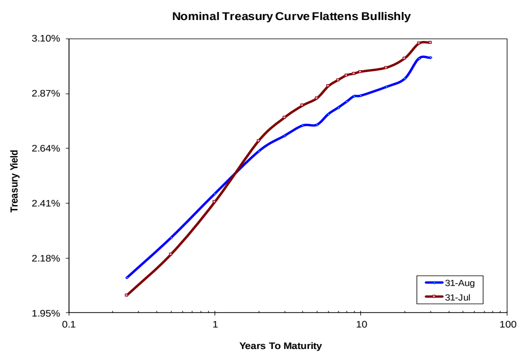
The Macro Environment For Financial Markets

Just when you thought the trade issue was on its way to resolution with a proposed agreement with Mexico, it reared its head again with China and showed no signs of dissipation elsewhere. If third quarter growth slows, something likely to happen as housing slows and consumer budgets start to feel the effects of tariffs, the Federal Reserve will have no choice than to signal an end to its rate hikes. The causal chain now is:

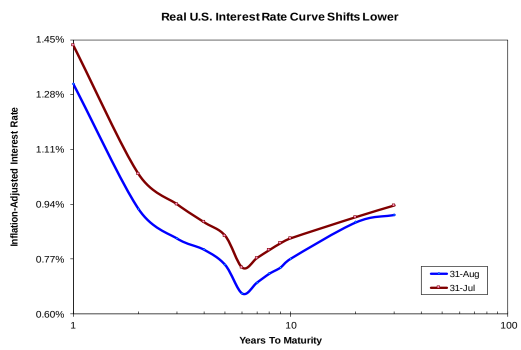
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations are declining very slowly;
3. The yield curve is starting to exit its secular flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap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

Key Market Indications

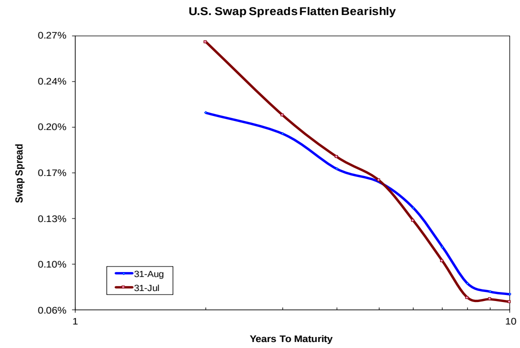
It is safe to say no one expected this narrow trading range in ten-year UST after the rise in yields over the winter. The credible forecast is inherently self-defeating. The trading range can continue at the long end of the yield curve while short-term yields are poised to move lower.



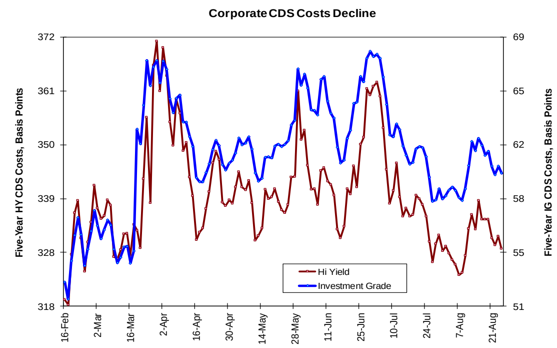
The pseudo-real yield curve declined bullishly. This will be positive for risky financial assets and will start to take some of the selling pressure off of precious metals.



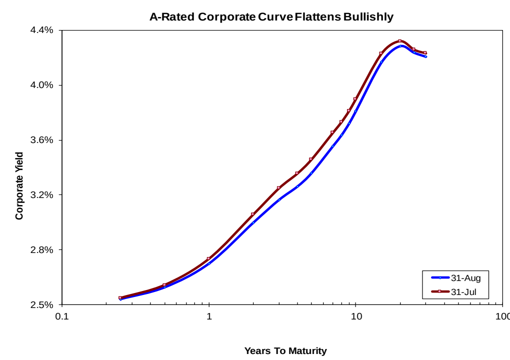
To repeat verbatim from the last two weeks, swap spreads, which rise when floating-rate borrowers want to fix their payments, declined at the short end of the yield curve as the prospects for aggressive short-term interest rate hikes fade but moved higher at the long end of the yield curve. This reflects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



The narrow range in CDS costs reflects the stall in equities more than anything specific to credit. A prospective end to rising short-term rates will reduce refinancing risks for floating-rate borrowers.



The A-rated corporate yield curve flattened bullishly. However, this market remains as confined as credit spreads are not declining and the declines in Treasury rates are minor.



Market Structure

Industrial Metals entered a structural downtrend within the physical commodities while Natural Gas entered a structural downtrend. The dollar index entered a structural downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate August 27 - 31
BBerg	22	Trending	-0.005	9.0%	-0.13%
BBerg Grain	29	Trending	-0.157	17.5%	-0.22%
BBerg Ind. Metl	21	Trending	-0.063	18.5%	-0.07%
BBerg Pre. Metl	10	Sideways	-0.029	8.6%	
BBerg Softs	4	Sideways	0.017	14.1%	
BBerg Nat. Gas	29	Trending	0.044	12.0%	0.12%
BBerg Petroleum	22	Trending	0.199	17.8%	0.07%
BBerg Livestock	29	Trending	0.194	14.4%	0.12%
Dollar Index	29	Trending	-0.030	5.2%	-0.14%
S&P 500 Index	29	Trending	0.244	7.2%	0.17%
EAFE Index	29	Trending	-0.049	8.5%	-0.13%
EM Index	29	Trending	-0.066	10.4%	-0.15%
Ten-year UST (price)	29	Trending	0.107	3.1%	0.05%

Performance Measures

Industrial Metals turned lower once again as trade tensions with China returned. The Petroleum complex moved higher as global inventories decline and production declines in Iran and Venezuela loom. The trade elsewhere was quiet, as befitting the last week of August.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.09%	-1.21%	-4.10%	0.13%
Grains Sub-Index	0.36%	-5.58%	-12.95%	-6.90%
Corn	0.66%	-4.73%	-11.94%	-9.29%
Soybeans	-1.33%	-6.36%	-22.97%	-15.42%
Wheat	1.72%	-5.44%	-0.58%	6.67%
Energy Sub-Index	1.19%	3.66%	15.57%	25.72%
Petroleum Sub-Index	1.68%	4.33%	19.52%	44.15%
WTI	1.52%	3.09%	17.66%	50.37%
Brent	2.02%	5.76%	24.12%	56.23%
ULSD	1.61%	5.42%	20.46%	33.18%
Gasoline	1.31%	2.87%	13.63%	22.61%
Natural Gas	-0.19%	1.83%	4.98%	-17.50%
Precious Metals Sub-Index	-0.90%	-2.37%	-10.17%	-12.34%
Gold	-0.50%	-1.19%	-9.60%	-10.12%
Silver	-2.27%	-6.30%	-12.11%	-19.11%
Industrial Metals Sub-Index	-1.66%	-2.16%	-11.21%	-8.90%
Copper	-1.87%	-3.92%	-15.37%	-15.74%
Aluminum	1.41%	5.34%	1.13%	0.76%
Nickel	-4.61%	-5.54%	-4.95%	5.76%
Zinc	-3.04%	-6.28%	-25.22%	-19.97%
Softs Sub-Index	0.68%	-5.33%	-16.54%	-19.97%
Coffee	-2.73%	-8.02%	-21.11%	-28.01%
Sugar	3.66%	-2.15%	-22.45%	-26.27%
Cotton	0.76%	-6.55%	3.69%	17.22%
Livestock Sub-Index	0.71%	-2.14%	-6.13%	-3.09%
Cattle	1.99%	-2.73%	-3.56%	0.84%
Hogs	-2.57%	-0.53%	-12.32%	-12.60%

Sharp declines in EM currencies continue, but they did not have the usual effect of pushing both the JPY and USD higher. The CHF was the unusual beneficiary; perhaps this is due to speculation the ECB will continue to push higher short-term rates further into the future.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.17%	-0.76%	-4.85%	-2.59%
Chinese yuan	-0.31%	-0.22%	-7.33%	-3.53%
Japanese yen	0.19%	0.75%	-3.92%	-0.95%
British pound	0.89%	-1.25%	-5.81%	0.23%
Swiss franc	1.51%	2.21%	-2.51%	-1.05%
Canadian dollar	-0.11%	-0.26%	-1.60%	-4.28%
Australian dollar	-1.91%	-3.17%	-7.38%	-9.54%
Swedish krona	-0.47%	-4.15%	-9.61%	-13.45%
Norwegian krone	0.14%	-1.90%	-5.00%	-6.68%
New Zealand dollar	-0.72%	-2.87%	-8.18%	-7.75%
Indian rupee	-1.53%	-3.45%	-8.20%	-9.98%
Brazilian real	1.22%	-7.35%	-19.92%	-22.34%
Mexican peso	-0.91%	-2.30%	-1.29%	-6.28%
Chilean peso	-3.23%	-6.76%	-12.96%	-8.19%
Colombian peso	-2.95%	-5.20%	-6.02%	-3.33%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.45%	-0.68%	-5.29%	-2.67%

The U.S. equity rally stalled on renewed trade tensions, but the Pacific markets rallied as China moved to slow the CNY's descent. Latin American markets followed their currencies lower.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.68%	1.16%	5.61%	13.36%
North America	0.90%	3.06%	7.95%	18.98%
Latin America	-1.10%	-8.33%	-18.32%	-11.49%
Emerging Market Free	0.60%	-2.68%	-9.95%	-0.32%
EAFE	0.28%	-1.92%	-2.17%	4.91%
Pacific	1.35%	0.09%	-1.53%	7.44%
Eurozone	-0.68%	-1.94%	-1.23%	1.06%

Both hedge funds and CTAs gained on the week, suggesting they captured the U.S. equity rally and perhaps the declines in EM currencies.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	0.35%	3.85%	1.25%	2.52%
SocGen Trend	0.29%	2.81%	-0.19%	0.66%
SocGen Short-Term	0.34%	0.96%	-0.52%	1.77%
HFR Global Hedge Fund	0.47%	0.49%	-0.43%	1.95%
HFR Macro/CTA	0.94%	1.84%	0.64%	1.13%
HFR Macro: Sytematic Diversified CTA	1.13%	2.42%	1.15%	3.65%