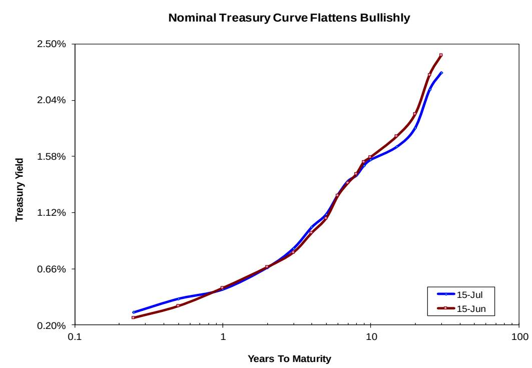
The Macro Environment For Financial Markets

If there is an equivalent to "hair of the dog that bit you" in Japanese, now is the time to proclaim it. The global equity rally of the past week was propelled in part by expectations the re-upped Abe government would engage in more of the same that has yet to work (Someone born when Japan embarked on ZIRP in February 1999 would be graduating secondary school this year). But, more important, the U.S. economy seems to be stabilizing, the earnings recession is not worsening and various FOMC members are putting their impotence on public display whenever they warble about their next rate hike. This is all very bullish if you ignore the Pyramid of Greater Fools being built in the bond market. The causal chain now is:

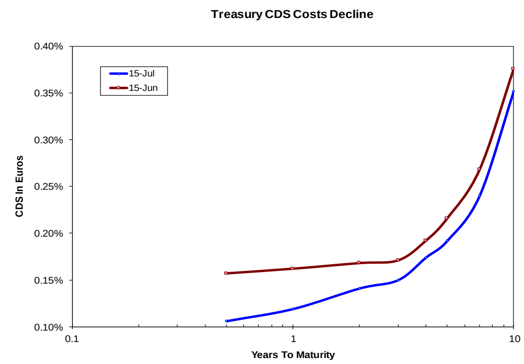
1. The market has no clear idea of if and when U.S. short-term rates will rise;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps have ended their downtrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are accepting rollover risk once again;
6. Swap spreads are finally moving higher; and
7. CDS costs are breaking resistance as part of a global search for yield.

Key Market Indications

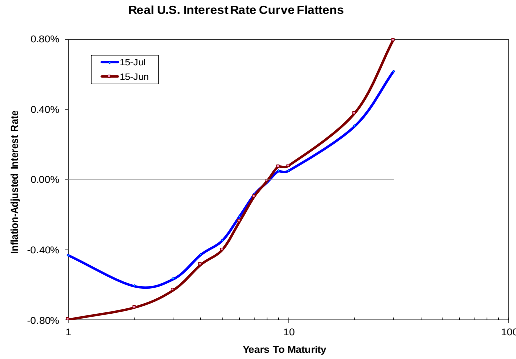
Before anyone gets ahead of themselves and proclaims last week's lows to be generational, consider that a downtrend is a series of lower lows and lower highs and that this one has been going on for 35 years. Still, anyone lending at a negative yield is doing nothing more than expressing confidence in an ample supply of greater fools willing to lend at an even lower yield.



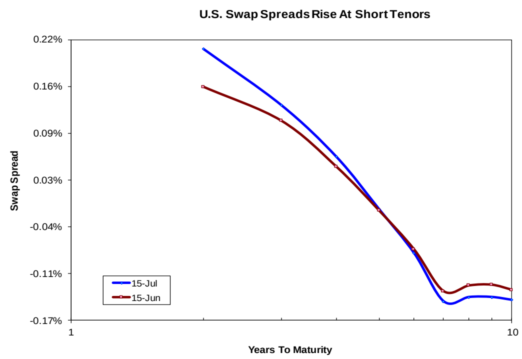
CDS costs declined over the past month, especially at the very shortest tenors. Guess what? The U.S. is not going to default at these debt service costs and Congress is not going to force a budget crisis in an election year.



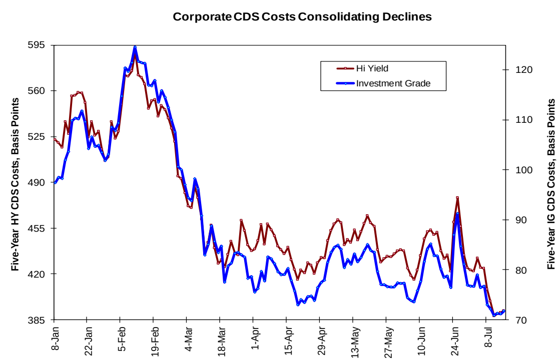
The decline in pseudo-real longer-term rates remains bullish for risky assets, but we would be hard-pressed to say it was causal. The rise in U.S. short-term implied real rates is a negative for precious metals. If global short-term implied real rates stop declining, as they must eventually, the precious metals rally will end unceremoniously.



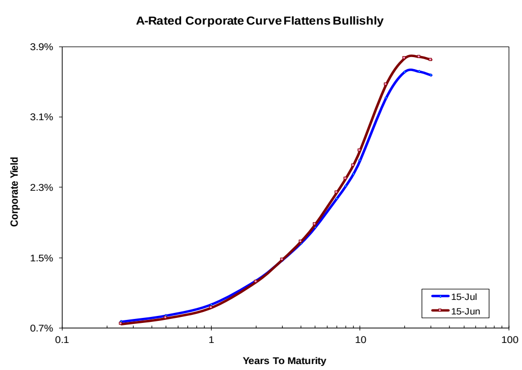
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose for short-dated tenors but continue to drift lower at long-dated tenors. This has been a dominant trend in the post-crisis era. It is a cheap place to be wrong, especially at the short end of the yield curve.



Both the investment-grade and high-yield CDS indices are consolidating their recent bullish moves. The entire upturn in credit risk beginning in August 2015 has been negated, which should put us on target to test the mid-2014 lows.



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 Industrial Metals are in a structural uptrend amongst the physical markets while Petroleum and Livestock are in structural downtrends. All of the financial markets save for the EAFE are in structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 18 - 22
BBerg	16	Transitional	-0.045	14.2%	
BBerg Grain	6	Sideways	-0.036	34.4%	
BBerg Ind. Metl	29	Trending	0.250	18.8%	0.14%
BBerg Pre. Metl	5	Sideways	-0.045	17.1%	
BBerg Softs	7	Sideways	0.006	26.4%	
BBerg Nat. Gas	4	Sideways	0.013	24.1%	
BBerg Petroleum	24	Trending	-0.101	28.7%	-0.60%
BBerg Livestock	29	Trending	-0.360	12.9%	-0.28%
Dollar Index	29	Trending	0.154	9.5%	0.11%
S&P 500 Index	29	Trending	0.289	10.3%	0.08%
EAFE Index	29	Trending	0.099	18.1%	
EM Index	27	Trending	0.352	13.3%	0.16%
Ten-year UST (price)	29	Trending	0.007	7.3%	0.06%

Performance Measures

Did cotton really jump 12.9% in a week? It did, on a lowered crop estimate, and once again we have to ask what all of those crop-monitoring satellites are doing up in space. A large number of physical markets entered bearish consolidations this past week, but this does not yet change last week's conclusion the January-June rally in the Bloomberg index was a cyclical affair in what remains a long-term secular bear market for physical commodities.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.35%	-2.26%	18.15%	-10.96%
Grains Sub-Index	-0.82%	-14.60%	0.15%	-16.10%
Corn	-0.77%	-20.42%	-5.83%	-22.69%
Soybeans	-0.04%	-7.91%	20.88%	4.69%
Wheat	-2.35%	-14.13%	-14.23%	-27.78%
Energy Sub-Index	0.32%	-3.47%	25.39%	-32.26%
Petroleum Sub-Index	1.19%	-5.07%	32.48%	-31.26%
WTI	1.15%	-4.95%	25.60%	-35.00%
Brent	1.40%	-4.68%	48.63%	-30.72%
ULSD	-1.00%	-5.25%	41.60%	-27.30%
Gasoline	3.26%	-6.05%	7.12%	-32.63%
Natural Gas	-2.15%	1.59%	6.44%	-37.19%
Precious Metals Sub-Index	-1.49%	6.19%	27.68%	21.80%
Gold	-2.27%	2.55%	21.53%	16.90%
Silver	0.33%	15.51%	44.32%	34.41%
Industrial Metals Sub-Index	3.30%	8.21%	19.48%	-6.91%
Copper	5.41%	8.63%	14.23%	-11.67%
Aluminum	0.08%	3.10%	11.44%	-5.55%
Nickel	4.01%	13.30%	21.45%	-11.94%
Zinc	2.85%	11.27%	48.42%	4.21%
Softs Sub-Index	2.21%	2.88%	24.74%	25.02%
Coffee	2.40%	3.31%	22.59%	4.10%
Sugar	-1.32%	-2.94%	27.77%	47.62%
Cotton	12.88%	12.71%	20.60%	13.32%
Livestock Sub-Index	-2.15%	-8.03%	-3.58%	-13.79%
Cattle	-1.82%	-2.09%	-4.31%	-20.41%
Hogs	-2.66%	-13.94%	-3.03%	-1.83%

The JPY had its worst week seen the 1999 introduction of ZIRP on the promise of more QE. The JPY rallied strongly after the last expansion of QE at the end of January. Discuss. Regardless, the realization the world is not going to implode led to a mutually reinforcing rally in EM equities and currencies as central banks' encouragement of yield-seeking continues to push the boundaries of common sense.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.14%	-2.00%	1.09%	0.78%
Chinese yuan	-0.04%	-1.67%	-1.62%	-7.24%
Japanese yen	-4.14%	1.08%	11.54%	18.00%
British pound	1.84%	-7.12%	-7.48%	-15.65%
Swiss franc	0.06%	-2.17%	1.88%	-3.13%
Canadian dollar	0.54%	-0.48%	12.08%	-0.47%
Australian dollar	0.12%	2.31%	10.40%	2.70%
Swedish krona	-0.08%	-3.23%	-0.07%	-0.95%
Norwegian krone	0.48%	-2.07%	4.14%	-3.87%
New Zealand dollar	-2.60%	1.17%	10.10%	7.98%
Indian rupee	0.45%	0.12%	0.80%	-5.44%
Brazilian real	0.60%	5.91%	23.44%	-4.27%
Mexican peso	-0.54%	1.65%	-1.83%	-15.17%
Chilean peso	1.15%	5.20%	12.09%	-1.46%
Colombian peso	0.34%	1.84%	12.94%	-7.09%
Bloomberg-JP Morgan Asian dollar index (spot)	0.14%	-0.11%	1.86%	-3.76%

As noted above, the push out the risk curve has made non-U.S. equities attractive; this had been the trend prior to the Brexit vote. If this pattern is to continue, investors will have to remain as willing to divorce financial returns from macro growth in those markets as they have been in the U.S.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.31%	4.11%	14.13%	-1.94%
North America	1.55%	4.41%	17.11%	3.90%
Latin America	4.30%	14.00%	46.80%	-2.69%
Emerging Market Free	4.85%	8.26%	24.46%	-4.85%
EAFE	3.66%	3.98%	7.98%	-9.15%
Pacific	3.92%	5.31%	11.23%	-5.15%
Eurozone	4.25%	2.20%	6.61%	-13.24%

If CTAs were on the right side of the JPY and GBP last week, they lost this week; ditto for anyone trying to get the last tick out of the bond market. Global hedge funds gained, as has been their habit whenever equity markets rally, but macro funds lost.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.66%	3.45%	-0.82%	4.97%
Newedge Trend	-0.60%	2.70%	0.67%	6.47%
Newedge Short-Term	-0.87%	-0.72%	2.75%	4.69%
HFR Global Hedge Fund	0.72%	1.29%	2.46%	-5.07%
HFR Macro/CTA	-0.01%	0.90%	-0.81%	-2.15%
HFR Macro: Sytematic Diversified CTA	-0.08%	2.87%	1.74%	4.00%