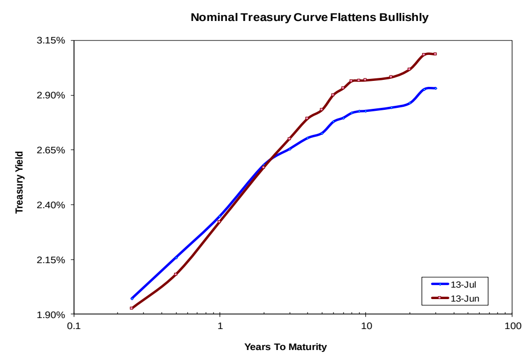
The Macro Environment For Financial Markets

You can manage risk, but you cannot manage uncertainty. This situation has been made worse by the irrational nature of U.S. trade policy. It threatens the U.S. as much as it does other nations and it comes at a time when China is economically fragile and the Eurozone is retreating from its 2017 growth path. As noted last week, fixed-income, currency and commodity markets are pricing in a shock and equity markets are "looking over the valley." Once again, all we can say is one side is going to be wrong. The causal chain now remains:

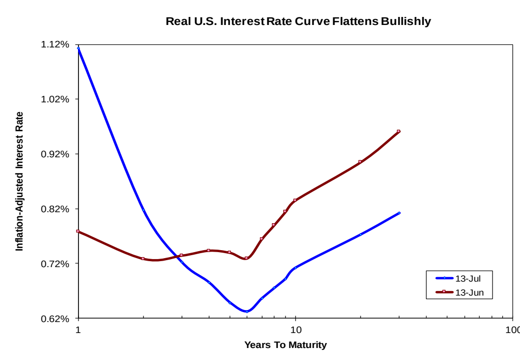
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to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

Key Market Indications

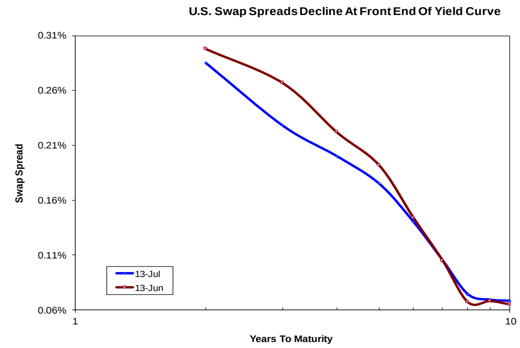
The yield curve continues to drive lower at the long end of the yield curve as trade tensions are driving risk-averse investors there. Inflation expectations remain confined even as backward-looking measures of reported inflation tick higher.



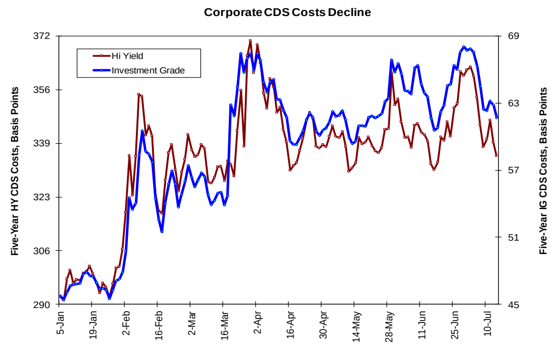
The pseudo-real yield curve continued to decline past two years' maturity even as it rose at the short end of the yield curve. This is bullish for risky financial assets and bearish for precious metals.



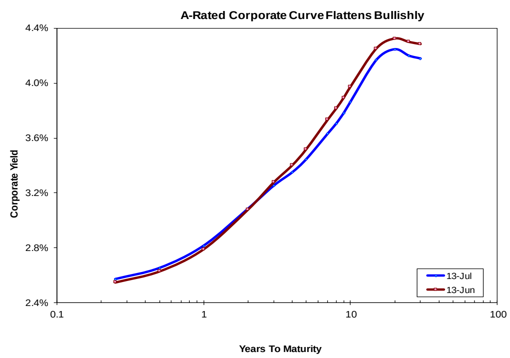
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined at the short end of the yield curve as the prospects for further short-term interest rate hikes fade.



The decline in CDS costs reflects the gains in equities more than anything specific to credit. The continued threat to individual companies from trade disruptions has yet to affect the corporate bond market on an index level.



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 as credit spreads are unlikely to compress much further.



Market Structure

Only Petroleum is in a structural uptrend within the physical markets. Both the main Bloomberg index and Industrial Metals are oversold. Within the financials, all but the EAFE are in consolidative structures.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 9 - 13
BBerg	29	Trending	-0.456	8.8%	-0.29%
BBerg Grain	8	Sideways	-0.081	21.1%	
BBerg Ind. Metl	29	Trending	-0.560	15.7%	-0.21%
BBerg Pre. Metl	8	Sideways	-0.098	9.6%	
BBerg Softs	6	Sideways	-0.095	16.5%	
BBerg Nat. Gas	29	Trending	-0.284	16.4%	
BBerg Petroleum	29	Trending	0.048	20.3%	0.53%
BBerg Livestock	28	Trending	-0.186	17.3%	-0.13%
Dollar Index	17	Transitional	0.007	5.8%	
S&P 500 Index	19	Transitional	0.184	9.7%	
EAFE Index	29	Trending	-0.040	9.2%	-0.24%
EM Index	9	Sideways	0.078	11.5%	
Ten-year UST (price)	6	Sideways	0.041	2.8%	

Performance Measures

Only cotton and nickel had positive returns on the week. This sort of across-the-board slaughter was seen during the financial crisis, and we are nowhere near that environment. Still, you do not want to be a primary commodity producer if Chinese demand starts to slide, and this makes it very difficult to assess any sort of bottom on fundamental terms.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-2.72%	-4.27%	-4.40%	2.86%
Grains Sub-Index	-5.21%	-7.55%	-6.27%	-19.82%
Corn	-5.24%	-7.82%	-7.49%	-20.07%
Soybeans	-6.70%	-10.21%	-16.69%	-20.80%
Wheat	-3.51%	-3.07%	9.86%	-18.36%
Energy Sub-Index	-2.25%	1.39%	4.37%	28.64%
Petroleum Sub-Index	-1.82%	5.10%	10.06%	50.90%
WTI	-2.23%	8.78%	12.93%	51.98%
Brent	-2.14%	3.37%	13.00%	61.21%
ULSD	-1.61%	2.29%	5.59%	44.22%
Gasoline	-0.59%	4.26%	3.55%	35.33%
Natural Gas	-3.57%	-8.76%	-10.52%	-21.23%
Precious Metals Sub-Index	-1.24%	-3.16%	-7.80%	-0.15%
Gold	-1.16%	-2.80%	-7.59%	0.36%
Silver	-1.54%	-4.34%	-8.48%	-1.74%
Industrial Metals Sub-Index	-2.15%	-10.97%	-9.74%	7.56%
Copper	-1.68%	-12.20%	-14.62%	1.36%
Aluminum	-2.47%	-8.03%	-5.58%	5.95%
Nickel	0.19%	-8.02%	11.41%	45.05%
Zinc	-5.67%	-16.09%	-23.20%	-4.98%
Softs Sub-Index	-2.26%	-9.58%	-13.53%	-13.95%
Coffee	-3.64%	-6.37%	-12.69%	-24.79%
Sugar	-4.74%	-11.12%	-20.55%	-26.79%
Cotton	4.05%	-2.09%	10.07%	35.03%
Livestock Sub-Index	-2.67%	-2.95%	-7.30%	-11.76%
Cattle	-1.40%	0.22%	-3.46%	-11.84%
Hogs	-4.56%	-7.90%	-14.74%	-12.44%

The pattern of the USD gaining against the majors while retreating against various EM currencies is a rather unusual one. It reflects the notion short-term interest rates will stop rising in the U.S. and will decline in both the Eurozone and in both China and Japan.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.52%	-0.90%	-4.72%	2.52%
Chinese yuan	-0.73%	-4.39%	-3.80%	1.37%
Japanese yen	-1.70%	-1.82%	-1.64%	0.80%
British pound	-0.46%	-1.15%	-4.13%	2.19%
Swiss franc	-1.24%	-1.62%	-3.85%	-3.44%
Canadian dollar	-0.58%	-1.31%	-5.55%	-3.33%
Australian dollar	-0.08%	-2.03%	-6.79%	-3.97%
Swedish krona	-1.75%	-3.07%	-9.66%	-5.87%
Norwegian krone	-1.05%	-1.30%	-2.87%	1.78%
New Zealand dollar	-1.10%	-3.86%	-7.49%	-7.75%
Indian rupee	0.51%	-1.29%	-7.35%	-5.96%
Brazilian real	0.32%	-3.34%	-16.49%	-16.59%
Mexican peso	0.79%	9.27%	-0.18%	-6.39%
Chilean peso	0.93%	-2.81%	-7.37%	1.53%
Colombian peso	0.45%	-0.03%	-0.65%	6.48%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.49%	-3.03%	-3.73%	0.14%

Equity markets are acting as if the trade war will be over soon; let us hope they are right. However, they also are benefiting from a more benign picture for both the USD and short-term interest rates, and these will reverse if trade tensions dissipate.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.01%	0.14%	-1.05%	12.26%
North America	1.49%	1.06%	1.57%	16.48%
Latin America	2.20%	3.65%	-12.25%	-1.32%
Emerging Market Free	1.71%	-4.52%	-9.47%	6.13%
EAFE	0.16%	-2.20%	-5.14%	6.90%
Pacific	0.56%	-2.76%	-7.10%	8.59%
Eurozone	-0.43%	-1.11%	-6.11%	4.58%

CTAs gained on the week, which is a bit of a departure from the normal pattern of losing money during physical commodity bear markets. Hedge funds gained; this is their normal pattern of gaining during strong equity markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	1.19%	2.31%	-8.43%	3.84%
SocGen Trend	0.69%	1.56%	-7.40%	1.60%
SocGen Short-Term	0.46%	0.57%	-2.18%	0.82%
HFR Global Hedge Fund	0.40%	-0.03%	-2.06%	2.79%
HFR Macro/CTA	0.90%	1.27%	-3.92%	1.89%
HFR Macro: Sytematic Diversified CTA	1.02%	1.58%	-6.51%	4.82%