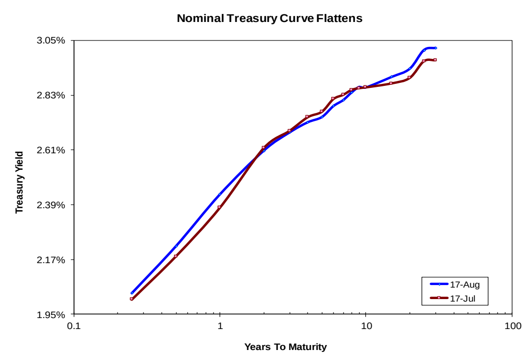
The Macro Environment For Financial Markets

The Federal Reserve has backed away from aggressive rate hikes in the past when they have produced casualties. For the moment, neither Turkey nor Argentina appear to count as casualties. In the Argentine case, it is because every IMF official has been through at least one Argentine default. The betting appears to be the U.S. and China will find some way to end the lunacy of the trade war; the interesting part will be watching how both sides will frame it as a victory when no one will believe it. The causal chain now is:

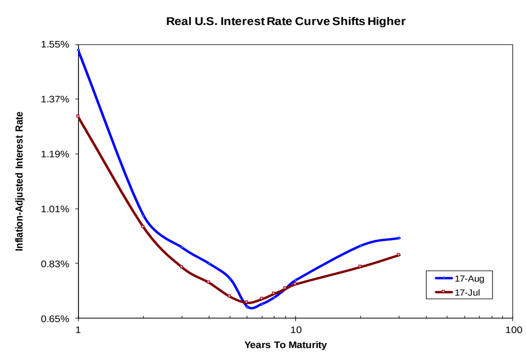
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations are declining very slowly;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue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

Key Market Indications

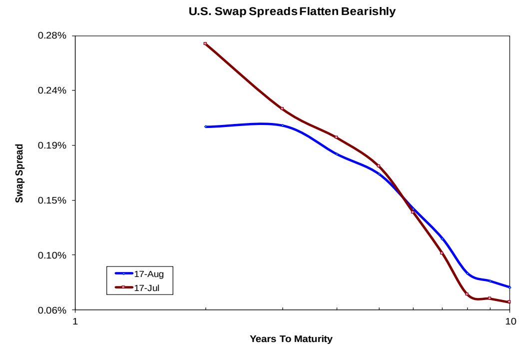
With all of the unrest in emerging markets and the sharp declines in commodities, the long end of the UST yield curve moved only slightly lower. It is hard to buy when the Federal Reserve is tightening credit and reported inflation measures are rising, but selling has not worked in an environment of rising global risk aversion and regulatory mandates to hold sovereign debt.



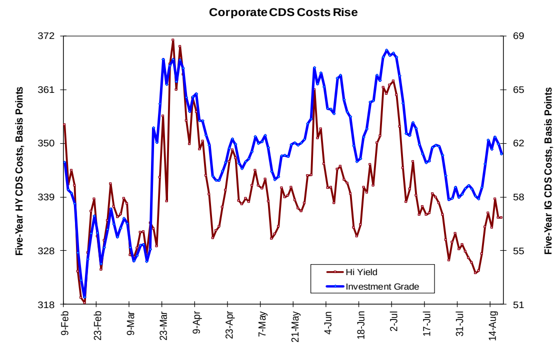
The pseudo-real yield curve rose at both the long and short ends of the yield curve. The continued rise at the short end remains a strong negative for precious metals.



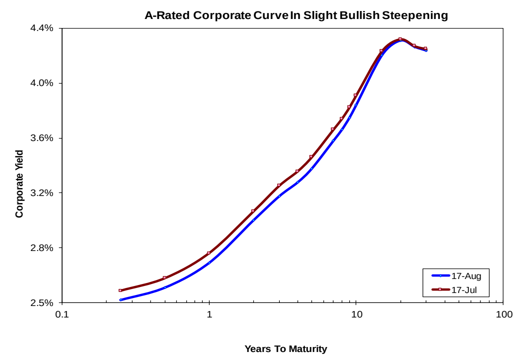
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined at the short end of the yield curve as the prospects for aggressive short-term interest rate hikes fade but moved higher at the long end of the yield curve. This reflects a strong split in borrowers' risk preferences.



The narrow range in CDS costs reflects the stall in equities more than anything specific to credit. The Turkey-induced selloff in equities had little follow-through and CDS levels started to drift lower by the end of the week.



The A-rated corporate yield curve steepened slightly as short-term borrowing costs fell. This market remains as confined as the Treasury market.



Market Structure

The main Bloomberg index and Softs entered downtrends; both metals subindices are headed in that direction as well. Nothing changed within the financials; the EM index is oversold now.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate August 20 - 24
BBerg	20	Trending	-0.127	9.3%	-0.13%
BBerg Grain	27	Trending	0.147	18.7%	0.94%
BBerg Ind. Metl	19	Transitional	-0.176	18.7%	
BBerg Pre. Metl	19	Transitional	-0.306	10.1%	
BBerg Softs	21	Trending	-0.391	14.1%	-0.26%
BBerg Nat. Gas	29	Trending	0.285	12.3%	0.23%
BBerg Petroleum	21	Trending	-0.118	17.9%	-0.15%
BBerg Livestock	17	Transitional	0.269	15.3%	
Dollar Index	29	Trending	0.182	5.4%	0.08%
S&P 500 Index	15	Transitional	0.067	7.9%	
EAFE Index	29	Trending	-0.278	8.6%	-0.13%
EM Index	26	Trending	-0.428	10.3%	-0.15%
Ten-year UST (price)	29	Trending	0.114	3.4%	0.05%

Performance Measures

While both Grains and the economically unimportant Livestock subindices advanced, Energy, Softs and both Precious and Industrial Metals sold off sharply on worries about emerging market demand in general and Chinese demand in particular. As always, producers faced with lower prices and in need of USD will increase production to maximize total revenue as opposed to profitability.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.01%	-0.25%	-4.42%	1.71%
Grains Sub-Index	2.36%	5.07%	-4.12%	-3.05%
Corn	1.92%	2.89%	-5.85%	-8.61%
Soybeans	3.64%	3.40%	-15.87%	-9.40%
Wheat	1.92%	8.34%	14.19%	12.36%
Energy Sub-Index	-1.36%	0.60%	9.85%	23.04%
Petroleum Sub-Index	-1.91%	-1.90%	10.24%	37.19%
WTI	-2.39%	-3.17%	9.27%	38.32%
Brent	-1.38%	-1.42%	13.97%	45.91%
ULSD	-1.77%	-0.31%	10.58%	32.58%
Gasoline	-2.17%	-1.85%	4.91%	23.00%
Natural Gas	0.14%	8.19%	8.56%	-12.66%
Precious Metals Sub-Index	-3.16%	-4.70%	-11.73%	-10.55%
Gold	-2.82%	-4.38%	-11.83%	-9.19%
Silver	-4.30%	-5.76%	-11.38%	-14.72%
Industrial Metals Sub-Index	-3.97%	-2.84%	-14.59%	-5.55%
Copper	-4.18%	-4.51%	-18.47%	-12.10%
Aluminum	-3.57%	0.09%	-5.13%	-0.45%
Nickel	-2.50%	-0.41%	-1.05%	22.04%
Zinc	-6.07%	-6.75%	-31.40%	-20.88%
Softs Sub-Index	-4.17%	-7.63%	-15.40%	-17.72%
Coffee	-4.83%	-7.88%	-17.20%	-27.48%
Sugar	-3.38%	-8.31%	-24.82%	-27.42%
Cotton	-4.47%	-6.39%	6.67%	23.92%
Livestock Sub-Index	5.09%	4.46%	-4.42%	-0.65%
Cattle	1.53%	0.72%	-6.00%	2.02%
Hogs	14.55%	14.46%	-0.53%	-5.65%

Interestingly, both the commodity-linked CAD and AUD advanced while physical commodity prices fell; expected increases in short-term interest rates proved to be more important. Not all emerging market currencies fell; the MXN gained as the incoming AMLO administration is getting the benefit of various doubts.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.22%	-1.91%	-7.81%	-2.43%
Chinese yuan	-0.45%	-2.49%	-7.79%	-2.94%
Japanese yen	0.30%	2.15%	-3.54%	-0.84%
British pound	-0.07%	-2.79%	-8.94%	-0.92%
Swiss franc	-0.06%	0.43%	-6.66%	-3.29%
Canadian dollar	0.60%	1.00%	-3.83%	-2.90%
Australian dollar	0.15%	-1.03%	-7.58%	-7.25%
Swedish krona	-0.33%	-3.42%	-12.77%	-11.08%
Norwegian krone	-1.10%	-3.56%	-7.98%	-5.73%
New Zealand dollar	0.71%	-2.15%	-9.97%	-8.86%
Indian rupee	-2.10%	-2.26%	-8.47%	-8.56%
Brazilian real	-1.17%	-1.83%	-17.30%	-18.79%
Mexican peso	0.10%	-0.01%	-1.89%	-5.51%
Chilean peso	-2.30%	-2.51%	-11.28%	-3.64%
Colombian peso	-2.82%	-5.27%	-6.36%	-1.32%
Bloomberg-JP Morgan Asian dollar index (spot)	0.12%	-1.22%	-6.03%	-1.86%

To repeat verbatim from last week, 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	-0.01%	0.15%	2.05%	13.46%
North America	0.57%	1.43%	5.25%	19.07%
Latin America	-2.46%	-3.97%	-18.29%	-7.60%
Emerging Market Free	-3.68%	-4.22%	-13.15%	-1.20%
EAFE	-1.10%	-2.03%	-4.96%	3.31%
Pacific	-0.69%	-1.26%	-4.04%	6.61%
Eurozone	-1.75%	-4.89%	-6.97%	-0.64%

Both hedge funds and macro CTAs gained on the week, suggesting they were long the USD and short non-U.S. equities and physical commodities.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	1.74%	1.70%	-1.21%	3.85%
SocGen Trend	1.17%	1.05%	-1.80%	1.35%
SocGen Short-Term	0.87%	0.23%	-0.78%	1.22%
HFR Global Hedge Fund	-0.22%	-0.85%	-2.60%	1.46%
HFR Macro/CTA	0.63%	1.03%	-1.52%	1.61%
HFR Macro: Sytematic Diversified CTA	0.80%	1.56%	-0.84%	4.61%