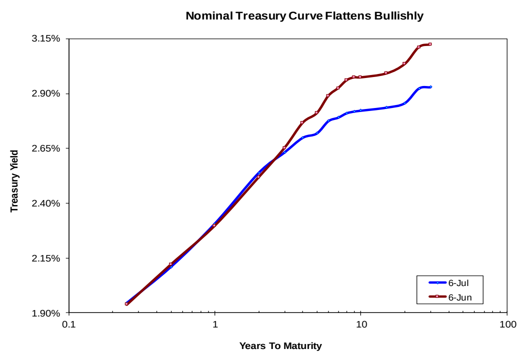
The Macro Environment For Financial Markets

Markets are excellent discounting mechanisms and there is no percentage in being right in the belief they are wrong. Still, it is a little disconcerting to see how quickly equity markets are to dismiss the trade threat when fixed-income, currency and commodity markets are dominated by them. The idea of one market being "smarter" than another is amateurism at its worst. All we can say is one side is going to be wrong. The causal chain now is:

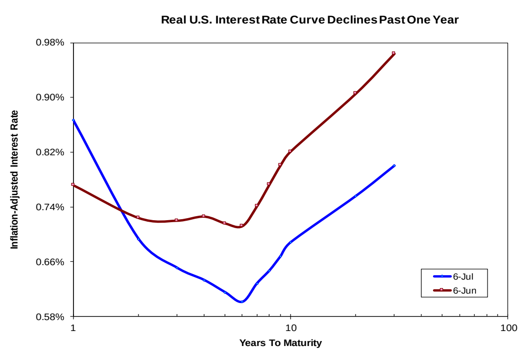
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to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

Key Market Indications

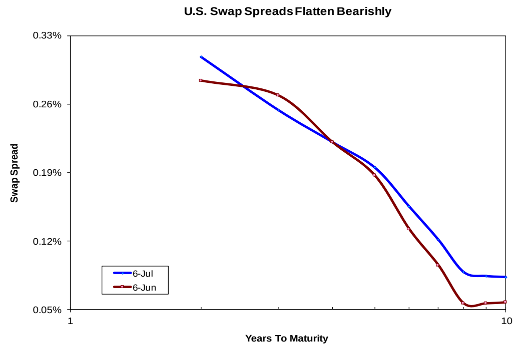
While most of the post-November 2013 flattening of the yield curve came from increases in short-term rates, the current phase is being driven by declining long-term rates. The U.S. is following the Eurozone lower and the market is trying to price in the effects of tariffs and other disruptions to trade.



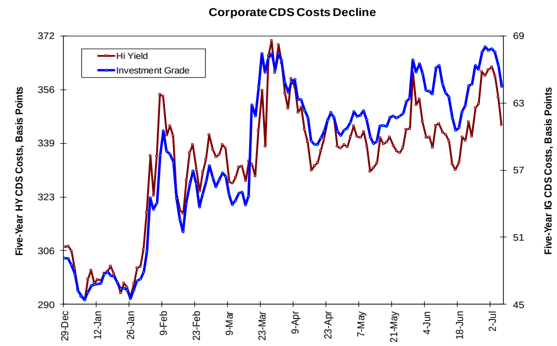
The pseudo-real yield curve declined sharply past one year as lower nominal yields and stable breakevens pushed implied real rates lower. This is bullish for risky financial assets.



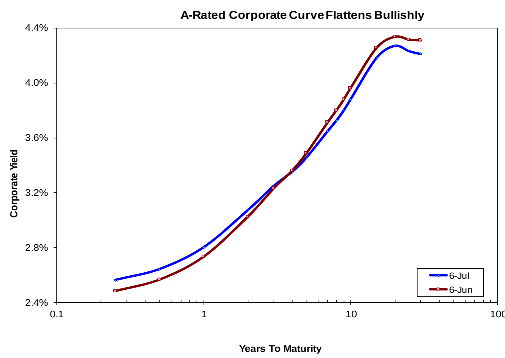
Swap spreads, which rise when floating-rate borrowers want to fix their payments, flattened bearishly as longer-dated spreads rose slightly. This has yet to impinge upon corporate bonds.



The decline in CDS costs reflects the gains 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.



The A-rated corporate yield curve mirrored the small bullish 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. While the S&P 500 reversed into an uptrend, the EAFE remains in a downtrend. The dollar index returned to neutral from its strong uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 9 - 13
BBerg	29	Trending	-0.306	8.6%	-0.29%
BBerg Grain	29	Trending	-0.169	22.0%	-0.42%
BBerg Ind. Metl	29	Trending	-0.570	14.7%	-0.21%
BBerg Pre. Metl	29	Trending	-0.263	8.4%	-0.08%
BBerg Softs	29	Trending	-0.286	16.7%	-0.40%
BBerg Nat. Gas	19	Transitional	-0.151	17.3%	
BBerg Petroleum	29	Trending	0.114	19.5%	0.53%
BBerg Livestock	25	Trending	-0.003	17.2%	-0.13%
Dollar Index	22	Trending	-0.075	6.5%	
S&P 500 Index	29	Trending	0.056	9.2%	0.07%
EAFE Index	24	Trending	-0.064	9.3%	-0.24%
EM Index	5	Sideways	-0.001	13.2%	
Ten-year UST (price)	24	Trending	0.154	4.0%	0.08%

Performance Measures

Industrial Metals continue to show the effects of trade threats. The Petroleum complex ended its rally on the likelihood Saudi Arabia will increase production. Grains, which had been under significant trade-related pressure, popped higher on news of preemptive export sales as lower prices made U.S. exports competitive.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.63%	-4.04%	-1.31%	6.92%
Grains Sub-Index	3.25%	-7.06%	-2.01%	-18.35%
Corn	1.74%	-6.74%	-2.56%	-19.13%
Soybeans	1.29%	-9.55%	-10.29%	-16.26%
Wheat	6.61%	-3.78%	9.73%	-19.21%
Energy Sub-Index	-1.04%	2.43%	8.39%	37.48%
Petroleum Sub-Index	-0.34%	3.62%	12.90%	60.82%
WTI	-0.29%	9.64%	17.00%	63.74%
Brent	-0.60%	1.36%	16.35%	72.38%
ULSD	-0.41%	0.31%	7.44%	53.19%
Gasoline	0.14%	0.29%	4.18%	40.91%
Natural Gas	-3.15%	-1.09%	-3.61%	-15.04%
Precious Metals Sub-Index	0.38%	-3.66%	-5.11%	3.07%
Gold	0.43%	-3.46%	-4.82%	3.03%
Silver	0.22%	-4.32%	-6.04%	3.11%
Industrial Metals Sub-Index	-4.83%	-12.41%	-7.13%	11.56%
Copper	-4.92%	-14.81%	-13.04%	4.83%
Aluminum	-3.57%	-9.48%	-1.54%	8.32%
Nickel	-5.72%	-9.61%	9.83%	55.39%
Zinc	-5.61%	-14.34%	-16.82%	0.37%
Softs Sub-Index	-2.76%	-6.15%	-14.34%	-11.45%
Coffee	-1.38%	-4.34%	-12.76%	-19.03%
Sugar	-6.00%	-7.99%	-23.03%	-22.32%
Cotton	1.12%	-8.81%	9.97%	25.99%
Livestock Sub-Index	1.51%	-0.29%	-4.45%	-9.05%
Cattle	2.60%	0.72%	-1.39%	-7.78%
Hogs	-0.35%	-2.05%	-10.96%	-12.06%

The threat to U.S. economic growth from trade disruptions carries with it the prospect of lower short-term rates and a weaker USD. The long-USD trade had become a bit crowded, anyway. However, the broader trend to a stronger USD remains.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.53%	-0.24%	-1.85%	2.83%
Chinese yuan	-0.33%	-3.83%	-2.15%	2.39%
Japanese yen	0.26%	-0.26%	2.37%	2.49%
British pound	0.58%	-0.97%	-2.10%	2.41%
Swiss franc	0.13%	-0.28%	-1.22%	-2.92%
Canadian dollar	0.37%	-1.07%	-5.07%	-0.81%
Australian dollar	0.34%	-3.09%	-5.25%	-2.06%
Swedish krona	2.51%	0.10%	-5.98%	-3.23%
Norwegian krone	1.46%	0.62%	0.59%	4.00%
New Zealand dollar	0.89%	-2.91%	-4.85%	-6.14%
Indian rupee	-0.59%	-2.83%	-7.80%	-5.95%
Brazilian real	0.37%	-0.30%	-16.20%	-14.61%
Mexican peso	4.55%	6.62%	0.97%	-4.12%
Chilean peso	-0.44%	-4.26%	-7.84%	1.36%
Colombian peso	2.06%	-1.51%	1.17%	7.74%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.16%	-3.01%	-3.13%	1.08%

The macroeconomic threat posed by trade wars hurt equities last week but seemed to be absorbed as "negotiating" this week. A weaker USD and lower long-term rates are helpful so long as the macro damage does not increase.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.19%	-0.99%	-0.83%	13.17%
North America	1.54%	-0.27%	1.53%	16.66%
Latin America	1.93%	0.53%	-13.61%	2.65%
Emerging Market Free	-0.68%	-7.22%	-10.45%	8.10%
EAFE	0.57%	-2.07%	-4.16%	8.00%
Pacific	-0.92%	-4.19%	-6.14%	10.82%
Eurozone	2.12%	-0.41%	-3.44%	7.42%

While CTAs lost on the week, perhaps on reversals in crude oil and in the USD, hedge funds returned to their normal pattern of gaining during strong equity markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	-0.10%	0.60%	-8.05%	3.31%
SocGen Trend	-0.14%	0.21%	-7.04%	1.47%
SocGen Short-Term	-0.41%	-0.49%	-1.35%	0.71%
HFR Global Hedge Fund	0.31%	-0.08%	-1.72%	2.77%
HFR Macro/CTA	0.60%	1.13%	-2.92%	2.35%
HFR Macro: Sytematic Diversified CTA	0.77%	1.17%	-5.04%	5.35%