7:00's Report

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

February 7th, 2014

Pre 7:00 Look

- Futures and global markets are marginally (and cautiously) higher ahead of the jobs report later this morning.
- Economic data o/n was mixed. Chinese service PMIs missed estimates, but more importantly stayed above the key 50 level, and China rallied 1% after being closed for a week.
- In Europe, German and Great Britain industrial production both missed estimates, although there is little market reaction as all eyes are on the US jobs report.
- Econ Today: Employment Situation (E: 181K).

Market	Level	Change	% Change
S&P 500 Futures	1770.25	3.75	0.21%
U.S. Dollar (DXY)	81.05	.048	0.06%
Gold	1260.60	3.40	0.27%
WTI	97.40	-.44	-0.45%
10 Year	2.702	.035	1.31%

Retail: This sector has gotten smoked since early December, but there have been some recent signs that the sector may finally be washed out and worth a look.

Equities

Market Recap

Stocks enjoyed a nice rally Thursday as emerging markets continued to stabilize and economic data largely met expectations, causing shorts to cover ahead of the jobs report this morning. The S&P 500 rose 1.24%.

Stocks opened modestly higher yesterday largely on short-covering ahead of the ECB and jobs report, but got a boost when jobless claims came in a bit better than expected (it helped to remind everyone that ADP and ISM non-manufacturing were "OK" and that the economy isn't totally falling apart). It seemed as though most investors expected yesterday to be a quiet day, and as the S&P continued to grind higher throughout the morning, it caused more short-covering and even some "chasing" by buyers, although it's not really fair to say the rally had a lot of conviction to it. But, stocks held their gains throughout the afternoon and went out basically at their highs.

Catalyst-wise, there really wasn't much after the morning session, although the continued rally in the Turkish lira certainly has helped ease some concerns about the emerging markets (the lira is at a 3 week high and well above the levels it was trading at when the Reserve Bank of Turkey hiked rates 4.5%).

Trading Color

Volumes were again subdued compared to earlier in the week and late last week, and we continue to see lower volumes on rallies than we do on sell-offs (to a point that's always true, but not to this extent). And, activity and participation was light yesterday due to the weather

Market	Level	Change	% Change
Dow	15,624.09	183.86	1.19%
TSX	13,723.98	164.29	1.21%
Brazil	47,738.09	1,113.70	2.39%
FTSE	6,571.58	13.30	0.20%
Nikkei	14,462.41	307.29	2.17%
Hang Seng	21,636.85	213.72	1.00%
ASX	5,166.53	35.13	0.68%

Prices taken at previous day market close.

and to the looming jobs report, so I'm afraid the gains in the market weren't quite as good as they seemed.

And, the market internals confirm that. The Russell 2000 was actually the laggard of the major indices yesterday, rallying less than 1%, while the Transports and Nasdaq also underperformed the S&P 500. That's not what we would typically see if "real money" was trying to add long exposure (cyclicals would normally handily outperform).

Market	Level	Change	% Change
DBC	25.23	.11	0.44%
Gold	1257.30	.40	0.03%
Silver	19.92	.115	0.58%
Copper	3.225	.0365	1.14%
WTI	97.82	.44	0.45%
Brent	107.27	1.02	0.96%
Nat Gas	4.986	-.044	-0.87%
RBOB	2.6812	.0399	1.51%
DBA (Grains)	25.10	-.27	-1.06%

Prices taken at previous day market close.

Sector-wise it was a bit more procyclical, as all ten S&P subsectors rallied yesterday, but cyclicals handily outperformed.

Retail was by far the best performer, rallying more than 3% on dip-buying and short-covering. Away from retail, homebuilders, financials, semiconductors and basic materials all rallied more than 1.5%, while utilities and REITs lagged on profit-taking as interest rates have moved higher over the past few days.

On the charts, the S&P 500 was surprisingly able to reclaim the 100-day moving average. As I said Tuesday, it's encouraging that it was able to retake that support level after only a day or two below it, which is consistent with the corrections from 2013. Holding that level into and through the jobs report will be important, and above there, 1,800 is the next major resistance. Support, should the jobs number be a disaster, remains at 1,739.

Is Retail Finally Washed Out?

The retail sector has been one of (if not the) worst-performing S&P 500 sub-sectors for more than two months, ever since "Black Friday" ended up disappointing. Concerns about margins, and to a lesser extent the consumer, have weighed on the sector, which was widely viewed to be overstocked with inventory and in an industry-wide price war.

But, over the past week, some signs of a bottom have formed. First, WMT warned on earnings last Friday, and the stock rallied. Then, it happened again yesterday with KSS, which rallied 5% after an earnings warning. And, some of the stronger names in the space (KORS) had big rallies and good earnings this week. (Meaning, people aren't painting the entire sector with the same brush as they were in December when every name went down.)

The retail ETF RTH is well off the highs, but looks to be trying to bottom in the low-$55 area. For those looking for a decent place to try and add some long exposure, RTH offers some significant upside if the market can stabilize, and a pretty limited downside (you'd sell it on a violation of $55, so it's less than 5% from here).

Bottom Line

If the jobs number beats this morning and the S&P closes above 1772 (the 100 day moving average) is this bad dream over? Maybe, but the "causes" of the correction (concerns about Chinese growth, emerging markets and the US economy) aren't going away and the market dynamic has become more cautious compared to last year. As a result, I wouldn't blanket add equity exposure if the market rallies, and would be much more selective (retail, DXJ, natural gas E&Ps, inverse bond ETFs). If the jobs number is a "miss" watch 1739 (low of the week) and if its really bad keep an eye on 1707. We won't get there today on bad news, but if we break 1739, that's the level to watch.

Economics

ECB Rate Decision

- The ECB made no changes to policy, as expected.

Takeaway

As was expected, the ECB chose not to take any policy actions at yesterday's meeting. And, while the ECB acknowledged the growing threat of dis-inflation, they didn't show that they are any closer to actually acting to help further ease policy or stimulate the EU economy.

As expected, though, Mr. Draghi used the press conference to try and "verbally" ease by stating that the ECB is monitoring the situation, and if it deteriorates further, they are prepared to act (although he didn't say what they would do).

As I said in yesterday's Report, the market wants to see the ECB use QE – and until EU inflation stops falling, the market will be looking for QE. Mr. Draghi did make some comments that were generally QE-positive when he said that QE wouldn't go against the EU treaties (therefore saying it is legal), but the actual use of QE by the ECB remains a very slim possibility.

Bottom line is the ECB remains unwilling to act further to combat disinflation in the EU, and is sticking to the belief that, over the medium term, inflation will return to normal.

There are two investment conclusions to take from the ECB's policy. First, the euro will remain buoyant vs. the dollar, because dis-inflation is, by default, euro-positive. That will mean the Dollar Index won't be able to rally materially, even in the face of tapering of QE, because the euro is such a huge part of the Dollar Index. And, that's peripherally positive for gold and other hard assets.

Second, and this is a general statement, but higher-yielding EU bonds, especially any PIIGS debt, should continue to be the big winner from the ECB's intransigence. There is little to no default risk for the PIIGS anymore – that much is clear. So, in the face of rising deflation risk (which is generally bond-positive), higher-yielding debt should become more and more attractive to international investors looking for yield.

Even if the ECB is right and dis-inflation stops over the coming year, we're still a very, very long way from a turn higher in inflation in the EU. "Long PIIGS debt" (and to a lesser point, long EU higher-yielding debt) remains one of the more-compelling fixed-income investments out there. There aren't really any ETFs that get you exposure to PIIGS or high-yield EU debt, but there are numerous mutual funds.

Market	Level	Change	% Change
Dollar Index	80.975	-.154	-0.19%
EUR/USD	1.3591	.0059	0.44%
GBP/USD	1.6325	.0017	0.10%
USD/JPY	102.11	.68	0.67%
USD/CAD	1.1068	-.0014	-0.13%
AUD/USD	.8955	.0051	0.57%
USD/BRL	2.3807	-.0174	-0.73%
10 Year Yield	2.702	.035	1.31%
30 Year Yield	3.675	.022	0.60%

Prices taken at previous day market close.

Commodities

Commodities were mixed yesterday ahead of today's jobs report. Industrial commodities showed strength while natural gas and grains were lower. The benchmark commodity tracking index ETF (DBC) was up 0.4%.

Copper futures and RBOB gasoline were the two best-performing commodities yesterday as they rallied 1.51% and 1.14% respectively. Copper moved higher for two reasons. First, copper has been absolutely crushed recently (in fact copper futures were down every day for two weeks straight starting on 1/22), so there was definitely some short-covering ahead of this morning's jobs report. Second, trading is set to resume in China today after being closed for a week for the lunar new year, and that led to additional short-covering. On the charts the first line of resistance hovers around $3.26 while the first line of support lies at this week's low tick of $3.175.

RBOB gasoline rallied 1.51% thanks to news out that a major European refinery went offline due to power outages. The refinery is expected to stay offline for 5-6 days for repairs, which was obviously enough to move the price higher by a few cents on the Nymex.

Staying in energy, it was like deja vu in the natural gas market yesterday. Just like last Thursday, natural gas rallied to new highs in the morning ahead of the EIA release and then reversed and fell to the low end of the current trading range after a smaller than expected draw in supplies (262k bcf vs. (E) 282k bcf). The technical support the level to watch remains $4.85.

The takeaway here is that once again there was a *huge* draw in natural gas supply, but futures sold off because the draw was slightly lower than analyst expectations, which was a disappointment for speculative longs in the market. But, short term expectations aside, supply levels are down **28.8% from last year and are sitting 22% lower than the 5-year average.** So with colder-than-normal temperatures supporting demand, and supply at multi-year lows, the fundamentals remain positive, especially for the natural gas E&Ps.

Moving to the precious metals market, gold futures rallied nearly $10 early yesterday due to the ECB decision being "less dovish" than many investors had hoped. The news sent the euro higher, which in turn sent the dollar lower and brought buyers into the gold futures market. But, as stocks rallied throughout the day, gold sold off and finished the day essentially unchanged. Yesterday's price action showed that gold is still primarily trading inversely to the stock market and the "crisis bid" remains the dominant factor in gold in the short term (and I don't like buying gold when its being pushed higher by a "crisis" bid. Watch gold closely upon release of the jobs report. If the number is much stronger than expected (say 200K), gold futures will likely fall substantially, and seeing as I'm a medium/longer term gold bull, I'd look to buy gold on a dip towards $1200 and silver on a dip towards $19.00.

Currencies & Bonds

Currency markets remained relatively quiet yesterday ahead of the jobs report, although the ECB decision did have some influence. Starting with the euro, it rallied 0.4% vs. the dollar after the ECB remained on hold and didn't alter monetary policy, although the euro finished well off the highs of the day as Draghi's press conference was somewhat dovish.

Given the ECB remains on hold and the Fed seems committed to a $10 billion per meeting tapering of QE, we can expect the Dollar Index and the euro to remain range-bound, until the policy outlooks for one of the central banks materially changes (and that's not going to happen anytime soon).

The yen was the worst-performing currency yesterday vs. the dollar, falling 0.8% as risk came back into the markets. The yen had rallied to a three-month high primarily on a "fear bid" based on emerging-market angst and economic slowdown. But as emerging markets have stabilized and the last few economic releases have been a bit better than estimates, some of those fears have subsided, and the yen has resumed its more-natural state of decline vs. the dollar. Obviously how the jobs report turns out is important, but I continue to stress that selling yen in the low-100s vs. the dollar is about as sound a trade in the markets over the medium/longer term as any.

On a fundamental note, there were some reports yesterday that several members of the BOJ said they weren't concerned about recent emerging-market volatility, and had no intention of providing more accommodation in the face of recent market "turmoil." Some took that to be slightly "hawkish." I do not think that's right, though. Frankly, compared to some of the things we've had to deal with over the past few years, this recent EM volatility is small potatoes. I'd become a lot more nervous about it if the world's central banks even acknowledged it – as I'd think to myself "Wow, if they are nervous about this, it must really be bad." So, I for one am pleased central banks are ignoring this recent correction and EM volatility, and take it as a vote of confidence that this isn't as bad as it seemed on Monday.

Treasuries declined modestly Thursday, although the 0.24% and 0.25% drop for the 10- and 30-year, respectively, is a lot less than you would typically expect with the market up more than 1%, and certainly that in part is due to the jobs report this morning. We should have a pretty good idea by about 8:31 whether this counter-trend rally in bonds is over, or if it's got further to go. And, while I am an ardent bond bear, I think the bar for the Fed to "taper the taper" of QE is set much higher than the market realizes. (Even with modest softness in the jobs report, the Fed will continue to taper.) As a result, I think you can continue to "leg into" bond shorts at these levels, barring a totally horrid jobs report this morning.

At some point, the global banking system has to return to some sense of normalcy. QE cannot be a panacea for every mild downturn in the economy or emerging-market currency crisis (we survived '98 without massive QE), and I think the sooner we get to that point, the better for the long run.

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	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.* *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.**