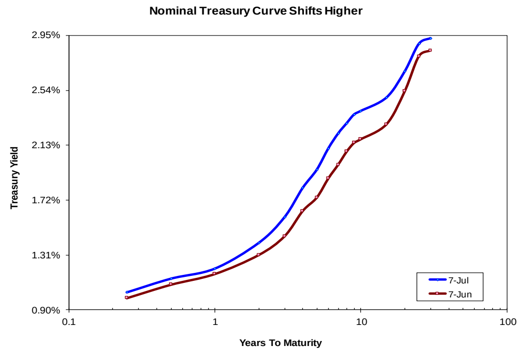
The Macro Environment For Financial Markets

Idle hands are the Devil's helpers, followed closely by bored traders. Someone, somewhere, is convinced a slow-growth, over-leveraged economy with stable inflation is going to go into overdrive as central banks shrink their balance sheets by selling trillions of dollars in bonds to as-yet unnamed buyers and crashing the Earth into some sort of cosmic guardrail. This is the level of analysis best-suited for screeds on global warming. The causal chain now is:

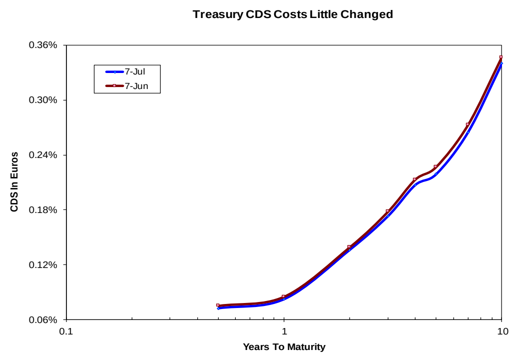
1. The market still is pricing in higher short-term rates in 2017, now possibly outside of the U.S., too;
2. Inflationary expectations remain under pressure;
3. The U.S. yield curve remains in a secular flattening trend;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are rising at the short end of the yield curve; and
6. CDS costs remain consistent with a bull market in risky assets.

Key Market Indications

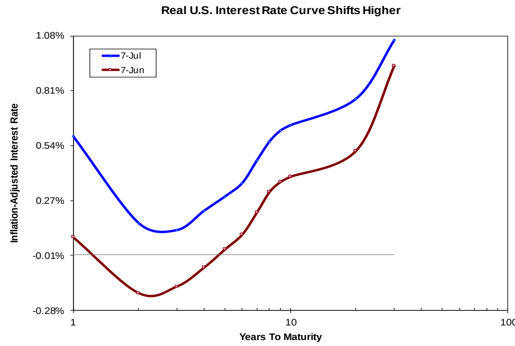
You might think we have entered into a bear market of Biblical proportions; if so, get another Bible. All we have done is rise to resistance level near 2.40% on the 10-year UST, one last breached to the upside in the immediate aftermath of the U.S. election. If we cross 2.65%, worry, but that will take an actual execution of QE-withdrawal outside of the U.S.



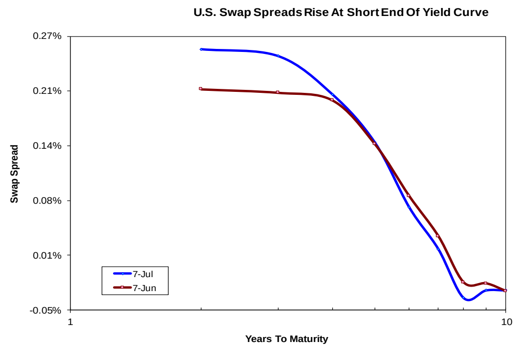
CDS costs on UST have changed little over the past month. This market remains unconcerned about the U.S. debt ceiling.



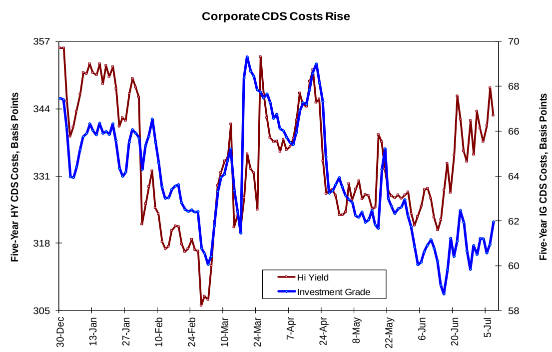
The pseudo-real yield curve shifted higher across the maturity spectrum. This contributed to declines in precious metals and to unsettled trading in risky financial assets.



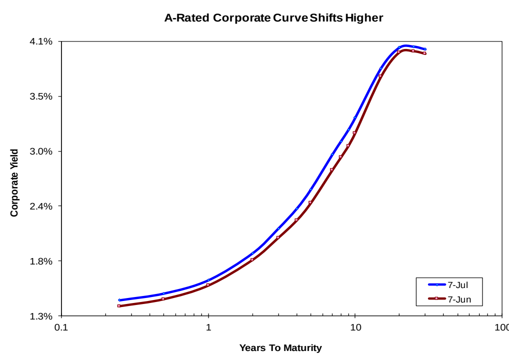
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted higher at the short end of the yield curve in response to perceptions of greater central bank tightening.



CDS costs rose from recent lows, but these were minor moves within the context of a secular bull market. We would need evidence of much higher short-term rates and of rising recessionary pressures to reverse these trends.



The A-rated corporate yield curve shifted slightly higher. This remains a bull market with limited upside potential.



Market Structure

Grains and Industrial Metals remained in structural uptrends amongst the physical commodities. The dollar index entered a downtrend amongst the financials. Nothing else is in a trending structure.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 10 - 14
BBerg	4	Sideways	0.108	15.6%	
BBerg Grain	28	Trending	0.225	17.5%	0.10%
BBerg Ind. Metl	29	Trending	0.249	12.4%	0.39%
BBerg Pre. Metl	4	Sideways	-0.021	13.4%	
BBerg Softs	4	Sideways	0.089	21.3%	
BBerg Nat. Gas	4	Sideways	-0.032	19.9%	
BBerg Petroleum	29	Trending	0.056	24.8%	
BBerg Livestock	4	Sideways	0.044	20.9%	
Dollar Index	20	Trending	-0.216	5.8%	-0.09%
S&P 500 Index	13	Transitional	-0.041	8.2%	
EAFE Index	4	Sideways	-0.058	9.6%	
EM Index	16	Transitional	-0.009	8.1%	
Ten-year UST (price)	19	Transitional	-0.172	4.9%	

Performance Measures

The Grains rally continued on the remarkable observation it gets hot in July in the Northern Hemisphere. Who knew? The energy markets turned lower once again, and the Precious Metals sold off sharply on the prospects for higher short-term rates. The trading glitches seen this past week in precious metals futures continue to highlight how vulnerable electronic markets are; it is impossible to conceive of such movements in the old open-outcry days.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.61%	-0.67%	-5.45%	-4.77%
Grains Sub-Index	7.84%	6.08%	4.56%	-1.73%
Corn	6.25%	-0.72%	3.60%	-0.96%
Soybeans	9.84%	7.17%	-2.29%	-7.88%
Wheat	7.89%	16.36%	15.02%	3.21%
Energy Sub-Index	-2.41%	-3.55%	-17.15%	-13.30%
Petroleum Sub-Index	-1.06%	-2.47%	-16.02%	-10.62%
WTI	-1.77%	-4.06%	-17.38%	-15.35%
Brent	-1.91%	-3.67%	-15.93%	-11.19%
ULSD	-0.26%	0.35%	-13.09%	-8.22%
Gasoline	1.11%	0.03%	-16.75%	-1.04%
Natural Gas	-5.91%	-6.35%	-20.28%	-20.14%
Precious Metals Sub-Index	-4.04%	-6.35%	-1.36%	-15.57%
Gold	-2.88%	-4.78%	1.59%	-11.89%
Silver	-7.36%	-10.76%	-9.22%	-24.68%
Industrial Metals Sub-Index	-0.88%	1.57%	0.41%	16.30%
Copper	-1.78%	-0.40%	0.16%	22.54%
Aluminum	0.75%	1.16%	9.29%	13.86%
Nickel	-4.06%	-0.79%	-16.66%	-11.15%
Zinc	1.31%	10.43%	2.22%	28.62%
Softs Sub-Index	3.14%	-1.58%	-21.14%	-19.39%
Coffee	2.04%	0.14%	-16.72%	-18.44%
Sugar	4.84%	-2.18%	-31.54%	-30.36%
Cotton	2.03%	-5.57%	-5.49%	4.39%
Livestock Sub-Index	0.34%	-3.74%	9.21%	8.86%
Cattle	-1.46%	-7.25%	9.76%	15.06%
Hogs	3.09%	1.89%	8.04%	-0.08%

Even though it feels as if the USD is in a pronounced downtrend, it gained against all of the majors save for the CAD and SEK. We are likely to see several false starts in the long-awaited campaigns to unwind QE over the next two years.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.22%	1.28%	7.82%	3.06%
Chinese yuan	-0.36%	-0.15%	1.94%	-1.82%
Japanese yen	-1.34%	-3.60%	1.85%	-11.54%
British pound	-1.04%	-0.54%	5.98%	-0.14%
Swiss franc	-0.63%	0.12%	5.32%	1.52%
Canadian dollar	0.68%	4.92%	2.64%	0.98%
Australian dollar	-1.14%	0.69%	3.36%	1.63%
Swedish krona	0.06%	3.13%	7.34%	1.81%
Norwegian krone	-0.25%	1.52%	2.05%	1.69%
New Zealand dollar	-0.71%	1.20%	3.78%	0.73%
Indian rupee	-0.02%	-0.41%	5.59%	4.34%
Brazilian real	0.83%	-0.35%	-2.48%	2.63%
Mexican peso	0.16%	0.74%	18.17%	4.08%
Chilean peso	-0.50%	0.27%	0.61%	-0.19%
Colombian peso	-1.38%	-5.57%	-5.16%	-3.28%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.40%	-0.61%	2.57%	-0.53%

For all of the attention focused on earnings reports in an index-ETF world, the real key to long-term equity trends is short-term interest rates. The ability of equities to withstand higher long-term rates is great, as seen this past week.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.12%	-0.34%	9.07%	18.00%
North America	0.08%	-0.04%	7.23%	17.69%
Latin America	-0.01%	-0.65%	8.31%	18.94%
Emerging Market Free	-0.58%	-0.61%	15.39%	24.41%
EAFE	-0.47%	-1.40%	11.71%	22.17%
Pacific	-1.48%	-1.20%	6.35%	18.30%
Eurozone	0.61%	-1.08%	16.86%	31.25%

Both CTAs and hedge funds lost again this week as both stocks and equities came under pressure, currency volatility remained high and physical commodities traded erratically. In other words, professional traders managed to lose money in the only environment wherein hiring them is justified.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-2.62%	-5.91%	-6.87%	-15.64%
Newedge Trend	-2.21%	-5.32%	-4.47%	-11.87%
Newedge Short-Term	-1.06%	-2.00%	-7.03%	-13.18%
HFR Global Hedge Fund	-0.08%	-0.20%	2.06%	5.62%
HFR Macro/CTA	-0.39%	-1.77%	-0.93%	-4.27%
HFR Macro: Sytematic Diversified CTA	-0.59%	-3.41%	-3.02%	-8.69%