The Macro Environment For Financial Markets

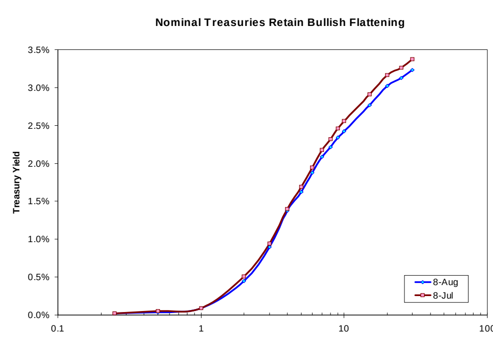
War! Huh! What is it good for? Creating volatility in markets and defining what may be long-term resistance levels in Treasuries and Bunds, apparently. If and when the news passes, as it either will or no one's market positions will matter at all, we will be left with slightly improving growth in the U.S. and deteriorating growth in the Eurozone. The stage will be set for the euro carry trade to offset the diminishing stream of excess liquidity in the U.S. Such a financial inflow will not be sufficient to produce gains in risky assets along the trend channel seen between November 2011 and July 2014, however, as that rally pushed credit spreads to extremes and made equity investors leery of valuations. If liquidity starts to move from financial assets to real plant and equipment, something not seen since the financial crisis, we will start to see a rise in the money supply and further hints of upward pressure on both short-term interest rates and long-term inflation expectations.

The causal chain is now:

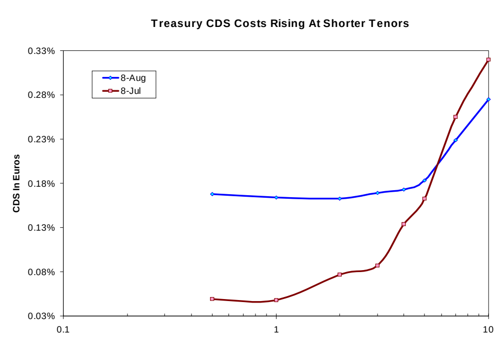
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve;
2. The longer-term uptrend in senior sovereign debt has hit a resistance point;
3. Inflation expectations as measured by the TIPS market will threaten the top end of their year-long range and must remain below 2.47% basis the ten-year. This expansion has been driven more by high demand for TIPS than by higher long-term nominal rates.
4. Short-term borrowers will continue to accept rollover risk and keep their effective maturities as short as possible;
5. Swap spreads will not revisit their recent lows for some time and will act to cap the corporate bond rally; and
6. Credit spreads have held support, as they should in the absence of either an economic shock a policy change, but are unlikely to revisit July lows unless an overt dovish monetary policy signal is given.

Key Market Indications

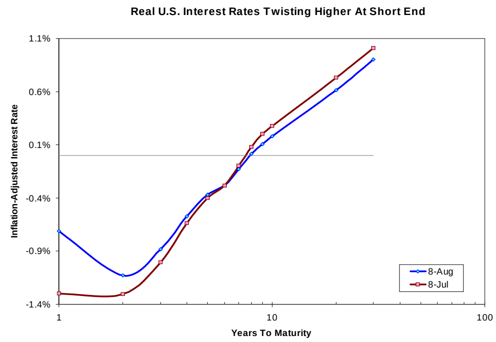
The bullish flattening of the Treasury yield curve pushed through into what may have been a bull trap by Friday morning. As this is and has been an extremely news-driven market, projections cannot be made with a great deal of confidence, but retreats to 2.50% and 3.35% on the ten- and thirty-year UST, respectively, are indicated.



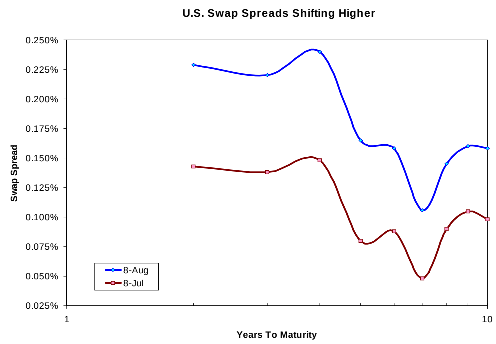
Euro-denominated CDS costs on U.S. Treasuries remain elevated at shorter-dated tenors. The market is pricing in future fiscal dysfunction in Congress, something that no doubt will increase if control of the Senate shifts after the November elections.



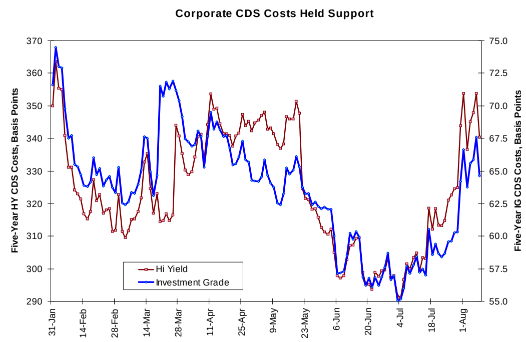
Real rates remain negative out to the seven-year horizon. The increase at short-dated maturities is a negative for precious metals. The decline at longer maturities is normally bullish for risky financial assets, but this factor is overwhelmed easily during risk-off periods.



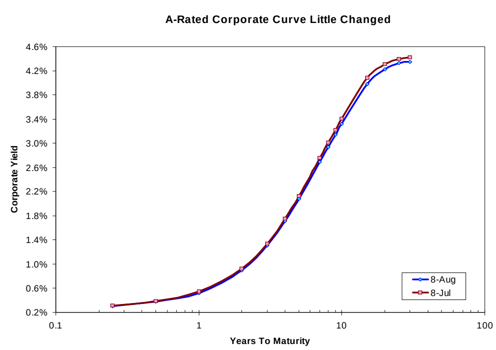
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to shift higher across tenors with greater increases occurring at the short end. This trend is a definite impediment to further compression in corporate bonds' credit spreads.



Five-year CDS costs for both investment-grade and high-yield bonds held support at the levels established during the previous week's Argentine default and indeed during April-May. However, until swap spreads start to decline or unless Treasury yields break through last week's lows, it is unlikely these CDS costs will revisit their July lows anytime soon.



The A-rated yield curve continues to move similarly to the Treasury yield curve. The resilience here is not being matched by high-yield bonds' yield curves; there an increased level of risk aversion has pushed yields higher at maturities of two years or less. While the present configuration is not significantly negative for equities, it is not the positive factor it was through July.



Market Structure

Livestock, Precious Metals and the two energy subindices remain in structural downtrends. The dollar index and ten-year UST moved into short-term consolidations. All of the equity indices are in structural downtrends, but these are unstable given the news-driven nature of the markets at present.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For Aug. 11 - 15
BBerg	5	Sideways	-0.054	6.5%	
BBerg Grain	8	Sideways	-0.023	14.0%	
BBerg Ind. Metl	5	Sideways	-0.055	11.9%	
BBerg Pre. Metl	20	Trending	-0.025	11.9%	-0.12%
BBerg Softs	27	Trending	-0.084	17.5%	
BBerg Nat. Gas	9	Sideways	0.122	20.3%	
BBerg Petroleum	29	Trending	-0.217	9.2%	-0.17%
BBerg Livestock	22	Trending	-0.449	13.4%	-0.34%
Dollar Index	5	Sideways	-0.004	4.1%	
S&P 500 Index	24	Trending	-0.177	8.4%	-0.28%
EAFE Index	29	Trending	-0.545	7.7%	-0.03%
EM Index	29	Trending	-0.287	6.5%	-0.27%
Ten-year UST (price)	12	Transitional	0.092	5.3%	

Performance Measures

Commodity subindices were mixed over the week with the largest declines occurring in economically unimportant Softs and Livestock. Short-covering pushed the previously weak Grains and Natural Gas up on the week. The performances of both Energy and Precious Metals were disappointing to those who reflexively view these as risk-off havens.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.19%	-3.80%	-0.87%	1.89%
Grains Sub-Index	1.22%	-6.42%	-11.70%	-12.55%
Corn	-0.20%	-11.66%	-22.12%	-27.06%
Soybeans	2.48%	-2.82%	-1.33%	12.38%
Wheat	2.79%	-1.27%	-7.79%	-19.96%
Energy Sub-Index	1.19%	-4.39%	-3.47%	6.71%
Petroleum Sub-Index	0.03%	-3.93%	-0.03%	1.45%
WTI	-0.28%	-5.04%	2.45%	0.98%
ULSD	0.39%	-0.39%	-4.23%	-1.24%
Gasoline	0.34%	-6.37%	-0.93%	0.31%
Natural Gas	4.29%	-5.55%	-11.39%	15.60%
Precious Metals Sub-Index	0.38%	-1.72%	2.58%	-0.80%
Gold	1.25%	-0.52%	3.67%	-0.15%
Silver	-2.11%	-5.10%	-0.53%	-2.29%
Industrial Metals Sub-Index	-0.01%	-0.91%	9.18%	5.32%
Copper	-1.26%	-2.54%	-1.32%	-2.80%
Aluminum	2.31%	3.92%	14.32%	1.58%
Nickel	0.80%	-6.32%	30.29%	27.43%
Zinc	-2.05%	0.33%	12.04%	16.88%
Softs Sub-Index	-2.90%	-3.66%	1.83%	-1.69%
Coffee	-5.97%	4.58%	27.74%	35.16%
Sugar	-1.28%	-8.71%	-7.20%	-15.69%
Cotton	1.49%	-8.40%	-20.52%	-23.29%
Livestock Sub-Index	-3.68%	-7.92%	6.72%	12.24%
Cattle	-3.85%	-4.00%	10.26%	16.64%
Hogs	-3.40%	-13.86%	2.80%	6.69%

The JPY and CHF resumed their role as risk-off instruments last week and rose along with the USD. Higher-yielding majors such as the CAD and AUD declined on this implied carry-trade unwindings, as did the Latin currencies. The EUR declined but remains resilient in the face of overt jawboning against it by the ECB.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.13%	-1.48%	-1.73%	0.22%
Japanese yen	0.56%	-0.46%	0.22%	-5.26%
British pound	-0.29%	-2.09%	2.26%	7.94%
Swiss franc	0.06%	-1.37%	-0.95%	1.63%
Canadian dollar	-0.52%	-2.68%	0.75%	-5.88%
Australian dollar	-0.40%	-1.32%	3.64%	1.87%
Swedish krona	-0.58%	-0.91%	-6.07%	-5.92%
Norwegian krone	0.56%	-0.75%	-1.72%	-5.28%
New Zealand dollar	-0.62%	-3.71%	2.35%	5.67%
Indian rupee	0.07%	-2.22%	2.11%	-0.46%
Brazilian real	-1.12%	-3.06%	5.54%	0.06%
Mexican peso	-0.50%	-2.01%	0.59%	-4.87%
Chilean peso	-0.39%	-3.91%	-3.54%	-11.72%
Colombian peso	-0.73%	-1.84%	8.53%	-0.67%
Bloomberg-JP Morgan Asian dollar index (spot)	0.05%	-0.17%	0.67%	0.09%

The risk-off trade ended in U.S. hours on Friday and saved the North American index from another negative week. A news-driven rally could continue, but there is no fundamental reason to expect the May-June rally to resume anytime soon.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.83%	-2.82%	6.47%	13.46%
North America	0.27%	-1.51%	8.74%	16.37%
Latin America	-1.56%	-0.53%	17.41%	7.81%
Emerging Market Free	-1.34%	-1.42%	13.69%	13.63%
EAFE	-2.44%	-4.72%	3.20%	9.34%
Pacific	-3.18%	-3.06%	7.21%	6.62%
Eurozone	-2.27%	-6.94%	-0.74%	10.52%

CTA's and macro-oriented hedge funds had a second consecutive negative week. This reflects their residual positioning for long equities. Winning positions in high-grade sovereign debt started to dissipate in the U.S. on Friday and may continue this week in the Eurozone unless someone really wants to buy ten-year Bunds under 1.05%.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-3.10%	-2.83%	4.68%	-1.54%
Newedge Trend	-1.89%	-2.24%	3.26%	-0.29%
Newedge Short-Term	-0.07%	-0.68%	-1.15%	1.79%
HFR Global Hedge Fund	-0.77%	-1.79%	0.25%	2.48%
HFR Macro/CTA	-1.18%	-1.24%	-0.44%	-1.71%
HFR Macro: Sytematic Diversified CTA	-0.80%	-1.56%	-2.56%	-1.97%