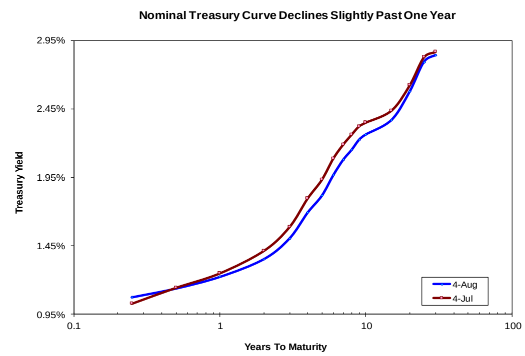
The Macro Environment For Financial Markets

Those complaining about low volatility should be careful what they wish for as indexation has created a large number of unintentionally crowded trades. When the time comes to sell, the question will be, "To whom?" In the meantime, we are in a global policy doldrum as central banks are uncertain about their next move and fiscal policy is in abeyance. Markets do not owe you a trend, but eventually they provide one. The causal chain remains:

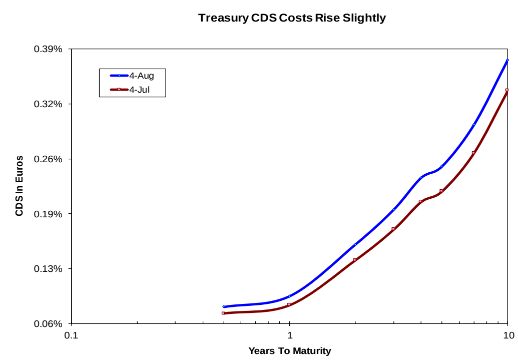
1. The market is pricing out expectations for another short-term rate hike in the U.S. in 2017;
2. Inflationary expectations have stopped declining;
3. The secular flattening trend in the U.S. is encountering resistance as expectations for higher short-term rates fade;
4. Short-term borrowers are close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

Key Market Indications

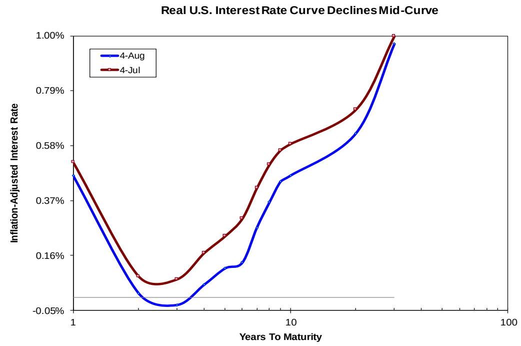
We entered 2017 divided as to whether the long-running bull market in bonds was over or whether it would resume. Very few said it would be boring, but that is what we have. The long-term holders of UST either must hold the assets for balance sheet reasons or they are not marked-to-market, and profit-seeking traders see little value in buying.



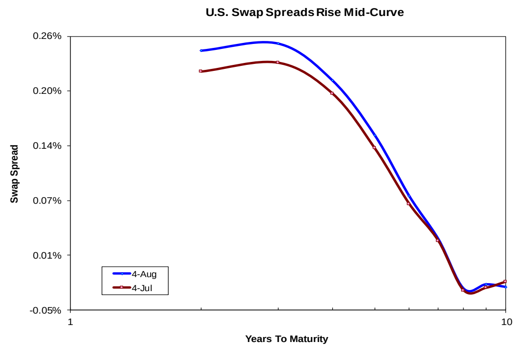
CDS costs on UST increased slightly over the past month. This market remains unconcerned about the U.S. debt ceiling. We are likely to see a bump higher sometime in September, though.



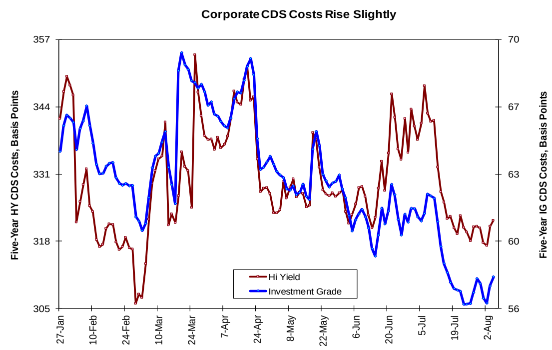
The pseudo-real yield curve declined across the maturity spectrum, with the strongest move at the mid-curve. The three-year remains negative. The shift is not as significant as it may appear as the market simply is pricing out some of its inflation protection taken out early in the year.



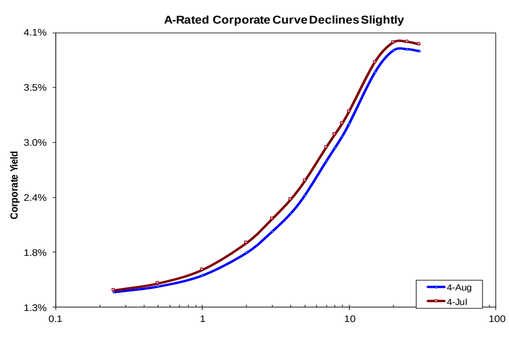
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose at the short end of the yield curve. The long end of the yield curve remains trapped in a range as it is dominated by very strong long-term holders.



CDS costs moved slightly 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. 7 - 11
BBerg	29	Trending	0.098	9.6%	0.07%
BBerg Grain	29	Trending	-0.156	20.9%	-0.52%
BBerg Ind. Metl	4	Sideways	-0.001	11.1%	
BBerg Pre. Metl	29	Trending	0.033	13.7%	0.20%
BBerg Softs	26	Trending	0.168	18.5%	0.26%
BBerg Nat. Gas	28	Trending	-0.245	20.2%	-0.21%
BBerg Petroleum	4	Sideways	0.018	22.9%	
BBerg Livestock	26	Trending	-0.052	14.7%	-0.56%
Dollar Index	29	Trending	-0.205	6.8%	-0.09%
S&P 500 Index	6	Sideways	0.024	4.3%	
EAFE Index	29	Trending	0.207	8.0%	0.19%
EM Index	6	Sideways	0.010	6.1%	
Ten-year UST (price)	9	Sideways	0.034	4.2%	

Performance Measures

Grains sold off strongly; I suppose the next rally will come with some harvest frost-scare. With the exception of Natural Gas' strong decline, other action was unremarkable.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.40%	1.89%	-4.82%	-0.05%
Grains Sub-Index	-4.00%	-8.73%	-6.81%	-3.30%
Corn	-2.05%	-6.55%	-5.91%	1.31%
Soybeans	-5.53%	-5.71%	-10.46%	-5.74%
Wheat	-5.44%	-14.93%	-3.09%	-8.21%
Energy Sub-Index	-1.35%	7.81%	-9.49%	-1.25%
Petroleum Sub-Index	0.11%	11.71%	-6.02%	7.35%
WTI	-0.24%	11.79%	-8.52%	4.38%
Brent	0.25%	11.04%	-7.84%	5.82%
ULSD	0.49%	13.47%	-1.33%	13.62%
Gasoline	0.05%	11.19%	-2.11%	10.69%
Natural Gas	-5.65%	-2.82%	-18.97%	-21.96%
Precious Metals Sub-Index	-1.28%	4.38%	-1.39%	-10.54%
Gold	-0.82%	4.02%	1.57%	-6.91%
Silver	-2.63%	5.45%	-9.20%	-19.46%
Industrial Metals Sub-Index	0.45%	5.43%	4.27%	19.67%
Copper	0.37%	9.08%	8.40%	31.46%
Aluminum	0.15%	-1.45%	3.28%	14.01%
Nickel	0.41%	14.84%	-1.75%	-5.80%
Zinc	1.26%	0.48%	-0.01%	22.28%
Softs Sub-Index	0.63%	5.43%	-19.68%	-18.46%
Coffee	1.69%	8.82%	-6.17%	-10.27%
Sugar	-1.58%	0.01%	-32.35%	-33.03%
Cotton	2.67%	3.05%	-5.11%	-7.77%
Livestock Sub-Index	1.13%	-2.29%	6.13%	11.15%
Cattle	1.51%	-0.69%	10.95%	10.65%
Hogs	0.43%	-4.67%	-1.47%	10.75%

The one-way decline seen recently for the USD ended as it gained against all of the majors save the EUR. The market has absorbed the obvious about the low probability of U.S. fiscal stimulus combined with further monetary contraction. Trade is likely to remain erratic through the remainder of August.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.19%	3.76%	9.52%	5.78%
Chinese yuan	0.12%	1.07%	1.99%	-1.29%
Japanese yen	-0.01%	2.34%	0.95%	-8.56%
British pound	-0.73%	0.93%	4.58%	-0.51%
Swiss franc	-0.41%	-0.74%	1.90%	0.14%
Canadian dollar	-1.68%	2.31%	3.47%	2.96%
Australian dollar	-0.81%	4.15%	3.42%	3.85%
Swedish krona	-0.33%	4.66%	8.31%	4.59%
Norwegian krone	-0.39%	5.18%	3.90%	6.24%
New Zealand dollar	-1.40%	1.65%	1.20%	3.29%
Indian rupee	0.90%	1.82%	5.72%	5.25%
Brazilian real	-0.01%	5.68%	-0.40%	1.97%
Mexican peso	-0.63%	1.73%	14.95%	5.69%
Chilean peso	0.56%	2.05%	-1.54%	0.93%
Colombian peso	0.46%	1.98%	-4.37%	3.22%
Bloomberg-JP Morgan Asian dollar index (spot)	0.07%	1.13%	1.89%	-0.40%

The U.S. managed small gains, but both the EAFE and EM indices posted stronger gains. As noted previously, the Eurozone can gain in the face of a rising EUR.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.42%	2.94%	11.08%	17.51%
North America	0.15%	2.17%	8.49%	16.56%
Latin America	1.21%	8.69%	9.96%	19.04%
Emerging Market Free	0.45%	6.51%	18.14%	25.05%
EAFE	0.88%	3.54%	14.25%	20.81%
Pacific	0.40%	4.43%	9.63%	17.44%
Eurozone	1.35%	4.52%	22.91%	29.95%

CTAs and macro hedge funds managed gains on the week, suggesting they gravitated toward the weaker USD trend. Global hedge funds declined, however.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.26%	2.01%	-4.15%	-11.91%
Newedge Trend	0.36%	1.82%	-1.79%	-8.79%
Newedge Short-Term	-0.01%	0.52%	-2.34%	-11.21%
HFR Global Hedge Fund	-0.10%	0.78%	2.46%	5.44%
HFR Macro/CTA	0.08%	1.06%	0.77%	-2.56%
HFR Macro: Sytematic Diversified CTA	0.45%	2.27%	0.20%	-5.53%