7:00's Report

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

February 3rd, 2014

Pre 7:00 Look

- Futures are flat and EU markets are little changed as better than expected economic data o/n helped calm investors' nerves.
- Global January Manufacturing PMIs were almost universally better than expected with beats in India, France, Germany and the EU composite.
- On Friday night, China's official January manufacturing PMI number was 50.5, meeting expectations and importantly staying above the 50 level, allying some growth concerns.
- Econ Today: ISM Manufacturing PMI (E: 56.0).

Market	Level	Change	% Change
S&P 500 Futures	1773.00	-3.50	-0.20%
U.S. Dollar (DXY)	81.25	-.153	-0.19%
Gold	1245.90	6.10	0.49%
WTI	97.28	-.21	-0.22%
10 Year	2.669	-.024	-0.89%

Equities

Market Recap

Stocks ended a volatile week down small (S&P 500 declined 0.5%), as concerns regarding domestic and global economic growth, as well as continued emerging-market turmoil (especially in Turkey), weighed on risk assets. The S&P 500 is down 3.56% year-to-date.

Stocks got hit early last week on more soft economic data (durable goods) and a steep drop in emerging-market currencies, as the Turkish lira became the epicenter of this latest round of emerging-market angst.

In response to the EM currency weakness, three central banks (India, Turkey and South Africa) surprisingly increased interest rates to help defend their currencies, although the efforts had little immediate effect. Turkey was the big mover, raising interest rates 4.25% on Tuesday night, while the RBI and RBSA took more-measured steps.

Things turned a bit more positive late in the week as U.S. Q4 GDP on Thursday was "not as bad feared" while a critical support zone on the S&P 500 (the 1,775 level) held and both the lira and rand stabilized. That led to a big oversold bounce in stocks on Thursday before markets sold off again Friday on more risk aversion heading into the weekend. (Historically, when central banks do crazy things like devalue their currencies, they do them over the weekend, so traders lighten up on Fridays during such periods.) Stocks finished down slightly on the week, but well off the lows.

Trading Color

Volumes were heavy early in the week and the selling was being done by "real" money (i.e., large hedge funds and mutual funds), but that started to dry up on Wednesday. The Wednesday dip took place on lower volumes, and it was due more to a lack of bids than aggressive selling (which was a change from Thursday-Tuesday). So, while clearly not definitive, there is some implication that this "re-adjustment" in positioning by larger funds that found themselves too "long" to start the year is closer to an end than a beginning, as long as there are no major negative surprises.

From an internals standpoint, we didn't see the textbook "risk off" move in the markets last week, again implying the dip isn't in reaction to some large systemic risk (like emerging-market contagion).

Market	Level	Change	% Change
Dow	15698.85	-149.75	-.94%
TSX	13694.94	-40.34	-.29%
Brazil	47638.99	394.73	.84%
FTSE	6494.79	-15.65	-.24%
Nikkei	14619.13	-295.40	-1.98%
Hang Seng	22035.42	-106.19	-.48%
ASX	5187.91	-2.09	-.04%
Prices taken at previous day market close.			

The Russell 2000 and the Dow Industrials were the laggards last week (both down more than 1%), while the S&P 500, Nasdaq and Dow Transports all outperformed (the Transports actually finished last week fractionally higher). Obviously that has something to do with earnings, but even so, it's not the traditional "risk off" move you would see if the market was turning more bearish. This again implies we're not seeing a structural shift in risk appetites among investors.

Market	Level	Change	% Change
DBC	24.87	-.04	-0.16%
Gold	1240.50	-2.00	-0.16%
Silver	19.135	.009	0.05%
Copper	3.193	-.0335	-1.04%
WTI	97.47	-.76	-0.77%
Brent	106.54	-1.41	-1.31%
Nat Gas	4.918	-.093	-1.86%
RBOB	2.6272	-.0354	-1.33%
DBA (Grains)	24.66	.28	1.15%
Prices taken at previous day market close.			

On the charts, the critical support zone of 1,775 in the S&P 500 held, and really the "Maginot Line" for this market remains the 100-day moving average (1,769-ish). Resistance lies at 1,800 (the market couldn't break through that level on the Thursday rally).

This Week

Focus will remain on the macroeconomic (global PMIs, U.S. jobs report), and although there are still a lot of earnings results to come, most of the "systemically important" companies have reported, so don't expect the results going forward to have much of an effect on the broader markets.

To touch on earnings for just a second, it's been lost amidst all this macro concern, but earnings season has so far been better-than-expected. Revenues are seeing nice quarterly improvement, and management commentary is generally more upbeat. Importantly, the 2014 EPS figure remains around the $120 level, which has the market below 15X earnings thanks to the sell-off (14.8 to be exact). So, while that's not cheap, it's not particularly rich, either.

In Washington, there is some concern about the debt ceiling, which needs to be raised this month. House Republicans ended their 2014 retreat on Friday and we should hear some details about what their strategy is regarding the debt ceiling. Most (including me) expect them to fold on the issue and just raise it, given it's an election year. Where we stand now, I'd aim to "buy" any "debt ceiling dip."

Bottom Line

This market isn't trading well, plain and simple. But, fundamentally I maintain that this sell-off remains more about investors coming into 2014 more long than they should have, and reducing exposure as it becomes reality that 2014 won't be as "easy" as 2013.

The "reasons" for the dip in stocks: Chinese growth slowing and adjustments in the emerging markets as the Fed unwinds unprecedented monetary stimulus, are two legitimate areas of concern. But, neither are new and both are going to be long, drawn-out processes that will have numerous "flare-ups" over the next few years. But, as of right now, there aren't signs that Chinese growth is collapsing and threatening to ignite a debt crisis, nor is there proof of contagion in the emerging markets (although we aren't moving in the right direction). So, neither of these events, in my opinion, are reasons to de-risk at the moment.

The pace of economic growth remains the major concern, and although the data shows that things have slowed domestically and globally, there's nothing to imply we're seeing growth fall off a cliff. So, again, that's not a reason to de-risk. That opinion might change after this week, but for now, growth is "OK."

Bottom line is I would maintain allocations and not materially de-risk, and would be more-inclined to buy this dip than sell it. Sector-wise I continue to favor cyclicals over safety (with a focus on banks); I think Mexico (EWW) is an attractive emerging market to buy on a dip if you can stand the risk; and although it's gotten beat up lately, DXJ still has a ways to rally. Finally, TBT and TBF are attractive here over the longer term.

Economics

Last Week

The parade of data misses continued last week, further stoking fears that economic growth both in the U.S. and globally is slowing. Meanwhile the Fed further tapered its QE program by another $10 billion, as expected, showing that regardless of recent emerging-market stresses, it remains committed to reducing the pace of stimulus.

Like most of January, the December economic data we received last week was worse than expectations, although the data didn't imply anything other than a slight slowing of economic momentum, which is to be expected after the very strong November. Nonetheless, the market has little tolerance for "misses" in the context of tapering of QE, and last week's data has now set the context for a very critical week. This week, we will get a lot of insight into whether growth further slowed in January.

Last week, durable goods, new home sales, jobless claims and personal income all missed estimates. But, there were some silver linings. While durable goods missed (down 4.3% in December), the more important sub-index "New Orders for Non-defense capital goods excluding aircraft" (NDCGXA) declined only slightly, and the rolling three-month average of NDCGXA continued to rise (NDCGXA is a much better indicator of capital spending by business than headline durable goods).

Pending and new home sales were bad numbers on the surface—the same was true of jobless claims, to a point—but all three were generally dismissed as the terribly cold weather likely had an outsized negative effect on the first two, while MLK day skewed the latter.

The first look at Q4 2012 GDP was the positive surprise of the week. Although it only "met" expectations at 3.2%, given the rash of recent data misses, that was taken as "better than feared" and helped the market rally Thursday.

Finally, on Friday night the markets got some "OK" news when the official Chinese January manufacturing PMI met expectations at 50.5. While that's a six-month low, it held the 50 level and will alleviate some (not all) concern about Chinese economic growth brought on by the HSBC manufacturing PMI, which dipped below 50. Although not a strong number, that PMI was definitely "not as bad" as feared, which is a peripheral positive, as the roots of this sell-off are concern about U.S. and Chinese economic growth.

Market	Level	Change	% Change
Dollar Index	81.36	.167	0.21%
EUR/USD	1.3496	-.0059	-0.44%
GBP/USD	1.6433	-.0051	-0.31%
USD/JPY	102.29	-.41	-0.40%
USD/CAD	1.1122	-.0033	-0.30%
AUD/USD	.8745	-.0045	-0.51%
USD/BRL	2.4113	0.00	0.00%
10 Year Yield	2.669	-.024	-0.89%
30 Year Yield	3.620	-.015	-0.41%
Prices taken at previous day market close.			

This Week

The key question facing he market this week is: "Is the economy still losing momentum in January?" (We know it did slightly in December.) And, data this week will go a long way to answering that question.

First, we get the official U.S. January ISM manufacturing PMI this morning (the rest of the world reported earlier this morning). We also get global January composite PMIs (manufacturing and service sector) Tuesday night/ Wednesday morning (which includes January U.S. service sector PMI).

Additionally, it's jobs week, highlighted of course by the January jobs report on Friday. Not only does the market want to see the monthly job adds get back toward the 200K level (estimates are around 180K as we start the week), but it will be critical to see large, positive revisions to that awful December number. In this release, the revisions will be as important as the headline number. But, before the official report, we'll also get the January ADP jobs report and weekly claims on Wednesday and Thursday, respectively.

Also, on Thursday morning both the Bank of England and European Central Bank have interest rate meetings. The BOE will be a non-event, but the ECB will be closely watched, given last week's EU HICP (measure of inflation) was again soft, showing that dis-inflation remains a risk to the Continent. There was a growing expectation at the end of last week that the ECB might incrementally take action (cut rates by 10-15 basis points), but the current "official" expectation is that it will keep policy unchanged.

Emerging-market headlines aside, the key concern for the market remains: "Is global and U.S. economic growth slowing in the face of less-accommodative central banks (particularly the Fed)?" How that question is answered is much more important over the medium term than a continued drop in the Turkish lira.

Commodities

Commodities markets were mixed last week with natural gas and precious metals declined while crude oil traded slightly higher. The benchmark commodity tracking index, DBC, finished the week little down 0.72%.

Natural gas remains by far the most active and volatile commodity as it saw multiple 10% swings last week. Natural gas futures finished the week down 5.2% after breaking to a fresh multi-year high of $5.486 on Wednesday. Weather continues to be the main driver of futures prices but dwindling supply levels is certainly turning the fundamentals more in the bull's favor, and I continue to believe the best way for most investors to play this bullish trend remains via the natural gas E&P ETFs, which should benefit over the medium term from structurally higher gas prices.

Crude oil was able to break through some long standing resistance levels as futures rallied 0.52% last week. A recent demand driven rally in heating oil prices has helped support WTI crude oil, however weak economic data, specifically in China, is proving to be a headwind for a continuation of the rally. We can expect WTI futures to remain largely range-bound between $92.00 and $100 per barrel in the near term.

There was weakness in the precious metals market last week as the "crisis" bid in gold came out of the market thanks to stabilization in emerging markets. Gold and silver lost 1.92% and 4.13% respectively. Gold threatened to break above some long standing technical resistance in the mid $1260's, but as I said, it's usually not a good idea to buy break outs in gold that are the result of a "crisis" bid. Inflation remains the next major positive catalyst for gold, and as I continue to recommend buying dips more toward the $1200 level with stops just below $1180.

Currencies & Bonds

The Dollar Index rallied more than 1% last week thanks to the Fed further tapering QE by $10 billion (and more importantly giving the impression that tapering will continue) and euro weakness. The Dollar Index is at a 2-week high and threatening to break resistance at 81.50.

The euro dropped nearly 1% to close at a three-month low after January HICP came in low, again—prompting more speculation that the ECB will do "more" to fight dis-inflation. That sentiment was furthered by a WSJ article Friday afternoon that implied the ECB may take more incremental easing steps (link here).

In Asia, the Aussie dollar saw a short-covering bounce ahead of the RBA meeting tomorrow (no change expected), while the yen rallied on a global "risk off" bid early in the week to close near a 2-month high vs. the dollar.).

In the emerging markets, the Turkish lira and South African rand are now the key currencies to watch, and both rose vs. the dollar last week thanks to a late-week rally in response to both CBs raising rates. In the lira particularly, holding the level pre-rate-hike (2.34 vs. the dollar) is key to global market psychology. Focus will remain on emerging markets this week as global data is released.

Turning to bonds, the "counter-trend rally" continued as global macro concerns and disappointing data trumped the Fed sticking to the tapering schedule. The 30-year Treasury yield is at 3.60%, while the yield on the 10-year dropped below 2.70% for the first time since early November.

Despite the rally, though, nothing fundamental has changed to imply the decline in bonds is over: The Fed is still tapering, growth is still accelerating and inflation, while still low, has likely bottomed. So, bottom line, while painful, I view this as an excellent entry point to "leg into" more bond shorts.

Have a good week,

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 stock finished January decidedly lower. But, this decline seems more about positioning than any significantly negative fundamental news, and as a result I view this more as a correction than a trend change.* *I remain bullish above the 100 day MA (1767) while 1800 is resistance.*

Trade Ideas

Long Japan: **DXJ has gotten hit hard as the yen has rallied, due mostly to emerging market angst. But, the Japanese economy is improving, and seeing as I don't think this latest EM angst is a bearish game changer, I believe the yen will resume its declines and DXJ is not done rallying.**

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**

	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**	*Treasuries have seen a decent "counter trend rally" and traded to multi-month highs, as emerging market angst put a "fear bid" into bonds. But, with the Fed intent on tapering and inflation likely having bottomed, the larger downtrend remains in place, and I would use this bounce to add to "short bond" positions.*

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.**