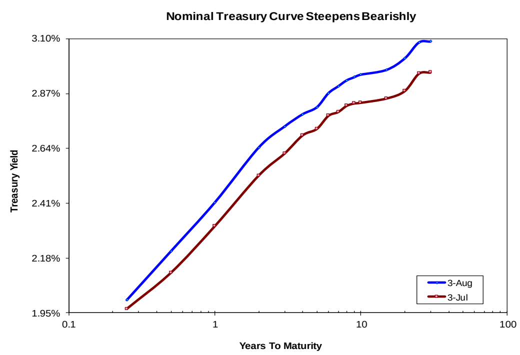
The Macro Environment For Financial Markets

When given a choice between stronger earnings growth and excess liquidity, equity markets tend to prefer excess liquidity. At present, however, stronger growth is winning the battle in the U.S. How long this situation will last before someone makes a huge policy error on either the monetary or the tariff front remains to be seen. The causal chain remains:

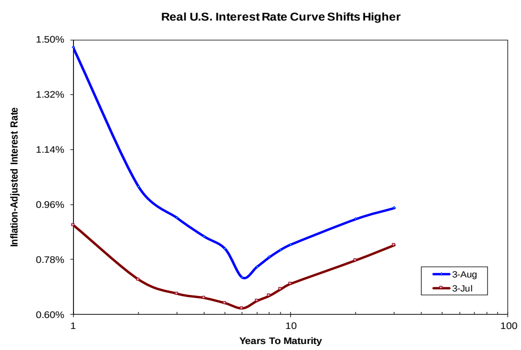
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve remains in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to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

Key Market Indications

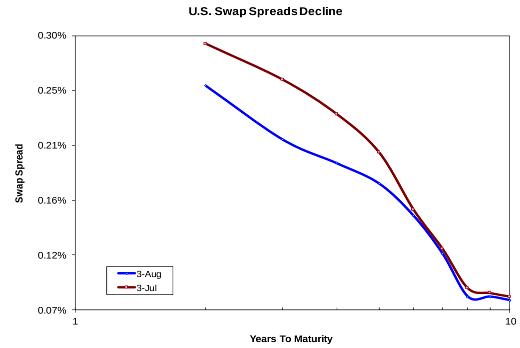
Economic data and central bank meetings were not enough to shift the long end of the UST market out of its narrow range. The yield curve continues to flatten and inflation expectations remain confined. A market that refuses to sell off given numerous opportunities to do so has some real underlying strength.



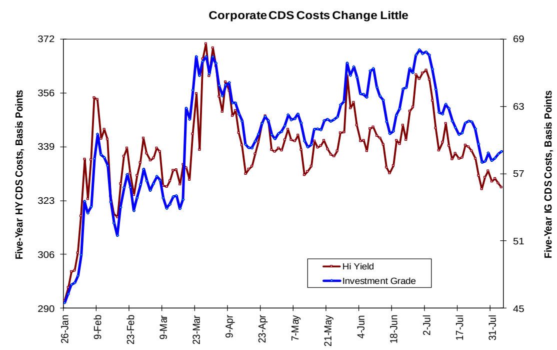
The pseudo-real yield curve rose across the maturity spectrum, especially at the short end of the yield curve. This is bearish for precious metals.



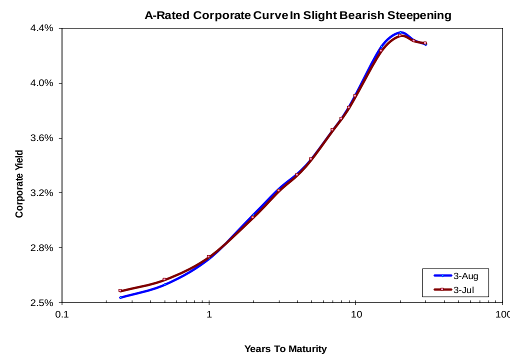
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined across all tenors but especially at the short end of the yield curve as the prospects for aggressive short-term interest rate hikes fade.



The narrow range in CDS costs reflects the stall in equities more than anything specific to credit. The continued threat to individual companies from trade disruptions has yet to affect the corporate bond market on an index level, but this threat is not going away anytime soon.



The A-rated corporate yield curve mirrored the bearish flattening seen in the UST market, but there is almost no capacity for a significant rally as credit spreads are unlikely to compress much further.



Market Structure

Only Grain is in a structural uptrend within the physical markets; both Livestock and Natural Gas are in structural downtrends. Within the financials, the EAFE and ten-year UST are in structural up- and downtrends, respectively.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate August 6 - 10
BBerg	12	Transitional	0.052	9.1%	
BBerg Grain	22	Trending	0.259	20.2%	0.94%
BBerg Ind. Metl	11	Transitional	-0.036	17.3%	
BBerg Pre. Metl	8	Sideways	-0.048	10.2%	
BBerg Softs	12	Transitional	-0.051	14.1%	
BBerg Nat. Gas	29	Trending	0.074	14.0%	-0.41%
BBerg Petroleum	18	Transitional	0.004	20.3%	
BBerg Livestock	29	Trending	-0.029	16.0%	-0.13%
Dollar Index	11	Transitional	0.101	5.2%	
S&P 500 Index	6	Sideways	0.080	9.1%	
EAFE Index	25	Trending	0.019	8.6%	0.31%
EM Index	19	Transitional	-0.030	9.7%	
Ten-year UST (price)	29	Trending	-0.133	3.4%	-0.04%

Performance Measures

U.S. grains are attractive on global markets, but the prospect of slower Chinese growth is pulling both Industrial Metals and Energy lower. Rising implied short-term real rates remain a negative for precious metals.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.11%	-1.37%	-2.84%	3.51%
Grains Sub-Index	3.14%	4.14%	-1.56%	-6.83%
Corn	2.18%	2.79%	-3.94%	-11.05%
Soybeans	1.96%	1.02%	-11.54%	-10.29%
Wheat	4.89%	8.12%	14.80%	2.68%
Energy Sub-Index	-0.38%	-2.24%	7.99%	24.66%
Petroleum Sub-Index	-1.34%	-3.33%	10.65%	39.17%
WTI	-0.25%	-4.16%	11.10%	40.39%
Brent	-1.90%	-4.24%	13.76%	48.67%
ULSD	-1.47%	-2.07%	8.90%	32.22%
Gasoline	-2.20%	-0.99%	5.77%	25.47%
Natural Gas	2.60%	1.12%	0.64%	-11.60%
Precious Metals Sub-Index	-0.60%	-3.38%	-8.46%	-4.60%
Gold	-0.73%	-3.31%	-8.83%	-4.23%
Silver	-0.16%	-3.63%	-7.21%	-5.77%
Industrial Metals Sub-Index	-1.33%	-2.51%	-10.74%	3.16%
Copper	-1.34%	-1.99%	-14.15%	-5.82%
Aluminum	-2.37%	-2.62%	-4.79%	7.03%
Nickel	-2.27%	-2.91%	1.14%	31.37%
Zinc	1.71%	-3.10%	-22.41%	-3.21%
Softs Sub-Index	-0.99%	-1.56%	-11.36%	-18.31%
Coffee	-2.41%	-5.42%	-16.04%	-29.62%
Sugar	-0.24%	-5.59%	-22.74%	-26.67%
Cotton	-0.21%	4.51%	18.05%	27.77%
Livestock Sub-Index	0.99%	-1.93%	-6.88%	-8.71%
Cattle	1.42%	2.97%	-2.67%	-4.39%
Hogs	-0.16%	-12.27%	-16.51%	-19.08%

Both the Bank of England and the Bank of Japan moved in a tightening direction and saw the GBP and JPY decline. The USD does appear to be running into resistance as the Federal Reserve is not going to risk global disruption by letting it strengthen too quickly, certainly not when the Administration is engaging in protectionism.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.76%	-0.77%	-6.46%	-2.54%
Chinese yuan	-0.20%	-2.70%	-7.83%	-1.61%
Japanese yen	-0.18%	-0.59%	-1.94%	-1.08%
British pound	-0.79%	-1.46%	-6.86%	-1.04%
Swiss franc	0.04%	-0.16%	-6.28%	-2.57%
Canadian dollar	0.49%	1.14%	-3.48%	-3.12%
Australian dollar	0.05%	0.24%	-6.02%	-6.87%
Swedish krona	-1.00%	-1.03%	-10.64%	-9.28%
Norwegian krone	-0.82%	-1.52%	-5.09%	-4.26%
New Zealand dollar	-0.68%	-0.18%	-7.17%	-9.29%
Indian rupee	0.07%	-0.06%	-6.63%	-7.18%
Brazilian real	0.12%	5.13%	-12.24%	-15.98%
Mexican peso	0.37%	4.85%	1.20%	-3.88%
Chilean peso	-0.01%	1.11%	-6.48%	0.98%
Colombian peso	-0.17%	0.55%	-1.70%	2.13%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.27%	-1.36%	-5.67%	-1.62%

Life is not fair, as evidenced by policy uncertainties in the U.S. leading investors to sell both EM and EAFE markets and to flee into U.S. equities.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.00%	2.06%	4.17%	12.20%
North America	0.80%	4.61%	3.82%	16.71%
Latin America	0.92%	11.95%	-10.76%	1.99%
Emerging Market Free	-1.67%	2.12%	-11.17%	3.62%
EAFE	-1.45%	1.89%	-4.60%	4.61%
Pacific	-1.87%	1.30%	-0.37%	7.50%
Eurozone	-1.55%	-0.40%	-1.12%	2.37%

Both hedge funds and CTAs again lost on the week. It is increasingly difficult to say why performance has been so bad other than to observe anyone trying to go short on bad news keeps walking into bear traps.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	-1.06%	-1.21%	-9.23%	0.89%
SocGen Trend	-0.88%	-1.02%	-7.56%	-0.49%
SocGen Short-Term	-0.40%	-0.93%	-4.48%	0.19%
HFR Global Hedge Fund	-0.27%	-0.35%	-2.79%	1.27%
HFR Macro/CTA	-0.40%	-1.22%	-5.03%	-0.33%
HFR Macro: Sytematic Diversified CTA	-0.25%	-1.02%	-6.82%	1.94%