7:00's Report

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

April 30th, 2014

Pre 7:00 Look

- Futures are slightly lower and international markets are mixed as the first wave of key data today was in-line.
- EU HICP April was 0.7% vs. (E) 0.8%, but it rebounded from March and won't compel the ECB to ease policy further next week (euro is up small on the news).
- The BOJ meeting was mostly in-line, as there was no change to rates and the BOJ remained confident about an impending uptick in inflation.
- Econ Today: ADP Employment Report (E: 210K), Q1 GDP (E: 1.1%), FOMC Rate Decision (2:00 PM).

Market	Level	Change	% Change
S&P 500 Futures	1870.00	-1.75	-.09%
U.S. Dollar (DXY)	79.82	-.061	-.08%
Gold	1292.40	-4.00	-.31%
WTI	100.42	-.86	-.85%
10-year	3.486	.027	0.78%

Equities

Market Recap

Stocks had a nice day Tuesday as a rebound in momentum sectors and more M&A news helped offset some earnings "misses." The S&P 500 rose 0.48% and it's sitting just below resistance at 1,880.

Stocks opened higher mostly following the strength in Europe, as earnings on the continent were pretty good. Also helping stocks rally was more chatter about M&A (RAI is apparently looking at LO, while ATK and ORB announced plans to merge).

Interestingly, earnings results weren't very good pre-open (MRK and S the exceptions). But the truth is, at this stage we're really into the "second-tier" companies reporting, and even misses won't really move the market like they would have last week.

Stocks spent pretty much the entire day up about 0.5%, as a quiet rally in "momentum" and lack of any escalation in Russia helped support stocks. The market closed relatively quietly, near the highs of the day.

Trading Color

Momentum sectors roared back yesterday, as both NBI and QNET rallied more than 2% each (implying that the Friday/Monday selling might have been a final "puking" of positions ahead of the end of the month).

But, despite the bounce in "momentum," we didn't see a lot of confirmation from the broader averages, as the Nasdaq, Dow Industrials, S&P 500 and Russell 2000 all saw gains within 40 basis points of each other (so, no clear cyclical outperformance).

Sector-wise it was a bit better, as consumer staples and utilities declined while tech, consumer discretionary, financials and healthcare rallied.

Volumes and activity were mostly average yesterday (no great conviction or apathy) while on the charts the S&P 500 is now up against resistance at 1,880. If it can break through, then a run toward 1,900 isn't out of the question.

Long Telecom

Telecom was one sector that bounced back nicely yesterday, courtesy of S earnings. Telecom has piqued my interest given its recent underperformance, despite the fact that it's a defensive sector (because defensive sectors have killed it this year.) Plus, there appears to be

Market	Level	Change	% Change
Dow	16535.37	86.63	.53%
TSX	14583.11	52.20	.36%
Brazil	51838.61	454.93	.89%
FTSE	6779.13	9.22	.14%
Nikkei	14304.11	15.88	.11%
Hang Seng	22133.97	-319.92	-1.42%
ASX	5489.07	2.50	.05%
Prices taken at previous day market close.			

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

some value here.

Telecom is trading at about 14.2X next year's earnings—well below the 15.8 of the S&P 500. Normally, telecom trades at nearly a 10% premium to the market, so you'd expect it to be trading over 17X next years earnings.

Given that discount and this recent dip, I could see telecom playing a bit of catch-up here over the coming weeks. (Although, admittedly, I would have preferred to buy it Monday than today.) IYZ (the iShares telecom ETF) is the easiest way to play this, but please be aware that it's heavily weighted to T and VZ.

Market	Level	Change	% Change
DBC	26.56	.08	0.32%
Gold	11295.70	-3.30	-0.25%
Silver	19.47	-.118	-0.60%
Copper	3.073	-.02	-0.65%
WTI	101.15	.31	0.31%
Brent	108.92	.80	0.74%
Nat Gas	4.835	.036	0.75%
RBOB	3.0627	.0224	0.74%
DBA (Grains)	29.37	.37	1.28%
Prices taken at previous day market close.			

The stop in this is pretty clear—I wouldn't want to see it close below Monday's close of $28.53, which would be a second violation of the 200-day moving average this week (IYZ has only closed below the 200 day twice in the last year, with the second time coming Monday). As far as a target, IYZ hit a new 52-week high in early April at $30.52, so it's a pretty good risk/reward setup (1% loss to a near-10% potential gain).

Economics

FOMC Preview

- No change to interest rates expected.
- Additional QE tapering of $10 billion, reducing monthly purchases to $55 billion/month.

This should be a pretty "boring" FOMC meeting. There are no economic projections (the "dots") to confuse investors and no press conference where Fed Chair Janet Yellen lets "6 months" slip out. In fact, there shouldn't be many changes in the language of the statement at all.

Since the March meeting, data has conclusively shown the economic dip was mostly weather-related and temporary. So, we should see a small change to communicate this reality, along with a small upgrade in language regarding the economy.

The two other areas where we may see some language change is toward inflation and housing. On the "hawkish" side of things, some Fed officials have expressed some concern that inflation may be gaining some steam.

If the inflation language is changed, it may imply some Fed officials are worried about a potential future uptick in inflation, and that will be taken as slightly hawkish.

Conversely, although the Pending Home Sales report on Monday was good, housing has been sluggish to recover since the winter economic dip. If the Fed highlights that, it may be a subtle clue that the FOMC may be getting a little uncomfortable with housing's inability to rebound.

If housing can't rebound over the coming months, it may warrant an extension of ZIRP (zero interest rate policy). If the housing language is changed materially, that will be taken as slightly "dovish."

Bottom line, though, is this meeting almost certainly be a non-event. Although the pundits will dissect the verbal minutiae in the written statement, the truth is that the expected path of policy will remain unchanged: Tapering of $10 billion at each meeting going forward, and the first interest rate increases in mid-2015.

Nothing today should change that.

Commodities

Commodities were mostly higher yesterday with the exception of the metals, as traders positioned ahead of an assortment of potentially market-moving events over the rest of the week. The benchmark commodity tracking index ETF, DBC, gained 0.32%.

Beginning with the underperformers: Gold, silver and copper fell 0.25%, 0.060%, and 0.65% respectively yesterday, mostly on positioning ahead of key economic events.

Trading in gold was volatile yesterday as traders positioned ahead of the FOMC announcement this afternoon (2 p.m.). Gold started the day at $1,290, rallied back above $1,300 by mid-morning, but then sold off to close

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

back in the low-$1,290s. When the dust settled, gold was only slightly lower, down 0.25%.

The technicals in gold remain in favor of the bears in the short term, as the downtrend line that has been in place since futures began to fall from the March highs remains intact. On the charts, the 200-day moving average ($1,300.20) remains resistance, while there is initial support below at $1,287.50 and further support in the $1,270 region (last week's spike low).

Barring any surprises out of the Fed, we can expect gold futures to continue to fluctuate and possibly retest last week's lows.

Copper futures were lower yesterday, down 0.65% as traders began to position ahead of the Chinese manufacturing PMI coming out tonight (9 p.m.). Copper did importantly close above the 50-day moving average at $3.07, and that will remain a critical level for the bulls to hold if the rally in copper is to continue.

WTI crude oil futures rallied sharply on the open, gaining more than 1% in the first hour of trade. But, the buyers (or heavyweight buy program) became exhausted by midmorning, at which point futures began to fall about as quickly as they rallied. WTI closed higher by 0.3%.

Although WTI futures are higher on the week, the "supply bears" are maintaining control of the market, quickly reversing any material rally. On the charts, WTI is pinned between the moving averages again with the 50-day above at $101.40 and the 200-day below at $100.60.

Market	Level	Change	% Change
Dollar Index	79.885	.123	0.15%
EUR/USD	1.3807	-.0042	-0.30%
GBP/USD	1.6826	.0019	0.11%
USD/JPY	102.56	.08	0.08%
USD/CAD	1.0955	-.0072	-0.65%
AUD/USD	.9272	.0015	0.16%
USD/BRL	2.2278	.0048	0.22%
10-year Yield	2.691	.014	0.52%
30-year Yield	3.486	.027	0.78%
Prices taken at previous day market close.			

We remain near-term bearish, as the market is largely ignoring geopolitics and continues to focus on supply-side economics. The EIA will release the weekly inventory report later this morning (10:30 a.m.), and analysts are expecting a build of 2.2M barrels, which will put supply levels at the highest since 1931.

Having said that, there are two aspects of the report that will be closely watched by traders tomorrow: gasoline supplies, and crude oil supplies at the Cushing hub in Oklahoma.

First, gasoline inventories are low, and the strength in gasoline prices has been supporting WTI crude for the past several weeks (low gasoline implies increased future refining demand for oil). So, the gasoline inventories will be watched as closely as the oil inventories. If the build is bigger-than-expected, look for oil to sell off. (The expectation is for a 900K draw in gasoline inventories.)

Second, Cushing inventories remain a concern for Nymex traders because, at the end of the day, the WTI futures contract in Nymex is for Cushing, Okla., delivery. This gets into the physical nuances of the business. But even though oil supplies nationally are soaring, most of the build is occurring in the west and on the Gulf—not at Cushing, as oil is leaving there via pipeline to be refined at Gulf refineries. As long as Cushing inventories are low, that will artificially support oil futures, even while national supplies build.

Bottom line is oil is at a critical juncture, and inventories will play a major role in whether we see a stabilization or further breakdown.

Currencies & Bonds

The euro was in focus in the currency markets yesterday, as it declined -0.31% on the day after German CPI rose less than expected in March (1.3% yoy vs. 1.4%), pushing expectations for this morning's HICP lower in the process.

April HICP increased by 0.7% yoy vs. (E) 0.8% yoy, but importantly rebounded from March's very low 0.5%. The euro is trading slightly higher on the news as this number is "not as bad

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

as feared" and it won't compel the ECB to act at the meeting next week. But it does reflect that dis-inflation remains a major threat to the EU economy and the ECB, at some point, will have to act in some fashion.

Regardless of the inflation data, though, the fact remains that QE in the EU remains a long way off (months and quarters), although that doesn't rule out additional accommodation in the coming months. But, Mario Draghi and the rest of the ECB have made it clear that QE will be the "last arrow" in the quiver. If the ECB is to ease policy further, it'll initially come in the form of a rate cut, another LTRO or negative deposit rates. QE is not coming to the EU anytime soon (although it will come eventually if they don't get the spreading dis-inflation under control).

Elsewhere in Europe, the pound rallied small after Q1 GDP slightly missed expectations (3.1% yoy vs. (E) 3.2%). The important thing here is that economic growth is at a six-year high in the UK (so pre-crisis), and that just reinforces the fact that the Bank of England will be the first major central bank to raise rates, likely later this year, and that should continue to make us buyers of the pound on any decent dips.

In Japan the BOJ concluded their rate meeting (with no changes to policy, as expected) and released their semi-annual growth and inflation outlook. Bottom line is it was mostly in-line with expectations and the yen is flat on the news. The BOJ didn't increase its inflation expectations for 2015 (as some feared they would), but instead said they remain confident they will hit 2% inflation by 2016 (they released inflation expectations of 2.1% for 2016). The need to know here is this likely pushes any further stimulus into the mid-late summer, but that was already priced in. The wildcard remains what the increased sales tax does to economic growth, and we just won't know that for a couple months. Bottom line is this doesn't change my "bearish yen/ bullish DXJ call," because if the BOJ is right, growth and inflation are good for Japanese stocks/bad for the yen, and if growth or inflation falters, the BOJ will act, so there's a "Kuroda put" in the market.

Finally turning back closer to home, the Dollar Index traded up given the weakness in the euro, as it largely ignored the domestic economic data and instead looked ahead to the FOMC announcement later today (the Dollar Index was up 0.15% and sitting just under 80 again).

Bonds ended lower on the day and the yield curve steepened slightly, but bonds remain resilient. Early Tuesday the 30-year was down nearly -0.7% for no real apparent reason (it was part of this short, sharp "inflation" trade that hit the markets exactly at 8:30 that saw gold and the dollar rally and bonds sell off). But, all of the above reversed methodically throughout the day, and the 30-year ended down -0.3% ahead of the FOMC today (although unless there are some surprising language changes, don't expect bonds to materially trade off the Fed).

Helping support bonds was the Fed buying $2.3 billion worth of 8- to 10-year bonds yesterday, while a 2-year floating-rate Treasury note auction saw relatively lackluster demand (although I wouldn't read too much into that). Bottom line is bonds remain illogically buoyant given what we know about the economy and the Fed.

But, I am happy to see that the "consensus" thinking in the bond market is shifting from "yields will certainly rise" more toward "maybe yields will rise, but only just a little bit and much more slowly and gradually than thought). Case in point PIMCO (which is obviously a great shop, but they are bond salesmen so you have to take their analysis with a grain of salt) released an article saying there is no coming spike in yields. (I agree there won't be a spike, but a "faster-than-expected" rise wouldn't shock me.) Meanwhile, the FT opined that the Fed will keep rates at zero longer than current consensus and well into 2016.

While both articles are well-written and the point of view well-founded, (links them are here and here respectively), as a contrarian I'm happy to see the bond bulls starting to puff their chests out a bit, as hopefully it's a sign this rally is near its end (which, remember, will be a good thing for the stock market).

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	Neutral	Bullish	*Gradual economic improvement domestically and globally is a tailwind on stocks, and as earnings season has largely com in "ok," the path of least resistance remains broadly higher. But, "momentum" sectors remain under pressure and QNET and NBI need to be watched closely for signs of a potential breakdown.* *The S&P 500 remains in the 1880-1840 trading range.*

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) 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). I'm adding IYZ (Telecom ETF) to this "market losers" basket this morning, as its trading at a valuation discount and has underperformed other defensive sectors recently.**

Long Japan: **"Hawkish" comments by BOJ Governor Kuroda sent the yen spiking higher vs. the dollar and DXJ near the lows for the year. I remain a fundamental bull on Japan, but a decisive break of 44.66 in DXJ will see me exit this trade, despite the fundamentals.**

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

Gold: **The outlook for gold remains unclear, but, gold has acted as a decent equity hedge all of 2014, so if you're nervous about the stock market here, buying gold isn't the worst idea. I added a long gold trade Wednesday with a stop at $1277 in futures or $123.11 in GLD.**

	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. **Similarly to DXJ, the yen caught a big rally this week after nearly breaking down to new lows just two weeks ago. If the yen were to trade below the low for the year, 100.26 yen/dollar, I would exit this trade as the trend will have clearly changed.**

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 longer term 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	*Bonds remain surprisingly buoyant despite economic data confirming the winter slowdown in the economy was temporary, while the Fed has confirmed it intends to continue tapering. The longer term trend remains lower, but the counter trend rally in bonds is continuing in the short/medium term.*

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.**

Buy A Steepening Yield Curve: **STPP and KBE give positive exposure to a steepening yield curve, as the 10's-2's spread appears to have bottomed and should rally from here. 2.20% in that spread is my stop on STPP and KBE longs.**

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