7:00's Report

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

December 9th, 2013

Pre 7:00 Look

- Futures are unchanged and international markets are slightly higher, as Chinese economic data over the weekend was "ok."
- Chinese November exports rose 12.7% (E: 7.0%), although imports slightly missed (5.3% vs. (E) 7.0%). More importantly, inflation remains stable as CPI rose 3.0% yoy vs. (E) 3.1%, implying the government won't have to dial back stimulus or accommodation, which is a positive.
- In Europe data wasn't so good, as both German exports and October Industrial Production missed expectations.
- Econ Today: No reports today. Fed Speak: Lacker (12:30 P.M.), Bullard (12:50 P.M.), Fisher (2:15 P.M. and 6:30 P.M.)

Market	Level	Change	% Change
S&P 500 Futures	1805.75	0.75	.04%
U.S. Dollar (DXY)	80.25	-.065	-.08%
Gold	1227.50	-1.50	-.12%
WTI	97.81	.16	.16%
10 Year	2.883	.021	.73%

Equities

Market Recap

Stocks closed virtually flat last week after a big jobs-related rally Friday recouped all the losses from declines Monday-Thursday. The S&P 500 is up 26.57% year-to-date.

Stocks acted heavy and declined for four-straight days, despite a lack of any fundamentally negative news. The usual suspects were dredged up by the financial media as reasons for the near-20-point drop in the S&P from Monday to Thursday, including "the market is worried about Fed tapering," "there won't be another budget deal in Washington" and "the holiday shopping season is going badly." But the truth is, markets were mostly digesting recent gains and consolidating ahead of the jobs report Friday.

But, Friday's "perfect" jobs report led to a widespread rally and markets grinding higher throughout the trading day, as good economic news is "good" for stocks. Markets went out basically at the highs of the day.

Trading Color

Volumes and participation in this market remained low last week, and that includes the Friday rally. Intraday movement is still being dominated by trading firms, day traders and algos, while real-money investors remain largely on the sidelines. From a "real money" standpoint, there doesn't appear to be a ton of conviction in this market one way or the other. (No one is really selling or de-risking, nor is anyone aggressively buying any dips either. Larger funds appear "on hold" for the rest of the year.)

From a internals standpoint, most sectors followed the averages this week (we saw sell-offs across virtually all sectors Monday-Thursday, and then a big rally Friday to end the week close to flat). But, there were a few observations to note.

Retail was the laggard last week, hurt by bad earnings and disappointing holiday sales commentary/initial results, and retail seems to be the market's whipping boy at the moment.

Banks ended the week flat thanks to a big rally Friday, but traded poorly early in the week on a combination of profit-taking into the jobs number, and on concerns the Volcker Rule will be tougher on the money-center banks than originally feared. But, with the jobs report solidify-

Market	Level	Change	% Change
Dow	16020.20	198.69	1.26%
TSX	13280.72	80.32	0.61%
Brazil	50944.27	156.64	0.31%
FTSE	6542.50	-9.49	-.15%
Nikkei	15650.21	350.35	2.29%
Hang Seng	23811.17	68.07	.29%
ASX	5186.02	-11.94	-0.23%
Prices taken at previous day market close.			

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

ing January as the likely first tapering of QE, banks remain one of the sectors with a bullish tailwind as the yield curve continues to steepen.

Market	Level	Change	% Change
Gold	1229.60	-2.30	-0.24%
Silver	19.53	-0.04	-0.20%
Copper	3.2695	.008	0.25%
WTI	97.82	0.44	0.45%
Brent	111.74	.76	0.68%
Nat Gas	4.13	-.002	-0.05%
Corn	434.25	.75	0.17%
Wheat	637.25	-.75	-0.12%
Soybean	1325.50	-2.50	-0.19%
Prices taken at previous day market close.			

Surprisingly, we saw some relative outperformance from the "bond proxy" sectors, which had been badly underperforming for weeks and months in the face of higher rates. Utilities, REITs, telecom and consumer staples all outperformed the S&P last week and finished higher, despite yields moving close to the highs for the year.

The reasons were twofold: First, shorts were booking profits ahead of (and after) the jobs number, and second, there was obviously some expectation of a "December taper" built into these sectors, and the jobs number wasn't good enough to confirm that.

So, positioning and sentiment had simply become too negative on the space short term, although I don't think this bounce negates the fact that we will see the "bond proxy" sectors lag over the coming months and quarters.

Finally, looking at the charts, the S&P 500 held support at the 20-day moving average (about 1,785-ish), while resistance sits at the old highs (1,813). Technically, last week looks like textbook consolidation, and the trend remains higher.

Progress In Washington, Not So Much In Europe

Two important, but less-followed, events from last week happened in 1) Washington and 2) Europe.

First, it appears that we will likely get a deal on the budget in the coming weeks, and will avoid another government shutdown. The self-imposed deadline for a deal is Dec. 13, but the real "drop dead" date when the government runs out of money is in early January. But, several reports have said Sen. Patty Murray and Rep. Paul Ryan have reached a deal to keep the government open and replace sequester cuts for two years, potentially providing some clarity for the markets. Bottom line is, as of now, it looks like the threat of another budget battle in January is about to come off the table, which is good.

Turning to Europe, last week the European Central Bank, at its rate meeting, came off as "hawkish" in that it seemed relatively uninterested in doing "more" to spur the European Union's economy and combat the growing risk of dis-inflation and then deflation. This has been the fear for the past few weeks (that the ECB won't do "more").

As that fear was realized, European stocks sold off hard, dropping more than 3% last week. And, as a result of the ECB's seeming comfort with current policy and lack of desire to do "more" to stimulate the EU economy, I exited my "long Europe" trade I've had on since mid-July. There's still a value argument to be made in Europe and I ultimately still think prices go higher over the medium/longer term. But I think it makes sense to step back while the ECB decides what it wants to do, as there will likely be an opportunity to buy back into Europe somewhere lower.

This Week

Since it's a quiet week economically, focus will be on any incremental insight into Fed policy (The WSJ's Hilsenrath is already on it with an article out over the weekend, link here.) Multiple Fed speakers today will also be in focus, although none of the "Big 3" of Bernanke, Yellen and Dudley are speaking.

Washington will be the other focus this week, as the "un-official" budget deadline of 12/13 approaches. On the micro front TOL and HOV earnings (tomorrow and Thurs. morning) will watched for anecdotal insight into the housing market.

Economics

Last Week

Last week's economic data continued the trend of surprising to the upside, highlighted by the jobs report on Friday. The takeaways from last week's data were threefold: First, from an economic perspective, the data further implied we're seeing a mild uptick in economic activity, although nothing huge. Second, from a WWFD

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

(What Will the Fed Do) standpoint, the economic data now solidifies January as the consensus expectation for the first tapering of QE (December remains a remote chance). Finally, looking a bit beyond the immediate term for Fed policy, last week showed inflation remains very, very low, and that will help traders continue to believe the Fed's ZIRP pledge, which should continue to steepen the yield curve (good for banks).

Starting with the jobs report, it was just about perfect, from a market standpoint. Job additions printed above 200K for the second-straight month, and revisions (remember, the direction of the revisions often reflects the general momentum in the labor market) were mildly positive (net revisions to September/October were positive, with 8K jobs added).

One detail that wasn't widely reported but is important was the drop in the "U-6" unemployment rate, which is a more-accurate picture of the actual labor market than the more-publicized unemployment rate because it factors in the underemployed and detached workers. It fell to 13.2%, the lowest level since November 2008. Undoubtedly, there is some positive seasonality in the jobs data that likely will be reversed in Q1 '14 (most of it having to do with holiday hiring), but broadly we can say we're seeing improvement in the labor market.

The second-most-watched number last week (and usually the second-most-important monthly economic number behind the jobs report), ISM Manufacturing PMI, also was strong. It printed its highest reading of 2013 at 57.3, and New Orders, the leading indicator in the report, rose to 63.3.

New Home Sales saw a big jump in October and a steep drop in September, and that mostly reflected the relative level of interest rates (remember they dropped sharply back in October). Bottom line with the housing market is the recovery is ongoing, inventory is low and prices are flat to higher.

Market	Level	Change	% Change
Dollar Index	80.25	.009	0.01%
EUR/USD	1.3703	.0036	0.26%
GBP/USD	1.6347	0.00	0.00%
USD/JPY	102.89	-.01	-0.01%
USD/CAD	1.0636	.0002	0.02%
AUD/USD	0.9100	.0038	0.42%
USD/BRL	2.3255	-.0354	-1.50%
10 Year Yield	2.883	.021	.73%
30 Year Yield	3.917	.003	.08%
Prices taken at previous day market close.			

But, going forward, the data since May has shown the recovery is sensitive to the rise in interest rates (as you'd expect). So, as rates continue to rise, housing numbers will need to be monitored, as an ongoing recovery in housing is essential to economic growth accelerating from current levels.

Finally, it was overlooked in all the focus of the jobs data Friday, but the "Core PCE Price Index"—which is contained in the Personal Income and Outlays Report, and is the Fed's preferred measure of inflation—showed inflation increased just 1.1% year-over-year in November, down from 1.2% in October. That remains well below the 2% goal for the Fed. Although it won't delay tapering, it does imply that the Fed does have substantial room to remain accommodative, even if the economy starts to accelerate (which would be good for stocks and hard assets).

This Week

It's a very quiet week, economically speaking. The only two domestic reports to monitor are weekly jobless claims and retail sales (both Thursday). In particular, retail sales will be watched because last week's commentary on the holiday shopping season turned pretty negative from a bunch of retailers. American Eagle Outfitters (AEO) and Big Lots (BIG) both joined a growing chorus of retailers saying the holiday season isn't going well. So, retail sales, although its November data, will be watched closely.

It's equally quiet in Europe this week, as EMU Industrial Production (also Thursday) is really the only material economic release. The one region where there is some action, however, is China. We already got China's latest trade balance and CPI numbers over the weekend, and Tuesday brings the release of November Industrial Production and retail sales. China remains important because a material economic slowdown there (of which there are fears) remains one of the macroeconomic risks to the global rally in stocks. So, the outlook for China remains important.

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

Commodities

Commodities rallied last week, as crude oil and natural gas lead the space higher. The benchmark commodity tracking index ETF, DBC, rallied 1.2%. This was the largest weekly gain in two months and marked the fourth weekly increase in a row. Commodities were helped last week by commodity specific positive supply/demand fundamentals, and a broadly lower US dollar.

Natural gas futures were able to break through resistance at the $4.00 level and finish the week up 5.6%, which made it the best performing commodity last week. Nat gas closed at $4.13 Friday, marking its highest close since May 29. Weather remains the key driver of natural gas, as early winter frigid temperatures led to a much lager than average draw in inventories last week, and that's continuing this morning as natural gas is up nearly 2%.

Staying in the energy complex, WTI crude oil saw a gain of 5.5% last week. The rally in WTI was fueled by several factors. First, the EIA reported the first draw in supply levels in 11 weeks as refinery utilization has continued to trend higher. Second, news broke that TransCanada plans to begin using the lower leg of the Keystone XL pipeline beginning in early January, which will put pressure on supply levels in Cushing, Okla., the delivery point for WTI futures contracts. Lastly, as year-end approaches, "destocking"—or the reduction of inventories to reduce tax costs—is also taking a toll on national supply levels. However, look for some consolidation in WTI crude prices early this week, as it has rallied six sessions in a row. Also, there is some resistance on the chart up near $98.38, the 200-day exponential moving average.

Gold was actually surprisingly resilient in the face of "hawkish" economic data, and after gold held support at $1200/oz. following Friday's jobs report, I'm starting to get the feeling that the "worst case" scenario may be priced into gold at these levels. However, while the prospects of a waterfall decline from here may be low, there aren't many positive catalysts, as inflation remains virtually non-existent and likely still months/quarter in the future.

Bottom line on commodities is complex is more trading like a market of individual commodities, rather than a broad commodity market. Natural gas, energy and industrial commodities continue to offer the most compelling fundamental investment case, while precious metals and grains continue to lack positive catalysts.

Currencies & Bonds

The dollar index fell almost .5% last week despite strong economic data that further solidifies the expectation of a January tapering of QE. The reason for the dollar index weakness wasn't US based, though, it was European based. The euro surged nearly 1% higher last week after ECB President Draghi signaled the ECB isn't about to take further action to stimulate the EU economy. Given the growing threat of deflation in the EU, the fact that the ECB seems content with current policy is, by default, euro bullish (currencies rise in deflationary environments as cash gets more powerful), and as long as the ECB stays on the sidelines, the trend in the euro will be higher.

The other major mover last week in the currency space was the yen. The yen spent most of last week rallying versus the US dollar, backing away from the 103 yen to the dollar level all week on "hawkish" comments by a BOJ member, and an underwhelming stimulus package. But, the yen dropped more than 1% on Friday following the jobs report to finish the week basically unchanged. Short term timing aside, the "short yen" trade via YCS or DXJ remains one of the most fundamentally backed trades across all asset classes today, and any rally in the yen should be further shorted.

Bonds traded to new lows last week thanks to the good economic data, but interestingly didn't sell off Friday on the jobs report, implying it was already "priced in." That's being further confirmed this morning by the rally in the 30 year (up .5%) as of this writing. So, that implies that, like the yen and gold, bonds have simply gotten too short term oversold. Also like the yen, though, short term timing aside, the trend in bonds is lower, and any rally should be shorted via TBT, TBF or STPP, as clearly the Fed is tapering QE, and rates will move higher over the coming months and quarters.

Have a good week—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)

	Fundamental Outlook	Technical Outlook	Overall	Comments
Stocks	Neutral	Bullish	Bullish	*Stocks continue to consolidate recent gains around the 1800 level. A calm macro-economic horizon and still skeptical sentiment towards the rally remain tailwinds, and over the medium term the path of least resistance remains higher.* *Support in the S&P 500 lies in the 1780-1785 region, while resistance is 18013 (the old highs).*

Trade Ideas

Long Japan: **With Fed tapering expectations shifting to early 2014, the dollar should be supported over the coming months, which likely will result in the resumption of the decline in the yen. The yen has broken through 101 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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Commodities	Bullish	Neutral	Neutral	*Commodities bounced last week thanks to the big rally in the energy space. But, 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.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index traded down last week mostly off euro strength, as a Dec/Jan/March tapering of QE is largely priced in. With the euro in a clear uptrend, it'll be tough for the Dollar Index to trade materially higher, despite the Fed starting to dial back policy.*

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	*Bonds resumed their declines last week, but notably we are seeing the long end of the curve sell off while the short end rallies, creating a steep yield curve. Continue to focus on the long end if you short any bounce (which I think you should).*

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.**

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