7:00's Report

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

March 25th, 2014

Pre 7:00 Look

- Futures are slightly higher this morning after a mostly quiet night. Asia drifted slightly lower while Europe is higher.
- European data was mixed. German IFO business expectation index missed, but Great Britain inflation data was lower than expected, implying the BOE could remain accommodative for a while longer (FTSE up 1% on the news).
- Geo-politically the G-7 is boycotting the Sochi summit, but that hasn't escalated the situation.
- Econ Today: New Home Sales (E: 440K). Fed Speak: Lockhart (4:00 PM), Plosser (7:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1852.50	2.75	.15%
U.S. Dollar (DXY)	80.175	.096	.12%
Gold	1315.80	4.40	.34%
WTI	99.95	.35	.35%
10-year	2.733	-.017	-0.62%

Equities

Market Recap

Stocks declined to start the week as steep selloffs in many "momentum" sectors weighed on the markets. The S&P 500 fell 0.49%.

Stocks opened relatively fine Monday as investors focused on the fact that Asian markets were able to rally despite the soft Chinese manufacturing PMI. However, the markets turned negative shortly after the release of the U.S. March flash manufacturing PMI, which slightly missed estimates.

The Russell 2000 looks like it may have put in a "lower high" and is now threatening to make a "lower low."

Although the market turning negative coincided with the economic release, it wasn't the real "reason" stocks fell. Instead, we saw a second-straight day of carnage in the "momentum sectors" — meaning, those sectors that have led the markets higher for months.

Biotech, cloud computing, small caps, and Internet stocks all got slaughtered yesterday, as those sectors declined between 1%-3%. And, that weakness dragged the entire market lower for a time yesterday, although stocks were able to stabilize and close well off the lows (the low in the S&P was 1,849). So, yesterday's weakness was much more "momentum"-based than anything fundamental. (Ukraine, China and the Fed outlook all were unchanged yesterday.)

Trading Color

If it was "high beta" yesterday, it got killed. The Russell 2000 fell 1.3%, the Nasdaq fell 1.2% and the Nasdaq Biotech Index (NBI) plunged 3% (and is off more than 10% from recent highs), while the Internet stocks (QNET) fell 2.7% and cloud computing stocks dropped 1.5%.

"Low beta" relatively outperformed as utilities were the

Market	Level	Change	% Change
Dow	16276.69	-26.08	-.16%
TSX	14278.55	-57.21	-.40%
Brazil	47993.42	612.48	1.29%
FTSE	6590.39	70.00	1.07%
Nikkei	14423.19	-52.11	-.36%
Hang Seng	21732.32	-114.13	-.52%
ASX	5336.63	-10.27	-.19%
Prices taken at previous day market close.			

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

only S&P sub-sector to finish positive (barely so), while consumer staples also were only slightly lower.

But, furthering my point in yesterday's report that this market is becoming a "market of stocks" rather than a "stock market," banks and financials held up very well amidst the selling yesterday. XLF gave up just one penny, while KBE was down 0.5% (which is pretty good considering the big rally we've seen in banks since last Thursday).

Market	Level	Change	% Change
DBC	25.76	0.00	0.00%
Gold	1309.80	-26.20	-1.96%
Silver	19.95	-.36	-1.76%
Copper	2.944	-.0065	-0.22%
WTI	99.55	.09	0.09%
Brent	106.73	-.19	-0.18%
Nat Gas	4.281	-.032	-0.74%
RBOB	2.8924	-.0155	-0.53%
DBA (Grains)	28.065	.215	0.77%
Prices taken at previous day market close.			

Away from those momentum sectors, things were relatively quiet, although total volumes were elevated (again thanks to a lot of heavy selling in those momentum sectors).

On the charts, the S&P 500 again held support at 1,850, and more broadly remains in the 1,880-1,850 range its occupied all of March.

Bottom Line

"Is the extreme sell off in the "momentum" sectors forecasting a greater market decline?" That's the question everyone was asking yesterday.

So far the answer is "no," but it's a situation that bears watching.

The chart on the previous page yesterday caught my attention. This long rally in stocks has been led by "high beta" sectors, including the small caps (Russell 2000). It's notable then that it looks like the Russell may be breaking down after failing to make a new high last week.

The old technical rule of trading is that "Markets Don't Break from Their Highs." Instead, they break down from a failed test of those highs. I'm not saying that's definitively what we're seeing in the Russell, but it needs to be watched. 1169 was yesterday's low, that's a level we shouldn't don't want to see violated.

As far as "why" there was such weakness in the "momentum" sectors recently, there are a myriad of reasons being cited, from worries about upcoming earnings season, to the forecast for higher interest rates in the future having a negative impact on DCF models and valuation, to investors just wanting to take some money off the table in sectors that have performed very well recently. Whatever the reason, the sectors were elevated and due for a pullback of some sort.

More broadly, the S&P 500 remains in 1850ish to 1880ish range that it's occupied since early March, and it'll likely stay there unless we get some material shift in the Chinese growth/liquidity outlook, Ukraine situation or Fed outlook (all of which are low probabilities at the moment).

This remains a "market of stocks" with sector divergences the key. Yesterday "growth" and "momentum" sectors got killed, but banks held up well as did coal, industrials, and consumer staples.

While risks to the market remain (and always will) the focus should remain on quality sectors within this market, not on the broader averages or indices, unless we get a material breakdown (so the S&P crashes through 1850ish or the Russell violates yesterday's low). Bottom line is until that happens, the benefit of the doubt remains with the bulls and good sector selection will remain the way to outperform this market (still like coals, natural gas E&P ETFs, banks, "bond short" basket).

Economics

'Flash' Manufacturing PMI

- March Flash Manufacturing PMI was 55.5 vs. (E) 56.9
- New Orders remain strong, falling just 0.8 to 58.0

Takeaway

Flash manufacturing PMIs were mostly in-line with analyst expectations. The headline index flash was 55.5 vs. (E) 56.9, and although there was a dip in the headline number month-over-month, the index remains well above the low of 53.7 we saw in January.

The details within the report were also good but, like the

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

headline, slipped slightly from last month. New orders, the leading indicator of the report, were little changed at 58.0 (down marginally from 58.8 last month) but importantly they continue to forecast strength going forward.

The important part of this report, while it was a technical miss vs. expectations, was that it further implies (and confirms the market belief) that the awful winter weather was mainly to blame for the dip in the economic data in December/January. (And, since it's weather-related, that would mean the dip is temporary and we should see the economic data continue to rebound.)

Commodities

Commodities markets were mixed yesterday, with gold trading down nearly 2% while energy was relatively flat and the grains outperformed. The benchmark commodity ETF, DBC, was unchanged.

Gold: You don't have to be a Certified Market Technician to see that $1300 is critical support for gold.

Gold was the big story in the commodity space yesterday as futures fell 1.96%, marking the fifth drop in the last six sessions. (The only day in the green was Friday, and that was largely due to shorts covering before the weekend.) Gold is now down 5.85% from last week's highs. In fundamental news the Commitments of Traders were released Friday, and the metals data showed that net long positions held by money managers jumped to a 15-month high at 121,063. However, that data was compiled through last Tuesday (the 18th), and it is likely that many of those "late longs" have unwound or stopped out of their positions as the price has come in over the past week.

Market	Level	Change	% Change
Dollar Index	80.07	-.191	-024%
EUR/USD	1.384	.0049	0.36%
GBP/USD	1.6496	.0012	0.07%
USD/JPY	102.22	-.01	-0.01%
USD/CAD	1.1196	-.0023	-0.20%
AUD/USD	.9126	.0047	-0.52%
USD/BRL	2.3215	-.0022	-0.09%
10-year Yield	2.733	-.017	-0.62%
30-year Yield	3.572	-.037	-1.03%
Prices taken at previous day market close.			

Bottom line in gold is I would recommend buying this dip with stops below the $1,300 level, which is a very important "line in the sand." That's the location of a supporting uptrend line dating back to the lows of December, both the 50- and 200-day moving averages, along with psychological support.

So, once again we've got a favorable risk/reward set up in gold. The clear stop ($1300) is basically 1% from here, while any rally should take us back to the recent highs of $1390ish—so we are risking $15 dollars to potentially make $65—that's a good set up in my book.

Elsewhere in the metals market, copper traded much better than expected given that the Chinese flash PMI results missed analyst estimates. Copper futures closed the day down just 0.22% at $2.9455, which is well off last week's multi-year lows of $2.877.

On the charts it continues to appear that copper is working to establish a bottom. The levels to watch are last week's aforementioned low of $2.877 and the high of Wednesday's short-covering rally of $2.998. The low should obviously not be violated while last week's high tick is the level to beat (or even better, a few closes above $3.00 would be very favorable for the bulls).

The energy space was rather quiet yesterday as WTI and Brent crude oil futures as well as the refined products were little-changed. This was in spite of news that there was a 4K-barrel oil spill in the Houston ship channel over the weekend (that was a logistical problem from many physical oil companies but generally these types of things don't effect the futures markets unless they carry on for days, and this situation didn't).

WTI ticked up to a two-week high in the first few minutes of the primary session thanks to the better-than-expected flash PMIs across the EU. However, once the U.S. flash PMIs were printed, crude oil futures reversed and gave back all of the morning's gains. This indicated that the crude oil market is again most-sensitive to economic

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

news.

On the charts, the market continues to look like it is in a sideways grind with a bit of a bias to the upside. Levels to watch are the 50-day moving average at $99.00 as support, while there is resistance above at the 200-day moving average ($100.31), which is just above yesterday's high tick of $100.29. A close above the 200-day MA would be technically bullish and supportive of a rally back toward the $103-$105 level.

Currencies & Bonds

The Dollar Index was slightly higher Monday morning, and it held those gains despite the slightly worse-than-expected March flash manufacturing PMI. But, the Dollar Index sold off hard shortly after 1 PM as Fed-speak weighed on the Dollar Index. Comments that Dallas Fed President Richard Fisher made in London sent the Dollar Index sharply lower, as my not-too-farfetched prediction that Fed speakers would try to be "dovish" following the FOMC meeting last week appears to be coming to fruition. The Dollar Index finished down 0.24%.

Thanks to the dollar sell-off, the euro ended the day higher by 0.34%, despite the fact that German flash manufacturing PMIs slightly missed expectations at 53.8 vs. 54.5. The euro remains more of a proxy for the old deutschmark than anything else, so what happens in Germany economically carries disproportionate weight in the currency. But, the "miss" in Germany wasn't that bad (the PMI remains comfortably above 50), and strength in France and the overall EU manufacturing PMIs helped support the euro.

Bottom line, though, is we need to expect the Dollar Index and the euro to remain relatively range-bound. A legitimate policy surprise from the Fed will almost certainly be "hawkish" while the ECB, despite the threat of dis-inflation and a surprisingly high euro, almost certainly won't get more-accommodative. That results in a range-bound stalemate, until something material changes from a policy outlook standpoint.

The yen was the only major currency to finish negative vs. the dollar, and it was only fractionally so. There wasn't any real impetus for the lack of the rally—in fact, the yen has been inordinately strong recently. If I had to point to a reason yesterday for the underperformance, I'd say it was a reduction in the geopolitical risk premium because Russia is allowing international monitors into the country. But, in truth we all know that the next major catalyst in the yen (the catalyst that will decide whether it's going sub-100/dollar or above 110/dollar) is when and by how much the BOJ eases further. And, until that's known—most of the other influences in the yen are just noise.

Treasuries were mixed yesterday (the 10-year was flat while the 30-year caught a bid thanks in part to the dovish "Fed-speak"). But frankly the Treasury market is still just digesting last week's FOMC meeting and the potential of a sooner-than-expected increase in interest rates.

Bottom line is the Fed will continue to be a headwind on bonds, and this "churn" at current levels remains an attractive entry point for medium-/longer-term "short bond" positions.

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 continues to bounce between 1850 and 1880 as geo-political and China concerns are a headwind, but 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.* *Support remains in the 1850 area for the S&P, with resistance at 1880.*

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 and banks. I think coal stocks (KOL, ACI) are now attractive, given positive fundamentals thanks to 1) high natural gas prices, 2) low inventories and 3) an attractive entry point due to China related basic materials sell off last week. I'd also 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 & Add Around $1300: **With a reduction in geo-political risk and a surprisingly hawkish FOMC statement, we are seeing some of the recent "froth" taken out of gold, as it's traded down towards $1300. I would look to buy or add to positions on this dip with a stop at $1300.**

	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