# 7:00's Report

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

***February 6th, 2014***

## Pre 7:00 Look

- Futures and most international markets are modestly higher as global markets tread water ahead of the ECB meeting later this morning and the jobs report tomorrow.
- News wise it was quiet. The only economic release was German Manufacturers Orders, which slightly missed estimates, although there's no reaction from the market.
- Econ Today: BOE Rate Decision (E: No Change to Policy). ECB Rate Decision (E: No Change To Policy). Weekly Jobless Claims (E: 337K).
- Fed Speak: Tarullo (10:00 AM), Rosengren (5:30 PM).

| Market | Level | Change | % Change |
|---|---|---|---|
| S&P 500 Futures | 1752.00 | 8.00 | .46% |
| U.S. Dollar (DXY) | 81.195 | .071 | .09% |
| Gold | 1260.80 | 3.90 | .31% |
| WTI | 97.90 | .51 | .52% |
| 10 Year | 2.667 | .043 | 1.64% |

## Equities

*Market Recap*

Stocks closed Wednesday basically flat as the market continues to digest Monday's collapse and traders look ahead to the jobs report Friday. The S&P 500 fell 0.20%.

Stocks were slightly lower Wednesday morning following an "in-line" ADP jobs report, but surprisingly took a leg lower after the ISM non-manufacturing PMI actually beat estimates. I heard this reaction explained as: "The market didn't like it because the good data meant the Fed will continue to taper." But that is B.S. Sellers tried to push the market below Monday's low immediately following the ISM yesterday to see if they could trigger more sell programs, and stocks hit their lows down close to 1% shortly after 10 a.m.

But, support at 1,739 held, and stocks began a slow and methodical rally back to unchanged, where they stayed for the remainder of the day.

From a catalyst standpoint, besides the aforementioned economic data, there were two Fed speakers yesterday (Dennis Lockhart and Charles Plosser). But, neither said anything new, as both reiterated that tapering of QE will continue at the pace of $10 billion per meeting unless the economy gets demonstrably worse or better.

*Trading Color*

It was a much more "quiet" market yesterday than it has been all week (and even last week) and volumes saw a big drop compared to earlier in the week. Part of that was due to the weather (commuting was not easy in many parts of the country yesterday) and also due to the lack of material catalysts.

From an internals standpoint, although it was on low volumes, the cyclical indices again lagged. The Dow Transports and the Russell 2000 badly underperformed the S&P (down 1.24% and 0.72%, respectively), while the Dow Industrials finished slightly positive. So, again, we didn't see any sort of buying conviction toward the cyclical side of the market.

Looking at the sectors, there was no discernible pattern to note. Most S&P 500 sub-sectors didn't move more than 0.5% up or down yesterday, and the best-performing sub-sector was retail (up 0.8%) while energy was the laggard (down 0.8%). On a macro and micro level, "digestion" was the word of the day, yesterday.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dow | 15,440.23 | -5.01 | -0.03% |
| TSX | 13,559.69 | 55.21 | 0.41% |
| Brazil | 46,624.39 | -339.83 | -0.72% |
| FTSE | 6516.96 | 59.07 | .91% |
| Nikkei | 14155.12 | -25.25 | -.18% |
| Hang Seng | 21423.13 | 153.75 | .72% |
| ASX | 5131.40 | 61.09 | 1.20% |
| Prices taken at previous day market close. | | | |

On the charts it was encouraging to see 1,739 hold support, and that remains a key area in the short term. 1,770 remains the first level of legitimate resistance.

*Bottom Line*

The market dynamic remains largely the same. Short term there is a lot of skepticism, as hardly anyone, including the bulls, thinks this correction is "over."

| Market | Level | Change | % Change |
|---|---|---|---|
| DBC | 25.11 | .04 | 0.17% |
| Gold | 1258.10 | 6.90 | 0.55% |
| Silver | 19.89 | .468 | 2.41% |
| Copper | 3.1915 | -.0005 | -0.02% |
| WTI | 97.40 | .21 | 0.22% |
| Brent | 106.28 | .50 | 0.47% |
| Nat Gas | 5.076 | -.299 | -5.56% |
| RBOB | 2.6433 | .0402 | 1.54% |
| DBA (Grains) | 25.37 | .22 | 0.87% |
| Prices taken at previous day market close. | | | |

At the same time, though, there's nothing fundamentally occurring to warrant a significant reduction risk—despite the pain this 5% drop seems to be causing.

Economic growth remains the key concerns, so the jobs number tomorrow is very, very important, and we won't know the near term direction of stocks until we get that report. In the mean time, watch 1770 and 1739 in the S&P 500 as key near term resistance and support.

## Economics

ADP Employment Report

• ADP Private Payrolls rose 175K vs. (E) 170K

*Takeaway*

ADP reported was largely in-line with analyst estimates that were calling for 170K. The ADP report is only really important because it's a precursor to the official government employment report coming Friday and can sometimes push expectations higher or lower. But, given it was in line, ADP yesterday won't effect expectations for Friday's number (80k) or the current "whisper" number (165ish).

ISM Non-Manufacturing PMI

• ISM Non-Manufacturing PMI was 54.0 vs. (E) 53.9

*Takeaway*

The ISM service index also was largely in-line with analyst expectations, and overall it was a solid report. The details in the report were mildly positive with all of the major components, including business activity, new orders and employment, showing rising slightly from December. Additionally, given the unknown negative influence of the weather on recent data, it was somewhat reassuring to several respondents who mentioned that severe weather has had a negative impact on business. Bottom line is that, although the number was good, it is not important (or followed ) enough to calm nervous investors who are concerned with economic growth.

Jobs Report Preview

Given the recent weakness in most December/January economic data points, the jobs number tomorrow has taken on additional importance with regard to the outlook for the economy and to Fed policy.

**The "Too Hot" Scenario: None.** Given the weakness in recent economic data releases, there isn't really a "Too Hot" scenario. Even if January jobs show a greater-than-250K addition, which is virtually impossible, the market will welcome it and stocks will move higher (potentially sharply so). If the number is a strong "beat" vs. expectations, look for equities and the dollar to rally, which would mean bonds and gold get hit, likely hard.

**The "Just Right" Scenario: >160K.** A solid "beat" vs. the whisper number (currently at mid-160K) would provide a strong boost of confidence for the market, and likely we'd see a nice rally in stocks (although I'm not sure it'd be a big one and wouldn't, by itself, end this correction). Bonds, the Dollar Index and gold would likely react the most to a number in this range, because it would solidify that there is no potential Fed "pause" to QE tapering, which would be bond- and gold-negative, and dollar-positive.

**The "Too Cold" Scenario: < 140K.** The risk heading into the report is definitely for a "miss." Make no mistake that "bad news" won't be good, because the market doesn't want to see "tapering" of QE occur – it wants to see a stronger economy. If the number is a big miss, expect stocks to take out the lows of the week, which means the dollar would also drop while bonds and gold would see strong rallies.

**Revisions:** Revisions to the December jobs report are equally as important as the headline tomorrow. It would be a big positive if we saw the December number revised into the mid-100K range. This by itself, even if the January number is soft, could help lift stocks, because inevitably weather will be used to explain any January miss. If we get a miss on the January number and no material revisions to December (say it stays near or below 100K), then hold on, because the market will get ugly quickly.

# Commodities

Commodities were mostly higher yesterday with the sole exception of natural gas. Despite the widespread strength in the space, the commodity tracking index ETF, DBC, was up just 0.17% as natural gas futures weighed heavy on the index.

Natural gas futures remain extremely volatile as the price hit fresh multi-year highs of $5.737 in pre-market trading yesterday morning. Sellers showed up upon the Nymex open and the spot price fell nearly 75 cents over the course of the day (briefly trading below $5) to close down -5.56%. The range of $0.747 was the largest single-day trading range in years. The fundamentals remain bullish but over the short term, there is no telling where traders will push the spot price. For now, psychological support lies at the $5 level while the first level of solid technical support lies below at $4.85. The EIA will release the weekly inventory data for nat gas this morning, with analysts calling for yet another substantial draw of 282 Bcf.

Elsewhere in the energy space, RBOB gasoline was one of the better performers yesterday, gaining 1.05% on a smaller-than-expected supply build. The EIA reported that inventories rose just 500K barrels last week vs. analyst estimates of +1.15M barrels. The EIA also said crude oil supply levels were lower-than-expected, up just 400K vs. analyst estimates of 2.55M barrels, while distillate inventories were largely in-line with analyst estimates at a draw of -2.4M barrels reported. Nymex crude remains range-bound between $92-$100/bbl. However, the fact that heating oil supply remains constrained is supportive of the energy space in general for the near term, especially with more cold temperatures in the forecast.

| Market | Level | Change | % Change |
|---|---|---|---|
| Dollar Index | 81.14 | -.084 | -0.10% |
| EUR/USD | 1.3533 | .0015 | 0.11% |
| GBP/USD | 1.6309 | -.0015 | -0.09% |
| USD/JPY | 101.35 | -.29 | -0.30% |
| USD/CAD | 1.1073 | -.0008 | -0.07% |
| AUD/USD | .8908 | -.0016 | -0.18% |
| USD/BRL | 2.402 | -.0033 | -0.14% |
| 10 Year Yield | 2.667 | .043 | 1.64% |
| 30 Year Yield | 3.653 | .060 | 1.67% |

Prices taken at previous day market close.

Gold prices remain active and continue to trade inversely with the stock market. Gold was up as much as 1.6% as investors digested the economic data releases yesterday morning. Based on the substantial rally in gold, investors continue to have a heightened sense of concern with regard to economic data, which is why we saw the spot price in gold rally to just below last week's high.

The technical resistance remains solid, though, as the sellers came in and defended the 100-day moving average, just as they did when the price visited the 100-day last week. The 100-day MA is sitting at $1,271.70/oz, which is the true level to beat now. A few closes above that level would add some bullish sentiment to the currently neutral market. Support lies at $1,240.

*Is Silver a Buy?*

Silver was the best-performing commodity yesterday, adding 2.41% in a rally driven by a combination of technical buyers and shorts covering. Technically, silver is trading between a downtrend line that has been in place since August (very similar trendline to the one we pointed out in gold several weeks ago), and strong support of $19/oz, which has held three separate times over the past few months, and which has created a "wedge effect" on the charts.

Turning to the fundamentals of the silver market, while we've seen short interest in gold decline over the last month, the short interest in silver has risen, and at 25,674, is historically very elevated level. That's helped to make the "net longs" in silver as low as they have been in several months, despite the recently resilient price action. (Reminder: the COT report is a contrarian indicator, so a high number of short positions poses a risk for a "squeeze"-style rally as those short-sellers are forced to buy back.)

So, both the fundamentals and technicals in silver seem to be turning a bit more bullish. For those with the capital to risk on a more-volatile commodity like silver, from a risk/reward standpoint any dip towards $19/oz. in the futures is worth a shot on the long side via SLV (if you don't trade futures).

## Currencies & Bonds

There wasn't much to speak of in the currency markets Wednesday, as everyone was looking ahead to two potentially market-moving events occurring over the next 24 hours, namely the ECB meeting and the January jobs report. The dollar was off small (0.1%), while the euro was up small (0.1%).


*Silver: Both the fundamental and techincal picture for silver is improving, and I'd look to buy any decent dip with a stop at $19.00/oz.*

The yen was the biggest gainer vs. the dollar yesterday, rallying just 0.2%, finishing basically at the day's lows as investor fear subsided just a bit yesterday. (Remember, the only reason the yen has rallied so much is because of a "fear trade" focused on emerging-market angst and potentially slowing economic growth in China and the U.S.) As those fears recede, so too will the yen. In testament to how quiet things were in the commodity markets yesterday, even EM currencies were flat, with the Turkish lira and South African rand both unchanged.

But, I don't expect yesterday's quiet to last in the currency markets, as two major issues will be further clarified today and tomorrow. First, we're going to see just how serious the ECB is about combating the growing risk of dis-inflation. The current expectation is for the ECB to simply try to be "verbally" accommodative without taking any concrete actions, but that expectation isn't particularly strong. The ECB could cut rates further by 10-15 basis points, or signal that it will no longer "sterilize" government bond purchases (which in theory would be somewhat accommodative).

So, if either of those announcements are made later this morning, expect the euro to fall. But, it's important to realize that either of those moves is a "half measure." The market wants the ECB to do QE, and that remains a very, very remote possibility for a multitude of reasons. So, even if the euro dips on policy action, it's not an outright short in my mind unless they totally shock everyone and announce some type of extraordinary stimulus.

The bond market was not quiet ahead of the key events today and tomorrow. The 10- and 30-year both fell modestly (down 0.2% and 0.6%, respectively) yesterday. That drop came despite any single catalyst, but if I had to pinpoint one thing, I think the in-line economic data (ADP and ISM) combined with recent Fed speakers reiterating that a $10-billion-per-meeting taper is the "default" reminded bond investors that we are in a new era of *less* accommodation. While market corrections and emerging-market flare-ups can cause rallies in bonds, the overall trend is now down.

Keep in mind as we approach the jobs report that only one scenario is bond-bullish, and that's if the jobs number is completely horrid. The financial media is starting to become obsessed with "tapering the taper" of QE, but the truth is it'll take a steep drop in economic activity to get the Fed to stop, and I think the bond market was reminded of that yesterday. And, it's something important to keep in mind during this counter-trend rally.

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 | Bullish | Neutral | Bullish | *Stocks are continuing to undergo a correction as domestic economic growth concerns joins a growing chorus of worries for the market (emerging markets & China growth). Technical support has been violated, but more broadly fundamentals remain positive, and unless data deteriorates further, the rally remains in tact.*<br>*Support now lies at 1707, while resistance is 1770.* |

**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 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 last 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:*** **The yen is seeing a massive "risk off" rally that can brought it below 102 dollar/yen. But, the fundamentals for a weaker yen remains in place, and I would view this rally as an entry point in a still down trending yen.**

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