|---|
| **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.**

| | | | | |
|---|---|---|---|---|
| **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.**