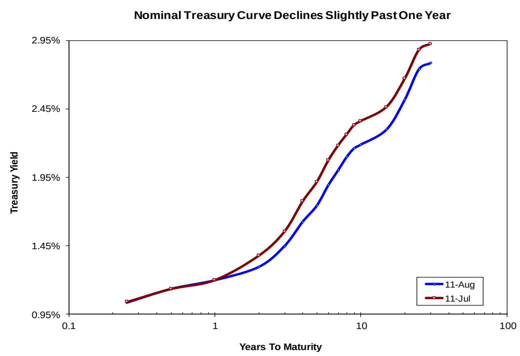
The Macro Environment For Financial Markets

It is best to address the obvious: The threat of war is not bullish, but if the missiles start flying, your portfolio will not matter. The strong selloff on Thursday was a one-day affair driven by unwinding of short-volatility trades and the need for market-makers to sell ever-greater stocks at ever lower prices as a hedge. Asylums are filled with more rational actors. The causal chain now is:

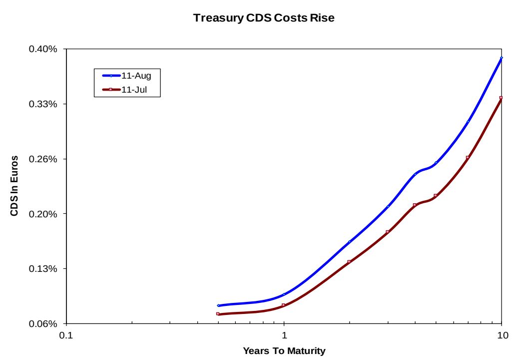
1. The market is pricing out expectations for another short-term rate hike in the U.S. in 2017;
2. Inflationary expectations have stopped declining;
3. The secular flattening trend in the U.S. is encountering resistance as expectations for higher short-term rates fade;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are rising; and
6. CDS costs are rising in response to declining equities.

Key Market Indications

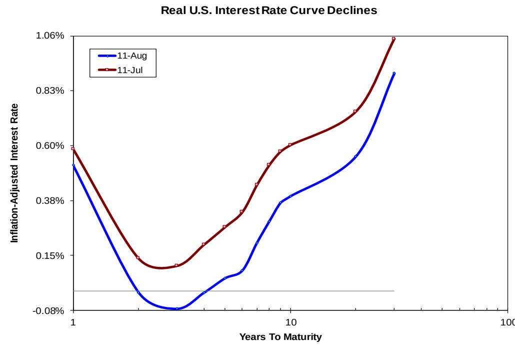
Once upon a time a period of heightened geopolitical risk would have prompted a flight into the long end of the yield curve. Not this time, and one of the more powerful signals extant is when a market fails to respond bullishly to bullish news. There is no reason to shorten duration, but this is not going to be a repeat of the bull runs of the last few years.



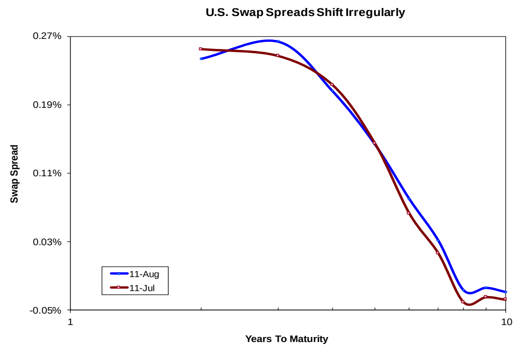
CDS costs on UST increased over the past month. This market remains unconcerned about the U.S. debt ceiling. We are likely to see a bump higher sometime in September, though.



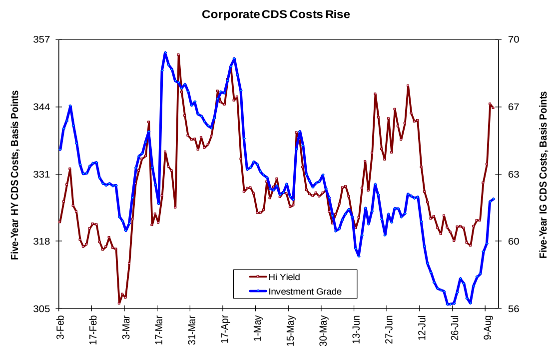
The pseudo-real yield curve declined across the maturity spectrum, with the strongest move at the mid-curve. The three-year remains negative. The shift is not as significant as it may appear as the market simply is pricing out some of its inflation protection taken out early in the year.



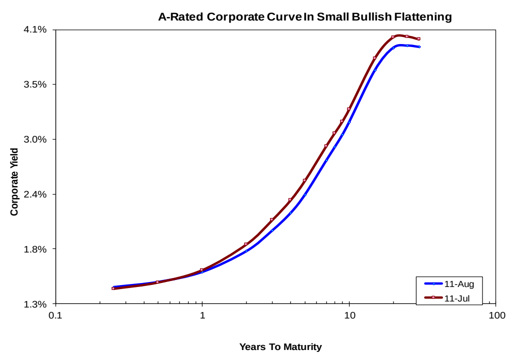
Swap spreads, which rise when floating-rate borrowers want to fix their payments, moved very irregularly.



CDS costs moved higher for both the investment-grade and high-yield indices. As very little changed on either the growth or monetary policy outlooks, it is likely the upturns reflect correlation trades against equities.



The A-rated corporate yield curve posted a small bullish flattening. This remains a bull market with limited upside potential.



Market Structure

Grains joined Natural Gas and Livestock in structural downtrends, while Industrial Metals and Petroleum entered sideways structures. The EAFE entered an uptrend and ten-year UST exited their downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Aug. 14 - 18
BBerg	9	Sideways	-0.009	8.5%	
BBerg Grain	29	Trending	-0.245	21.1%	-0.52%
BBerg Ind. Metl	29	Trending	0.382	12.6%	0.30%
BBerg Pre. Metl	29	Trending	0.228	13.5%	0.20%
BBerg Softs	27	Trending	-0.042	17.4%	
BBerg Nat. Gas	29	Trending	0.025	19.7%	0.25%
BBerg Petroleum	7	Sideways	-0.040	19.6%	
BBerg Livestock	29	Trending	-0.193	14.2%	-0.56%
Dollar Index	8	Sideways	-0.036	6.5%	
S&P 500 Index	29	Trending	-0.118	6.3%	-0.04%
EAFE Index	29	Trending	-0.041	7.8%	
EM Index	11	Transitional	-0.281	7.8%	
Ten-year UST (price)	29	Trending	0.144	4.6%	0.04%

Performance Measures

The Precious Metals rose strongly, as could be expected in a time of heightened geopolitical risk, but their gains paled in comparison to those for the Industrial Metals. Does the end of the world justify a 7% gain in aluminum? Grains continued their decline, as did the Petroleum complex. Natural Gas, a previous laggard, advanced 6.7%.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.52%	1.29%	-5.15%	0.22%
Grains Sub-Index	-1.90%	-7.25%	-10.34%	-5.43%
Corn	-1.50%	-4.00%	-8.74%	0.22%
Soybeans	-1.21%	-5.56%	-11.76%	-7.57%
Wheat	-3.18%	-13.74%	-10.32%	-11.79%
Energy Sub-Index	0.61%	3.83%	-8.97%	-2.53%
Petroleum Sub-Index	-1.37%	5.30%	-9.21%	0.63%
WTI	-1.57%	4.46%	-11.60%	-3.08%
Brent	-0.97%	5.08%	-10.30%	-1.09%
ULSD	-0.84%	7.66%	-3.34%	6.02%
Gasoline	-2.34%	4.92%	-8.27%	7.41%
Natural Gas	6.68%	-0.32%	-8.31%	-10.89%
Precious Metals Sub-Index	3.02%	5.49%	2.02%	-7.62%
Gold	2.35%	4.91%	4.85%	-4.65%
Silver	5.04%	7.21%	-5.35%	-14.94%
Industrial Metals Sub-Index	3.30%	7.31%	3.77%	24.77%
Copper	0.95%	8.30%	5.08%	33.58%
Aluminum	7.08%	5.84%	7.28%	21.34%
Nickel	3.98%	11.25%	-1.75%	1.89%
Zinc	3.06%	3.92%	-0.85%	27.69%
Softs Sub-Index	-3.24%	3.58%	-20.94%	-19.35%
Coffee	0.17%	5.06%	-6.66%	-6.38%
Sugar	-6.63%	-7.61%	-35.83%	-35.45%
Cotton	-3.34%	2.59%	-10.22%	-3.17%
Livestock Sub-Index	-2.77%	-5.31%	5.07%	7.38%
Cattle	-5.85%	-9.35%	6.73%	5.07%
Hogs	2.79%	2.24%	2.51%	10.61%

This week saw an odd combination of haven currencies such as the CHF and JPY rising along with *tres pesos* while the BRL collapsed. Commodity-linked currencies such as the CAD and AUD declined as well. Those seeking a theme here will be disappointed as none exist.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.41%	3.09%	11.54%	6.14%
Chinese yuan	0.98%	2.08%	3.25%	-0.45%
Japanese yen	1.37%	4.35%	4.17%	-6.62%
British pound	-0.20%	1.29%	3.90%	0.45%
Swiss franc	1.13%	0.20%	4.56%	1.42%
Canadian dollar	-0.25%	1.88%	3.11%	2.49%
Australian dollar	-0.35%	3.35%	3.32%	2.53%
Swedish krona	0.34%	3.47%	10.11%	4.36%
Norwegian krone	0.16%	4.38%	5.79%	4.02%
New Zealand dollar	-1.32%	1.19%	1.90%	1.41%
Indian rupee	-0.87%	0.71%	4.48%	4.22%
Brazilian real	-1.94%	1.90%	-2.61%	-1.54%
Mexican peso	0.32%	0.43%	13.74%	2.23%
Chilean peso	0.54%	3.04%	-0.62%	-0.60%
Colombian peso	0.32%	3.23%	-3.47%	-2.89%
Bloomberg-JP Morgan Asian dollar index (spot)	0.11%	1.17%	2.43%	-0.65%

The combination of heightened geopolitical risk and lofty valuations is not a bullish one. Interestingly, the Eurozone declined more than the U.S. did.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-1.44%	-0.37%	7.82%	14.41%
North America	-1.42%	0.79%	6.02%	13.65%
Latin America	-0.79%	5.51%	7.65%	12.87%
Emerging Market Free	-2.24%	2.76%	14.08%	17.95%
EAFE	-1.48%	2.23%	12.58%	15.77%
Pacific	-0.04%	1.73%	9.50%	13.41%
Eurozone	-2.35%	-0.20%	18.83%	22.68%

The sales pitch for alternative investments is they are supposed to zig when others zag. This week demonstrated once again they are an alternative to making money when others lose it.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.76%	0.20%	-7.13%	-15.56%
Newedge Trend	-0.14%	1.88%	-2.15%	-10.09%
Newedge Short-Term	-0.43%	-0.46%	-3.03%	-12.38%
HFR Global Hedge Fund	-0.62%	0.06%	1.49%	4.42%
HFR Macro/CTA	-0.61%	0.30%	-0.77%	-4.33%
HFR Macro: Sytematic Diversified CTA	-1.13%	0.34%	-2.71%	-8.83%

Futures trading involves the substantial risk of loss and is not suitable for all investors. Each investor must consider whether this is a suitable investment since you may lose all of or more than your initial investment. Past performance is not indicative of future results.