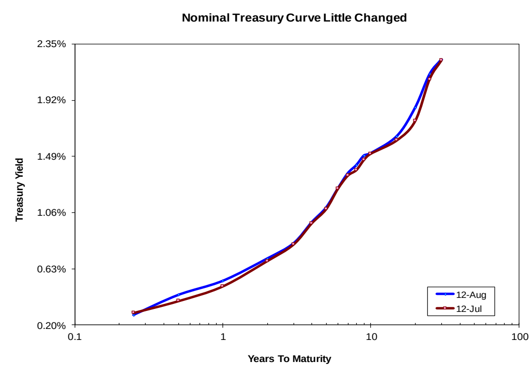
The Macro Environment For Financial Markets

As the late Yogi Berra noted, you can observe a lot just by watching. Or listening, as your humble correspondent does when accosted by all manner of non-financial professionals whose first question, posed with hope, is "when are they going to raise interest rates?" They want to be savers, not investors, and are wary of assets pushed higher by the TINA trade. Extraordinary popular insights and the wisdom of masses. The answer, which they do not like, is "Not for a long time." We can muddle through this forever with controllable consequences, but a financial deleveraging will release the hounds of hell. A 0% return looks good in comparison. As an aside, I have made this argument since at least 2012 and it has remained intact for more than four years. That is unusual. The causal chain remains:

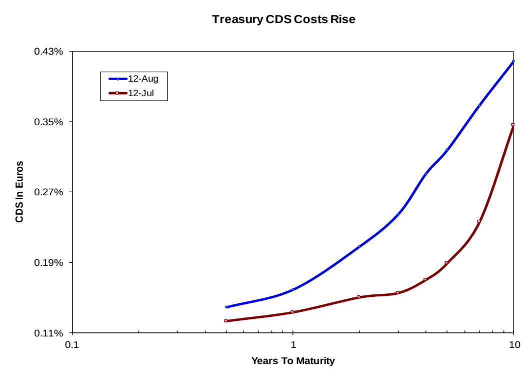
1. The market has no clear idea of if and when U.S. short-term rates will rise;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps have ended their downtrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are accepting rollover risk once again;
6. Swap spreads are finally moving higher; and
7. CDS costs remain suppressed as part of a global search for yield.

Key Market Indications

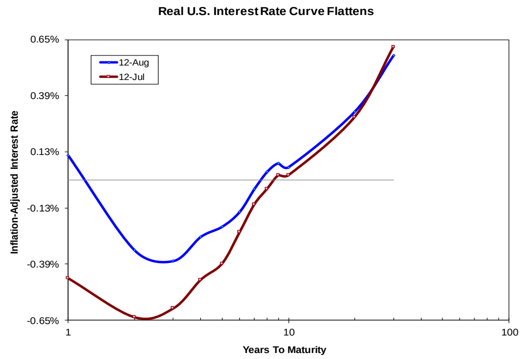
The best indication in any market is when it rejects an open invitation to move in a given direction. The Treasury market has rejected any selloff attempt since the Brexit vote even as the risk/reward for lending has deteriorated. Much of this resilience is attributable to external events, but this excuse is starting to wear thin for bears. After all global QE has been a fact of life and to lament it after all of these years is to signal your comfort in denying reality.



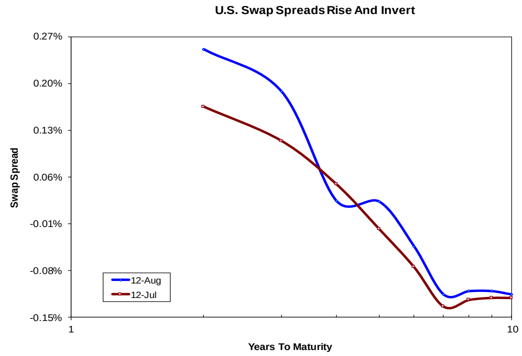
While the thinness of the sovereign CDS market is such we should not engage in over-analysis, the rise in CDS costs this past week in the face of modest economic data has to reflect on the U.S. political landscape.



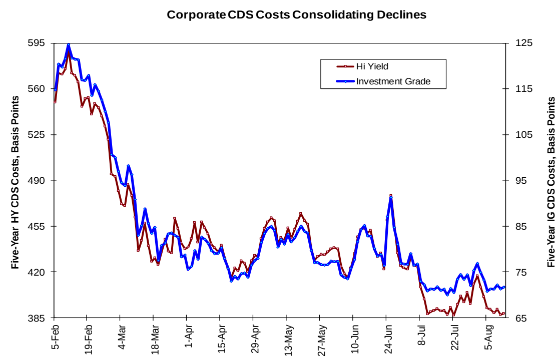
Pseudo-real rates at the long end of the yield curve have changed little over the past month. Precious Metals have been able to sidestep the rise in U.S. implied short-term real the U.S. as the negative-carry trade in other currencies remains open.



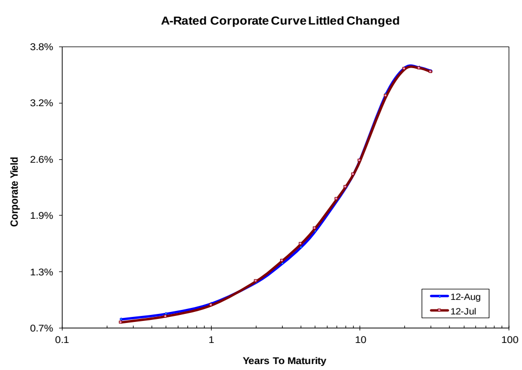
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across the maturity spectrum save for the relatively inactive four-year tenor. The risk/reward for fixing payments remains attractive.



Both the investment-grade and high-yield CDS indices are consolidating their recent bullish moves. The extension of QE to both Eurozone and now U.K. corporate bonds has inflated demand for corporate credit. Compensation for assuming credit risk is sparse, but this is the world in which we live.



The A-rated corporate yield curve continues to mirror the UST curve as credit spreads remain in a narrow range. So long as both the European Central Bank and the Bank of England are in the market buying corporate bonds, it will be hard for U.S. investment-grade bonds to sell off very much.



Market Structure

Only Natural Gas is in a structural trend at all within the physical markets. The EM index and the EAFE remain in structural uptrends and the dollar index remains in a structural downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate August 15 - 19
BBerg	8	Sideways	0.028	11.0%	
BBerg Grain	4	Sideways	0.005	18.3%	
BBerg Ind. Metl	12	Transitional	-0.093	13.9%	
BBerg Pre. Metl	18	Transitional	-0.042	14.1%	
BBerg Softs	18	Transitional	-0.048	18.5%	
BBerg Nat. Gas	25	Trending	-0.157	22.1%	-0.96%
BBerg Petroleum	29	Trending	0.042	29.2%	
BBerg Livestock	5	Sideways	-0.032	13.5%	
Dollar Index	29	Trending	-0.097	6.7%	-0.04%
S&P 500 Index	12	Transitional	0.077	5.8%	
EAFE Index	29	Trending	0.340	9.8%	0.11%
EM Index	29	Trending	0.520	8.6%	0.18%
Ten-year UST (price)	12	Transitional	0.027	5.5%	

Performance Measures

The IEA turned more positive on the global petroleum supply balance, and these markets rallied accordingly. And the long-term forecasting record of the IEA or anyone else in these markets is? I thought so. The move in the petroleum markets offset continuations of bear markets elsewhere and a downturn in the economically sensitive Industrial Metals. Of course, thin trading conditions and the continued effect of the Volcker Rule are making for some exaggerated price moves. In addition to the reversals in petroleum, cotton declined almost 8% in one week.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.25%	-3.03%	11.58%	-6.77%
Grains Sub-Index	0.31%	-6.20%	-4.33%	-11.72%
Corn	-0.44%	-8.34%	-12.59%	-18.35%
Soybeans	0.75%	-7.12%	13.11%	6.80%
Wheat	0.75%	-1.31%	-12.50%	-22.08%
Energy Sub-Index	1.92%	-3.82%	18.70%	-27.54%
Petroleum Sub-Index	5.21%	-3.30%	22.03%	-23.69%
WTI	6.01%	-5.00%	21.66%	-25.94%
Brent	5.95%	-2.63%	29.57%	-21.87%
ULSD	6.26%	-1.62%	24.33%	-23.06%
Gasoline	0.64%	-3.11%	6.27%	-27.68%
Natural Gas	-6.57%	-5.05%	8.77%	-39.05%
Precious Metals Sub-Index	-0.22%	-0.23%	12.09%	22.38%
Gold	-0.08%	0.65%	7.63%	19.85%
Silver	-0.55%	-2.25%	24.14%	28.12%
Industrial Metals Sub-Index	-0.92%	-1.72%	13.42%	-1.20%
Copper	-0.64%	-4.16%	4.86%	-9.93%
Aluminum	0.61%	-1.05%	8.97%	0.58%
Nickel	-3.87%	0.10%	30.76%	-4.21%
Zinc	-1.30%	1.42%	30.32%	19.65%
Softs Sub-Index	-4.29%	-2.17%	31.09%	32.38%
Coffee	-3.99%	-7.26%	13.15%	-10.05%
Sugar	-3.14%	2.10%	47.49%	68.77%
Cotton	-7.93%	-4.86%	21.19%	6.61%
Livestock Sub-Index	0.64%	-1.57%	-7.02%	-15.15%
Cattle	-0.86%	4.28%	-0.72%	-15.73%
Hogs	2.92%	-9.07%	-15.51%	-13.30%

The USD weakened everywhere save the GBP, INR and BRL. As interest rate arbitrage has become a through-the-looking-glass affair, currency movements increasingly by being driven by expected asset returns. The pre-Brexit notion the U.S. was about to start underperforming the rest of the world is returning and is allowing the USD to remain tame even as short-term interest rates elsewhere remain under pressure.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.69%	0.91%	-0.84%	0.03%
Chinese yuan	0.36%	0.79%	-0.93%	-3.77%
Japanese yen	0.51%	3.35%	11.80%	22.62%
British pound	-1.17%	-2.47%	-10.92%	-17.25%
Swiss franc	0.65%	1.50%	0.28%	0.10%
Canadian dollar	1.71%	0.70%	6.94%	0.20%
Australian dollar	0.43%	0.38%	7.59%	3.70%
Swedish krona	1.34%	1.02%	-0.61%	1.66%
Norwegian krone	3.61%	2.70%	4.75%	-0.68%
New Zealand dollar	0.74%	-1.41%	8.60%	8.72%
Indian rupee	-0.17%	0.44%	2.01%	-3.10%
Brazilian real	-0.84%	3.24%	25.40%	9.04%
Mexican peso	2.71%	0.45%	3.55%	-10.85%
Chilean peso	1.13%	1.58%	8.69%	5.29%
Colombian peso	3.67%	-0.38%	15.44%	0.31%
Bloomberg-JP Morgan Asian dollar index (spot)	0.31%	0.82%	1.50%	-0.46%

Lost in the march of the U.S. to new nominal highs this past week was the continued strong advance in the emerging markets beaten so bloody over the past two years. A little momentum can go a long way, often for the worst of reasons.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.22%	2.27%	17.31%	2.22%
North America	0.28%	1.82%	19.41%	6.37%
Latin America	3.40%	7.93%	50.31%	18.16%
Emerging Market Free	2.81%	6.88%	30.33%	8.61%
EAFE	2.85%	4.73%	17.51%	-3.88%
Pacific	3.51%	4.78%	19.31%	1.93%
Eurozone	3.44%	4.74%	12.02%	-6.91%

CTAs gained this past week, suggesting they were not trapped in the long side of bonds or the short side of crude oil. Hedge funds gained, as they generally do when equity markets rise.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.82%	-0.02%	-4.59%	1.70%
Newedge Trend	0.30%	-0.49%	-3.42%	4.00%
Newedge Short-Term	0.24%	-1.42%	-1.89%	4.45%
HFR Global Hedge Fund	0.45%	1.03%	6.13%	-3.42%
HFR Macro/CTA	0.58%	0.53%	-0.23%	-2.14%
HFR Macro: Sytematic Diversified CTA	0.73%	0.59%	-1.60%	2.94%