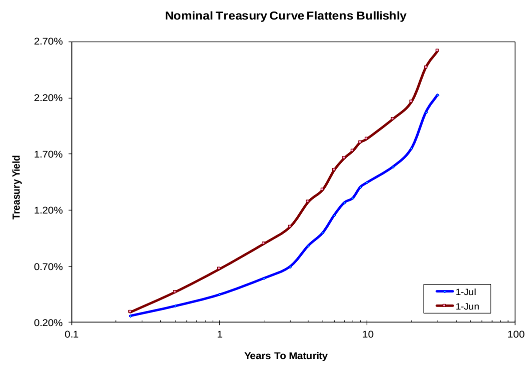
The Macro Environment For Financial Markets

If we have learned anything over the past two weeks it is uncertainty leads to risk-off trades and the abatement of uncertainty leads to the closure of those trades, both with the exception of the flight into sovereign debt. This is now the ultimate greater-fool trade of my lifetime, and that is a significant honor. As you are knowingly buying insurance, you are knowingly accepting a small loss and hoping someone else takes the offal off your hands. They will not do so, and no one can say for certain how that will look if and when the day of reckoning arrives. The causal chain remains:

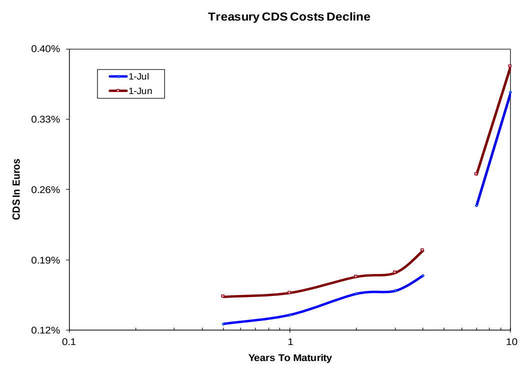
1. The market has no clear idea of if and when U.S. short-term rates will rise;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps are turning lower;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are accepting rollover risk once again;
6. Swap spreads are finally moving higher; and
7. CDS costs remain within a trading range.

Key Market Indications

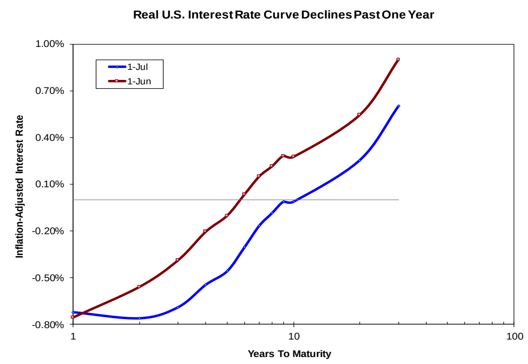
I asked rhetorically last week why U.S. rates had not collapsed even further. They moved to a new low on the year even as equity markets recovered. The U.S. is something of a quality haven given the stresses seen elsewhere and UST remain somewhat rich. Experience dictates that when all roads lead to the Rome of always buying (selling) something, the market should reverse. This has yet to happen.



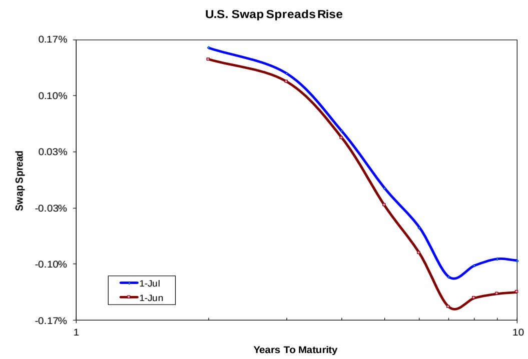
CDS costs declined over the past month, although this market is on its way toward disappearing. At least it is not at the level of absurdity seen throughout much of Europe where a government can get paid to borrow and by implication improve its debt service capabilities by borrowing more.



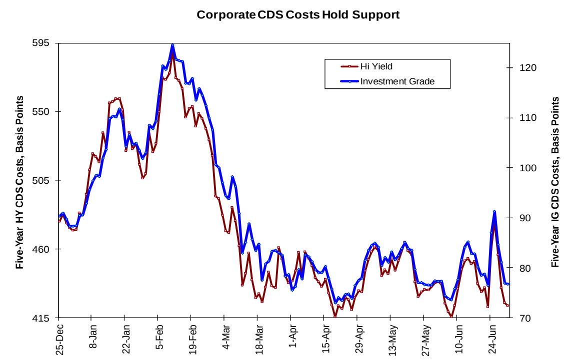
The decline in pseudo-real longer-term rates was, inter alia, bullish for risky assets, but we would be hard-pressed to say it was causal. The ongoing declines in short-term global implied real rates have been bullish for precious metals.



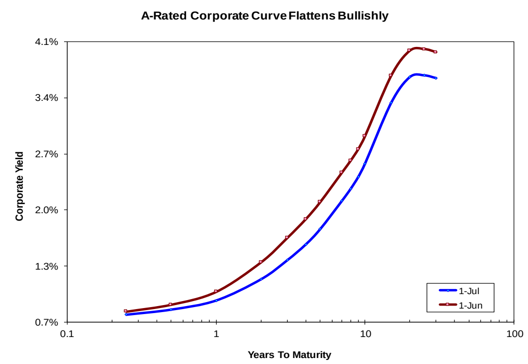
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across tenors as floating-rate payors calculated the risk/reward for remaining floating in a negative-rate world is poor. This trade has yet to prove correct, but it is a cheap place to be wrong.



Both high-yield and investment-grade CDS indices retreated as part of the general closure of hedges. The high-yield index is close to breaking its resistance for the year.



The A-rated corporate yield curve continues to mirror the UST curve as credit spreads remain in a narrow range. The general bull market remains intact, but the potential for further gains is limited.



Market Structure

Only Grains are in a structural downtrend amongst the financial markets. The S&P and the EM index moved into structural uptrends in the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 5 - 8
BBerg	29	Trending	0.243	10.5%	0.14%
BBerg Grain	29	Trending	-0.329	20.2%	-0.36%
BBerg Ind. Metl	29	Trending	0.342	17.5%	0.14%
BBerg Pre. Metl	29	Trending	0.416	17.5%	0.22%
BBerg Softs	10	Sideways	0.141	22.7%	
BBerg Nat. Gas	29	Trending	0.388	22.9%	0.34%
BBerg Petroleum	16	Transitional	0.042	25.5%	
BBerg Livestock	21	Trending	-0.083	12.4%	-0.28%
Dollar Index	27	Trending	0.090	9.6%	0.11%
S&P 500 Index	29	Trending	0.088	10.0%	0.08%
EAFE Index	29	Trending	-0.044	17.6%	-0.08%
EM Index	27	Trending	0.203	13.2%	0.16%
Ten-year UST (price)	29	Trending	0.273	6.7%	0.06%

Performance Measures

Fewer markets have more visible fundamentals than grains, and yet the markets got surprised with more wheat and corn and fewer soybeans. Maybe they should take the lens caps off those satellites. Elsewhere we saw some massive fund-driven gains following last week's fund-driven losses. When markets such as nickel and natural gas gain more than 10% on the week, we are getting divorced from reality.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	3.14%	2.93%	15.27%	-11.80%
Grains Sub-Index	-2.73%	-8.96%	7.39%	-15.59%
Corn	-7.45%	-14.71%	-0.55%	-22.52%
Soybeans	5.48%	2.27%	33.54%	10.05%
Wheat	-7.47%	-15.33%	-10.18%	-31.38%
Energy Sub-Index	4.21%	3.94%	10.92%	-32.04%
Petroleum Sub-Index	2.24%	-0.47%	11.70%	-33.27%
WTI	2.78%	-0.10%	7.04%	-38.18%
Brent	2.68%	0.64%	20.89%	-32.94%
ULSD	3.02%	1.72%	25.78%	-29.28%
Gasoline	-0.75%	-5.87%	-9.59%	-32.20%
Natural Gas	10.34%	19.18%	5.27%	-30.48%
Precious Metals Sub-Index	3.66%	10.96%	28.80%	17.49%
Gold	1.26%	7.76%	24.32%	14.63%
Silver	9.81%	19.36%	40.74%	24.45%
Industrial Metals Sub-Index	5.40%	7.77%	13.49%	-10.92%
Copper	4.78%	4.71%	5.96%	-16.83%
Aluminum	2.94%	7.86%	11.53%	-7.39%
Nickel	10.50%	17.21%	16.31%	-19.49%
Zinc	6.78%	8.15%	36.64%	4.20%
Softs Sub-Index	6.66%	15.77%	21.14%	26.14%
Coffee	6.75%	13.58%	12.79%	4.09%
Sugar	8.46%	10.44%	37.03%	54.45%
Cotton	0.89%	1.35%	3.49%	-4.05%
Livestock Sub-Index	0.35%	-3.59%	-0.77%	-11.77%
Cattle	1.90%	-4.07%	-8.24%	-21.24%
Hogs	-1.20%	-3.07%	10.45%	4.60%

The GBP is a special case, and will be as Brexit is executed. The most interesting aspect is the rush into emerging market currencies in general and Latin American currencies in particular. The expected pause in U.S. rate hikes and the willingness of Mexico to raise rates in defense of the MXN indicate this may be one of the few places left for yield-seekers.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.17%	-0.46%	2.58%	0.75%
Chinese yuan	-0.57%	-1.20%	-2.49%	-6.88%
Japanese yen	-0.29%	6.85%	17.59%	20.14%
British pound	-3.01%	-7.97%	-10.03%	-15.05%
Swiss franc	-0.13%	1.52%	2.89%	-2.56%
Canadian dollar	0.71%	1.29%	7.30%	-2.49%
Australian dollar	0.43%	3.32%	2.67%	-1.92%
Swedish krona	0.34%	-1.66%	0.28%	-0.64%
Norwegian krone	-0.13%	-0.46%	6.26%	-4.90%
New Zealand dollar	0.72%	5.25%	4.90%	6.55%
Indian rupee	0.96%	0.20%	-1.75%	-5.52%
Brazilian real	4.28%	11.28%	22.38%	-2.69%
Mexican peso	3.09%	0.88%	-5.98%	-14.06%
Chilean peso	2.78%	4.64%	7.18%	-3.36%
Colombian peso	1.33%	6.14%	8.24%	-10.00%
Bloomberg-JP Morgan Asian dollar index (spot)	0.42%	0.65%	0.31%	-4.19%

I noted last week that defensive plays seldom lead markets to new highs. However, the close of short hedges and the near-complete lack of yield globally have forced investors out the risk curve. The TINA trade will end one day, but we all will be older when it does.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	3.27%	-0.91%	3.43%	-2.29%
North America	3.14%	0.39%	4.43%	2.28%
Latin America	6.99%	11.84%	26.53%	-5.75%
Emerging Market Free	4.50%	4.77%	7.25%	-11.15%
EAFE	3.48%	-2.12%	-3.31%	-9.71%
Pacific	3.37%	-1.31%	-0.56%	-7.97%
Eurozone	3.71%	-5.16%	-2.28%	-11.37%

CTAs had a strong week, suggesting they rode the long bond trade as too many other markets had surprising reversals. Hedge funds managed some small gains, which we should expect given the recovery in equity markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	4.53%	4.20%	1.82%	3.72%
Newedge Trend	3.33%	3.70%	3.99%	6.27%
Newedge Short-Term	1.79%	1.41%	5.64%	4.60%
HFR Global Hedge Fund	-0.20%	0.21%	-0.98%	-5.63%
HFR Macro/CTA	1.16%	0.77%	-0.88%	-0.95%
HFR Macro: Sytematic Diversified CTA	3.65%	3.23%	2.41%	5.14%