

7:00's Report

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

October 7th, 2014

Pre 7:00 Look

- Futures are moderately weaker this morning as Europe again came for sale overnight following another disappointing German economic report.
- German Industrial Production badly missed estimates, falling -4% vs. (E) -1.1%, adding to concern about the German economy after the soft manufacturers orders report from Monday.
- Outside of that number it was a quiet night, as the two central bank decisions (BOJ/RBA) met expectations, and the situation in Hong Kong remains orderly.
- Econ Today: No reports today. Fed Speak: Kocherlakota 2:30, Dudley 3:00 PM, Potter 4:30 PM.

Market	Level	Change	% Change
S&P 500 Futures	1948.75	-7.00	-0.36%
U.S. Dollar (DXY)	86.175	.131	0.15%
Gold	1205.20	-2.10	-0.17%
WTI	89.96	-.37	-0.46%
10 Year	2.425	-.022	-0.90%

Equities

Stocks were little-changed during a day of digestion to start the week. The S&P 500 declined -0.16%.

Stocks opened higher Monday following a quiet weekend, and what news there was Monday morning was good: Hong Kong protests remained mostly orderly and there were signs of crowds dispersing ... the "pro-business" candidate in Brazil made it into the run-off, helping that market rebound ... and the market had more good corporate news on the news of the HPQ split into two companies.

But, there wasn't much conviction to the rally and stocks felt "heavy." By the midmorning, stocks were flat and heading lower (the soft Fed Labor Market Conditions Index weighed a bit on sentiment, but more on that later).

The declines throughout the morning were steady, but interestingly the selling accelerated almost immediately following the European close (Europe remains an underappreciated influence on both the equity and bond markets). And, things got interesting around noontime as the S&P 500 tested the 100-day moving average at 1,959. But the test held, and stocks began to rally throughout the afternoon, turning flat after 2 o'clock before fading a bit into the close.

Trading Color

Internals weren't that great yesterday, as the Russell 2000 came for sale again and badly underperformed (down -0.91%). Cyclical generally didn't trade as badly (Nasdaq and SPHB both fell -0.5%), but it certainly wasn't a "good" day from an internals standpoint.

And, that spilled over into sector trading as industrials, consumer discretionary and financials/banks all lagged, falling between -0.5% and -0.8% respectively. Consumer discretionary lagged partially because of a downgrade of MCD by MS and some who are cautious on department stores. Healthcare also traded poorly (it was actually the second worst performing S&P 500 sub-sector), but that was due to biotechs pulling the space lower.

News-wise, tech got a boost from the HPQ split news,

Market	Level	Change	% Change
Dow	16991.91	-17.78	-0.10%
TSX	14,743.12	-46.66	-0.32%
Brazil	57,115.90	2,576.35	4.72%
FTSE	6,527.06	-36.59	-0.56%
Nikkei	15,783.83	-107.12	-0.67%
Hang Seng	23,422.52	107.48	0.46%
ASX	5,284.20	-8.71	-0.16%

Prices taken at previous day market close.



I'll be appearing on Closing Bell at 3:00 PM EST with hosts Bill Griffeth and Kelly Evans to discuss what's next for stocks. Tune In!

which helped offset the demolition of GTAT (the glass provider for the new Apple gadgets declared bankruptcy and dropped a cool -92.76%).

Internationally the star was Brazil as EWZ, the Brazil ETF, rose +5% on news that pro-business candidate Aecio Neves turned in a surprisingly strong showing at the polls and made it to the run-off election against current president Dilma Rousseff.

On the charts the S&P 500 bounced off the 100-day moving average almost to the tick, and that remains key support. A major violation of that moving average would distinguish this decline as different from the four previous ones (the markets insulated themselves from the 100-day quickly during the previous pull-backs).

Bottom Line

Not much changed yesterday, although I will say the market was a bit more sluggish than I would have liked given the test of the 100-day and the fact that small caps came for sale. But, the 100-day held and JNK was again higher, so we're not seeing anything that would make me think we're about to roll over again.

Focus now is on the FOMC minutes coming tomorrow, as they are the next potential catalyst. The market needs them to be modestly "dovish" to continue this recovery, but even in that case, I don't think we're going to see the melt-up higher to 2000 anytime soon. It would take good earnings to push us materially higher, and we don't get into the thick of earnings season until next week (although AA does officially kick off earnings season Wednesday after the close).

For now, though, this remains a typical 5% pullback, but we're likely to see some consolidation before probably moving a bit higher from here, but I'm skeptical of the

market hitting new highs anytime soon without a fantastic earnings season.

Market	Level	Change	% Change
DBC	23.12	.29	1.27%
Gold	1208.00	15.10	1.27%
Silver	17.34	.514	3.05%
Copper	3.0375	.039	1.30%
WTI	90.47	.73	0.81%
Brent	92.98	.67	0.73%
Nat Gas	3.906	-.133	-3.29%
RBOB	2.4141	.0356	1.50%
DBA (Grains)	26.44	.71	2.76%

Prices taken at previous day market close.

Economics

Labor Market Conditions Index

- September LMCI rose 2.5 points in September.

Takeaway

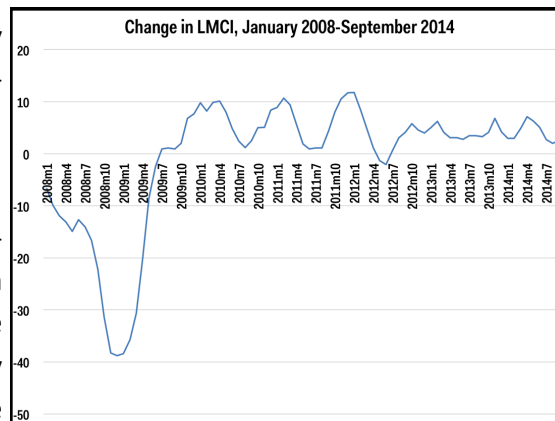
There was a lot of talk about this number yesterday, as it is a new publicly published, comprehensive labor market index the Fed used to use internally (it's been around since the 1970s). It's comprised of 19 different labor market indicators (all of which are public). Basically, this is the Fed's employment indicator "dashboard" and as such it's something we all need to follow.

Much was made yesterday about the fact that the index rose just 2.5 points compared to an average of 4.9 points each month for the first 6 months of 2014. As a result this was construed as "dovish" and was partly responsible for the big sell-off we saw in the Dollar Index.

It's odd, then, that virtually every major job indicator in September was good, yet the LMCI was "soft." And, that likely had to do with the fact that the LMCI probably puts a

lot of weight on hours worked, changes in the participation rate, or wages themselves (all of which were subdued in the jobs report Friday).

Given the release contains just the monthly change and not an absolute level, it's hard to get too much of a gauge on how important this report really is from a Fed standpoint, and frankly I'm thinking not *that* important. For instance, the absolute level of this index could be at multi-year highs, and as such the incremental monthly 2.5-point disappointment really isn't that big a deal (because the absolute level is good). Point being, a 2.5 point increase if the absolute level were at 100 (which



This is the Fed's labor market index everyone was talking about yesterday. The chart doesn't look that great until you keep in mind it's a momentum indicator, so anything above zero is incremental growth.

could be a 6 year high) is a lot less disappointing than a 2.5 point gain when the absolute level is at 40 (a multi-year low). I'm guessing it's more towards the later.

Regardless, while it was taken as "dovish" yesterday and helped the dollar to sell off and bonds to rally, I don't think it negates the strong September jobs report and really isn't that dovish in a fundamental sense (and definitely won't change any Fed policy decisions).

But, it's a new monthly number we all need to watch—so going forward we'll be keeping an eye on it.

Commodities

Commodities traded mostly higher to start the week yesterday as some of last week's losses were retraced. The primary driver of the space was dollar weakness, which supported rallies most notably in the metals but also in the energy sector. The broad-based commodity tracking index ETF, DBC, added +1.27% on the session, its best single day in months.

Beginning with the metals, gold approached support late Sunday night but the sell-off ran out of steam just shy of major support at \$1,180. Then, prices began to methodically rally as the dollar steadily declined over the course of the day. Futures finished the session up +1.27%, comfortably above the \$1,200 mark.

Copper held onto support at the psychological \$3.00 level yesterday as futures bounced +1.30%, also largely influenced by dollar weakness.

Bottom line, the metals are currently trading almost exclusively off of movement in the dollar. If we do indeed see some consolidation in the greenback, both precious and industrial metals should be able to hold current levels and possibly even rally on some short-covering. However, such a bounce would be an opportunity to initiate shorts

because when the dollar begins to rally again, metals will again come under pressure.

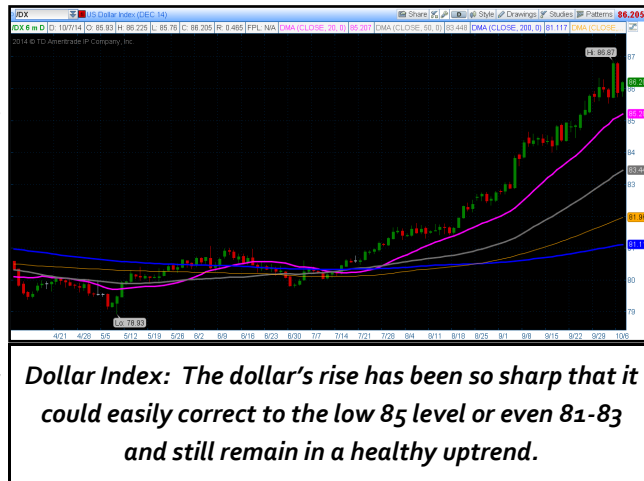
Crude oil futures spent much of the session in the red, but a midday reversal saw prices close higher by +0.81%. There was not a specific reason for the reversal but, as was the case with the metals, the weaker dollar surely helped to lift futures as the day progressed. Going forward,

the situation remains largely the same as global supplies remain abundant while "questionable" economic data keep the speculative bulls out of the market.

As was the case last week, natural gas bucked the trend (remember, natural gas was the best performer last week while all other commodities sold off) yesterday and fell nearly -4% to

close right on initial support at \$3.90. The key catalyst for the selling was speculation that demand has been less than initially expected to start the month as weather remains moderate across the country.

But, national stockpiles are not yet restored to the "normal" levels most analysts see fit for entering the draw season, and we are running out of time (the draw season officially kicks off in late October/early November). So, any cold surprises in the forecast will likely cause a leg higher in natural gas futures. We continue to view the high \$3.00 range as "value" in natural gas given current market dynamics.



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Currencies & Bonds

We've been waiting for a reversal in the dollar, and yesterday we got it. The Dollar Index fell the most in months yesterday as more disappointing economic data from Germany put a bid under the euro early on deflation fears; meanwhile the aforementioned Fed labor market Index caused the dollar to break the morning lows. From there it was a stampede out the

Market	Level	Change	% Change
Dollar Index	85.90	-.923	-1.06%
EUR/USD	1.2647	.0131	1.05%
GBP/USD	1.6074	.0112	0.70%
USD/JPY	108.80	-.95	-0.87%
USD/CAD	1.1129	-.0113	-1.01%
AUD/USD	.8759	.0086	0.99%
USD/BRL	2.428	.0044	0.18%
10 Year Yield	2.425	-.022	-0.90%
30 Year Yield	3.128	-.006	-0.19%
Prices taken at previous day market close.			

door by late dollar longs.

Simply, the currency markets had become much, much too extended in the long dollar/short everything else trade, and now we are seeing a needed and healthy unwind of that setup.

Across the board, currencies were up by more than +1% versus the dollar: euro up +1.17%, yen up +1%, Aussie up +1% and Loonie up +1.18%. The pound was the underperformer, up just +0.8%.

News-wise, the German manufacturers orders disappointed and a surprisingly strong Canadian Ivey PMI (Ivey is the firm that does the survey) were the reasons those two currencies outperformed the others.

Although the FOMC minutes loom tomorrow, unless they are very hawkish, I would expect this sell-off in the Dollar Index to last for a bit longer, as this market still has a long way to go before a more healthy balance is restored. We're seeing a bit of a rebound in the dollar/decline in the euro following the horrid German Industrial Production report, but I don't think that number is going to lead to the euro hitting new lows and would expect a chop today.

Longer term, does yesterday's declines make us any less "dollar bullish"? No, not at all. The fundamentals of the long dollar trade remain very much intact—but it has simply gotten way too overextended, and now a now there needs to be some mean reversion. We should eventually look to buy dollars and short euros, yen, Aussie and Loonie when this reversal has run its course.

Staying in 'Oz, there was a Reserve Bank of Australia meeting overnight and they, as expected, held interest rates firm at 2.5%. The statement, while citing the Aussie as overvalued wasn't all that "dovish" and given the steep drop we've seen in Aussie over the past month plus, we're seeing a bit of a "buy the news rally." If this gains momentum, though, towards .90 over the next few days, it will be a good entry point for Aussie shorts.

Turning to bonds, they also benefited from the soft LMCI, although after the short-squeeze last week, that trade isn't as crowded and as a result the gains were more muted. The 30-year Treasury rose +0.18% while the yield on the 10-year inched closer to 2.40%.

The 30-year failed to break through the 2014 uptrend yesterday, but clearly the bond market is benefiting from renewed money flows from Europe in the face of depressing economic growth and renewed fears of ECB failure and deflation. Meanwhile the stronger U.S. dollar here is spurring worries of renewed dis-inflation. I'll continue to hold my TBT until the previous low (\$53.91) is violated for an hour or two—which will be entirely plausible if the Fed minutes are "dovish" tomorrow.

Have a good day,

Tom

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

<u>Date</u>	<u>Position</u>	<u>Open Price</u>	<u>Stop</u>	<u>Strategy</u>
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).

<u>Date Initiated</u>	<u>Strategy</u>	<u>Position (s)</u>	<u>Investment Thesis</u>
November 2012	Long Japan	DXJ/YCS	The election of Prime Minister 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.
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Strategy Update (9/8/14): One of the biggest positive influences on bonds 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.

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.

	<u>Near Term Trend</u>	<u>Long Term Trend</u>	<u>Market Intelligence</u>
Stocks	Neutral	Bullish	<i>The S&P 500 looks to have completed another typical 4%-5% pull back last week, as stocks temporarily violated the 100-day moving average before recovering late in the week. Going forward global economic growth is becoming a greater risk to equity prices, but as of now the benefit of the doubt remains with the bulls.</i>

Best Idea: Buy Regional Banks (KRE).

Best Contrarian Idea: Buy Consumers Stocks (XLY)

Commodities	Bearish	Bullish	<i>Commodities again tried to stabilize last week, but the surge in the dollar Friday weighed on the space as both gold and oil traded to new lows last week. The outlook remains dim near term: Slowing global growth and a surging US Dollar is not a good recipe for commodities.</i>
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Best Idea: Buy Natural Gas (UNG)

Best Contrarian Idea: Buy Grains (DBA)

U.S. Dollar	Bullish	Bullish	<i>The Dollar Index surged to another 4 year high last week thanks to a massive Friday rally off the strong jobs report. The divergence in economic growth and policy between the US and Europe/Japan/China continues to grow, and that will continue to support the dollar.</i>
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Best Idea: Sell the Yen (YCS)

Best Contrarian Idea: Long Canadian Dollar (FXC)

Treasuries	Neutral	Bearish	<i>The Treasury bounce accelerated last week, as a "risk off" move Wednesday caused a big short covering rally, a "disappointing ECB" sent European money back into Treasuries, while the sluggish wage number in the jobs report kept Fed policy expectations anchored. The bond market is threatening a new uptrend, but for now remains neutral.</i>
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Best Idea: Short "long" bonds (TBT)

Best Contrarian Idea: Short High Yield Bonds (SJB)

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