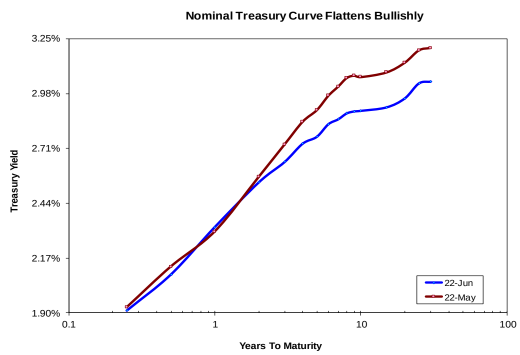
The Macro Environment For Financial Markets

The worst part about the trade wars is they seem to be unfolding without war aims or any sort of rationale. Bad policies introduced randomly and often revoked just as quickly raise the cost of doing business. They affected a range of industrial equities, emerging markets and physical commodities this week. Nothing good will come from this, but that does not mean it will stop. The causal chain now is:

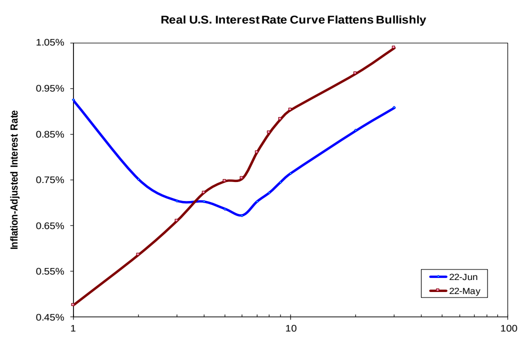
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to invert bullishly; and
6. CDS costs are starting to reflect increased corporate bond issuance.

Key Market Indications

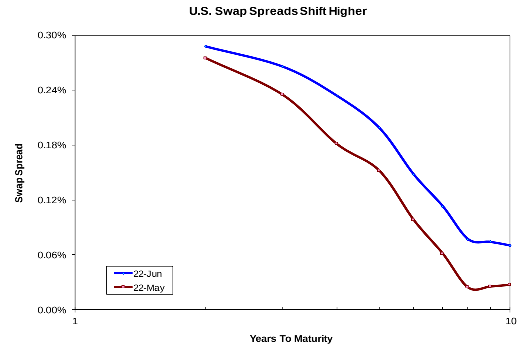
As was the case with the default scare of 2011, self-destructive U.S. policies led to a flight into Treasuries. This time it was the tariff threats and associated issues. In the meantime, the Federal Reserve's policy of raising short-term rates is leading to a flatter yield curve and stable inflation expectations.



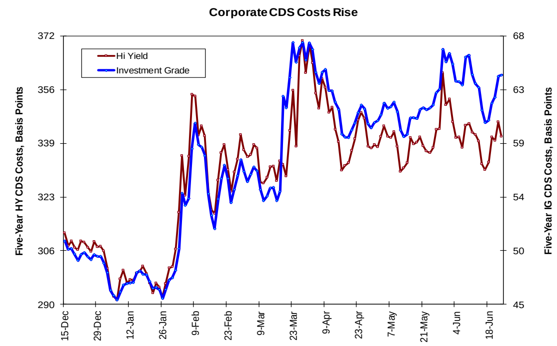
The pseudo-real yield curve continued to shift higher at the short end of the yield curve. This is a major negative fundamental for gold. The move lower at the long end of the curve is supportive for risky financial assets.



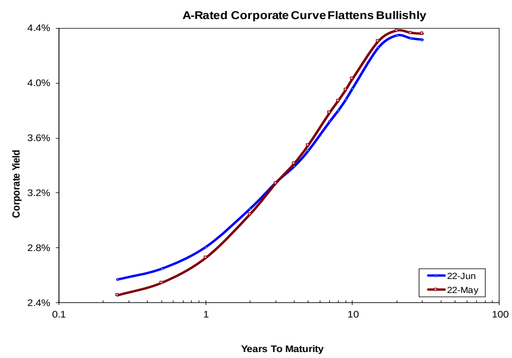
Swap spreads, which rise when floating-rate borrowers want to fix their payments, once again rose across all tenors. The gains are not significant enough to affect the corporate bond market yet.



CDS costs rose as a flood of new issuance is starting to choke the corporate bond market. The various trade threats raise the risks for individual corporations.



The A-rated corporate yield curve mirrored the small bullish flattening seen in the UST market, but there is almost no capacity for a significant rally, especially given the upturn in credit spreads.



Market Structure

Only Natural Gas and Livestock are not in structural downtrends amongst the physical commodities. The EM index remains in a structural downtrend while the S&P 500 remains in an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate June 25 - 29
BBerg	29	Trending	-0.342	8.1%	-0.13%
BBerg Grain	29	Trending	-0.345	19.9%	-0.42%
BBerg Ind. Metl	29	Trending	-0.216	13.7%	-0.21%
BBerg Pre. Metl	22	Trending	-0.192	8.5%	-0.08%
BBerg Softs	29	Trending	-0.117	14.5%	-0.27%
BBerg Nat. Gas	14	Transitional	-0.014	17.7%	
BBerg Petroleum	22	Trending	-0.020	19.0%	-0.25%
BBerg Livestock	6	Sideways	-0.003	20.2%	
Dollar Index	15	Transitional	0.045	6.9%	
S&P 500 Index	29	Trending	0.044	7.7%	0.10%
EAFE Index	15	Transitional	-0.111	8.8%	
EM Index	29	Trending	-0.374	10.3%	-0.09%
Ten-year UST (price)	15	Transitional	0.067	4.4%	

Performance Measures

Both Grains and Industrial Metals showed the effects of trade threats. The surprise of the week came in the Petroleum complex, which regarded OPEC's ability to manage a production increase as bullish. While the Precious Metals sagged, they did not decline as much as they could have given rising short-term pseudo-real rates.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.40%	-3.82%	2.71%	11.21%
Grains Sub-Index	-1.76%	-12.11%	-0.88%	-9.38%
Corn	-1.11%	-11.74%	-1.71%	-11.68%
Soybeans	-1.49%	-13.77%	-7.78%	-4.42%
Wheat	-1.76%	-9.84%	9.28%	-10.70%
Energy Sub-Index	1.85%	-1.32%	13.51%	37.00%
Petroleum Sub-Index	3.36%	-1.64%	15.64%	60.38%
WTI	5.05%	0.33%	18.73%	58.67%
Brent	3.10%	-0.93%	20.81%	71.85%
ULSD	1.92%	-3.41%	10.37%	57.47%
Gasoline	2.06%	-4.99%	5.59%	44.17%
Natural Gas	-2.30%	-0.36%	8.33%	-14.98%
Precious Metals Sub-Index	-0.46%	-2.23%	-0.80%	-0.29%
Gold	-0.57%	-2.78%	-1.06%	0.34%
Silver	-0.07%	-0.36%	0.03%	-2.05%
Industrial Metals Sub-Index	-2.49%	-1.47%	-0.31%	21.30%
Copper	-3.66%	-1.37%	-6.77%	13.67%
Aluminum	-1.25%	-3.51%	1.09%	17.39%
Nickel	0.55%	3.28%	25.86%	67.05%
Zinc	-5.18%	-3.84%	-9.41%	10.42%
Softs Sub-Index	-1.15%	-1.72%	-7.40%	-1.11%
Coffee	-0.47%	-4.53%	-7.06%	-13.05%
Sugar	0.52%	-2.52%	-16.27%	-10.04%
Cotton	-5.03%	-2.27%	11.76%	30.19%
Livestock Sub-Index	-0.67%	2.97%	-3.70%	-7.53%
Cattle	1.11%	3.67%	-2.62%	-8.62%
Hogs	-3.64%	1.72%	-7.01%	-7.04%

When emerging market central banks start raising rates to "defend" their currencies, nothing good happens as external investors start to flee. The only way for this cycle to break effectively is for the Federal Reserve to signal an end to its campaign, and this simply does not appear likely.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.35%	-1.09%	-1.78%	4.47%
Chinese yuan	-1.02%	-2.12%	1.11%	5.07%
Japanese yen	0.63%	0.85%	3.02%	1.24%
British pound	-0.13%	-1.27%	-0.76%	4.57%
Swiss franc	0.96%	0.48%	-0.01%	-1.65%
Canadian dollar	-0.64%	-3.39%	-4.07%	-0.27%
Australian dollar	-0.03%	-1.80%	-3.49%	-1.35%
Swedish krona	-0.80%	-1.97%	-6.09%	-1.22%
Norwegian krone	0.64%	-0.42%	2.76%	4.86%
New Zealand dollar	-0.59%	-0.38%	-1.62%	-4.90%
Indian rupee	0.27%	0.31%	-5.58%	-4.77%
Brazilian real	-1.47%	-3.63%	-11.83%	-11.71%
Mexican peso	3.07%	-1.19%	-1.31%	-9.48%
Chilean peso	-0.47%	-1.88%	-2.23%	4.21%
Colombian peso	-0.68%	-2.15%	1.55%	3.84%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.62%	-1.62%	-0.82%	2.17%

The rising USD and trade threats continue to pummel the EM indices and the trade effect is becoming increasingly negative for both U.S. and EAFE markets.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-1.30%	-0.04%	1.75%	12.09%
North America	-1.18%	0.73%	3.41%	15.16%
Latin America	-2.89%	-10.27%	-12.12%	-0.06%
Emerging Market Free	-3.99%	-4.64%	-3.66%	10.18%
EAFE	-2.52%	-3.84%	-1.28%	7.70%
Pacific	-1.10%	-1.52%	-0.05%	11.45%
Eurozone	-2.91%	-3.03%	-2.44%	4.77%

Both CTAs and hedge funds lost on the week, suggesting they stayed too long at the party with the USD and crude oil. CTAs often have trouble trading bear markets in physical commodities and hedge funds struggle when equities stop rising.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.43%	-4.57%	-5.81%	-3.06%
Newedge Trend	-1.07%	-3.68%	-5.46%	-3.71%
Newedge Short-Term	-0.75%	-1.61%	0.31%	-0.68%
HFR Global Hedge Fund	-0.45%	-0.94%	-0.69%	2.48%
HFR Macro/CTA	-0.49%	-3.82%	-1.94%	-0.60%
HFR Macro: Sytematic Diversified CTA	-0.63%	-5.04%	-4.07%	0.37%