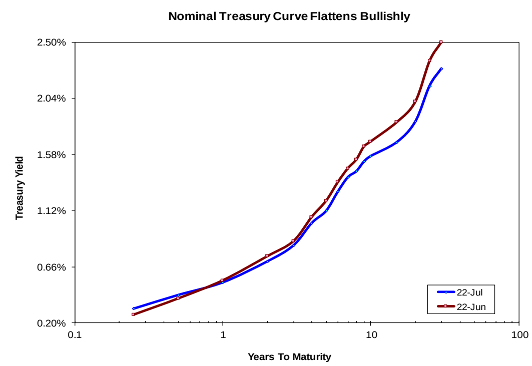
The Macro Environment For Financial Markets

We are about to be reminded once again financial assets may be many things, but GDP futures they are not. In addition, we are going to be reminded earnings are nice but lack of suitable alternatives are better. If short-term interest rates are pushed higher and if the USD resumes its May 2014 – January 2016 rally, equity valuations will stall even if earnings surprise to the upside. Markets have ignored the upcoming U.S. election so far. It will be a delicious irony indeed if the Obama administration starts to look like the good old days for investors. The causal chain remains:

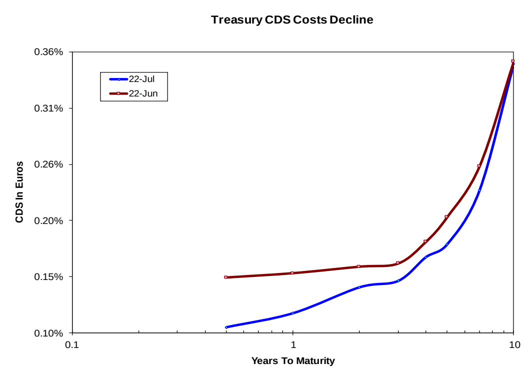
1. The market has no clear idea of if and when U.S. short-term rates will rise;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps have ended their downtrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term 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

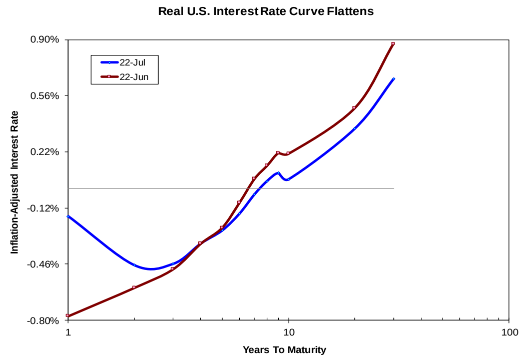
If the European Central Bank does not force short-term rates further into negative territory – and there is no good reason for them to do so – then the UST market becomes less of a haven. The ten-year could rise all of the way back to 1.98% and still remain within a strong bull market. If the FOMC resumes talking about higher short-term rates, the yield curve will continue to flatten.



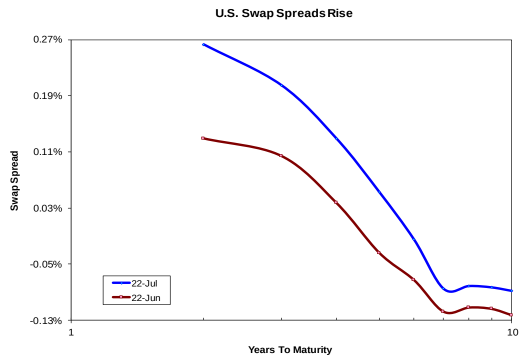
CDS costs declined over the past month, especially at the very shortest tenors. Guess what? The U.S. is not going to default at these debt service costs and Congress is not going to force a budget crisis in an election year.



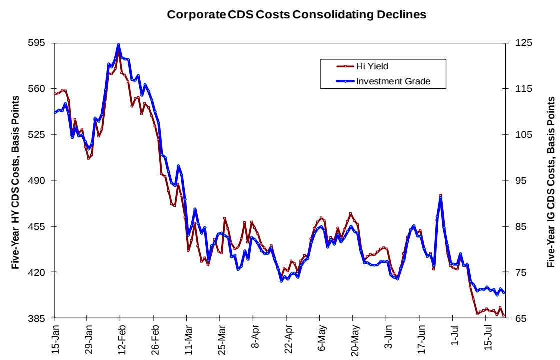
The decline in pseudo-real longer-term rates remains bullish for risky assets, but we would be hard-pressed to say it was causal. I noted last week if global short-term implied real rates stop declining, the precious metals rally would end unceremoniously. This is starting to happen in the U.S., but the negative-carry trade in other currencies remains open.



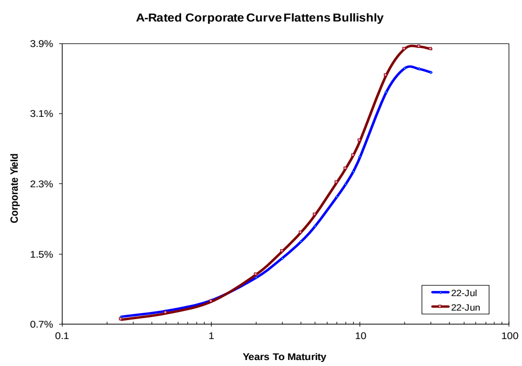
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across the maturity spectrum and have inverted further. The risk/reward for fixing payments at these levels is a good one.



Both the investment-grade and high-yield CDS indices are consolidating their recent bullish moves and look as if they are about to push through to new lows. If you combine low interest rates, strong investor demand for anything with a positive yield and the absence of negative economic news, this is what should happen.



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

None of the physical markets are in structural uptrends while both Petroleum and Livestock are in structural downtrends. The EAFE moved into a structural uptrend while both ten-year UST and the dollar index exited structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 25 - 29
BBerg	17	Transitional	-0.182	13.5%	
BBerg Grain	9	Sideways	-0.110	32.1%	
BBerg Ind. Metl	5	Sideways	-0.046	15.1%	
BBerg Pre. Metl	9	Sideways	-0.058	14.8%	
BBerg Softs	9	Sideways	-0.042	23.1%	
BBerg Nat. Gas	14	Transitional	0.000	27.9%	
BBerg Petroleum	29	Trending	-0.230	27.9%	-0.60%
BBerg Livestock	29	Trending	-0.369	13.8%	-0.28%
Dollar Index	29	Trending	0.194	9.4%	0.11%
S&P 500 Index	29	Trending	0.306	10.1%	0.08%
EAFE Index	25	Trending	0.099	17.9%	0.18%
EM Index	4	Sideways	-0.011	5.4%	
Ten-year UST (price)	4	Sideways	-0.004	5.1%	

Performance Measures

The strong downturn in Grains, Petroleum and Livestock are reminiscent of action over the winter of 2015-2016. Unlike that period, however, we cannot blame fears of recession in China or the prospect of a march higher in U.S. short-term rates. And we can dismiss any sort of blanket "dollar up/commodities down" response unless it can explain a strong performance by Industrial Metals. The simple answers are the best: Favorable growing weather has pushed Grains down and crude oil producers have been able to adjust to lower prices.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-2.37%	-2.65%	13.77%	-9.09%
Grains Sub-Index	-4.33%	-10.46%	-5.25%	-14.55%
Corn	-4.89%	-13.86%	-12.02%	-21.28%
Soybeans	-6.52%	-8.35%	12.80%	2.09%
Wheat	0.12%	-8.53%	-15.51%	-21.73%
Energy Sub-Index	-3.18%	-5.88%	19.32%	-31.43%
Petroleum Sub-Index	-4.43%	-8.27%	24.23%	-31.09%
WTI	-5.27%	-8.51%	19.17%	-34.50%
Brent	-4.26%	-7.42%	34.98%	-30.81%
ULSD	-2.83%	-6.96%	37.36%	-27.62%
Gasoline	-4.78%	-11.08%	1.35%	-32.43%
Natural Gas	0.55%	1.54%	5.63%	-34.59%
Precious Metals Sub-Index	-0.89%	3.03%	24.44%	25.38%
Gold	-0.25%	0.15%	19.60%	21.71%
Silver	-2.35%	10.39%	37.38%	34.38%
Industrial Metals Sub-Index	-0.37%	6.17%	16.80%	-3.33%
Copper	0.10%	5.67%	11.21%	-7.37%
Aluminum	-3.52%	-0.77%	7.34%	-5.76%
Nickel	1.24%	15.29%	20.73%	-9.25%
Zinc	1.86%	11.13%	47.17%	12.39%
Softs Sub-Index	-0.80%	3.83%	25.08%	31.13%
Coffee	-3.82%	3.49%	16.33%	5.15%
Sugar	1.46%	2.27%	37.16%	59.36%
Cotton	-2.15%	12.85%	17.64%	11.88%
Livestock Sub-Index	-2.30%	-7.25%	-8.12%	-14.14%
Cattle	-1.61%	-2.21%	-8.51%	-18.98%
Hogs	-3.18%	-12.56%	-7.92%	-5.80%

The CNY firmed, probably more out of political window-dressing than anything else, but the USD advanced strongly against all of the majors as speculation arose once again of a move higher in U.S. short-term rates. With the exception of the crude oil-linked COP, the Latin currencies rose.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.53%	-2.82%	1.68%	0.44%
Chinese yuan	0.21%	-1.51%	-1.51%	-7.04%
Japanese yen	-1.18%	-1.62%	11.92%	16.81%
British pound	-0.63%	-10.87%	-8.10%	-16.04%
Swiss franc	-0.45%	-2.90%	2.94%	-2.75%
Canadian dollar	-1.17%	-2.16%	7.56%	-0.72%
Australian dollar	-1.53%	-0.52%	6.57%	1.15%
Swedish krona	-0.73%	-4.50%	-0.77%	-0.63%
Norwegian krone	-0.79%	-3.03%	2.19%	-4.81%
New Zealand dollar	-1.67%	-2.33%	7.76%	6.47%
Indian rupee	-0.02%	0.59%	0.82%	-5.22%
Brazilian real	0.73%	3.72%	25.71%	-1.03%
Mexican peso	0.32%	-0.28%	-0.56%	-13.18%
Chilean peso	0.28%	3.66%	10.03%	0.55%
Colombian peso	-0.93%	-1.07%	12.13%	-5.43%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.02%	-0.56%	1.33%	-3.57%

If you add a few decent earnings reports to unnaturally low interest rates, you get a rally. What is interesting, though, is how scared investors are of buying at these levels, mostly on account of those very same low rates.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.39%	6.24%	14.02%	0.42%
North America	0.62%	4.31%	15.99%	4.44%
Latin America	1.63%	11.07%	49.65%	3.34%
Emerging Market Free	0.25%	5.54%	24.51%	-3.94%
EAFE	0.00%	-0.56%	7.76%	-8.85%
Pacific	0.26%	6.72%	11.21%	-3.93%
Eurozone	-0.14%	5.41%	4.25%	-12.60%

CTAs had a poor week, suggesting they stayed with long bond positions and had not moved into long USD positions forcefully enough. Global hedge fund continued their longstanding pattern of gaining during equity rallies, but macro funds did not fare well.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.01%	4.51%	-4.21%	1.58%
Newedge Trend	-0.63%	3.34%	-2.07%	4.00%
Newedge Short-Term	-0.66%	0.72%	1.19%	3.52%
HFR Global Hedge Fund	0.33%	1.51%	3.81%	-4.91%
HFR Macro/CTA	-0.23%	1.28%	-1.48%	-3.38%
HFR Macro: Sytematic Diversified CTA	-0.88%	3.02%	-0.94%	1.81%