7:00's Report

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

January 9th, 2014

Pre 7:00 Look

- Futures are modestly higher, as are European markets, thanks to generally upbeat economic data.
- German industrial production beat estimates and EU economic sentiment hit a multi-year high, continuing the week long trend of good data from Europe.
- In China, CPI came in lower than estimates, which is a positive, but concerns about growth remain and most of Asia traded lower.
- Econ Today: BOE Decision (No change expected), ECB Decision (No change expected), Weekly Jobless Claims (E: 331K).
- Fed Speak: George (1:30 PM), Kocherlakota (8:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1838.00	5.50	0.30%
U.S. Dollar (DXY)	81.095	-.067	-0.08%
Gold	1226.50	1.00	0.08%
WTI	92.72	.39	0.42%
10 Year	2.995	.058	1.97%

Equities

Market Recap

Despite several potential market moving catalysts on the calendar, Wednesday was another quiet day in the stock market, as investors continue to look ahead to the Bureau of Labor Statistics' jobs report on Friday. The S&P 500 never strayed far from unchanged and closed down 0.21%

The ADP jobs report and the release of the Fed Minutes from the December meeting had the potential to be market movers yesterday, but neither really caused

Banks: The broad market has been sluggish YTD, but banks are marking new highs, and that's usually a bullish sign.

much of a stir in equities. Futures were slightly weaker pre-open, and when the better than expected ADP report hit, stocks dipped for a second, but then recovered as ADP wasn't so good that it implied tapering may be increased.

Stocks traded either side of flat for the majority of the day, until the FOMC minutes were released. Initially taken as "hawkish," stocks again dipped . But, like ADP, the initial reaction wasn't really accurate, as the Minutes didn't really provide anything new. They reflected the fact that the decision to taper in December was a relatively easy one given the uptick in the economy, but the FOMC remains very cautious about tapering too quickly.

Stocks recovered during the final hour of trading to finish basically flat on the day.

Trading Color

Trading was again quiet yesterday, despite the news items. And, although everyone is back at work and wants to get active, news and data so far this year isn't really changing the outlook for stocks, so there's not a

Market	Level	Change	% Change
Dow	16,462.74	-68.20	-0.41%
TSX	13,614.63	17.70	0.13%
Brazil	50,576.64	146.62	0.29%
FTSE	6,743.75	21.97	0.33%
Nikkei	15,880.33	-241.12	-1.50%
Hang Seng	22,787.33	-209.26	-0.91%
ASX	5,324.41	8.36	0.16%

Prices taken at previous day market close.

lot to do. The outperformance in banks remains the only discernible trend in the market so far in 2014, as banks are up 1.8% year-to-date.

Market	Level	Change	% Change
DBC	24.88	-.26	-1.03%
Gold	1220.30	-9.30	-0.76%
Silver	19.44	-.347	-1.75%
Copper	3.338	-.0215	-0.64%
WTI	92.43	-1.24	-1.32%
Brent	107.27	-0.08	-0.07%
Nat Gas	4.218	-.081	-1.88%
RBOB	2.6599	-.0187	-0.70%
DBA (Grains)	21.32	-.082	-0.34%
Prices taken at previous day market close.			

Tech traded well Wednesday with the exception of Microsoft (MSFT) due to Ford's (F) Alan Mulally withdrawing as a potential CEO candidate.

Homebuilders saw a bit of an oversold bounce yesterday as investors continue to take profits after the outperformance in December.

Materials was one of the better-performing sectors ahead of Alcoa's (AA) earnings this afternoon after the close. Meanwhile, energy was one of the worst-performing sectors as natural gas and crude oil futures both sold off substantially. Sentiment remains depressed in this space.

From a technical standpoint, the situation remains the same. The highs of 1849 remain resistance, while initial support at the 20 day moving average lies at 1817.

Bottom Line

The fact that stocks are down 4 out of 5 days in 2014 is getting to be a bit disconcerting to some, and the fact both the three day and five day indicators are negative is also causing a bit of anxiety. But, the overall market dynamic hasn't really changed, and this market is soft not so much because the fundamentals have turned more bearish (they haven't), but instead because of positioning and a lack of new catalysts or reasons to buy stocks.

And, I think the "hangover' from 2013 is still weighing a bit on the market, as PMs re-allocate funds (case in point, some of 2013's best performers are the biggest laggards year to date: NFLX, BBY, MSFT, GME, TWX). And, while the tape has acted "tired" so far this year, at this point it appears to be little more than consolidation.

Bonds remain the biggest risk to the equity market, and so far they continue to relatively behave. Until we see an acceleration in the rise in yields, the benefit of the doubt remains with the equity bulls.

Jobs Report Preview

Although the Fed is now tapering QE, the jobs report remains the single-most-important economic indicator from a stock and bond investment standpoint. We know the consensus expectation (205K), but savvy investors need to understand *how* the bond market will react to the number whether it's in-line, a miss or a beat. That's because the single-greatest risk to the stock market rally remains an acceleration in the rise in interest rates. Here's what we can expect in each scenario ...

The "Too Hot" Scenario: >250K Jobs Added: The focus of the market, from a Fed perspective, is when the Fed will taper QE again, and how much the taper will be. Currently, the market expects an additional taper of $10 billion at the March meeting.

But, if Friday's jobs report is greater than 250K, it may serve to "pull forward" tapering into the January meeting, or perhaps increase the expected amount of Fed tapering at the March meeting. That's important because it would likely result in a material jump in interest rates, which could weigh on stocks.

Also, keep in mind that the key to Fed policy going forward is the market's belief in the Fed's "Forward Guidance" and ZIRP (Zero Interest Rate Policy). If the jobs number is very strong and implies the economy is really starting to grow, markets will begin to doubt the Fed's "Forward Guidance" on low rates … and that will put additional upward pressure on interest rates.

Likely Market Reaction: If the jobs number is too hot, expect a somewhat "hawkish" reaction. Bonds will be the biggest mover and likely will decline sharply while the dollar will rally. But, unlike pre-tapering, gold won't necessarily sell off materially, because strong economic growth will be associated with an uptick in inflation. If gold spikes lower following the report to around $1,200/oz., I would look to potentially buy that dip.

How equities trade will depend on how quickly yields rise and how emerging-market debt trades. But, it would be unlikely that we would see stocks rally in this scenario, and if anything I'd expect some small, temporary weakness while all eyes turn to the bond market.

__The "Just Right" Scenario: 150K – 250K Jobs Added__: Current expectations are for around 205K jobs added, and that would be the "sweet spot" for the market and the Fed. The market still wants strong economic data, because at the end of the day a strong economy with no QE is the preferred scenario for markets and the economy.

Likely Market Reaction: Equities will rally, while gold and bonds should remain relatively flat or decline marginally, as this scenario will basically reflect what the market has already priced in.

__The "Too Cold" Scenario: <150K Jobs Added__: A jobs print below 150K would re-ignite fears that we're seeing a repeat of the last few years – where we saw a seasonal uptick in economic activity in Q4 that ran out of steam in Q1. With the Fed tapering QE, economic growth is key for a continued stock market rally, and it would be very unnerving if the jobs report was surprisingly weak.

Likely Market Reaction: In this scenario, expect a very dovish response: Equities and the dollar would decline sharply, while bonds and gold would rally.

Economics

ADP Employment Report

- Private Payrolls grew by 238K vs. (E) 205K

Takeaway

The ADP employment report, a pre-cursor to the official U.S. employment situation report out on Friday, beat estimates yesterday. It showed 238K jobs were created in December, the largest single monthly jobs add in more than a year.

The better-than-expected report will certainly move the "whisper number" above the official consensus of 205K for Friday's government report, although the recent trend has been for the ADP report to be modestly higher than the official BLS report, evident by comparing the November headline numbers (ADP 229K and BLS 196K).

The market reaction to the ADP report was hawkish, as the dollar rallied while gold and bonds declined. Stock futures initially dipped on the report, but then rallied back to previous levels. After that immediate reaction, stocks largely ignored the report.

The big mover off the ADP report was the bond market, though, as it seems to have taken over the title from gold as the most-volatile asset when it comes to "hawkish" or "dovish" economic data. Within two hours of the ADP report release, both the 10- and 30-year Treasuries were down more than 0.5% each, which is a decent reaction to a report like ADP. And, that trend of increasing bond volatility is something we can expect to continue as we approach the government report Friday.

Commodities

Commodities were universally lower yesterday, led down by precious metals, the grains and energy. The benchmark commodity tracking ETF, DBC, fell 1.03% as a stronger dollar weighed on precious metals and deteriorating fundamentals in the crude oil market pressured energy.

Precious metals were among the worst performers yesterday as gold fell 0.39% while silver lost 1.50%. Gold and silver futures were flat early on, but then sold off upon the release of the better-than-expected ADP employment report. The strong jobs report stirred a general "hawkish" reaction across all major asset classes, sending gold down toward support levels between $1,215 and $1,220.

Market	Level	Change	% Change
Dollar Index	81.24	.26	0.32%
EUR/USD	1.3568	-.0047	-0.35%
GBP/USD	1.6439	.0038	0.23%
USD/JPY	104.83	.23	0.22%
USD/CAD	1.0803	.0039	0.36%
AUD/USD	.8902	-.0023	-0.26%
USD/BRL	2.3981	.0261	1.10%
10 Year Yield	2.995	.058	1.97%
30 Year Yield	3.907	.026	0.67%
Prices taken at previous day market close.			

Gold came under additional pressure once the December FOMC meeting minutes were released in the afternoon. But the key takeaway from yesterday in gold wasn't the declines, it was the fact that gold didn't decline further than it did. Support at $1220/oz. held, and part of the reason is because as economic growth accelerates, investors are starting to anticipate inflation, which is supportive of gold. Yesterday inflation expectations rose to early a 5 month high, and this underscores the fact that unlike in 2013, good economic data isn't automatically negative for gold.

Turning to energy, WTI crude oil futures fell 1.4% yesterday, closing well-below the major uptrend line I pointed out earlier in the week that dates back to June 2012. The spot price traded more than a dollar below that aforementioned trendline ($93.30) at session lows ($92.26), which is rather bearish. It appears the "trust the trendline" saying is failing to work this time, and one or two more closes below the trendline will be a pretty bearish signal for crude.

As far as fundamentals go, crude oil futures were able to sell off despite the EIA reporting the sixth draw to inventories in a row. Crude supply fell by 2.7M barrels, but the report showed builds of 6.2M barrels and 5.8M barrels in RBOB gasoline and heating oil inventories, respectively. The increase in product supply is largely responsible for the breakdown in crude futures, as outlooks for physical crude demand by refineries are weakening. We are now looking at that first potential price target of between $85 and $87.50, if that trendline is decisively broken.

Natural gas gave up 1.88% yesterday and is down an additional 1.21% this morning ahead of the EIA inventory report. Natural gas futures have broken through the first line of support at $4.20 in overnight electronic trading. The breakdown is mostly a result of broad weakness in the energy sector weighing on natural gas and preventing it from trading independently from the space as it has been doing for some time now. Support now lies between $4.00 and $4.05 while the level to beat is still the December high of $4.532. In order to break out to new highs, however, there will need to either be a substantial draw in inventory levels or several more days of very cold temperatures in the extended weather forecast.

Currencies & Bonds

The Dollar Index gained 0.32% yesterday as it rallied against all major currencies except the Pound, thanks largely to the better than expected ADP report and expectations the FOMC Minutes would be "hawkish" (which they weren't).

European currencies traded mostly off positioning ahead of the central bank meetings this morning, rather than any fundamentals. The pound rallied .23% ahead of this morning's BOE meeting (no policy changes are expected). The euro was down 0.27% despite relatively good economic data released early yesterday morning (both EU retail sales and German manufacturing orders beat analysts' estimates), as investors are anticipating ECB President Mario Draghi to be "dovish" during the press conference later this morning, given the soft inflation readings. No changes to policy are expected, though.

Back in the States, bonds sold off materially on the better-than-expected ADP data, and before the FOMC minutes both the 30- and 10-year Treasury were close to the lows of the day (down 0.7% and 0.52%, respectively). As I mentioned in the ADP write-up, yesterday's price action implies that bonds are now becoming the asset most susceptible to shifting "hawkish" or "dovish" news (taking that title over from gold).

Fundamentally, yesterday's 10-year auction was "OK." Despite the yield on the debt being north of 3% (3.009%, to be exact), demand was still relatively lackluster, and certainly nowhere near enthusiastic. The bid to cover was 2.68, which is better than the very weak December figure of 2.61, but below the average for 2013 (2.71). Bottom line is that the higher yield didn't really attract much demand. While the auction wasn't a total stinker, the somewhat-soft results remind us that, even at higher yields, demand for longer-dated Treasuries is fading, and that's another fundamental negative for the bond market.

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.**