7:00's Report

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

September 26th, 2014

JNK: Support at the early August closing low held yesterday, but obviously this isn't a good looking chart, and we need to continue to watch this ETF.

Pre 7:00 Look

- Markets are trying to stabilize as futures are bouncing slightly this morning and international markets are little changed.
- Asia was mixed (Japan down modestly, Shanghai up slightly) while Europe is flat to slightly higher this morning.
- News wise it was a very quiet night, as the only notable economic release was Japanese CPI, which missed estimates (3.1% yoy vs. (E) 3.2% yoy) and the yen is modestly weaker as a result.
- Econ Today: Final Reading 2Q GDP (E: 4.6% Q/Q SAAR).

Market	Level	Change	% Change
S&P 500 Futures	1964.25	3.00	0.15%
U.S. Dollar (DXY)	85.365	.062	0.07%
Gold	1224.00	2.10	0.17%
WTI	93.00	.46	0.50%
10 Year	2.511	-0.58	-2.26%

Equities

Market Recap

Stocks suffered their worst day in months Thursday as general concerns about economic growth led to key support levels being violated. From there, stocks fell sharply on light volume. The S&P 500 declined -1.62%.

Thursday started out "all right," with futures down marginally and most international markets flat to up slightly. And, from a news standpoint, there weren't any major negative catalysts. Jobless claims, durable goods, and the "flash" service PMI were all more or less in line (and none were "bad").

But, as has been the case, this market remains dominated by positioning. Regardless of the news, sellers were all over the indices from the outset, pushing the S&P 500 through key support at 1,980 before 10:30 AM.

1,980 had held multiple tests over the past two weeks, and once that was broken, we saw a "pile on" effect that saw the S&P 500 drop another 15 points by 1:30.

From there the market stabilized and then chopped sideways until the final 20 minutes of trading, where a slew of "market on close" sell orders sent the S&P to the lows of the day.

As far as "why" stocks dropped, there wasn't any specific catalyst. General concerns about Chinese growth, some wavering on Japanese pension reform and "hawkish" comments by the Bank of England's Mark Carney were all cited, but none of those were real reasons to sell yesterday. The truth is this market (last week's spike to new highs on low volume aside) has traded heavy for a over two weeks, and yesterday was just a tipping point.

Market	Level	Change	% Change
Dow	16945.80	-264.26	-1.54%
TSX	14893.57	-226.97	-1.50%
Brazil	55962.08	-862.34	-1.52%
FTSE	6637.64	-2.07	-0.03%
Nikkei	16229.86	-144.28	-0.88%
Hang Seng	23678.41	-89.72	-0.38%
ASX	5313.42	-68.75	-1.28%
Prices taken at previous day market close.			

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

(The fact that volumes and attendance were low undoubtedly had something to do with it.)

From a market internals standpoint, things were as you'd expect for a down 260+ day in the Dow. The Russell 2000 and Nasdaq both underperformed, and the selling was broad with all 10 S&P 500 sub-sectors declining.

Market	Level	Change	% Change
DBC	23.53	-0.05	-0.21%
Gold	1222.10	2.60	0.21%
Silver	17.51	-.19	-1.08%
Copper	3.03	-.02	-0.64%
WTI	92.47	-.34	-0.37%
Brent	97.03	.08	0.08%
Nat Gas	3.957	.046	1.18%
RBOB	2.70	.04	1.47%
DBA (Grains)	25.14	-.32	-1.26%
Prices taken at previous day market close.			

Cyclicals and high-beta names got hammered, while defensive sectors relatively outperformed but still were negative.

Tech was the biggest laggard, down -2% thanks in large part to AAPL (the stock was down nearly -4% on bending phones angst) while financials and healthcare also lagged (healthcare was weighed down by biotechs.

The only place to "hide" yesterday was in the miners, as GDX rallied +0.63%. Other commodity names underperformed on general China concerns.

S&P 500: This is the 4th dip towards the 100 day MA this year (red line), and until that level is broken materially, the decline must be considered a normal pullback.

Bottom Line—Is This The Start of Something More?

There are several things to consider regarding the sell-off.

First, yesterday was painful and JNK disconcertingly traded poorly again (bouncing off the August closing lows). But that level did hold so we didn't see a material breakdown, and it's still too early to declare this is anything different than the typical 3% to 5% correction we've seen multiple times over the past two years, although obviously we remain cautious and I would not be buying this dip today.

Second, 1,955 in the S&P 500, which is the 100-day moving average, has now become very important. I imagine we'll as least test that level before this dip is done. If this level is violated decisively, then things get more interesting.

Third, broad fundamentals remain equity-market-positive at the moment, and nothing has happened over the past week to make the outlook decidedly more negative. That said, though, I am more nervous about this dip turning into something more given my "As Good as It Gets" thesis (i.e., the outlook is as good as it's going to get for U.S. stocks at the moment). But again we need to wait for confirmation, because every time you've tried to sell this market for the last 2+ years, it's been wrong.

Fourth, if JNK breaks materially though $40.06, that will change my tune. I'll move to get more defensive, because I simply can't see how junk bonds and emerging markets can decline without stocks following suit. And, EUM remains an excellent hedge—it was up +2.07% yesterday and hit a new multi-week high, so both the fundamentals and the chart look good. It remains one of the ETFs out there that I feel can do well even if the market consolidates. EUM remains my favorite hedge at the moment.

Bottom line, the market isn't acting well but fundamentals haven't changed, although the underperformance of high-yield bonds and emerging markets has me more concerned than before. But, for now, there's nothing definitive that says this isn't just about a 3% - 5% dip in the market, yet.

Need to Know on China

China has been in the news the last two days, specifically a WSJ article speculating that the head of the PBOC will be replaced in October. This was the main headline cited for both Wednesday's move higher, and yesterday's breakdown.

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

Before getting into the market reaction, though, basically what the article said was Chinese leadership was considering replacing the current head of the PBOC, Mr. Zhou Xiaochuan.

Zhou is seen as a reformist—meaning he is intent on imposing structural reforms on the Chinese economy (which are needed and longer-term positive). But, those changes, as we've seen, also dampen economic growth.

So, his potential removal was seen by the market as a sign that Chinese authorities may be focusing more on stimulating short-term economic growth, and U.S. stocks rose on the news Wednesday.

But, Chinese stocks didn't—they ignored the news (implying U.S. markets overreacted) and this was part of what turned futures negative Thursday morning (the unwind of the Wednesday rally).

Bottom line with China is this: 7% GDP growth is the Maginot Line. Fears are rising that the Chinese government will reduce its 2015 GDP growth target from 7.5% to 7.0%, and that may well happen in October. But if growth is forecast sub-7%, that will re-ignite worries about a "Chinese hard landing," which will be a new macro headwind on stocks. So, despite all the "noise," the number to watch is 7% — above that and China will not be a major negative on equity prices.

"We are alert to the possibility that financial markets may be mispricing risk." BOE Governor Marc Carney. 9/25/2014

Economics

Durable Goods

- Durable Goods Orders in August decreased -18.2% vs. (E) -17.1%

Takeaway

New orders for durable goods in August fell a sharp 18.2% vs. analyst expectations of -17.1%, marking the biggest drop on record. But, the headline was misleading due to the surge in aircraft orders in the July report, which was revised slightly lower from +22.6% to +22.5%.

In the details of the report, Non-Defense Capital Goods Ex-Aircraft, a widely followed proxy for business investment, rose +0.6% and the respective 3-month moving average improved +1.83%. That's the most since May '13, and it suggests corporate investment is not only healthy, but on the rise. This number won't alter any Fed expectations, but positive business investment will be a boost to Q3 GDP and its further confirmation the recovery in the US is still gathering steam.

Market	Level	Change	% Change
Dollar Index	85.33	.175	0.21%
EUR/USD	1.2756	-.0031	-0.24%
GBP/USD	1.6303	-.0024	-0.15%
USD/JPY	108.74	.03	0.04%
USD/CAD	.8982	-.0036	-0.40%
AUD/USD	.8739	-.0085	-0.96%
USD/BRL	2.4278	.0001	0.01%
10 Year Yield	2.511	-0.58	-2.26%
30 Year Yield	3.220	-.63	-1.92%
Prices taken at previous day market close.			

Commodities

Commodities were modestly lower yesterday and relatively outperformed, but that was mainly because gold caught a late bid on a "risk off" move and oil declined only slightly. The broad-based commodity ETF, DBC, fell -0.21%.

Gold started trading Thursday by making a new 11-month low, hitting $1,206/oz. early Thursday almost entirely because of dollar strength. But, once stocks opened and the market began to sell off, the dollar came in and gold began to methodically rise—turning positive around 11 AM and almost tracing out a bullish "outside reversal," but not quite.

Gold rallied in a knee-jerk reaction as stocks fell. Nothing really positive happened in gold yesterday, and while we may see a bounce over the next few days depending on what the stock market does, I would be surprised if we don't see $1,200 tested over the next week or two—barring some absurd decline in equities.

WTI crude finished the day little-changed, down -0.39%, in relatively quiet trading, considering the volatility in equities. WTI seems quite content in the lower - to mid-$90s at the moment, as economic growth appears good enough to support $90/bbl, as do the fears of a Saudi production cut, which could come any minute.

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

But, that said, those factors will likely keep crude north of $90/bbl, and it's hard to see a compelling case for oil to move back into the $95-$100 range in the near future.

Staying in the energy patch, one commodity that did finish positive yesterday was natural gas, and that was despite the weekly inventory build being bearish (+97 Bcf increase vs. (E) +90). Nonetheless, reports of Russia starting to "turn off" gas imports into Europe—combined with a weather outlook that shows cold temperatures appearing in the northern portion of the country—helped support gas, as at $3.80 the current supply situation is "balanced." We continue to like natural gas at these levels given the low supply and generally depressed sentiment, and think there's upside based on potential demand heading into the winter.

Currencies & Bonds

Yesterday looked like we may have finally seen some short-term exhaustion in the dollar bulls and the euro bears. The Dollar Index rose to a new 4-year high yesterday morning, shooting through $85.50 early Thursday. Meanwhile the euro was again under severe pressure, and actually hit 1.2703 in early trading.

The reason was more of the same: ECB President Mario Draghi was quoted in a Lithuanian newspaper saying the ECB "unanimously" supports unconventional measures (read: QE) to stimulate growth if needed. That's nothing really new (and might not even be accurate), but it implied the Germans are ultimately on board with QE if needed, and the market took that as "dovish."

Also, some hard data pushed the euro lower. Money supply increased in the EU a paltry +1.8% (meeting expectations), and in what was a technically positive surprise, private sector lending declined just -1.5% year-over-year (compared to -1.6% in July). While the numbers were in line, they reflected the challenges the EU faces and reminded everyone just how close the EU is to outright deflation.

But, in what might be a sign of exhaustion, the respective highs for the dollar/low for the euro were hit early in the day. As stocks sold off, the euro gradually rose while the Dollar Index declined. They finished the day down -0.23% and up +0.15%, respectively.

Staying in Europe, the pound declined -0.15% and was unable to rally yesterday despite some "hawkish" comments by Bank of England Governor Mark Carney. He stated in an interview that the time interest rates would rise was "getting closer" and that "we are alert to the possibility that financial markets may be mispricing risk." Neither comment broke new ground, but I do think they reflect the fact that the BOE is moving closer to raising rates than perhaps the market is considering at the moment. The pound is probably a "buy" vs. any other currency than the dollar at the moment.

Finally, turning to Asia, the Aussie remains in utter free-fall, as it declined about -1% vs. the greenback thanks to "dovish" comments from the Bank of New Zealand (the Aussie dollar and New Zealand dollar trade with a decently high correlation) and as China optimism faded (as discussed earlier).

The ferocity with which the Aussie has declined has surprised even me (and I've said for 6 months it was a short), and now support at $0.8632 (a 52-week low) is in view. Ultimately I think the Aussie is "worth" somewhere around $0.80. So, there is ultimately some more downside, although you've got to wait for a bounce to get short at this point, given how absurdly oversold it is.

In the bond market, the old "risk off" trade out of stocks and into bonds worked yesterday, as Treasuries staged a strong rally amidst carnage in the equity market. The 30-year Treasury rallied +0.75% mostly on a "risk off" sentiment (economic data didn't really affect trading yesterday) and the 30-year made a new multi-week high, implying this bounce isn't over yet, which isn't shocking.

Technically speaking, the 30-year could rally all the way to 139'00 (the 2014 trend line) and the trend would still be lower. I am viewing this rally as a shorting opportunity (I'm just not shorting it yet).

Have a good weekend,

Tom

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

7:00's REPORT

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

Position Sheet

Tactical Trading/Investment Account (Time frame of a few weeks to months).

Date	Position	Open Price	Stop	Strategy
9/11/14	EUM	24.05	None	*Short Emerging Markets. With the dollar surging higher and the global bond yields rising, this should put pressure on the emerging markets, as money rotates out of those economies back towards developed markets. Original Issue*
9/4/14	HEDJ EUFN EWI EWP TBT	59.35 24.67 16.44 41.34 56.59	None	*"Long Europe" Portfolio. The move by the ECB to start a private market QE program, combined with the impending TLTROs, should give the European economy a significant boost over the coming months. HEDJ remains the best way to hedge out a falling euro, while higher beta sectors of the EU economy (financials, Italy, Spain) should rally the hardest. Finally, the moves should end the German bond mania, which should weigh on Treasuries. Original Issue*
7/21/14	UNG	20.98	None	*Natural gas is a supply/demand based trade. While injections over the summer have replenished supply, we are still 15% below historical levels, with the winter heating season drawing near, Natural gas in the highs $3.00's appears to be a value. Original Issue.*
6/11/14	SPHB	32.73	30.32	*Long domestic cyclicals. Part of the "Post ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
6/11/14	UUP	21.55	21.13	*Long Dollar. Part of the "Post ECB Decision" portfolio of what should outperform if bond rally is done. Original Issue*
12/13/13	FCG XOP	18.97 65.62	None	*Natural gas supplies low, increased demand, E&Ps at a value. Original Issue.*

Longer Term Macro-Trend Investment Account (Long term time frame of months/quarters).

Date Initiated	Strategy	Position (s)	Investment Thesis
November 2012	**Long Japan**	**DXJ/YCS**	*The election of Prime Minster Abe in late 2012 resulted in massive monetary and fiscal stimulus designed to break Japan out of decades long deflation and stagnation. The resulting efforts will be yen negative/Japanese stock positive for years to come.*
Strategy Update (9/8/14): After spending most of 2014 in trading range, the yen have broken down to new lows as expectations for pension reforms (allocation more Japanese pension funds away from Japanese bonds and into stocks) as well as the rising potential for more stimulus have weighed on the yen. It appears after nearly a year of consolidation, this trade is back "on."			
April 2013	**Short Bonds**	**TBT/TBF/ STPP/KBE**	*The 30 year bull market in bonds is over, as the Fed begins to gradually remove stimulus, the economy recovers, and inflation slowly begins to increase.*
Strategy Update (9/8/14): One of the biggest positive influences on bods in 2014 has been buying from Europe, as German bunds and peripheral European debt saw mania buying on rising fears of deflation. Those money flows overwhelmed negative bond fundamentals in the US and sent Treasuries soaring. But, with the ECB engaging in QE, the European bond mania should break, and Treasuries should now resume their declines.			

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

7:00's REPORT

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

Asset Class Dashboard

(Updated 9.22.14)

This page is meant to provide a general outlook for the path of each major asset class and is updated at the start of each week.

Near Term Trends are provided primarily for tactical and trading accounts (Time Horizon of weeks and months).

Long Term Trend is provided for longer term asset allocation models/retirement accounts (Time Horizon of Months/Quarters).

The "Best Idea" represents our best idea at the moment. Not all best ideas are trades we make—they are provided for idea generation.

	Near Term Trend	Long Term Trend	Market Intelligence
Stocks	**Neutral**	**Bullish**	*The S&P 500 rallied to new highs again last week after the FOMC was less "hawkish" than feared, which caused traders and faster money to chase indices higher. Broadly speaking the "4 pillars" of the rally remain in tact, but we continue to be cautious near term, as things in the US appear to us simply "a good as it gets" economically.*
Best Idea: Buy Regional Banks (KRE). **Best Contrarian Idea:** Buy Small Caps (IWM).			
Commodities	**Bearish**	**Bullish**	*Commodities continued to be under pressure, as a very strong dollar and concerns about Chinese economic growth weigh on the complex. Oil continued to slip last week and previous metals sold off hard as gold traded with currencies and bonds, taking the Fed as hawkish. With Chinese growth worries and a strong dollar, the near term out-look for commodities remains unattractive.*
Best Idea: Buy Natural Gas (UNG) **Best Contrarian Idea:** Buy Grains (DBA)			
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index surged to a new 4 year highs (again) as both bonds are currencies took the FOMC as incrementally more "hawkish" due to the rise in the Fed rate forecasts (the dots). The Dollar Index is now very overbought, and consolidation is needed, but the trend remains clearly higher.*
Best Idea: Sell the Yen (YCS) **Best Contrarian Idea:** Long Canadian Dollar (FXC)			
Treasuries	**Neutral**	**Bearish**	*Treasuries actually bounced last week thanks to a big Friday rally, despite trading lower following the Fed (bonds took the meeting as hawkish). The trend in bonds is now downward but we could see a bounce this week on renewed European demand for Treasuries, but any material rally should be sold.*
Best Idea: Short "long" bonds (TBT) **Best Contrarian Idea:** Short High Yield Bonds (SJB)			

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