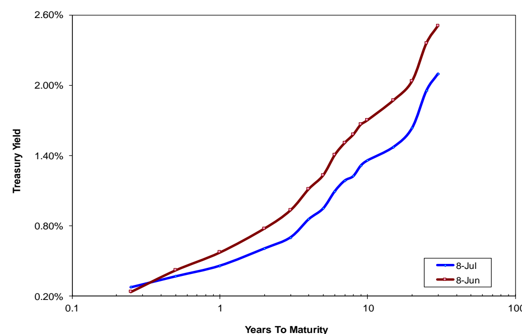
The Macro Environment For Financial Markets

The cumulative brainpower of the world's financial services industry is impressive. So why does so much money trade in such a short period of time each and every month on a number sure to be revised, and revised substantially, over the following months? Last month's weak report did not mean we were headed into a recession and this month's strong report has no policy content whatsoever. The causal chain now is:

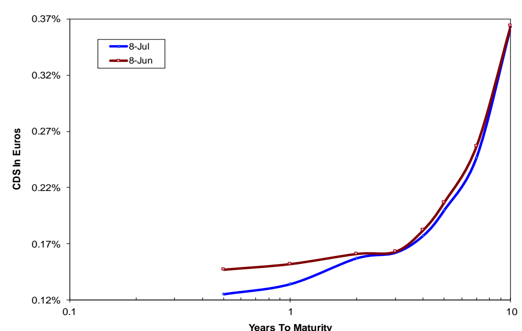
1. The market has no clear idea of if and when U.S. short-term rates will rise;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps remain in a downtrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term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

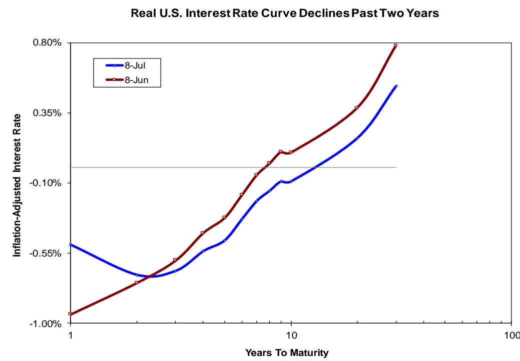
Last chance to get long? In a world where 50-year Swiss rates are negative and European banks are becoming impaired in their basic roles, the receipt of an allegedly safe income stream of any positive magnitude appears attractive. But this is silliness of the first order. The duration risk of sovereign debt makes it highly risky and the OAS/yield-to-maturity ratio of even investment-grade corporate debt makes it return-free risk.



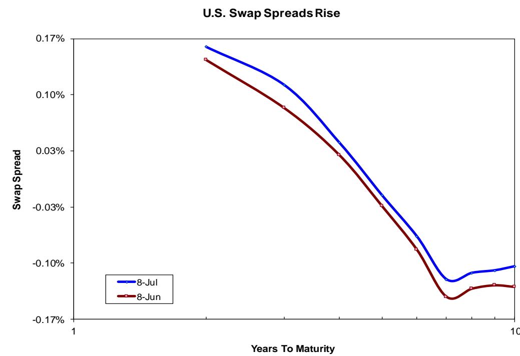
CDS costs declined slightly over the past month, although this market is on its way toward disappearing. At least it is not at the level of absurdity seen throughout much of Europe where a government can get paid to borrow and by implication improve its debt service capabilities by borrowing more.



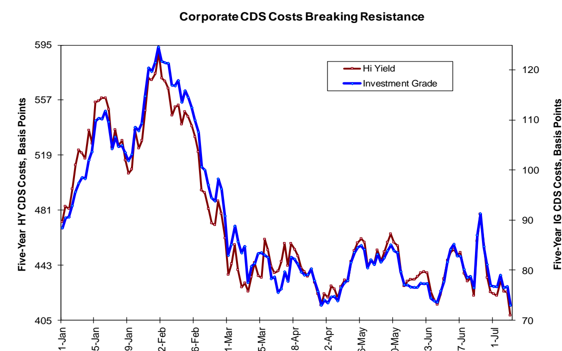
The decline in pseudo-real longer-term rates remains bullish for risky assets, but we would be hard-pressed to say it was causal. The rise in U.S. short-term implied real rates is a negative for precious metals, but this is being overwhelmed by a continued decline in global short-term implied real rates.



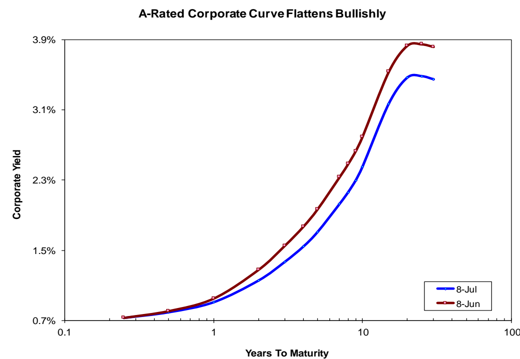
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across tenors as floating-rate payors calculated the risk/reward for remaining floating in a negative-rate world is poor. This trade has yet to prove correct, but it is a cheap place to be wrong.



The investment-grade CDS index broke resistance as the search for yield has reached desperation levels. The high-yield index is close to breaking its resistance for the year as well. Those who throw caution to the wind often are amazed at the damage wind can do.



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

Petroleum and Livestock joined Grains in structural downtrends amongst the physical markets. The S&P and the EM index remain in structural uptrends in the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 11 - 15
BBerg	14	Transitional	-0.089	14.6%	
BBerg Grain	29	Trending	-0.372	23.4%	-0.36%
BBerg Ind. Metl	29	Trending	0.165	18.5%	0.14%
BBerg Pre. Metl	29	Trending	0.381	19.0%	0.22%
BBerg Softs	13	Transitional	-0.007	24.5%	
BBerg Nat. Gas	29	Trending	0.107	25.0%	0.34%
BBerg Petroleum	28	Trending	-0.208	27.1%	-0.60%
BBerg Livestock	29	Trending	-0.187	12.7%	-0.28%
Dollar Index	27	Trending	0.144	9.9%	0.11%
S&P 500 Index	29	Trending	0.186	10.5%	0.08%
EAFE Index	8	Sideways	0.010	16.2%	
EM Index	27	Trending	0.079	13.5%	0.16%
Ten-year UST (price)	29	Trending	0.283	7.1%	0.06%

Performance Measures

The January-June broad rally in physical commodities was a cyclical affair in what remains a secular bear market. Interestingly, some of the more industrial commodities such as cotton and metals such as aluminum and zinc, gained, along with Precious Metals. But if the Petroleum index declines, it overwhelms interest in physical markets and leads to a liquidation of financial inflows.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-2.74%	-2.84%	15.18%	-12.85%
Grains Sub-Index	-4.75%	-13.46%	3.40%	-17.89%
Corn	-2.87%	-16.98%	-2.00%	-24.69%
Soybeans	-8.28%	-9.10%	23.42%	3.14%
Wheat	-2.35%	-14.12%	-11.27%	-28.87%
Energy Sub-Index	-5.63%	-5.30%	13.71%	-33.70%
Petroleum Sub-Index	-6.04%	-8.48%	20.27%	-34.45%
WTI	-5.89%	-8.18%	16.04%	-38.17%
Brent	-5.93%	-8.31%	32.33%	-33.95%
ULSD	-4.71%	-6.34%	31.29%	-29.81%
Gasoline	-8.13%	-11.80%	-4.57%	-36.53%
Natural Gas	-4.44%	5.09%	-3.15%	-33.64%
Precious Metals Sub-Index	4.34%	9.08%	29.18%	20.20%
Gold	2.87%	6.49%	23.71%	16.86%
Silver	7.93%	15.66%	44.16%	28.37%
Industrial Metals Sub-Index	-0.32%	5.17%	15.37%	-10.03%
Copper	-3.48%	4.18%	6.78%	-17.57%
Aluminum	0.75%	5.70%	12.42%	-5.78%
Nickel	4.59%	10.57%	18.49%	-13.54%
Zinc	1.73%	2.68%	43.80%	4.09%
Softs Sub-Index	-1.91%	0.21%	22.97%	24.00%
Coffee	-1.06%	3.79%	20.19%	3.39%
Sugar	-3.73%	-0.86%	36.53%	44.17%
Cotton	2.56%	1.17%	6.69%	-0.07%
Livestock Sub-Index	-3.75%	-6.70%	-2.31%	-12.00%
Cattle	-2.26%	-4.35%	-5.94%	-19.68%
Hogs	-5.34%	-9.15%	3.08%	2.19%

Gainers against the USD included an odd mix of the negative-yielding JPY and the relatively high-yielding AUD and NZD. Welcome to the world of inferring whose expected real rates are higher, especially when market-derived inflation measures have been distorted by flights into nominal sovereign bonds as opposed to indexed bonds.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.76%	-3.02%	1.18%	-0.23%
Chinese yuan	-0.46%	-1.92%	-1.43%	-7.20%
Japanese yen	1.97%	6.42%	16.63%	20.06%
British pound	-2.36%	-10.69%	-10.77%	-15.67%
Swiss franc	-1.02%	-2.44%	1.17%	-3.86%
Canadian dollar	-1.01%	-2.69%	8.65%	-2.28%
Australian dollar	0.95%	1.31%	8.86%	1.88%
Swedish krona	-1.69%	-5.50%	-0.94%	-1.39%
Norwegian krone	-2.12%	-4.97%	4.17%	-3.52%
New Zealand dollar	1.83%	4.22%	11.63%	8.57%
Indian rupee	-0.07%	-1.07%	-1.09%	-5.60%
Brazilian real	-1.93%	1.88%	21.96%	-1.96%
Mexican peso	-0.78%	-2.09%	-3.08%	-14.36%
Chilean peso	0.20%	2.16%	10.30%	-1.16%
Colombian peso	-0.01%	-0.30%	11.38%	-8.51%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.22%	-0.84%	1.53%	-4.23%

It is important to distinguish a U.S. equity rally from a global equity rally. The U.S. has been outperforming the rest of the world since 2011, and it appeared this might be changing prior to the Brexit mess. This is no longer the case.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.16%	0.00%	8.45%	-2.09%
North America	1.27%	0.44%	12.51%	5.19%
Latin America	-1.08%	2.35%	36.66%	-3.26%
Emerging Market Free	-1.16%	-0.89%	13.75%	-5.72%
EAFE	-1.74%	-6.00%	1.23%	-8.11%
Pacific	-0.92%	-2.02%	2.93%	-5.56%
Eurozone	-2.37%	-4.58%	-0.82%	-15.97%

CTAs once again had a strong week, suggesting they remained long bonds and were on the right side of the JPY and GBP. Hedge funds gained once again, as has been their habit whenever equity markets rally.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.76%	4.81%	2.50%	4.33%
Newedge Trend	1.29%	4.03%	3.75%	6.67%
Newedge Short-Term	0.98%	1.54%	5.53%	5.73%
HFR Global Hedge Fund	0.31%	-0.20%	0.85%	-5.03%
HFR Macro/CTA	0.26%	0.49%	-0.57%	-1.36%
HFR Macro: Sytematic Diversified CTA	1.05%	3.13%	2.06%	4.95%