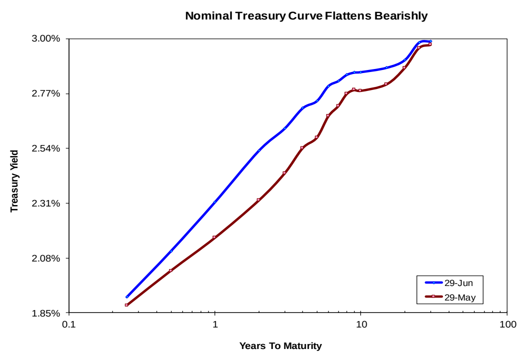
The Macro Environment For Financial Markets

About the last thing anyone needs is an escalation of trade disputes. Not only will this lower growth, raise currency risks, pressure emerging markets and all commercial banks with USD liabilities, it will kneecap trade-dependent firms and those who have built elaborate global supply chains. If anything derails the course of tighter U.S. monetary policy, it will be this foolishness. The causal chain now is:

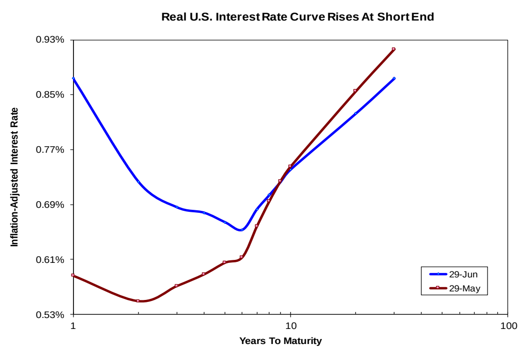
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to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

Key Market Indications

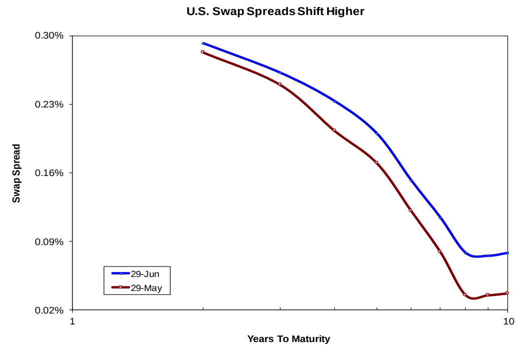
To repeat verbatim from last week, self-destructive U.S. policies led to a flight into Treasuries. The Federal Reserve may point to a small increase in the core PCE as justification for tightening, but it is impossible to link monetary policy and core PCE over the past thirty years. Facts are stubborn things.



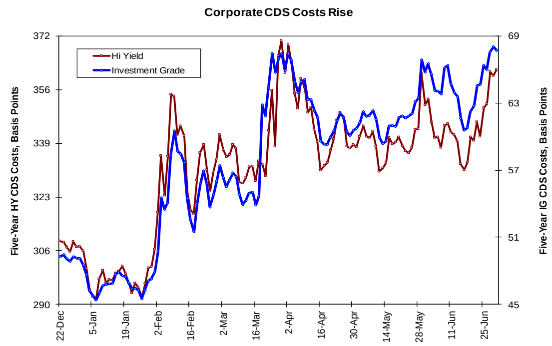
The pseudo-real yield curve continued to shift higher at the short end of the yield curve. This remains a major negative fundamental for gold. The small move lower at the long end of the curve is slightly supportive for risky financial assets.



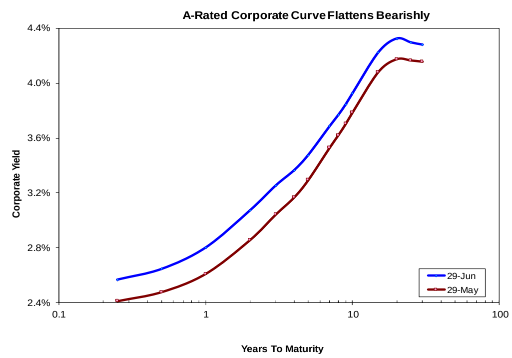
Swap spreads, which rise when floating-rate borrowers want to fix their payments, once again rose across all tenors. The gains are not significant enough to affect the corporate bond market yet.



As was the case last week, CDS as 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

Petroleum moved into a structural uptrend within the physical markets. All of the equity indices are in structural downtrends, while ten-year UST and the dollar index moved into uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 2 - 6
BBerg	5	Sideways	0.059	8.5%	
BBerg Grain	29	Trending	-0.360	21.0%	-0.42%
BBerg Ind. Metl	29	Trending	-0.337	14.2%	-0.21%
BBerg Pre. Metl	26	Trending	-0.313	8.2%	-0.08%
BBerg Softs	6	Sideways	-0.042	13.1%	
BBerg Nat. Gas	14	Transitional	-0.049	17.5%	
BBerg Petroleum	26	Trending	0.226	19.3%	0.53%
BBerg Livestock	22	Trending	-0.008	18.6%	-0.13%
Dollar Index	20	Trending	0.015	6.7%	0.08%
S&P 500 Index	29	Trending	-0.106	9.2%	-0.10%
EAFE Index	20	Trending	-0.160	9.2%	-0.24%
EM Index	29	Trending	-0.400	10.5%	-0.09%
Ten-year UST (price)	21	Trending	0.101	4.1%	0.08%

Performance Measures

Industrial Metals continue to show the effects of trade threats. The Petroleum complex built on last week's rally and the possible disruption of supplies to move strongly higher. While the Precious Metals sagged, they did not decline as much as they could have given rising short-term pseudo-real rates. Both Grains and Softs moved lower; there was a time about twelve years ago they would have moved higher on the effects of indexation. No more.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.14%	-3.22%	-0.29%	7.35%
Grains Sub-Index	-2.37%	-11.49%	-4.13%	-16.74%
Corn	-1.87%	-10.21%	-3.94%	-16.88%
Soybeans	-3.92%	-15.54%	-11.84%	-12.40%
Wheat	-0.56%	-6.99%	6.43%	-20.07%
Energy Sub-Index	4.00%	3.58%	12.58%	34.76%
Petroleum Sub-Index	5.59%	5.15%	18.92%	58.45%
WTI	7.18%	10.88%	23.33%	58.94%
Brent	5.23%	3.71%	23.57%	69.61%
ULSD	3.89%	1.64%	10.73%	52.23%
Gasoline	4.82%	0.99%	10.37%	41.80%
Natural Gas	-0.62%	-0.99%	-5.09%	-17.81%
Precious Metals Sub-Index	-1.42%	-2.96%	-5.42%	-0.78%
Gold	-1.24%	-3.30%	-5.10%	0.20%
Silver	-2.03%	-1.79%	-6.38%	-3.59%
Industrial Metals Sub-Index	-2.36%	-5.64%	-4.97%	15.19%
Copper	-2.69%	-4.71%	-10.41%	7.48%
Aluminum	-2.00%	-7.50%	-4.16%	11.79%
Nickel	-2.40%	-3.52%	18.09%	57.69%
Zinc	-2.07%	-7.32%	-13.66%	6.11%
Softs Sub-Index	-1.43%	-5.47%	-11.78%	-6.79%
Coffee	-1.55%	-7.84%	-15.42%	-16.25%
Sugar	-1.25%	-4.24%	-21.29%	-15.30%
Cotton	-1.58%	-8.07%	10.47%	25.18%
Livestock Sub-Index	1.05%	2.57%	-5.53%	-9.37%
Cattle	0.82%	3.14%	-5.66%	-8.71%
Hogs	1.46%	1.54%	-6.69%	-11.44%

Only a Friday rally by the EUR prevented the USD from showing much stronger gains. He real concern lies with the CNY and China's apparent willingness to use a weaker currency to counter U.S. tariffs. As we saw in 2015, this pressures emerging market currencies and equities lower.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.28%	1.25%	-2.67%	2.12%
Chinese yuan	-1.75%	-3.07%	-1.72%	2.51%
Japanese yen	-0.71%	-1.80%	1.74%	1.28%
British pound	-0.41%	-0.32%	-2.26%	1.54%
Swiss franc	-0.25%	0.07%	-1.65%	-3.50%
Canadian dollar	1.04%	-0.88%	-4.28%	-0.98%
Australian dollar	-0.47%	-1.33%	-5.17%	-3.62%
Swedish krona	-0.96%	0.21%	-8.49%	-5.32%
Norwegian krone	-0.64%	1.68%	0.70%	2.92%
New Zealand dollar	-2.03%	-1.96%	-4.65%	-7.28%
Indian rupee	-0.93%	-0.87%	-6.71%	-5.61%
Brazilian real	-2.36%	-3.85%	-14.56%	-14.81%
Mexican peso	0.52%	-0.35%	-1.25%	-9.37%
Chilean peso	-2.61%	-3.67%	-5.88%	1.72%
Colombian peso	-0.55%	-0.89%	1.85%	3.95%
Bloomberg-JP Morgan Asian dollar index (spot)	-1.01%	-2.06%	-2.43%	1.04%

The macroeconomic threat posed by trade wars is starting to take a real toll on equities. Higher costs and lower growth in a rising short-term rate environment is anything but bullish.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-1.17%	-0.79%	0.15%	11.70%
North America	-1.24%	1.31%	2.59%	14.42%
Latin America	1.60%	-3.00%	-10.99%	0.67%
Emerging Market Free	-1.41%	-4.54%	-6.51%	8.25%
EAFE	-1.03%	-0.92%	-2.37%	6.66%
Pacific	-1.22%	-1.54%	-2.31%	10.20%
Eurozone	-1.02%	-1.69%	-2.57%	5.84%

Both CTAs and macro-oriented hedge funds gained on the week, suggesting they moved to the long side in crude oil and the USD and to the short side on equities.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.07%	-1.01%	-5.45%	-0.75%
Newedge Trend	0.79%	-1.10%	-5.05%	-1.75%
Newedge Short-Term	0.65%	-0.96%	1.04%	0.02%
HFR Global Hedge Fund	-0.41%	-0.45%	-1.04%	2.01%
HFR Macro/CTA	1.05%	-0.02%	-1.42%	0.58%
HFR Macro: Sytematic Diversified CTA	1.28%	-0.84%	-3.39%	2.44%