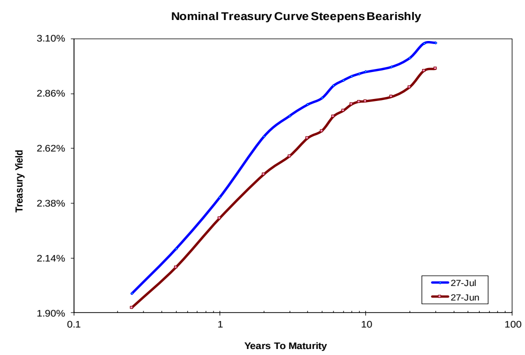
The Macro Environment For Financial Markets

The Bank of Japan may go to 11; basis points, that is, for the ten-year JGB. Why not; they have three Lost Decades™ to prove they do not know what they are doing; you have fewer. The threat here is all major central banks are going to be tightening while non-U.S. growth is tenuous, China is fragile and equity valuations are rich. What could go wrong? The causal chain remains:

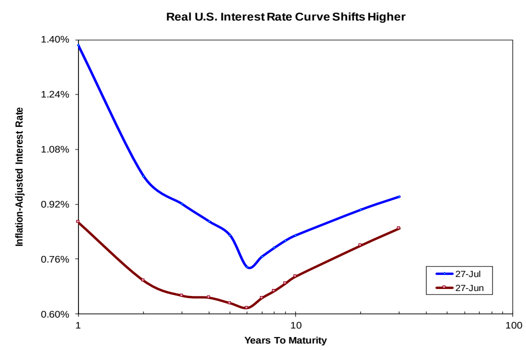
1. The market is pricing in September and, decreasingly, December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads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

Key Market Indications

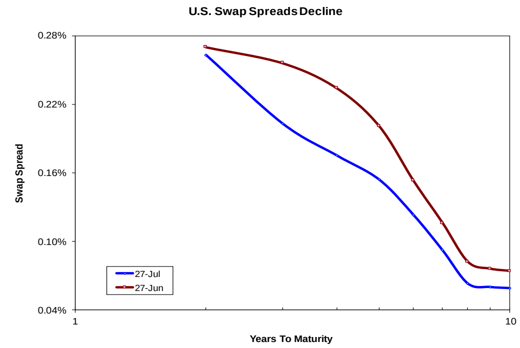
I commented last week the long end of the yield curve was skittish. This week's small selloff seemed worse than it was; in reality, we just moved back to levels reached in early March. The yield curve continues to flatten and inflation expectations remain confined.



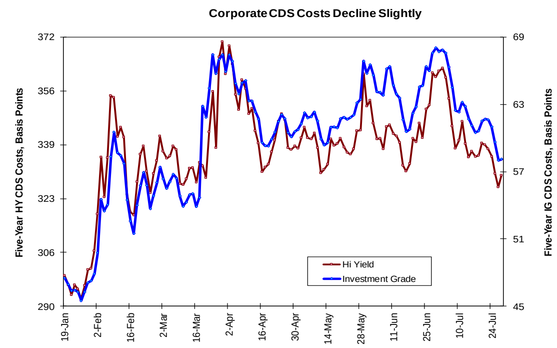
The pseudo-real yield curve rose across the maturity spectrum, especially at the short end of the yield curve. This is bearish for precious metals.



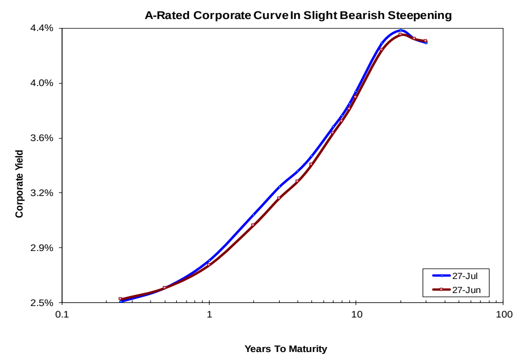
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined across all tenors but especially at the short end of the yield curve as the prospects for further short-term interest rate hikes fade.



The small decline in CDS costs reflects the stall 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, but this threat is not going away anytime soon.



The A-rated corporate yield curve mirrored the bearish 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. Within the financials, all the EAFE and dollar index joined the S&P 500 in structural uptrends while the ten-year UST moved into a structural downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 30 - August 2
BBerg	16	Transitional	0.093	9.0%	
BBerg Grain	17	Transitional	0.180	19.7%	
BBerg Ind. Metl	8	Sideways	0.056	17.9%	
BBerg Pre. Metl	4	Sideways	-0.024	10.1%	
BBerg Softs	10	Sideways	0.003	13.9%	
BBerg Nat. Gas	29	Trending	-0.079	14.6%	-0.41%
BBerg Petroleum	29	Trending	0.050	20.6%	0.60%
BBerg Livestock	29	Trending	-0.127	16.2%	-0.13%
Dollar Index	20	Trending	0.013	5.8%	0.04%
S&P 500 Index	28	Trending	0.182	8.9%	0.16%
EAFE Index	22	Trending	0.220	8.9%	0.31%
EM Index	13	Transitional	0.156	10.4%	
Ten-year UST (price)	29	Trending	-0.165	3.5%	-0.04%

Performance Measures

While crude oil futures are not inventory scorecards, it is hard to ignore the effects of rising global demand and various logistical bottlenecks in the industry. Grains and Industrial Metals moved higher on the trade truce with the EU, but the EU is not China. Nothing is out of the woods here yet. Rising implied short-term real rates remain a strong negative for Precious Metals.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.42%	-2.79%	-5.19%	1.94%
Grains Sub-Index	2.55%	2.69%	-5.29%	-13.28%
Corn	1.94%	0.85%	-5.44%	-14.73%
Soybeans	2.41%	0.75%	-14.43%	-16.88%
Wheat	2.85%	6.00%	6.84%	-7.43%
Energy Sub-Index	2.08%	-3.91%	2.11%	23.44%
Petroleum Sub-Index	2.10%	-3.89%	9.20%	41.22%
WTI	0.67%	-5.06%	9.49%	40.40%
Brent	2.44%	-4.96%	13.05%	51.92%
ULSD	2.41%	-2.41%	6.16%	34.84%
Gasoline	3.90%	-0.75%	4.39%	28.36%
Natural Gas	2.01%	-3.96%	-15.28%	-18.71%
Precious Metals Sub-Index	-0.52%	-2.86%	-9.03%	-5.25%
Gold	-0.58%	-2.46%	-8.85%	-4.31%
Silver	-0.32%	-4.21%	-9.64%	-8.10%
Industrial Metals Sub-Index	1.78%	-5.57%	-10.07%	5.02%
Copper	1.71%	-5.38%	-12.96%	-4.19%
Aluminum	2.00%	-2.82%	-4.18%	9.79%
Nickel	2.42%	-7.07%	3.72%	34.98%
Zinc	0.81%	-8.73%	-24.53%	-3.64%
Softs Sub-Index	-0.53%	-5.02%	-11.61%	-16.43%
Coffee	-0.14%	-3.89%	-13.56%	-26.67%
Sugar	-2.12%	-11.05%	-21.86%	-27.66%
Cotton	1.49%	5.43%	17.04%	31.46%
Livestock Sub-Index	-0.03%	-3.53%	-8.16%	-8.59%
Cattle	0.24%	1.23%	-3.69%	-4.30%
Hogs	-0.74%	-13.28%	-18.05%	-18.60%

Latin American currencies, the COP excepted, continued their relief rally. The USD gained on the majors excepting the CAD and JPY; speculation of a change in BOJ policy is responsible for gains there.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.57%	0.89%	-5.86%	-0.17%
Chinese yuan	-0.64%	-3.01%	-6.94%	-1.03%
Japanese yen	0.32%	-0.71%	-1.88%	0.19%
British pound	-0.24%	-0.06%	-6.89%	0.30%
Swiss franc	-0.22%	0.28%	-5.73%	-2.98%
Canadian dollar	0.69%	2.20%	-5.48%	-3.84%
Australian dollar	-0.20%	0.82%	-8.57%	-7.12%
Swedish krona	0.13%	1.55%	-10.72%	-7.07%
Norwegian krone	-0.13%	0.05%	-5.84%	-2.86%
New Zealand dollar	-0.28%	-0.01%	-7.28%	-9.31%
Indian rupee	0.28%	-0.04%	-7.39%	-6.63%
Brazilian real	1.57%	4.03%	-14.98%	-15.11%
Mexican peso	2.11%	8.31%	-0.12%	-4.86%
Chilean peso	2.66%	0.45%	-6.07%	1.02%
Colombian peso	-0.29%	2.06%	-1.66%	4.35%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.18%	-1.27%	-5.62%	-1.33%

The combination of yet another de-escalation in trade tensions and solid growth helped equities globally. At some point, though, we are going to have to learn how to live without the FANG stocks rising every day.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.81%	3.28%	-1.22%	12.67%
North America	0.51%	4.37%	-0.92%	15.64%
Latin America	3.08%	13.33%	-14.35%	2.70%
Emerging Market Free	2.15%	4.51%	-12.64%	4.93%
EAFE	1.35%	3.21%	-5.86%	7.24%
Pacific	1.70%	2.29%	-4.68%	9.99%
Eurozone	1.14%	3.31%	-5.70%	5.38%

Both hedge funds and CTAs lost on the week, continuing their recent uncharacteristic moves in opposite directions from global equities. The rallies in physical commodities probably trapped the CTAs offsides, and there is a good chance hedge funds were wrong-footed on Facebook.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	-1.69%	1.72%	-12.18%	1.61%
SocGen Trend	-1.25%	1.25%	-9.99%	0.24%
SocGen Short-Term	-0.69%	-0.12%	-5.68%	-0.02%
HFR Global Hedge Fund	-0.25%	0.33%	-3.70%	1.55%
HFR Macro/CTA	-0.24%	0.94%	-6.25%	0.43%
HFR Macro: Sytematic Diversified CTA	0.34%	1.54%	-9.21%	3.03%