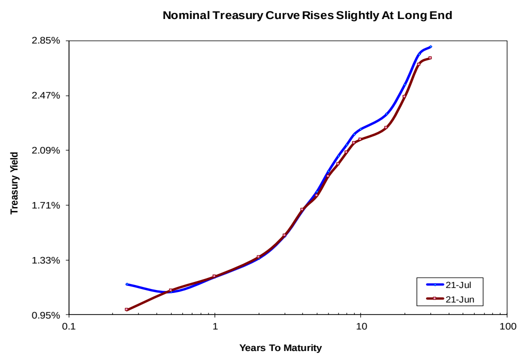
The Macro Environment For Financial Markets

Mario Draghi certainly manages to produce market-moving changes without undertaking actions. This week he managed to push the EUR higher and Eurozone stocks lower by stating the obvious, that Eurozone QE will end one day. The rest of the world seems fine with the USD's pullback, though, and it certainly relieves pressure on global commercial banks with USD liabilities. As the Federal Reserve is being forced off their preferred path, for this week at least, of tightening credit. The party in financial assets continues, no matter how uncomfortable this makes the people benefiting from it. The causal chain now is:

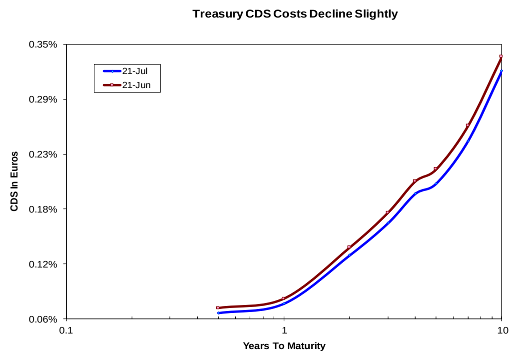
1. The market is pricing out expectations for another short-term rate hike in the U.S. in 2017;
2. Inflationary expectations have stopped declining;
3. The secular flattening trend in the U.S. is encountering resistance as expectations for higher short-term rates fade;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are rising; and
6. CDS costs remain consistent with a bull market in risky assets.

Key Market Indications

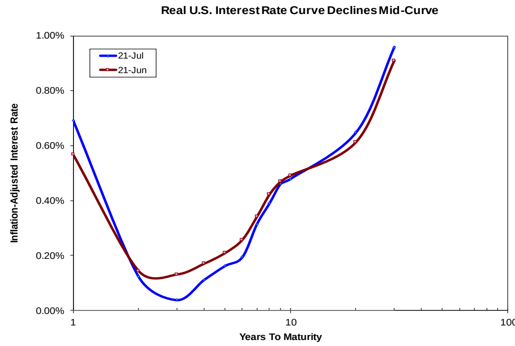
Support for the ten-year UST held at 2.40%, making it likely the month-long selloff related to expectations of an end to QE in the Eurozone was nothing but one more failed downturn. Central banks simply have no simple exit mechanism from QE as their balance sheets are too big to distribute and they are hesitant to drive down the value of their own holdings and raise the cost of servicing government debt.



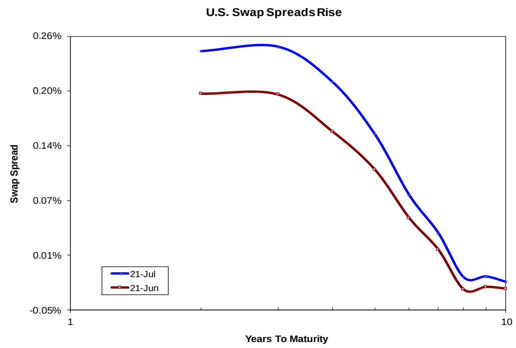
CDS costs on UST have declined over the past month. This market remains unconcerned about the U.S. debt ceiling.



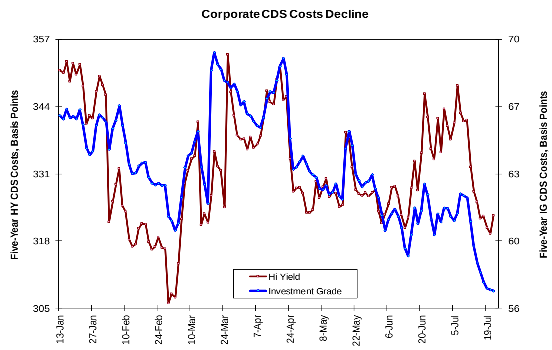
The pseudo-real yield curve shifted higher at both the long and short ends of the yield curve, but this did not push precious metals lower as the USD declined. The small rise at the long end of the yield curve was insufficient to pressure risky financial assets.



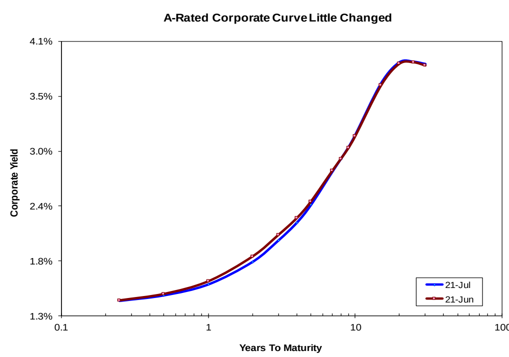
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted higher across tenors as traders accept the eventual end to central bank QE. The small rise at the long end was in response to the small rise in inflation expectations.



CDS costs declined for both the investment-grade and high-yield indices. This reflected the belief increases in short-term rates will not be as rapid as supposed only one month ago as well as continued downward pressure on both equity and fixed-income volatility measures.



The A-rated corporate yield curve has remained over the past month. This remains a bull market with limited upside potential.



Market Structure

None of the physical markets are in downtrends, but Softs, Natural Gas, Petroleum and Livestock all are in unstable transitional structures. Ten-year UST exited their structural downtrend, while all of the equity indices are in structural uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 24 - 28
BBerg	29	Trending	0.191	9.9%	0.07%
BBerg Grain	29	Trending	0.123	20.8%	0.10%
BBerg Ind. Metl	29	Trending	0.186	11.8%	0.39%
BBerg Pre. Metl	29	Trending	0.044	13.2%	
BBerg Softs	18	Transitional	0.231	18.2%	
BBerg Nat. Gas	17	Transitional	-0.061	21.6%	
BBerg Petroleum	18	Transitional	0.028	25.9%	
BBerg Livestock	29	Trending	0.057	15.1%	0.22%
Dollar Index	29	Trending	-0.423	5.9%	-0.09%
S&P 500 Index	21	Trending	0.173	7.1%	0.07%
EAFE Index	29	Trending	0.191	7.8%	0.05%
EM Index	29	Trending	0.468	7.6%	0.06%
Ten-year UST (price)	24	Trending	0.016	4.8%	

Performance Measures

The Energy subindex pulled back this week, but remains near the support level of its emerging uptrend. Precious Metals gained on the back of USD weakness. The remainder of physical commodity markets remained uninteresting.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.36%	4.29%	-6.12%	-1.35%
Grains Sub-Index	0.32%	6.70%	-0.89%	0.29%
Corn	0.95%	3.98%	-1.12%	1.57%
Soybeans	2.09%	12.30%	-5.78%	-0.72%
Wheat	-2.23%	5.52%	7.36%	-1.45%
Energy Sub-Index	-0.98%	4.98%	-16.06%	-7.66%
Petroleum Sub-Index	-1.22%	6.75%	-15.44%	-4.47%
WTI	-2.08%	5.86%	-17.17%	-8.88%
Brent	-1.74%	5.02%	-16.14%	-5.94%
ULSD	0.06%	9.65%	-11.06%	-0.24%
Gasoline	0.07%	8.90%	-15.30%	4.24%
Natural Gas	-0.30%	0.49%	-17.86%	-15.84%
Precious Metals Sub-Index	2.46%	-0.47%	0.91%	-9.69%
Gold	2.17%	-0.14%	3.13%	-6.30%
Silver	3.31%	-1.42%	-5.02%	-17.94%
Industrial Metals Sub-Index	0.06%	3.04%	-0.86%	14.76%
Copper	1.19%	3.42%	-0.62%	19.50%
Aluminum	-0.73%	2.43%	1.40%	16.72%
Nickel	-0.59%	4.73%	-3.58%	-9.98%
Zinc	-1.16%	1.66%	-3.14%	20.92%
Softs Sub-Index	1.72%	7.91%	-19.38%	-19.19%
Coffee	2.15%	11.10%	-14.45%	-12.23%
Sugar	0.72%	9.43%	-30.66%	-29.18%
Cotton	2.78%	2.17%	-6.19%	-5.68%
Livestock Sub-Index	-0.60%	1.78%	9.76%	13.56%
Cattle	-0.97%	1.73%	12.30%	21.65%
Hogs	0.09%	1.55%	5.84%	1.70%

The GBP and MXN stood in the way of another across-the-board decline in the USD this past week. Some of this decline is taking on the feel of markets discounting the same thing twice, in this case the simultaneous expectation of no fiscal stimulus or no monetary contraction in the U.S. Yes, but what about policies elsewhere?

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.68%	4.43%	8.34%	5.78%
Chinese yuan	0.13%	0.93%	1.29%	-1.35%
Japanese yen	1.26%	0.23%	1.42%	-4.78%
British pound	-0.77%	2.57%	3.69%	-1.78%
Swiss franc	1.88%	2.83%	5.37%	4.23%
Canadian dollar	0.84%	6.34%	5.57%	4.38%
Australian dollar	1.07%	4.81%	4.38%	5.62%
Swedish krona	0.81%	6.15%	7.12%	4.28%
Norwegian krone	2.13%	6.40%	4.13%	5.94%
New Zealand dollar	1.46%	3.14%	3.06%	6.53%
Indian rupee	0.20%	0.32%	6.06%	4.44%
Brazilian real	1.15%	6.12%	0.68%	4.09%
Mexican peso	-0.51%	3.31%	21.15%	5.23%
Chilean peso	0.94%	2.16%	0.37%	-0.07%
Colombian peso	0.45%	1.46%	-2.86%	-2.39%
Bloomberg-JP Morgan Asian dollar index (spot)	0.26%	0.90%	2.75%	0.04%

European equity markets are reacting to the EUR's rebound very negatively, but this, too, shall pass. Something different applies to EM indices; their rallies pull their currencies higher.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.56%	1.87%	10.98%	17.65%
North America	0.62%	1.94%	9.73%	16.43%
Latin America	0.90%	10.74%	13.28%	17.74%
Emerging Market Free	1.35%	6.20%	20.65%	24.92%
EAFE	0.47%	2.48%	14.51%	20.03%
Pacific	1.32%	2.24%	10.54%	18.05%
Eurozone	-0.25%	1.79%	17.93%	28.62%

Macro/CTA hedge funds struggled this past week, but both CTAs and global hedge funds managed to ride the strong trends in both the USD and in global equities to gains.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.30%	-3.68%	-4.47%	-12.14%
Newedge Trend	0.36%	-3.13%	-2.09%	-9.01%
Newedge Short-Term	-0.14%	-1.20%	-3.59%	-11.49%
HFR Global Hedge Fund	0.24%	0.88%	3.04%	5.52%
HFR Macro/CTA	-0.01%	-0.61%	0.85%	-2.95%
HFR Macro: Sytematic Diversified CTA	0.45%	-1.69%	-0.45%	-6.37%