7:00's Report

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

August 21, 2013

Pre 7:00 Look

- Futures drifting slightly lower after another quiet night of news ahead of FOMC minutes later today.
- Economic data o/n was sparse, and the only real print was UK industrial trends, which beat expectations. But, Europe isn't really reacting and most indices are down about .5%.
- Emerging markets continue to try and stabilize, as Indonesia bounced and the Reserve Bank of India provided more liquidity, but its an uneasy calm this morning.
- Econ Today: Existing Home Sales (E: 5.15M saar), FOMC Minutes (2:00 PM)

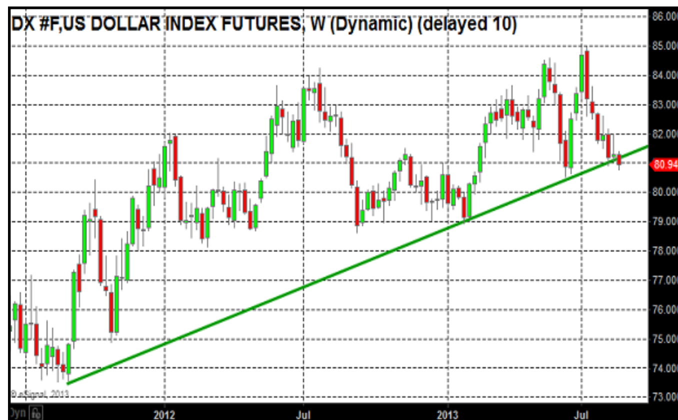
Market	Level	Change	% Change
S&P 500 Futures	1645.00	-5.50	-.32%
U.S. Dollar (DXY)	81.095	.161	.20%
Gold	1363.80	-8.80	-.63%
WTI	105.60	-.05	-.05%
10 Year	2.814	-.07	-2.43%

Equities

Market Recap

Stocks bounced back Tuesday as "good" earnings by Home Depot (HD), The TJX Companies (TJX) and others, combined with some calm from the emerging markets, helped stocks have one of their best days of the month (which isn't saying much). The S&P 500 rose 0.38%.

It doesn't take much analysis to figure out why stocks bounced yesterday: Best Buy (BBY), Urban Outfitters (URBN), TJX, J.C. Penney (JCP) and, although it finished lower, HD, all beat earnings. Plus, we saw relative calm from the emerging markets. (The Reserve Bank of India stepping in to support the rupee at about 5:30 a.m. yesterday helped instill some calm in the markets.)



The Dollar Index weakness continued yesterday as the dollar broke through a long standing uptrend line, before bouncing back above it this morning.

But, despite the positive catalysts and a short-term oversold market, the bounce wasn't really all that great. Markets finished well-off their highs in what was another very quiet day.

Trading Color

While yesterday wasn't really impressive, the one positive that I do want to point out was the Russell 2000 had a big day, rallying more than 1.5% to easily outperform all the other major averages. I point that out because for the last several corrections in the market, the Russell has bottomed first. While I don't think yesterday was the bottom, a 1.5% gain on an otherwise slow day is certainly worth pointing out.

Looking at the sectors, obviously with so many good earnings, consumer discretionary and retailers were the big outperformers. (Although, keep in mind that this group has been under pressure for a few weeks and the earnings "beats" came after some pretty dialed-down

Market	Level	Change	% Change
Dow	15002.99	-7.75	-.05%
TSX	12670.11	82.09	.65%
Brazil	50507.02	-1067.07	-2.07%
FTSE	6404.66	-48.80	-.76%
Nikkei	13424.33	27.95	.21%
Hang Seng	21817.73	-152.56	-.69%
ASX	5099.99	21.81	.43%
Prices taken at previous day market close.			

Copyright 2013, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

expectations.)

Away from the retailers, we saw bounce-backs in some of the "bond-proxy" sectors as utilities, REITs and telecom all rallied close to 1%. But, again, take that in the context that they have been the big underperformers lately.

Homebuilders also recovered nicely, and bulls continue to hope that homebuilders are trying to put in a bottom here. If they can, bulls hope that's a leading indicator for the broader markets. I watch the SPDR S&P Homebuilders (XHB), so jot down $28.16 and $30.30—that's the old low and overhead resistance. If homebuilders are bottoming, the former should hold and the latter should be broken in the next few weeks.

Market	Level	Change	% Change
Gold	1372.20	6.50	.48%
Silver	23.10	-.12	-.52%
Copper	3.33	.00	.09%
WTI	105.00	-2.10	-1.96%
Brent	110.15	.25	.23%
Nat Gas	3.44	-.03	-.75%
Corn	4.75	-.10	-2.06%
Wheat	6.46	-.07	-1.15%
Soybean	12.90	-.13	-.98%
Prices taken at previous day market close.			

Volumes were again very low and trading was extremely thin yesterday, as its been throughout August. Although the S&P 500 rallied yesterday, the index stalled right at its 50-day moving average and closed below it for the second-straight day—not the most-encouraging technical signal. Next support lies in the mid-low 1620's.

Bottom Line

If you're looking for a reason to be a bull, there were some anecdotal positives yesterday, but nothing much changed. If interest rates can slow their ascent and emerging markets can behave (they don't really have to rally) then, like we saw in July, this market can rally.

But, the bottom line is the global market continues the process of adjusting to the beginnings of a policy change from the Fed, and it's an adjustment process that will take time and have its share of hiccups. Although I think the burden of proof remains with the equity bears, I'd be cautious about adding any additional long exposure other than to European equities so far on this dip.

I will again point out that the much-easier way to make money from the new reality of higher interest rates is by getting positive exposure to higher rates (TBF, TBT, STPP), not by analyzing each and every tick of an equity market in August that is very thinly traded.

Economics

FOMC Minutes Preview

If past is prologue—and it usually is with the Fed—then we can expect these Federal Open Market Committee minutes to be, on the margin, dovish.

But, the key in this release is whether or not it's dovish enough to push back the consensus expectation of tapering being announced in September, and the answer will most likely be "no."

We can expect there to be some mention in the minutes about the economy losing some steam in July (remember, the Fed statement from this meeting saw a reduction in economic growth from "moderate" in June to "modest" in July). This will likely be the most "dovish" aspect of the minutes. Other "dovish" topics of discussion will likely be the low levels of inflation and the rise in mortgage rates (as both were singled out in the FOMC statement).

As far as new topics being discussed at the meeting, investors will want to see if there was any further discussion about the actual logistics of tapering QE. Specifically, as September nears, some of the questions the market will want answered are:

- How much will QE be tapered? (I've heard $20 billion starting in October is the general consensus right now, although that likely will change.)
- How will QE be tapered? By reducing the purchases of Treasuries and mortgage-backed securities, or just one of the two? (Consensus right now is that because of their concern about mortgage rates, the reduction will only be in Treasuries.)

As I said, these minutes should be "dovish." But unless there's a sentence like "many Fed governors worried that a reduction in asset purchases would hurt the recovery," don't expect the minutes to significantly alter the expectations of a September tapering announcement.

Copyright 2013, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

Commodities

Commodities were mildly weaker Tuesday, with DBC trading down 0.2%. There wasn't a lot to talk about in commodities yesterday outside of oil and gold.

Starting with the latter, gold rallied 0.4% and continued to trade well since breaking out of a months-long downtrend last Thursday. Although, obviously, the FOMC minutes and resulting dollar reaction will be an important factor as to whether or not gold continues to rally from here. We're seeing some weakness early this morning on modest dollar strength, but that's to be expected ahead of the minutes.

WTI Crude again failed to trade through $108/bbl and remains range bound in the low $100's.

Turning to WTI crude, it fell 2% yesterday in thin trading. Outside of the grains it was the only commodity to move more than 1%. If we've got to point to something fundamental to explain the weakness in WTI, the Chicago National Manufacturing index was a touch weak, but that by itself didn't cause a 2% decline in the contract.

What did cause it, most likely, was the fact that the WTI chart is looking worse and worse, with WTI apparently putting in a triple-top at the $108/bbl level. Truth is, WTI appears to be range-bound at the moment between about $102.50-ish on the downside and $108 on the upside. So, once WTI failed to break through resistance again yesterday, any late longs sold and shorts jumped on for a quick trade. Combine that with a thin market given that it's the middle of August, and down we go.

I'd continue to look to buy WTI crude/energy on a dip toward the lower end of the range. But, more broadly, it's going to take another round of positive economic data to get WTI through resistance. Given the economy is expanding, I think ultimately we do break through and head higher in WTI crude, but for now we remain range-bound.

Commodities are treading water so far this week, and that makes sense, as the FOMC minutes have the potential to be a market-mover for the non-industrial commodities (precious metals and grains). Meanwhile the global flash manufacturing PMIs tomorrow morning will be a potential catalyst for the industrial commodities (oil and copper). But, the quiet trading in the commodity markets so far this week is likely over, and the events today and tomorrow may decide whether we extend the rally or test the recent breakout levels.

Currencies & Bonds

The currency markets were completely devoid of any fundamental news Tuesday, although that didn't stop the Dollar Index from trading moderately lower (0.4%) and breaking through support and an uptrend line that's been in place since May of '11. There wasn't a reason for the dollar weakness yesterday other than euro strength, although there was no fundamental reason at all for the euro to rally 0.6% vs. the dollar other than money seems to want to come out of the dollar and into the euro, regardless of fundamentals that say the exact opposite should be happening.

I'll cover why I think this is happening below, but looking around the rest of the currency markets, the pound was flat vs. the dollar, while the yen rallied modestly (0.3%). The yen rose not because of any fundamental news, but instead because money moves into the yen whenever there is turmoil in Asia and the emerging-market weakness is causing turmoil in Asia (evidenced by the Nikkei's 2%+ dive Tuesday).

Market	Level	Change	% Change
Dollar Index	80.912	-.314	-.39%
Euro	1.3418	.0083	.62%
Pound	1.5676	.0028	.18%
Yen	97.25	-.30	-.31%
CAD $	.9626	-.0040	-.41%
AUD $	.9090	-.0019	-.21%
Brazilian Real	.4173	.0039	.94%
10 Year Yield	2.829	-.054	-1.91%
30 Year Yield	3.871	-.03	-.77%
Prices taken at previous day market close.			

Copyright 2013, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

Treasuries saw an oversold bounce yesterday, rallying .6% on little more than profit-taking and short-covering ahead of presumably dovish FOMC minutes.

Turning to the topic of the week, emerging markets, we saw a bit of a bounce-back in emerging-market currencies as the Mexican peso and Brazilian real saw strong gains. The rupee finished flat after the Reserve Bank of India intervened in the currency markets Tuesday, selling dollars to help arrest the decline in the currency. The move was a temporary measure and certainly isn't going to stop the rupee from falling, but it was a signal to the market that the RBI is going to get more-aggressive in defending the currency, which peripherally is a positive. While there was a bounce in emerging-market currencies yesterday, EM bonds continued their decline, falling modestly. Emerging markets remain a major area of concern.

Why is the Dollar Down?

The dollar's decline simply doesn't make sense. If we agree that this recent market correction and the turmoil in the emerging markets is a direct result of expected Fed tapering of QE, then that should be dollar-bullish. That's because the marginal direction of interest rates in the U.S. will now be higher, compared to flat to potentially lower rates in the rest of the world.

So, I think there are two potential reasons the dollar is stubbornly weaker. The first I detailed last week in the Report. The gold breakout has caught a lot of international funds off-guard, as they are massively short of gold in dollar terms. With gold apparently breaking its downtrend, those trades have to be unwound, and the way a European-based firm unwinds a gold short position priced in dollars is they 1) cover their short position in gold, 2) sell the remaining dollars they bought to fund the futures trading account and 3) buy euros to repatriate the money.

So, the unwind of that trade results in 1) higher gold prices, 2) a lower Dollar Index and 3) a higher euro, which is exactly what we've seen since gold broke out last Thursday.

That's one, shorter-term "trading" explanation. And if that's right, then the dollar remains a buy here.

The second, more-fundamental explanation is this: The currency markets are calling the Fed's bluff. One problem with my "trading" explanation is that it doesn't explain why the dollar has gone straight down since early July. The only explanation for that, given the increasing expectation of Fed tapering in September, is the market doesn't believe the Fed will actually do it. And, there's precedent for the market to be skeptical.

The Fed has tried twice previously to stop QE, and both times it's ultimately had to "blink" and increase accommodation to help the economy. With 10-year yields near 3%, inflation uncomfortably low and mortgage rates moving higher, the case can be made for the Fed to withhold tapering of QE.

But (and this is just an opinion, so take it for what it's worth), if the Fed doesn't taper QE, it will risk creating a much-bigger problem than we are experiencing currently. The Fed has spent 3+ months preparing the market for tapering, and if they blink now, then I think they risk losing credibility and what control they still have over the bond market.

One way or another, interest rates are rising. The Fed can either moderate that rise as best it can, or it can flinch at the market's "taper tantrum" and risk something much worse. The S&P 500 was at 1,597 on May 1, shortly before the idea of tapering QE was revealed. It's now at 1,650-ish. The prospects of Fed tapering, while hitting the bond market, haven't caused an equity-market decline, and the economic data has gotten better over that period. If that's not enough to begin to reduce QE, then it's hard to think of a scenario that will be right to taper QE.

The reason I bring up this scenario is because if the market is indeed calling the Fed's bluff and the Fed delays tapering, then this is not a buying opportunity in the dollar—it's a selling opportunity. I personally think the Fed will announce a small tapering in September, because I think they realize they can't appear controlled by the market. So, I continue to think this is a dollar-bullish world, but of course I could be wrong. And, if I am wrong, buy gold, because it's the big winner in the above scenario.

Have a good day—Tom.

Copyright 2013, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

The 7:00's Report Asset Class Dashboard

(Outlook on the primary trend for major asset classes over the next month)

<table>
<tr><th></th><th>Fundamental Outlook</th><th>Technical Outlook</th><th>Overall</th><th>Comments</th></tr>
<tr><td>Stocks</td><td>Neutral</td><td>Bullish</td><td>Bullish</td><td>US equities have been consolidating recent gains and going through a typical correction. But, turmoil in emerging markets is threatening to be a potentially bearish game-changer. EM bonds haven't moved to new lows (which would be a signal to de-risk) but stocks will have a hard time rallying until the emerging markets stabilize.

The S&P has broken through its 50 day MA and support now lies in the mid 1620 area.</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

Long/Overweight: The biggest trend in the equity markets currently is the rotation out of “bond proxy” sectors and into sectors positively correlated to higher rates and more economic growth. So, banks are the most favored sector in that environment, followed by other typical cyclicals like tech, consumer discretionary, and energy. For those looking for a contrarian play, basic materials remains on of the biggest underperformers in the market, but offers value if the economic recovery turns global in the coming months.

Internationally, European economic data shows the EU economic is finally stabilizing, so long EWU (UK ETF) or EIRL (Ireland ETF) are two ways to potentially get exposure to a recovery in Europe. Also, the “Long Japan” DXJ trade appears to be back “on” and I'd use any decent dip to initiate or add to positions.</td></tr>
<tr><td>Commodities</td><td>Neutral</td><td>Neutral</td><td>Neutral</td><td>Commodities continue to try and “bottom,” as recent global economic data appears to be showing signs of stabilization in Europe and China. Commodities, as measured by broad based commodity ETFs like DBC finally broke out of a months long downtrend last week .</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

Long: WTI crude remains one of the more bullish commodities, as increasing domestic demand should help push oil higher over the coming months. A double top appears to have been traced out at $108, but I would look to be a buyer of oil on any material decline down to support at $103/bbl (using the ETFs USO or XLE).

Copper has broken its months long downtrend as global growth appears to be stabilizing, and if that continues, industrial commodities offer some value, and an ETF like DBB will offer substantial upside. More broad based commodity ETF's (like DBC) are also a potential value at these levels, if growth continues to stabilize. Commodities and raw materials are the ultimate “contrarian” investment in the current market environment.</td></tr>
<tr><td>U.S. Dollar</td><td>Bullish</td><td>Bullish</td><td>Bullish</td><td>The dollar index has traded to support at the 81.00 level, which should hold if the trend is still higher in the dollar. I remain dollar bullish based on the marginal direction of monetary policy, but if the uptrend at 81.00 is decisively broken, I'll have to admit I'm wrong.</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

Short: Japanese Yen on any decent bounce (YCS being the ETF to use), like we've seen now, especially in the face of weak GDP reports. Short the euro (EUO) on any further bounce due to the fact the ECB is squarely focused on economic growth, and won't let the currency appreciate too much as that would cause a stagnation in exports.</td></tr>
<tr><td>Treasuries</td><td>Bearish</td><td>Bearish</td><td>Bearish</td><td>The outlook for FOMC tapering is more cloudy after the recent FOMC meeting, but the bottom line is whether tapering occurs in Sept or Oct, as long as economic data stays good, tapering will occur, which is bearish bonds.</td></tr>
<tr><td colspan="5"><u>Trade Ideas</u>

Buy: TBF (unleveraged short 20+ year Treasurys) and TBT (2X leveraged short 20+ year Treasury). SJB (inverse junk bond ETF) is also rallying during this period of global uncertainty, and basically has acted as a hedge against falling equity prices. Finally, with the Fed committed to holding down near term rates, the yield curve will steepen dramatically, so STPP should continue to do well.</td></tr>
</table>

Copyright 2013, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

Disclaimer: **The 7:00's Report is protected by federal and international copyright laws. Kinsale Trading, LLC is the publisher of the newsletter and owner of all rights therein, and retains property rights to the newsletter. The Newsletter may not be forwarded, copied, downloaded, stored in a retrieval system or otherwise reproduced or used in any form or by any means without express written permission from Kinsale Trading LLC. The information contained in the 7:00's Report is not necessarily complete and its accuracy is not guaranteed. Neither the information contained in The 7:00's Report or any opinion expressed in The 7:00's Report constitutes a solicitation for the purchase of any future or security referred to in the Newsletter. The Newsletter is strictly an informational publication and does not provide individual, customized investment or trading advice to its subscribers. SUBSCRIBERS SHOULD VERIFY ALL CLAIMS AND COMPLETE THEIR OWN RESEARCH AND CONSULT A REGISTERED FINANCIAL PROFESSIONAL BEFORE INVESTING IN ANY INVESTMENTS MENTIONED IN THE PUBLICATION. INVESTING IN SECURITIES, OPTIONS AND FUTURES IS SPECULATIVE AND CARRIES A HIGH DEGREE OF RISK, AND SUBSCRIBERS MAY LOSE MONEY TRADING AND INVESTING IN SUCH INVESTMENTS.**

Copyright 2013, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com