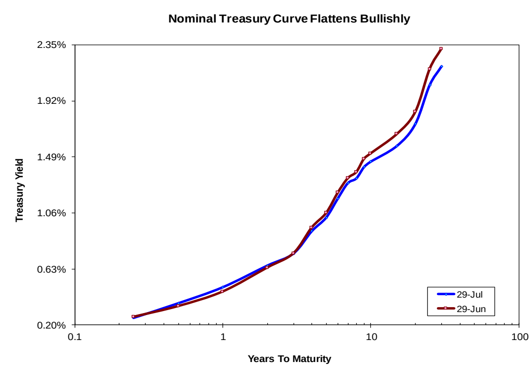
The Macro Environment For Financial Markets

Bond fund managers turned media commentators and tweeters should recall the wisdom of Sam Giancana. He pointed to a bass mounted over a bar and noted the preserved piscine got in trouble by opening his mouth. Moving on, I am certain we could learn much in reverse from Haruhiko Kuroda at the Bank of Japan who has proven he can make the yen rally both by being too aggressive and by not being as aggressive as the market expected. When you do not know what you are doing, the best course of action is to do nothing, Haruhiko-san. The causal chain remains:

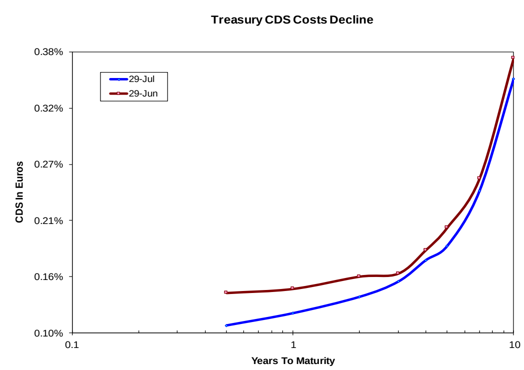
1. The market has no clear idea of if and when U.S. short-term rates will rise;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps have ended their downtrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term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

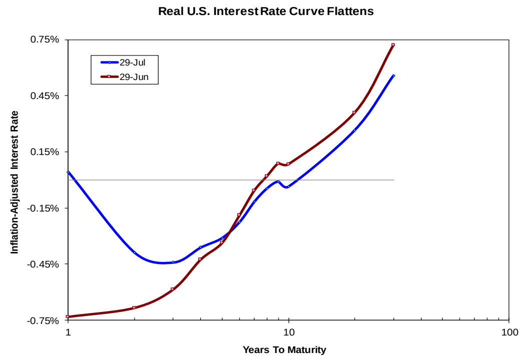
The toughest trade in the world must be staying long sovereign debt. Even Japan, which saw the largest jump in its ten-year rates since 2013, lost all of 0.29% on its 7-10 year bond index this week. The lower debt-service costs go, the greater debt levels will rise and preclude higher rates. This may be especially true in the U.S. given the political impulses toward rewarding voters with “free” goods and services.



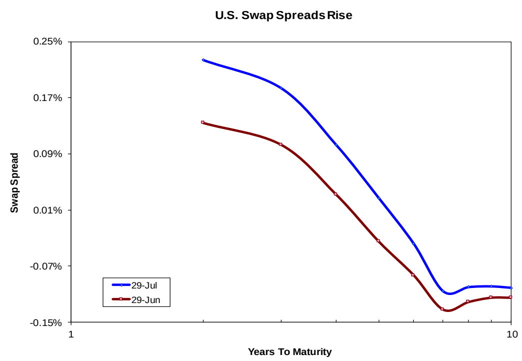
CDS costs declined over the past month, especially at the very shortest tenors. Guess what? The U.S. is not going to default at these debt service costs and Congress is not going to force a budget crisis in an election year.



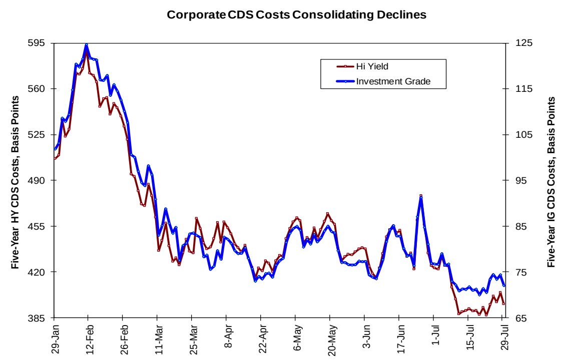
The decline in pseudo-real longer-term rates remains bullish for risky assets, but we would be hard-pressed to say it was causal. Precious Metals have been able to sidestep the rise in U.S. implied short-term real the U.S. as the negative-carry trade in other currencies remains open.



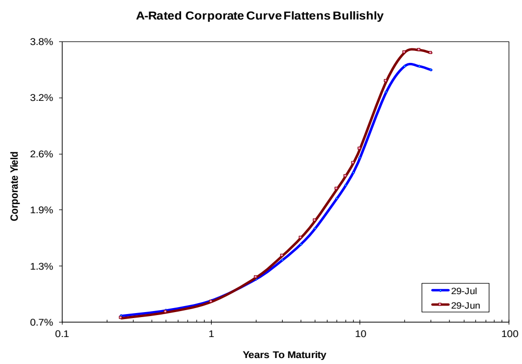
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across the maturity spectrum and have inverted further. The risk/reward for fixing payments at these levels is a good one.



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

Only the Petroleum index is in a structural downtrend amongst physical markets, but this is sufficient to put the main Bloomberg index in a downtrend as well. Only the EAFE remains in a structural uptrend amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate August 1 - 5
BBerg	28	Trending	-0.180	13.1%	-0.45%
BBerg Grain	4	Sideways	0.036	19.3%	
BBerg Ind. Metl	11	Transitional	0.029	15.4%	
BBerg Pre. Metl	12	Transitional	0.118	14.2%	
BBerg Softs	14	Transitional	-0.013	21.4%	
BBerg Nat. Gas	19	Transitional	0.109	26.3%	
BBerg Petroleum	29	Trending	-0.349	28.1%	-0.60%
BBerg Livestock	6	Sideways	-0.101	15.2%	
Dollar Index	29	Trending	-0.062	9.3%	
S&P 500 Index	5	Sideways	0.026	7.1%	
EAFE Index	29	Trending	0.209	17.0%	0.18%
EM Index	6	Sideways	0.025	6.6%	
Ten-year UST (price)	17	Transitional	0.076	6.0%	

Performance Measures

Just as people say "the dollar" when they really mean the dollar/euro rate, they say "commodities" when they really mean crude oil. The Petroleum index appears determined to revisit the early April breakout point, and that has been sufficient to drag the main Bloomberg index down with it. What is becoming notable, however, is the presence of large single-commodity moves in markets such as wheat, natural gas and hogs. This is as it should be; the index approach to physical commodity markets always was an exercise in self-defeating money flows.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.41%	-6.00%	11.12%	-7.98%
Grains Sub-Index	-0.35%	-8.26%	-5.43%	-11.44%
Corn	-0.14%	-7.06%	-12.51%	-16.83%
Soybeans	1.50%	-11.80%	14.45%	6.35%
Wheat	-4.11%	-5.21%	-17.92%	-23.06%
Energy Sub-Index	-2.57%	-12.00%	11.10%	-31.58%
Petroleum Sub-Index	-5.20%	-14.94%	10.55%	-33.04%
WTI	-5.86%	-16.19%	7.65%	-37.00%
Brent	-5.37%	-14.68%	17.00%	-32.05%
ULSD	-5.42%	-14.58%	19.08%	-29.44%
Gasoline	-3.09%	-13.18%	-4.55%	-34.14%
Natural Gas	4.86%	-3.50%	10.91%	-29.93%
Precious Metals Sub-Index	2.38%	1.75%	25.33%	26.98%
Gold	1.96%	0.85%	19.51%	23.06%
Silver	3.35%	3.90%	41.09%	36.46%
Industrial Metals Sub-Index	0.58%	1.32%	13.84%	-1.47%
Copper	-0.62%	0.23%	7.42%	-7.20%
Aluminum	2.14%	-1.54%	6.58%	-2.32%
Nickel	2.09%	6.52%	24.70%	-5.11%
Zinc	-0.07%	4.00%	35.17%	14.50%
Softs Sub-Index	-0.22%	-2.70%	30.99%	31.50%
Coffee	3.04%	-0.11%	18.53%	5.75%
Sugar	-2.75%	-8.30%	46.58%	56.37%
Cotton	1.88%	13.95%	19.47%	14.74%
Livestock Sub-Index	-1.38%	-8.85%	-11.27%	-15.87%
Cattle	3.38%	-0.79%	-6.97%	-17.27%
Hogs	-7.58%	-18.21%	-17.23%	-12.54%

The ease with which sentiment reverses regarding U.S. short-term rates is leading to some substantial volatility in the USD. Combine that with the JPY rally over disappointment with the BOJ and you have a reversal of last week's gains. As an aside, the three pesos listed here declined to reverse last week's gains. Some currencies do not march in synch with others.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.79%	0.44%	3.17%	1.73%
Chinese yuan	0.67%	0.03%	-0.89%	-6.42%
Japanese yen	3.99%	0.75%	18.69%	21.44%
British pound	0.92%	-1.48%	-7.12%	-15.20%
Swiss franc	1.82%	1.05%	5.53%	-0.15%
Canadian dollar	0.74%	-0.73%	7.26%	-0.65%
Australian dollar	1.80%	1.95%	7.23%	4.13%
Swedish krona	1.10%	-1.17%	0.26%	0.96%
Norwegian krone	1.25%	-0.62%	2.76%	-3.47%
New Zealand dollar	2.89%	1.21%	11.03%	8.00%
Indian rupee	0.13%	1.03%	1.19%	-4.61%
Brazilian real	0.23%	-0.87%	23.09%	2.53%
Mexican peso	-1.10%	-1.43%	-3.45%	-13.13%
Chilean peso	-0.80%	0.95%	8.53%	1.55%
Colombian peso	-3.93%	-5.07%	6.96%	-7.22%
Bloomberg-JP Morgan Asian dollar index (spot)	0.88%	0.77%	2.04%	-2.50%

It appeared prior to the Brexit vote as if the World Ex-U.S. index was going to outperform the U.S. That call remains uncertain still, but if investing rewards those who buy low and sell high, then this week's actions with the U.S. underperforming make sense.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.89%	3.80%	11.66%	0.13%
North America	0.04%	5.11%	14.00%	4.66%
Latin America	-0.03%	7.24%	39.00%	7.10%
Emerging Market Free	0.52%	6.69%	19.79%	-0.18%
EAFE	2.38%	6.06%	8.68%	-6.17%
Pacific	2.77%	6.10%	11.39%	-1.75%
Eurozone	2.81%	4.49%	5.34%	-10.71%

CTAs' positive returns this week suggests they remained in a few strong trends, principally short crude oil and long equities. Surprisingly, global hedge funds did not gain during a positive week for equities.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.45%	2.30%	-0.47%	2.85%
Newedge Trend	1.09%	1.56%	0.94%	5.14%
Newedge Short-Term	0.36%	-0.02%	2.65%	4.50%
HFR Global Hedge Fund	-0.01%	2.36%	3.88%	-3.97%
HFR Macro/CTA	0.20%	1.12%	-0.62%	-2.85%
HFR Macro: Sytematic Diversified CTA	0.74%	2.32%	1.53%	2.23%