7:00's Report

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

January 8th, 2014

Pre 7:00 Look

- Futures and European markets are drifting slightly lower despite decent economic data o/n.
- Data was strong in Europe o/n as EU retail sales handily beat expectations, while German exports and November Manufacturer's Orders also beat estimates.
- Not all news was good: Chinese exports for December missed estimates and the UK Halifax Home Price Indicator unexpectedly fell in December, although it was higher yoy.
- Econ Today: ADP Employment Report (E: 205K), FOMC Minutes (2:00 PM)

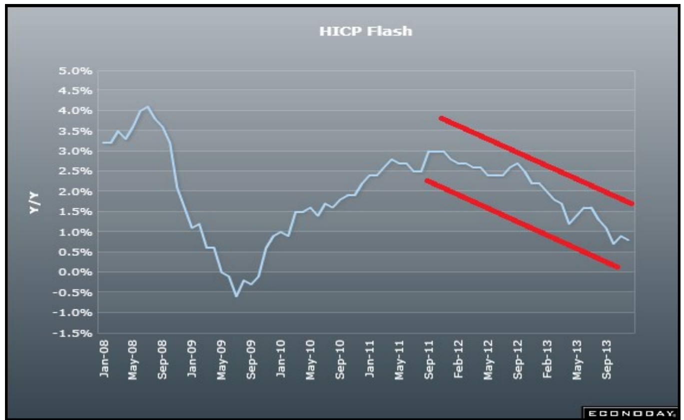
Market	Level	Change	% Change
S&P 500 Futures	1828.25	-2.50	-0.14%
U.S. Dollar (DXY)	81.19	.21	0.26%
Gold	1225.20	-4.40	-0.36%
WTI	93.92	.25	0.27%
10 Year	2.937	-.024	-0.81%

Equities

Market Recap

Stocks got back on track Thursday as buyers emerged for the first time in 2014 while a lower November trade deficit resulted in several upward revisions to expected Q4 GDP. The S&P 500 rose 0.61%.

Futures were already higher when the November trade data hit at 8:30 a.m. yesterday, but that gave markets a boost and buying continued immediately after the open, with markets hitting their highs for the day shortly after the bell.



"Dis-Inflation" is continuing to creep across Europe, and how the ECB reacts (or doesn't react) will present several investment opportunities.

Stocks spent the next several hours drifting not far off the highs.

The next catalysts for the market yesterday were comments by Fed Presidents Eric Rosengren and John Williams. The former yielded little market reaction, but Williams, largely considered neither a "dove" nor a "hawk," made comments that saw markets dip right around lunchtime. He didn't say anything particularly "hawkish," although it seems from his comments that most Fed members were very comfortable with the December decision to taper QE. This implies that unless something materially changes in the economy, the Fed will be comfortable further tapering QE.

And, reaction from stocks to the Williams' comments perfectly reflects how the market currently views the Fed: Stocks saw a mild sell-off on the idea of further "tapering," solely because anything with the word "tapering" in it unleashes a knee-jerk negative reaction. But, after a few minutes, the market arrested the declines and rallied, as the truth is the market generally is "OK" with the Fed tapering QE, as long as the economic

Market	Level	Change	% Change
Dow	16,530.94	105.84	0.64%
TSX	13,596.93	101.39	0.75%
Brazil	50,430.02	-543.60	-1.07%
FTSE	6,728.69	-26.76	-0.40%
Nikkei	16,121.45	307.08	1.94%
Hang Seng	22,996.59	283.81	1.25%
ASX	5,316.05	-.94	-0.02%
Prices taken at previous day market close.			

data remains solid.

Stocks recouped all of the midday dip by the close, and went out just a few points off the highs.

Market	Level	Change	% Change
DBC	25.11	-.05	-0.20%
Gold	1230.40	-7.60	-0.61%
Silver	19.805	-.298	-1.48%
Copper	3.36	.0005	0.01%
WTI	93.78	.35	0.37%
Brent	107.37	.64	0.60%
Nat Gas	4.322	.016	0.37%
RBOB	2.6781	.0321	1.21%
DBA (Grains)	24.37	-.18	-0.73%
Prices taken at previous day market close.			

Trading Color

Volumes and activity saw an uptick yesterday, as it seems more of Wall Street got back to work, although it would be a stretch to say that things were "busy." But, we did see the end of the "no bid" condition that led to the dip that started the year, as buyers did return to the market and began laying out positions for 2014.

From an internals standpoint we saw cyclical outperformance in the indices, as the Nasdaq and Russell 2000 both outperformed the S&P 500 (each rallied nearly 1%).

From a sector perspective, though, we didn't see the typical cyclical outperformance, and trading was dominated much more by "micro" factors than "macro" ones.

Utilities bucked the trend and actually outperformed yesterday, thanks to several articles over the past few days that implied we may see a wave of M&A in the utilities sector in the coming quarters. Additionally, given the FOMC minutes today and the jobs report Friday, we almost certainty saw some mild short-covering in the "bond proxy" sectors.

Tech was the best-performing subsector yesterday, thanks to strength in FSLR, WDC and STX, and the trend continued after hours as MU posted a solid earnings beat (the stock was up 5% after hours). Of note, the soft Samsung earnings didn't really weigh on the sector, as that news was largely priced in thanks to the tech drop of last Thursday.

Materials and retail were the only two S&P 500 subsectors to finish yesterday in the red . Materials were weighed down by a drop in the fertilizer and seed companies (MON was downgraded ahead of earnings), while retail saw some selling ahead of same-store sales Thursday and the TIF holiday sales update Friday. (Remember, retailers saw a nice run into year-end so yesterday undoubtedly brought some de-risking.)

On the charts the story remains the same: The old highs of 1,849 remain resistance, while first support sits at 1,815 in the S&P 500.

Don't Miss What Happened In Europe

This most "important" thing that happened yesterday was that the EMU HICP fell to just a 0.8% increase year-over-year, and "core" HICP (which removes energy, food, alcohol and tobacco) fell to its lowest year-over-year increase since the EMU was formed, at just 0.7%.

I'm going to be covering this more, but this all pertains to a very big question: Is Europe turning into Japan of the 2000s, where dis-inflation becomes entrenched? If that's the case, it presents multiple risks and opportunities that we can potentially take advantage of, depending on how things go.

In the U.S. and UK, these low inflation readings would be met with almost-immediate additional easing or economic stimulus. But in Europe, the wide expectation is that the ECB is "on hold" for the foreseeable future. It will be very interesting to see how the ECB verbally reacts to this low inflation reading at its meeting tomorrow, as there is little to no chance we'll see any policy changes from the ECB tomorrow.

The reason I'm pointing this out is because, depending on how the ECB reacts to this threat of dis-inflation, there is potentially a lot of money to be made in being long either European equities or European bonds, especially higher yielding bonds. But, we have to wait a bit longer to see which one it is—but this could be one of the next big trends emerging in the market.

Economics

Get Ready for a Strong Q4 GDP Report—But It Won't Be As Good As It Looks.

You can expect to hear a lot about how fourth-quarter GDP is going to be better than initially expected over the coming weeks, but while Q4 GDP may print north of 3%, I'm afraid it'll be somewhat overstating the pace of economic growth.

Yesterday we got the November trade balance (exports—imports), and it shrunk more than expected, from -39.3 billion to -34.3 billion. And, on the surface, the report looked good. That's the lowest monthly trade deficit since October 2009, and even October's data was revised lower.

And, certainly there were some positives in the report, as exports grew nicely, up 3.6% in October and 0.5% in November (thank you weaker U.S. dollar), while imports dropped (presumably meaning we are buying more of our own stuff, as aggregate demand isn't declining).

And, here's why that lower trade deficit is a positive for GDP: Given the way that GDP is calculated, imports *reduce* GDP, so *fewer imports* means *less of a reduction* in quarterly GDP. So, all other things being static, a smaller the trade deficit means a higher quarterly GDP.

But, here's the rub: The reason imports are dropping is almost entirely because we are importing less crude oil, thanks to surging domestic production. And, while that's a good thing, it doesn't really have much to do with the health of the overall economy. To my point, the "non-petroleum" trade balance fell by a much more modest $0.3 billion in November, not the $6.3 billion the headline number reported.

But, Q4 GDP will reflect the headline trade balance, not the ex-petroleum trade balance, so as a result we should see analysts upping their estimates for Q4 GDP over the coming days and weeks.

Market	Level	Change	% Change
Dollar Index	81.015	.209	0.26%
EUR/USD	1.3614	-.0013	-0.10%
GBP/USD	1.6406	.0002	0.01%
USD/JPY	104.54	.33	0.32%
USD/CAD	1.0776	.0123	1.15%
AUD/USD	.892	-.0042	-0.47%
USD/BRL	2.372	-.0039	-0.16%
10 Year Yield	2.937	-.024	-0.81%
30 Year Yield	3.881	-.017	-0.44%
Prices taken at previous day market close.			

But, from a "real economy" standpoint, those increases aren't going to mean that the economy got materially stronger in the fourth quarter, as undoubtedly some in the media will try to say. Things are getting better economically, but they aren't as good as Q4 GDP will likely imply.

Commodities

Commodities were mostly lower yesterday with the exception of energy futures. The dollar was stronger, up 0.26%. This weighed on the space, specifically precious metals. The PowerShares DB Commodity Tracking Index ETF, DBC, fell 0.20%.

Energy futures were the only commodities that were able to log gains yesterday. They were led higher by RBOB gasoline, which was up 1.21%. The jump in RBOB prices was mostly a result of the record-breaking low temperatures across the nation causing a variety of complications at oil refineries which, in turn, lowered production levels. So, bottom line is the spike should be short-lived and RBOB futures are not expected to make a material move from current levels unless there is a substantial surprise in the EIA inventory report released later this morning.

Crude oil futures were only slightly higher yesterday, adding 0.37%. The modest rally marked the end of a five-day sell-off that sent the spot price lower by about 7% from recent highs of over $100 per barrel. The move was largely an "oversold bounce" but it was also due to some traders buying on technicals. The spot price approached a greater trendline that dates back to June 2012.

As you can see in the chart, the trendline has been tested on three occasions and has proven to be solid support, which was enough to draw in some speculative, technical traders. If there is a substantial build in supply levels or if tension in the Middle East all of a sudden calms down (both of which are unlikely), the price may break through the trendline—in which case the WTI futures would likely fall to between $85 and $87.50 in coming weeks. But, as any experienced market professional will tell you, "you must trust the trendline." So, for now it seems like it will be more range-bound trading in WTI crude oil, with support lying between $93 and $93.20 (Monday's low) while there is psychological resistance at $100 per barrel.

Precious metals were the worst-performing commodities yesterday, with gold and silver falling 0.61% and 1.48%, respectively. The reason behind yesterday's sell-off was mostly positioning ahead of several key events taking place in the latter half of the week (release of the Fed minutes today, ECB/BOE meetings Thursday, and the jobs report Friday), all of which are capable of moving precious metals markets. Support on the chart lies in the $1,220 area and then $1,200 while the 50-day moving average will present some resistance at $1,254.20.

Currencies & Bonds

The Dollar Index caught a mild bid yesterday (up 0.23%) on the stronger-than-expected trade data, and on some short-covering ahead of the FOMC minutes (there are some whispers going around desks that the minutes may be a touch "hawkish" and you saw that reflected in the dollar and gold yesterday).

Turning to Europe, the euro dropped modestly yesterday in quiet trading, as the market further digests the fact that inflation readings are remaining stubbornly low, yet the ECB seems decidedly uninterested in easing policy further. All the while, dis-inflation continues to "creep" across the continent, which should limit any material downside in the euro going forward. Elsewhere in currencies, the pound was flat and the yen gave back a bit of ground vs. the dollar (down 0.25%), as traders positioned ahead of the FOMC minutes this afternoon.

The big movers in the currency markets yesterday were the commodity currencies, as the Canadian and Australian dollars saw sharp declines vs. the greenback thanks mostly to weak trade balance numbers. And, trade balance is particularly important to both Canada and Australia, as their economies are heavily dependent on exports of commodities and natural resources like oil, timber and iron ore.

Starting with the Loonie, it dropped nearly 1% vs. the dollar after two pretty bad economic reports were released. First, November exports in Canada were basically stagnant month-over-month, and that contributed to a trade deficit of C$940 million, much worse than the expected C$140 million deficit. But, the trade balance wasn't the only bad piece of data. The December Ivey Composite Purchasing Managers' Index (PMI) surprisingly dropped below the 50 level to 46.3, badly missing estimates of 54.5. Like most PMIs, a drop below the 50 level indicates contraction, so there are concerns about the business outlook for Canadian firms, given the reluctance of managers to commit capital.

In Australia the data was "less bad" compared to Canada, although the soft export number led to a 0.5% drop in the "Aussie," and with Chinese growth concerns weighing and the Reserve Bank of Australia actively trying to push the Aussie lower, it's likely just a matter of time until we see new lows.

Bottom line, it looks more and more like the "Golden Age" of the commodity currencies has come and gone, and it's just a question of by how much they decline vs. more developed currencies over the coming quarters. With regards to Aussie, we know the target: RBA governors have all but said they want the Aussie at 85 cents vs. the dollar. With regards to the Loonie, there is some support at 92 cents and then at 90 cents, but I imagine it's a question of when, not if, those levels are tested.

Treasuries saw a mild rally yesterday (10-year up 0.14%, 30-year up 0.17%), as shorts continue to cover ahead of the FOMC minutes and other catalysts later this week. The rally in Treasuries came despite a surprisingly soft three-year auction, which saw a bid to cover of 3.25, slightly below the recent average. The soft auction saw Treasuries trade off their best levels, and it makes the $21 billion 10-year Treasury auction later today a bit more interesting , because if we are starting to see a lack of demand for near-dated Treasuries, then we could see rates start to accelerate higher sooner than I thought.

Have a good day—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**	*Stocks opened 2014 with a thud, but that was more positioning than anything else. 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.*

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: **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).**

U.S. Dollar	**Neutral**	**Neutral**	**Neutral**	*The Dollar Index rallied last week, but mostly thanks to a weak euro. The Dollar Index should remain largely range bound, as a stubbornly strong euro caps any material upside.*

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.*

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.**