7:00's Report

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

March 11th, 2014

Pre 7:00 Look

- Futures are flat this morning and international markets are little changed after an uneventful night.
- Asian markets bounced slightly as everyone further digested the Chinese economic data from the weekend.
- Geo-politically there was no change in the Ukrainian situation, and all eyes are now on the Crimean elections.
- Economically German trade balance largely met estimates and Great Britain industrial production slightly missed (0.1% vs. (E) 0.2%), but neither are moving markets.
- Econ Today: There are no reports today.

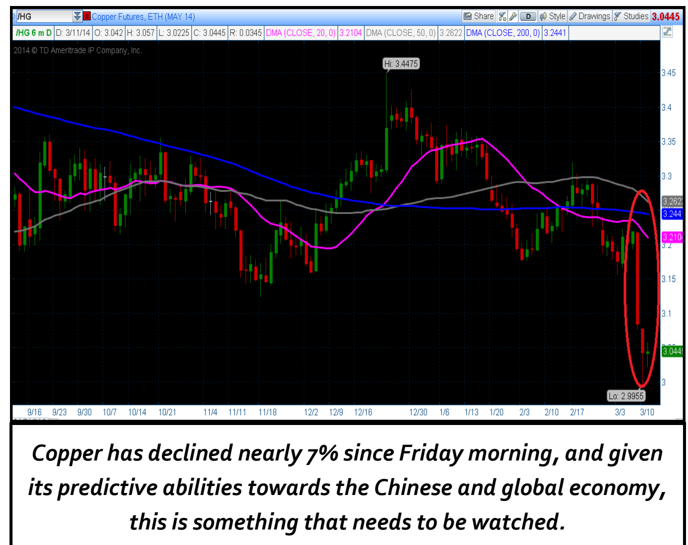
Market	Level	Change	% Change
S&P 500 Futures	1875.50	-1.75	-0.09%
U.S. Dollar (DXY)	80.005	.111	0.14%
Gold	1348.20	6.70	0.50%
WTI	101.43	.31	0.31%
10-year	2.784	-.006	-0.22%

Equities

Market Recap

Stocks were nearly unchanged to start the week Monday as markets shrugged off disappointing Chinese data and some backsliding in the situation in Ukraine during a very quiet session. The S&P 500 declined .05%.

Monday morning saw a bit of trading gamesmanship in the markets, as stocks opened slightly lower but sellers were quick to try to engineer a bigger correction by pushing the market lower, hoping to force out some of those "late longs" I've been referencing. By 10:30 AM



Copper has declined nearly 7% since Friday morning, and given its predictive abilities towards the Chinese and global economy, this is something that needs to be watched.

the S&P was down 10 points and at the lows of the day, despite the fact there were no real, negative catalysts to account for the declines.

But, the market again showed resiliency and the those 10:30 lows proved to be the lows for the day, as the declines stopped and stocks began a rally that lasted the rest of the morning and all afternoon, and stocks briefly turned positive for the first time all day right before the close, but slipped just a touch as the day ended.

Trading Color

It was so quiet yesterday one could be forgiven for thinking it was a holiday, and as silly as it sounds I think we have day light savings time and spring break to blame.

But, despite the low volumes and levels of activity, markets were resilient yesterday, as given the low volumes and participation it was impressive stocks were able to stop the sellers attempt to shake out the weak handed longs early yesterday morning and turn around and grind steadily higher into the close.

Looking at market internals, given the relatively small moves in stocks there weren't a lot of takeaways, but

Market	Level	Change	% Change
Dow	,16418.68	-34.04	-0.21%
TSX	14,302.06	2.98	0.02%
Brazil	45,533.20	-710.87	-1.54%
FTSE	6,673.00	-16.45	-0.25%
Nikkei	15,244.11	103.97	0.69%
Hang Seng	22,269.61	4.68	0.02%
ASX	5,413.84	2.32	0.04%

Prices taken at previous day market close.

Copyright 2014, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

there were some.

First, the weakness in China didn't negatively effect the entire market, but it did weigh on specific stocks. Global miners and basic materials stocks got hit very hard yesterday on the weak China news, and by far were the laggards on the day. I still like this sector on a longer term value play, and that's because I believe in the global economic recovery—but some decent technical damage was done yesterday so I want to see this market settle a bit before adding more.

Market	Level	Change	% Change
DBC	26.07	-.22	-0.84%
Gold	1339.90	1.70	0.13%
Silver	20.85	-.078	-0.37%
Copper	3.0395	-.043	-1.39%
WTI	101.07	-1.51	-1.47%
Brent	107.94	-1.06	-0.97%
Nat Gas	4.651	.033	0.71%
RBOB	2.9475	-.0263	-0.88%
DBA (Grains)	28.49	.11	0.42%
Prices taken at previous day market close.			

The other trend in the market yesterday was that of a continuation of the "higher interest rate" trade, as banks continued to outperform while "bond proxy" sectors like the utilities (XLU) and REITS (VNQ) both finished negative and again lagged the broad market. And, that "higher interest rate" trade is something I think will continue well into the future.

On the charts the market was little changed so you know the set up: Resistance at the old highs of 1883, support at 1867, 1850 and 1827.

Something I Saw Yesterday Reminded Me of 2007.

Copper has fallen 7% in two days, and the potential implications of the cause of that decline are something we all need to monitor very closely, as they represent an unlikely but potentially significant risk to this 5-year bull market.

Copper slumped again yesterday on weak Chinese import data, closing down another 1.33%, and hitting lows of sub-$3.00 early Monday morning. This made the two-day drop in copper a whopping 7% peak to trough. That's the equivalent of oil dropping to $94.82 and gold falling to $1,255 since Thursday's close. That is not an insignificant amount for a major commodity.

Copper is one of the more-predictive commodities (the old saying is that copper has a master's degree in economics). So it's disconcerting, then, that copper and other base metals have fallen out of bed the way they have over the past two trading days.

I've traded copper and the base metals for over 10 years now, and the reason I'm bringing this up to you is because I want to make sure this violent decline isn't foreshadowing some bigger trouble in the Chinese economy.

As you all likely know, I'm not a China fatalist, and I'm not "convinced" the Chinese economy will eventually implode on itself due to the weight of the "Shadow Banking System." It certainly could happen, but I don't believe, as some analysts do, that it's a foregone certainty (and to be honest many of those analysts predicted China's doom years ago, and it's still going strong).

I acknowledge that there is a fair chance that the Chinese government will manage a relatively "soft" landing, and that China will successfully make the transition to a more-balanced economy the same way the UK economy did in the mid-1800s and the USA did in the early 1900s (from an export/manufacturing economy to a balanced economy).

But, I'm also aware of the risk China poses to the global economy, and as such it needs to be monitored. And, to that end, something I read yesterday spooked me.

Apparently the main reason copper fell so hard the last few days wasn't because of the Chinese trade data. Instead, it was because of the default of a Chinese solar company called Shanghai Chaori Solar Energy Science & Technology Co. "Chaori" as it's called, missed a $14.7 million interest payment, and in doing so became the first Chinese bond to default.

What does that have to do with copper dropping?

Well, it turns out that copper is used as collateral for many companies that can't get conventional loans from banks. So, they buy copper in the open market, and then pledge the copper as collateral for cash from lenders. When Chaori defaulted, it reminded everyone that we may see more defaults going forward, and if that occurs, a lot of lenders may be selling their copper to raise

Copyright 2014, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

cash – sending the price substantially lower.

Now, is this Chaori company with the $14.7 million missed interest payment going to be China's "Bear Stearns" moment? No.

But, this sort of "bird's nest" financial integration, where you see two supposedly uncorrelated assets all of a sudden very correlated, does remind me of 2007 (not 2008).

The very first signs of stress in the financial markets started to appear early in 2007, MLK weekend to be exact, and they first appeared in the commodity markets. It took a long time for the cracks to work their way up the foundation of the financial system, but for those of us in the commodity markets – we saw the first signs there (although we didn't realize what they were at the time).

I'm not saying this Chaori default and subsequent copper decline are the same thing – and I don't all of a sudden believe China is about to experience a similar financial crisis.

But, this type of financial interconnectivity does spook me, and it solidifies to me that China remains the No. 1 risk to the global rally, and it needs to be watched carefully.

And, although I was recently called a "methodical contrarian" by a friend and colleague, with regard to copper and China, I'd prefer to sit and wait to see some sort of a bottom start to form before buying into anything China- or copper-related on this decline.

Economics

There were no economic reports yesterday.

Market	Level	Change	% Change
Dollar Index	79.76	.038	0.05%
EUR/USD	1.387	-.0006	-0.04%
GBP/USD	1.664	-.0071	-0.42%
USD/JPY	103.21	-0.04	-0.04%
USD/CAD	1.1098	.0017	0.15%
AUD/USD	.9014	-.0057	-0.63%
USD/BRL	2.3537	.0134	0.57%
10-year Yield	2.784	-.006	-0.22%
30-year Yield	3.728	.006	0.16%
Prices taken at previous day market close.			

Commodities

It was a rough start to the week for commodities yesterday thanks mainly to the soft Chinese trade data, as almost all of the commodities on our watch list traded lower, led down by the industrials. Gold, and natural gas were the only exceptions, as both were able to rally slightly, gaining 0.25% and .6% on the day. The benchmark commodity tracking index ETF, DBC, fell 0.65%.

I've already covered copper, but WTI, Brent, and the refined products also all traded lower yesterday with crude oil leading the way down, again mostly on reaction to China and further profit taking (commodities remain on of the better performing asset classes year to date). WTI crude oil fell 1.47% yesterday, as it again tested support levels toward the lower end of the trading range. And, for now the story remains the same in crude oil, as WTI remains range-bound with support at the 200-day moving average ($100.08) and resistance at $105.

Rising distillate and heating oil inventories, as well as the (eventual) ending of winter, are acting as a headwind on the space, but I don't believe that's enough to turn "bearish" on energy here, partially because geo-politics remain a potential positive wild card (and not just in Ukraine). Case in point, late in the session yesterday there was a universal "pop" in energy futures. The jump was due to a story hitting the newswires that a North Korean tanker was impounded by the Libyan navy for trying to export Libyan oil from Es-Sider, a rebel-occupied port. Front-month crude oil futures jumped nearly 50 cents on the news.

The pop was temporary, but it serves as a good reminder that whether it's Libya, Iran, Nigeria or the Ukraine, there are plenty of areas of the world where geo-politics could be a positive for the oil markets. They, by themselves, aren't a reason to get "long" here, but they are a reason to be very cautious about getting "short" energy at these levels.

Gold futures were able to finish the day slightly higher yesterday, up 0.13%. Gold traded lower overnight Monday but buyers came into the market shortly before the open and sent prices up into positive territory, where futures spent the rest of the day, drifting sideways. The "reason" was the slight backsliding of the Ukraine situation that has occurred over the past few days, and likely we'll see

Copyright 2014, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com

that offer some support in gold at least until the elections in Crimea this coming Sunday.

On a fundamental note, the Commitments of Traders report was released on Friday by the CFTC. The report showed that net long positions held by money managers increased by 4,911 to 101,167, a level not seen since December 2012. And, although the net longs are not historically overextended (a reading above 135K would be concerning), the fundamental situation remains more "neutral" than "bullish."

Gold is trading higher again this morning and fundamentals aside gold continues to "act" very well (I would have expected some follow through selling given Friday's jobs report). Geo-politics are helping, and although I still am waiting to more aggressively buy a bigger dip in gold, these current levels remain "ok" to initiate some exposure if you don't have any on. On the upside, $1362, the multi-month high, remains the key. If gold can decisively break above that level, then the next leg of the rally will have begun and that will be signal to no longer wait for a dip, and to just buy the break out, because this market will be heading higher.

Currencies & Bonds

It was a pretty quiet day in the currency markets yesterday, as the Dollar Index, euro and yen were all flat. The two big movers on the day were the pound and Aussie, which each oddly fell 0.53% vs. the dollar.

Starting with the pound, its decline was due to comments by Bank of England Deputy Governor Charlie Bean, who said at a presentation that any further strength in the pound wouldn't be "particularly helpful" for exports and could prompt the Bank of England to delay any interest rate increases.

The comments caught the market off-guard, as the BOE generally refrains from commenting on the value of the pound, but I don't think they materially changed the outlook for the pound. Despite Mr. Bean's comments, the BOE "delaying" increasing interest rates won't slow the appreciation in the pound for anything other than a temporary period. The market will increase rates commensurate with economic growth, and the BOE will be "forced" up at the short end of the curve.

Bottom line is this dip is probably a "buy" vs. the dollar, as the pound has traded much higher than this in recent history. With the euro now buoyant thanks the ECB being on hold, I don't see any FX differentials materially effecting the UK economy. (Remember the euro/pound value is much more important to the UK economy than the pound/dollar value. The EU is a much bigger trading partner as exports to Germany, the Netherlands, France and Belgium-Luxembourg account of over 30% of total exports compared to just 11% to the U.S.)

Turning to the Aussie, it fell due to an obvious reason: China. As China goes, so too goes Australia and the Aussie, and the soft Chinese import data obviously weighed on the currency. The Aussie enjoyed a nice short-covering rally late last week, but China remains a potential economic headwind for Australia. With the risk of Chinese growth slowing further, combined with the RBA's desire to see a weaker Aussie, I continue to think there are attractive levels to lay out short positions for the medium/longer term.

Bonds were little-changed yesterday as they digested the late-week sell-off amidst little news. Ukrainian tension surrounding the upcoming Crimea vote will likely put some small support into Treasuries the same way it did in gold yesterday. But that's temporary and unless the situation there materially devolves, I'd expect the decline in bonds to resume in the next few days.

Fundamentally, with the jobs report behind us and the mood around the U.S. economy a bit improved, it'll be interesting to see how the bond auctions go this week. Today we get a 3-year note auction that should see good demand, but the more interesting offerings come tomorrow and Thursday, with 10- and 30-year auctions. I'm interested to see the appetite for the debt given the Fed is committed to tapering and the weakness in the economy appears to be temporary.

Have a good day,

Tom

Copyright 2014, 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	Bullish	Bullish	Bullish	*The S&P 500 traded to a new all time high last week, although the gains came on low volumes and with little conviction. But, the broadly speaking the positive backdrop for stocks (macro-economic calm, accommodative central banks, growing economic recovery, skeptical sentiment) remains, so the benefit of the doubt remains with the bulls.* *Resistance is now the all time highs at 1876, while support is the 50 day MA at 1820.*

Trade Ideas

Long Market "Losers": **So far in 2014 the right strategy has been to buy beaten down sectors that offer some value, as opposed to the broad market. It has worked with utilities and most recently the retailers. Now, the banks seem to be the sector that has lagged recently, and if the market continues to rally, we should see them play catch up. KBE remains one of the "easiest" ways to get broad bank exposure. I'd look to allocate to deep cyclicals like industrials (DIA), basic materials (IYM) and global industrial miners (PICK).**

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 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.**

	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 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 Gold: **Gold has now broken out above resistance at $1300/oz., as gold has benefitted from the recent dollar weakness due to soft economic data. Short term I'd only nibble around the mid-$1300's and would prefer to buy more towards $1300/oz. But, short term timing aside, it appears as though a longer term bottom is "in" in gold.**

	Fundamental Outlook	Technical Outlook	Overall	Comments
U.S. Dollar	Neutral	Neutral	Neutral	*The Dollar Index remains largely range bound, as a stronger euro will hamper any ability for the US Dollar Index to rally, despite continued tapering of QE.*

Trade Ideas

Short: Japanese Yen. **This year has been choppy for the yen as there have been several macro-inspired "risk off" episodes, most recently with the Ukraine. But, with the BOJ expected to ease policy further, fundamentals for a weaker yen remains in place, and I would view this rally as a longer term entry point in a still down trending yen.**

Short: Aussie Dollar. **Aussie saw a big short covering rally last week on better than expected data, but with risks to Chinese growth skewed to the downside and the Reserve Bank of Australia wanting a weaker Aussie, the trend remains lower. For those non-futures traders, shorting FXA or buying CROC is the easiest way to put this trade "on."**

	Fundamental Outlook	Technical Outlook	Overall	Comments
Treasuries	Bearish	Bearish	Bearish	*Economic data has turned a bit more positive and it appears as though the counter trend rally in the bond market is ending. The primary trend remains lower, as the Fed seems intent on further "tapering" of QE.*

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 2014, 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 2014, Kinsale Trading LLC. All Rights Reserved. www.sevensreport.com