7:00's Report

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

December 11th, 2014

Pre 7:00 Look

- Futures are bouncing slightly and international markets are mixed as oil is higher and the latest ECB TLTRO offering largely met expectations.
- Oil is up about 1% this morning, bouncing after yesterday's beating. There's no reason for the bounce other than the fact that oil is very near-term oversold.
- Economically the ECB TLTRO saw 130 billion euros of demand, meeting low expectations, and importantly increasing the chances of ECB QE in early 2015.
- Econ Today: Jobless Claims (E: 295K), Retail Sales (E: 0.4%).

Market	Level	Change	% Change
S&P 500 Futures	2028.50	2.00	0.10%
U.S. Dollar (DXY)	88.475	-.062	-0.07%
Gold	1222.80	-6.60	-0.54%
WTI	61.58	.64	1.05%
10 Year	2.169	-.051	-2.30%

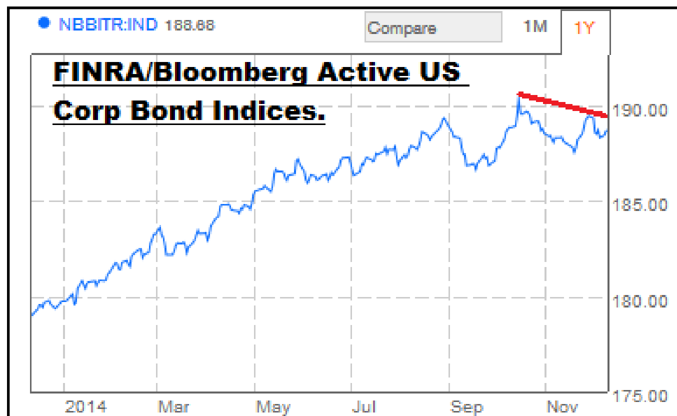
Equities

Market Recap

Stocks suffered their worst daily decline since early October as new lows in oil and junk bonds weighed on markets. The S&P 500 declined 1.64%.

The general "reasons" for the decline were the same as they have been: New lows in energy stocks and oil as well as junk debt, but in truth the drop in the stock market was more technical-based than anything.

A poll that showed Greece's leftist Syriza party with a 5-



Bonds: As we've been saying, it's not just junk bonds that have declined recently. We are also seeing selling in investment grade indices as well.

point general election lead hit midday via a Reuters article, but that didn't tell us anything we didn't already know. (Syriza was already leading in national polls, but keep in mind it may not get to a general election if a president is elected.)

Stocks started the day mildly lower after global markets tried to stabilize from Tuesday's drop, but when oil made a new low through $62.25 right around the U.S. stock market open, selling pressure started to build.

I'll be appearing on Fox Business today at 12:45 PM EST with Stuart Varney to discuss the sell off and what's next for the markets.

That pressure was then exacerbated after the 10:30 EIA data showed a bigger build in oil inventories than expected. Unlike the past several weeks, there were no buyers willing to step in and support prices.

The third and final technical break yesterday came in the mid-afternoon when Tuesday's lows were violated, invalidating the nice bounce from Tuesday. From there

Market	Level	Change	% Change
Dow	17533.15	-268.05	-1.51%
TSX	13,852.95	-342.78	-2.41%
Brazil	49,548.08	-654.39	-1.29%
FTSE	6,469.19	-30.85	-0.47%
Nikkei	17,257.40	-155.18	-0.89%
Hang Seng	23,312.54	-211.98	-0.90%
ASX	5,230.97	-28.03	-0.53%

Prices taken at previous day market close.

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

the selling accelerated and, after a weak bounce failed during the 3 p.m. hour, stocks rolled over and basically went out on the lows of the day.

Trading Color

Unlike Tuesday, the sell-off yesterday was totally driven by cyclical underperformance. The Russell 2000 dropped 2.2% and the Nasdaq gave back 1.8% (pulled down by large-cap tech names), while SPHB (S&P 500 high-beta ETF) dropped 2.15%.

Market	Level	Change	% Change
DBC	19.61	-.35	-1.75%
Gold	1229.10	-2.90	-0.24%
Silver	17.13	-.004	-0.02%
Copper	2.895	-.0325	-1.11%
WTI	61.34	-2.48	-3.89%
Brent	64.65	-2.19	-3.28%
Nat Gas	3.704	.052	1.42%
RBOB	1.6511	-.0725	-4.21%
DBA (Grains)	25.24	-.16	-0.63%
Prices taken at previous day market close.			

Sector-wise, the selling was broad and forceful. All 10 S&P 500 sub-sectors finished lower, led down by XLE, which declined another 3%. The "outperformer" on the day was consumer staples, which saw a 1% drop.

Basic materials, industrials, tech, healthcare and financials were the worst-performing S&P 500 sub-sectors.

Disconcertingly, there were some signs of "contagion" in the markets yesterday as JNK, the junk bond ETF, dropped sharply to new 52-week lows. More importantly the banks got hit very hard, as KRE (regional banks) dropped 3.33% and KBE (money center banks) fell 2.7%.

Late last week I cautioned that regional banks may come under further pressure if worries about energy-related junk bonds grew, and that's exactly what's happening now. To a point the selling is indiscriminate (a Florida regional bank obviously doesn't have a ton of Bakken shale debt exposure) So, there will be buys out of this, but I think we have to be a bit patient.

ECB TLTRO Takeaway

This morning the ECB reported demand of 129.84 billion euros for the latest TLTRO, basically meeting lowered expectations of 130 billion. The euro is slightly higher on the news as are European markets. This marks the second disappointing takedown of the cheap loans (only 220 billion has been taken of 400 billion offered this year), but in the context of QE in the EU this is a positive. The weak demand will further the case for the ECB "doves" that want QE early next year, and the lower demand will hurt the German argument against no QE. This is classic "bad news is good," but that's the world we live in with QE, and the bottom line is this news is supporting of our "Long Europe' thesis and positive for HDJ. This reinforces our desire to buy this or any further dip.

Bottom Line

Fundamentals haven't materially deteriorated, but at 2,080 stocks were mostly priced for perfection into year-end. But the collapse of oil/energy, turmoil in Greece and corporate bond market stresses shattered that possibility.

Despite the sharp sell-off this week, nothing fundamentally has changed. This market continues to be driven by energy stocks (XLE) and credit (JNK). Neither have stabilized or put in a bottom yet, so neither have stocks.

Greece is an issue to monitor but for now, this is about energy stocks and credit market stresses—not European geopolitics. (The concern there is a bit overblown so far, as Greece had no trouble selling debt in the market Wednesday morning.)

Stocks are now about 2.5% off the highs, so this is a dip we were waiting for. But before adding any long exposure, we will want to see energy stocks (XLE) and credit markets (JNK) stabilize. Seeing as both made new 52-week lows yesterday, I don't think we are there yet—so we remain cautious.

Thoughts on Oil Stocks

Ever since we first alerted you to the potential for oil company bond stress in the junk market two Mondays ago, energy stocks (specifically XLE) have been leading stocks. Generally speaking, during the past two weeks, if XLE was up, stocks were up (or flat). If XLE was lower, stocks were lower.

To that end, where XLE goes from here is very important, and there is a lot of misinformation out there about oil companies shutting in production, etc. I have a lot of contacts in the physical energy business, and I wanted to share some takeaways from recent conversations with them.

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

First, a lot of energy companies are *embellishing* about the price where they will cut production. In truth, most oil companies' true shut-in price for production is well-below where they say it is.

And, that's because they simply shift production from expensive wells (which they do shut in) to more economical wells.

Second, lower prices may well result in increased short-term production. Think about it—if we were running an oil company and all of a sudden our margins (the price) are being squeezed, how would we make it up? By pumping more product at lower prices (i.e., more volume). As noted above, we would increase production at economical wells and squeeze every drop out of them.

Third, oil companies will not shut in production (i.e., stop making revenue) just because margins are compressed (the price is lower).

Case in point, Goodrich Petroleum (GDP) said capital spending (exploration) will drop nearly 50% in '15 given the drop in prices, but output will increase 30% to 40%. So, if we are expecting shut-ins of production to help the oil price, it likely won't happen near term. As a result, I think neither oil nor energy stocks are done declining yet.

With regard to oil, I'm not sure why there's so much mystery. The Saudis have said they think Brent crude will stabilize around $60/bbl. It's currently at $64-ish, so I think their target (or close to it) is reasonable.

Economics

There were no economic reports yesterday.

Commodities

The oil sell-off resumed yesterday and the rest of the space followed suit as all commodities but natural gas declined Wednesday. The benchmark commodity tracking index ETF, DBC, fell another 1.93% on the session.

After a low-volume rally on Tuesday, oil prices punched through Monday's lows yesterday, falling 4.29% by the NYMEX close. News-wise, there were several bearish headlines out: OPEC cut its 2015 demand estimate, Kuwait extended the biggest discounts in 6 years to customers in Asia, in the U.S., the EIA reported sizeable builds in the refined products, and the Saudi oil minister was quoted saying, "This is a market and I'm selling in a market. *Why should I cut.*"

Although all of those pieces of news are decidedly bearish for oil prices, that last point there is likely the most important in the current scheme of things.

That's because the financial world is very focused on the energy markets, watching for any potential production cut from OPEC (and as we have said before, the Saudis have the ultimate say when it comes to OPEC's decision-making). So, basically, Ali al-Naimi, the Saudi Oil Minister, basically said he is going to keep on producing and keep on selling at market despite the collective concern of the rest of the world's oil cartel. This is very bearish for oil from a supply standpoint.

Bottom line, the slide in global energy prices is clearly not over yet, and the declines are starting to materially weigh on other asset classes—most notably, U.S. stocks.

Natural gas futures rallied 1.4% yesterday but relatively, it was little more than a second day of a "dead-cat bounce" following the extremely steep sell-off of 90 cents (or 20%) that took place between the last week of November and Monday. Today, the EIA will report inventory statistics from last week and analysts are calling for a -50 Bcf draw. With the current market dynamics, any material miss on the side of a smaller draw could result in another leg down toward $3.40 while a larger than expected draw would likely spur some short-covering towards $3.80.

Market	Level	Change	% Change
Dollar Index	88.47	-.47	-0.53%
EUR/USD	1.2443	.0069	0.56%
GBP/USD	1.5709	.004	0.26%
USD/JPY	117.84	-1.85	-1.55%
USD/CAD	1.1479	.0037	0.32%
AUD/USD	.8325	.0034	0.41%
USD/BRL	2.615	.0222	0.86%
10 Year Yield	2.169	-.051	-2.30%
30 Year Yield	2.835	-.040	-1.39%
Prices taken at previous day market close.			

Gold largely drifted sideways yesterday, finishing the day down 0.40% as Tuesday's $40 short-squeeze-rally was digested. The fact that gold did not rally in big way yesterday is a bearish sign for gold. The two biggest influences—the Dollar Index and stock market—both

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

made moves lower, which is obviously favorable for gold prices in most cases.

Gold's inability to rally yesterday further supports the thesis that the recent surge in prices was almost entirely due to short-covering. And, that short-squeeze appears to have run its course.

Bottom line, we continue to see gold prices moving lower in the near term. In yesterday's Report, we mentioned a band of resistance between $1,240 and $1,250, and we continue to see gold futures holding below that level for the near term.

Currencies & Bonds

Currencies traded with the stock market yesterday as the drop in stocks resulted in the continuation of the dollar rally reversal.

The Dollar Index fell 0.45% yesterday, although the weakness wasn't universal—the Canadian dollar dropped 0.40% on lower oil prices. Until oil stabilizes, the Loonie will continue to decline.

Dollar/yen was by far the biggest mover in the currency markets yesterday, as the dollar/yen continues to correct its very oversold condition. The yen rallied 1.26% vs. the dollar and dollar/yen dropped back below 118 (after sitting above 121 as we started the week).

The euro also continued to rally despite Greek political worries, mostly on short-covering ahead of the TLTRO auctions this morning. Remember, a higher euro is "bad" in that it reflects increased deflation expectations (i.e., that the ECB is failing). So, European stocks and the currency are now, and for the foreseeable future, inversely correlated. As a result, when U.S. and European stocks are down, the euro will almost certainly be up, and that happened again yesterday.

The euro rallied 0.43% vs. the dollar and broke through 1.24 (after finishing last week below 1.23, so we've seen a decent bounce-back already).

Importantly, there weren't any real "reasons" for the moves in currencies yesterday other than the general increase in the level of angst in the market and declining stock prices.

A stronger dollar/weaker euro and yen has been positively correlated with "risk on" moves in stocks, so yesterday we saw a bit of a "risk off" move in stocks and currencies. And, we can expect those general correlations to continue for the foreseeable future.

Turning to the bond market, it continues to be well supported as there was a trifecta of positive influences on the bond market that helped push the 30 year Treasury up .6% yesterday.

First, DoubleLine Capital CEO Jeff Gundlach's prediction that the 10-year yield may hit 1% (if oil continues lower) was still in people's minds as we started trading. But as if the bond market needed help, the drop in stocks, political concern in Greece (which pushed German bunds higher/yields lower) and a good 10-year auction all helped support Treasury prices.

Bonds were slightly higher most of yesterday, but caught an additional bid following a 10-year auction that received a "B" in Rick Santelli's grading system. Demand was good for the offering despite the fact that the yield was the lowest since June 2013. The bid to cover (a measure of demand) was the highest of the year (again despite the yield being the lowest)—clearly demonstrating that low yields didn't sap demand. Now, to be fair, this is the last 10-year auction of 2014, so perhaps there was some last-minute demand, but even so the auction was positive.

Bottom line, although the Fed will likely get more "hawkish" at next week's FOMC meeting and the economic data continue to get better and better domestically, bonds remain supported by a multitude of international factors, and that continues to trump the fundamentals.

Have a good day,

Tom

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

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	59.35 24.67 16.44 41.34	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*
12/13/13	FCG XOP	18.97 65.62	None	*Natural gas supplies low, increasing 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
September 2014	**Long Europe**	**HEDJ**	*On a longer time frame, Europe is poised to outperform other major developed economies as the ECB is proving their unanimous commitment to increasing the Balance Sheet. HEDJ is the equivalent of Japan's DXJ ETF and is the best way to gain exposure to Europe while hedging against currency depreciation.*
Strategy Update (11/6/14): The ECB continues to slouch towards more stimulus and QE, and at the October ECB meeting Mario Draghi did as good of a job as possible to "speak" dovish and reiterate that the ECB remains unanimously for more stimulus if needed. Additionally, the ECB staff has begun work on modeling more stimulus, which is the most concrete sign yet the ECB is planning to do "more" in early 2015. We continue to view dips as buying opportunities.			
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 (11/3/14): The Bank of Japan shocked markets last week by announcing massive new monetary stimulus. I have been a Japan bull since late 2012, and I never thought the BOJ would go this far. The trend lower in the yen/higher in DXJ has clearly resumed, with a reasonable target for the dollar/yen now 115-120. This is a trend that will outperform over the coming months/quarters as the yen devalues and the BOJ/GPIF buys Japanese stocks.			
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 (11/6/14): Treasuries are finally beginning to roll over here on the charts. The fundamentals for this trade remain decidedly negative, but once again money flows (specifically European) have recently been trumping the fundamen-			

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 12.8.14)

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 hit a new all time high last week thanks to strong US data and rising hopes of QE in the EU. But, markets also acted a bit fatigued as Friday's blow out jobs report failed to spur much of a rally, as data that good is seen as potentially creating a slightly more hawkish Fed. Bottom line, it'll be tough for stocks to sell off materially given current sentiment, but we see limited upside over the coming weeks.*

Best Idea: **Buy Regional Banks (KRE).**

Best Contrarian Idea: **Buy Energy (XLE)**

	Near Term Trend	Long Term Trend	Market Intelligence
Commodities	**Bearish**	**Bullish**	*Commodities declined again last week as oil tried to stabilize (but largely failed) and gold got hit on Friday following the strong jobs report. With concerns about the global economy and a relentlessly stronger dollar, the near term outlook for commodities remains poor.*

Best Idea: **Buy Natural Gas (UNG)**

Best Contrarian Idea: **Buy Grains (DBA)**

	Near Term Trend	Long Term Trend	Market Intelligence
U.S. Dollar	**Bullish**	**Bullish**	*The Dollar Index shot to new multi-year highs last week following the blow out jobs report. The yen was the weakest performer vs. the dollar, dropping more than 2%, but every major currency declined as the difference between US growth/monetary policy and the rest of the world continues to widen.*

Best Idea: **Sell the Yen (YCS)**

Best Contrarian Idea: **Long British Pound (FXB)**

	Near Term Trend	Long Term Trend	Market Intelligence
Treasuries	**Neutral**	**Bearish**	*Treasuries declined last week on slightly "hawkish" comments by Fed officials Dudley and Fischer, and the strong jobs report. Importantly, last week the rising prospect of a more "hawkish" Fed weighed on bonds, and there are cracks appearing in the rally.*

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