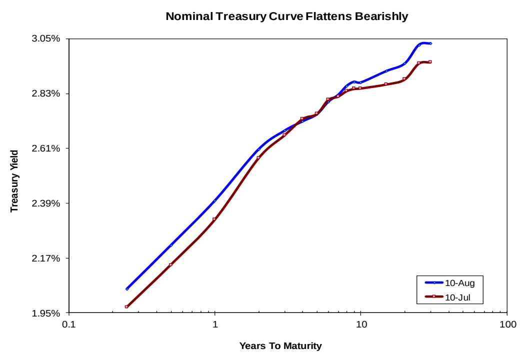
The Macro Environment For Financial Markets

Someone, somewhere needs to intervene in the interest of the greater good to prevent misguided trade policies from plunging the world into an unnecessary economic crisis. This is going to be difficult. Consider how no one in 1914 wanted the Great War but all accepted it. If anyone thinks China is going to back down from U.S. bluster, they are wrong; that is a culture that values "face." The causal chain remains:

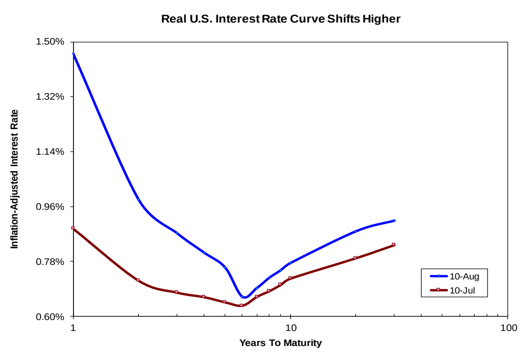
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to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

Key Market Indications

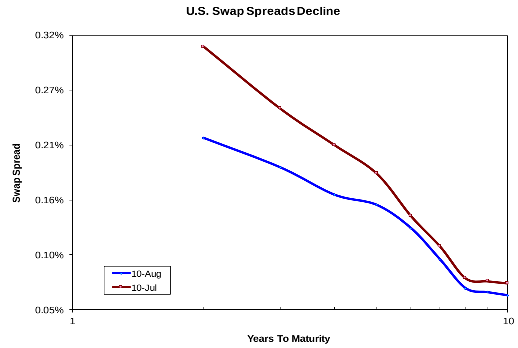
The rise in reported inflation was not enough to overwhelm the haven bid for nominal Treasuries. This perpetuated the flattening of the yield curve despite renewed speculation the Federal Reserve might have to back away from its rate-hike campaign in light of the flight into the USD. This is naïve; the FOMC is out to prove it is right regardless of what the rest of the world thinks.



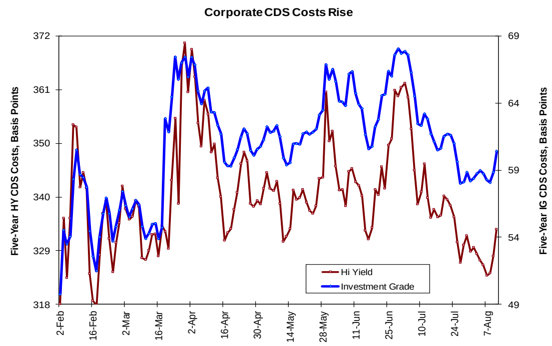
The pseudo-real yield curve rose across the maturity spectrum, especially at the short end of the yield curve. This is bearish for precious metals.



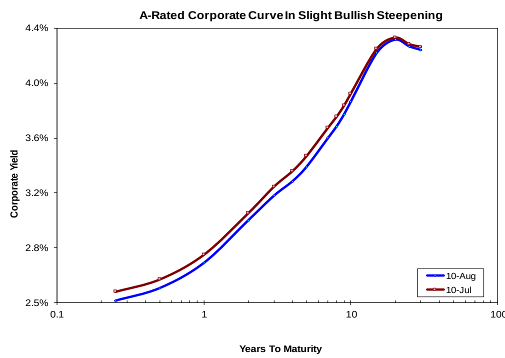
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined across all tenors but especially at the short end of the yield curve as the prospects for aggressive short-term interest rate hikes fade.



The narrow range in CDS costs reflects the stall in equities more than anything specific to credit. The EM shock on Friday pushed the USD higher and equities lower, but this did not alter the fundamentally benign picture for corporate credit.



The A-rated corporate yield curve steepened slightly as short-term borrowing costs fell. This is the first divergence of significance this year; prior to now, the A-rated curve mirrored the UST curve closely.



Market Structure

Natural Gas joined Grain in a structural uptrend within the physical markets; while Petroleum turned negative. Within the financials, the EM and EAFE indices are in downtrends while both the S&P 500 and ten-year UST are in structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate August 13 - 17
BBerg	6	Sideways	-0.093	8.8%	
BBerg Grain	26	Trending	0.062	19.8%	0.94%
BBerg Ind. Metl	12	Transitional	-0.009	17.4%	
BBerg Pre. Metl	4	Sideways	-0.021	8.1%	
BBerg Softs	15	Transitional	-0.153	14.0%	
BBerg Nat. Gas	29	Trending	0.267	12.7%	0.23%
BBerg Petroleum	21	Trending	-0.015	19.1%	-0.15%
BBerg Livestock	12	Transitional	-0.004	16.9%	
Dollar Index	29	Trending	0.298	5.5%	0.08%
S&P 500 Index	29	Trending	0.132	7.1%	0.07%
EAFE Index	27	Trending	-0.196	8.3%	-0.13%
EM Index	22	Trending	-0.137	9.7%	-0.15%
Ten-year UST (price)	29	Trending	0.072	3.5%	0.05%

Performance Measures

Once again Grain traders were wrong-footed by a USDA report. What do they do with all of their satellite photos? The moves elsewhere amongst physical commodities were fairly tame despite the ongoing trade-related disruptions. The declines in both Softs and Livestock have little in direct economic impact.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.75%	0.63%	-2.06%	2.20%
Grains Sub-Index	-2.95%	6.62%	-6.33%	-7.83%
Corn	-3.08%	5.13%	-7.72%	-12.47%
Soybeans	-4.45%	3.46%	-17.59%	-13.24%
Wheat	-1.47%	10.40%	9.42%	4.49%
Energy Sub-Index	0.28%	0.29%	15.28%	24.26%
Petroleum Sub-Index	-0.71%	-2.23%	17.39%	40.11%
WTI	-1.21%	-3.16%	17.34%	40.90%
Brent	-0.53%	-2.67%	20.44%	49.32%
ULSD	0.58%	0.11%	17.97%	34.11%
Gasoline	-1.26%	-1.66%	11.48%	26.85%
Natural Gas	3.22%	8.23%	9.42%	-14.47%
Precious Metals Sub-Index	-0.47%	-2.63%	-8.90%	-7.84%
Gold	-0.30%	-2.48%	-9.20%	-6.71%
Silver	-1.04%	-3.14%	-7.90%	-11.22%
Industrial Metals Sub-Index	0.74%	0.38%	-9.62%	0.61%
Copper	-0.70%	-1.01%	-14.03%	-7.36%
Aluminum	4.24%	4.07%	0.55%	4.18%
Nickel	2.05%	-1.11%	2.71%	28.93%
Zinc	-3.17%	-0.54%	-25.18%	-9.07%
Softs Sub-Index	-2.19%	-5.64%	-13.50%	-16.78%
Coffee	-0.68%	-2.51%	-16.69%	-30.22%
Sugar	-2.82%	-3.68%	-23.04%	-23.68%
Cotton	-3.24%	-2.82%	13.95%	27.90%
Livestock Sub-Index	-1.55%	-0.80%	-7.63%	-7.56%
Cattle	-2.42%	1.90%	-5.20%	-0.90%
Hogs	0.83%	-7.32%	-13.42%	-20.62%

The JPY has been acting as a haven asset, and this prevented the USD from scoring gains across the board. The losses in commodity-linked and Latin American currencies were especially severe. This is going to produce major financial stress unless the Federal Reserve signals it is going to pause in its rate-hike campaign, something that appears highly unlikely given the inflation data.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.34%	-2.82%	-7.15%	-3.05%
Chinese yuan	-0.29%	-3.11%	-7.58%	-2.92%
Japanese yen	0.38%	0.15%	-1.96%	-1.47%
British pound	-1.87%	-3.90%	-7.80%	-1.69%
Swiss franc	-0.11%	-0.33%	-5.62%	-3.28%
Canadian dollar	-1.13%	-0.21%	-4.28%	-3.01%
Australian dollar	-1.38%	-2.10%	-7.12%	-7.28%
Swedish krona	-2.11%	-4.19%	-11.60%	-10.83%
Norwegian krone	-1.24%	-4.12%	-5.34%	-4.91%
New Zealand dollar	-2.28%	-3.63%	-9.28%	-9.42%
Indian rupee	-0.32%	-0.02%	-6.57%	-6.91%
Brazilian real	-4.07%	-1.29%	-14.57%	-17.81%
Mexican peso	-1.84%	0.10%	-1.60%	-4.96%
Chilean peso	-1.84%	-1.20%	-8.50%	-1.02%
Colombian peso	-1.79%	-2.54%	-1.84%	1.77%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.37%	-1.96%	-5.76%	-2.09%

Only a stable performance in the U.S. prevented global equity losses from being greater in USD terms. The damage from bad policy can get worse and very likely will.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.64%	0.39%	4.37%	13.11%
North America	-0.20%	1.36%	9.20%	18.12%
Latin America	-6.67%	0.63%	-11.45%	-3.99%
Emerging Market Free	-0.98%	-0.96%	-5.28%	3.31%
EAFE	-1.46%	-1.53%	0.21%	4.47%
Pacific	-0.36%	0.37%	-0.80%	7.15%
Eurozone	-2.79%	-2.75%	-2.76%	1.91%

Both hedge funds and CTAs gained on the week, suggesting they were long the USD and were breaking even elsewhere.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	0.59%	0.04%	1.05%	2.59%
SocGen Trend	0.44%	-0.02%	0.09%	0.44%
SocGen Short-Term	0.03%	-0.75%	-0.88%	0.98%
HFR Global Hedge Fund	0.11%	-0.62%	-0.75%	1.88%
HFR Macro/CTA	0.96%	0.09%	-0.79%	1.42%
HFR Macro: Sytematic Diversified CTA	0.85%	0.18%	0.47%	4.24%