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ASSET MANAGEMENT

The Weekly Speculator

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Our week ended pretty much where it began, as far as the SPX index is concerned, closing at 2775.63, just 3.28 points above its level last Wednesday. Nor was this small move a reflection of large intraday moves cancelling each other out, with Wednesday's -0.40% decline the largest single session move. This session did of course have a burst of activity around the release of the FOMC statement, whose hawkish tilt caused a modest gain to turn into a measurable loss. Prior to this the index had reached 2791.47, the closest it has got to testing key resistance at 2800.

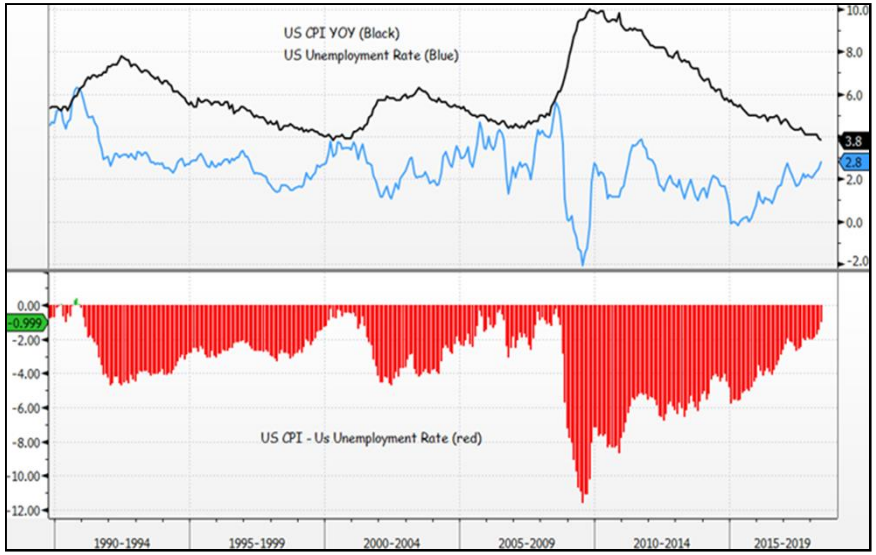
It is too soon to call Wednesday's reversal decisive, and it is not really surprising that the index found a reason to decline given the importance of resistance at this level. Even if the current attempt were to be result in failure the index has hung around the high 2700's long enough to eat into a good portion of the supply that we assume exists, although the attempt has also used a good portion of the cash generated from the prior liquidation and forced short positons to be trimmed considerably. We would there not be shocked to see another pullback develop if the index fails to quickly breach 2800 but support continues to climb quite rapidly with the 50 day ma now at 2697 and the 200 day at 2652, the latter being very much a "worst case" target.

Neither the NDX or RTY index were able to break out of the slothful mood of recent sessions, which can be ascribed in part to the unwillingness to jump ahead of Wednesday's FOMC meeting. This did at least prove to be a meeting that looks to have shifted both the policy rate and future guidance, with the majority of FOMC members now expecting 4 rate hikes over the course of 2018. This has been our position for several months, based on a belief that US economic data would be strong enough to shift the consensus of the Committee. With Unemployment matching the 2000 cycle low at 3.8% and CPI breaking out to a 6 year high at 2.8% and a host of other metrics showing similar trends of tightening labor markets and recovering inflationary pressures, it is hardly surprising that opinion within the FOMC has taken a more hawkish tone.

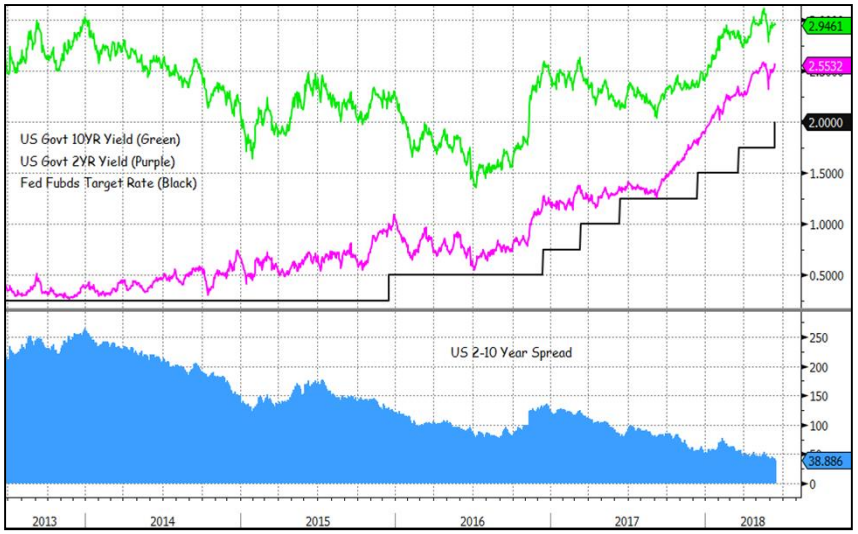
The actual shift in the trajectory of interest rates is of course quite small, but there is no mistaking the sense that the Powell era at the FOMC is starting to take on a quite different character from the Bernanke and Yellen eras that preceded it. Over the last few months the template language of the statement has been trimmed, and news conferences somewhat clipped. On the other hand Chairman Powell has indicated an intention to hold a press

conference after each meeting, which might add some clarity to guidance but has the effect of making all meetings "live" as far as expectations are concerned (it has generally been assumed that the FOMC will only change policy at a meeting with a press conference). This obviously is not in itself "hawkish", but it is different. We have described the Powell regime as being more "businesslike" than the Yellen regime, and although this could be taken as a compliment it is a somewhat more brusque style that may take some getting used to.

More important than the change in leadership style is the fact that the FOMC continued to be confronted with evidence that the US economy is starting to run hot. There is even the possibility that CPI will cut across the Unemployment rate in the months ahead, something that has not taken place since 1990 (although it came close to doing so in in both 2008 and 2000. The current gap at 100 bp is down from 430 bp when the FOMC started to hike in December 2000. Although we do not ascribe to a straightforward Phillips curve tradeoff between these measures, inversions between the two are a pretty reasonable signal that something has gone wrong with the administration of the economy.



At the same time that economic data is calling for more aggressive tightening the yield curve is warning of the risk of inversion. Wednesday saw the 2-10 year spread close below 40 bp for the first time and all major spreads with the exception of the 1-2 year are currently at or very close to their cycle lows. As we have discussed before the yield curve is being compressed by the unwillingness of the 30 year bond yield to move above 3.25%, despite the buildup of inflationary pressures. Wednesday's FOMC statement makes it clear that the short end is priced realistically and can be expected to continue to move higher over the summer months.



At the current pace of flattening an inverted curve could be generated at some point in Q4 2018. It is too early to worry about such an outcome, and there is still plenty of time for the 30 year bond yield to break higher and make room for other yields to follow, but once again we find ourselves watching a central bank edge towards the classic late cycle dilemma of whether risking policy that is too loose or too tight. We suspect that the Powell style of leadership is more likely to result in the latter outcome but it remains to be seen if we are correct.

S&P 500

The SPX has been clawing its way higher over the past four trading sessions although yesterday's -0.40 bps selloff ameliorated a good deal of the gains. The large cap index has been quietly eating through overhead supply although the attempt has also used a good portion of the cash generated from the prior liquidation and forced short positons to be trimmed considerably. As we said last week the current advance from support at the 200-day ma has been much more orderly than the failed March rally and a break above that key level (2,800) would likely force the hands of people who have been on the sidelines for the past four months into the game. Even though the rally has not been as sharp as was the initial move at the start of last month MACD is still tracking higher in positive territory and the 50-day ma is beginning to follow. We continue to mark first support at 2,700 and second at 2,680.

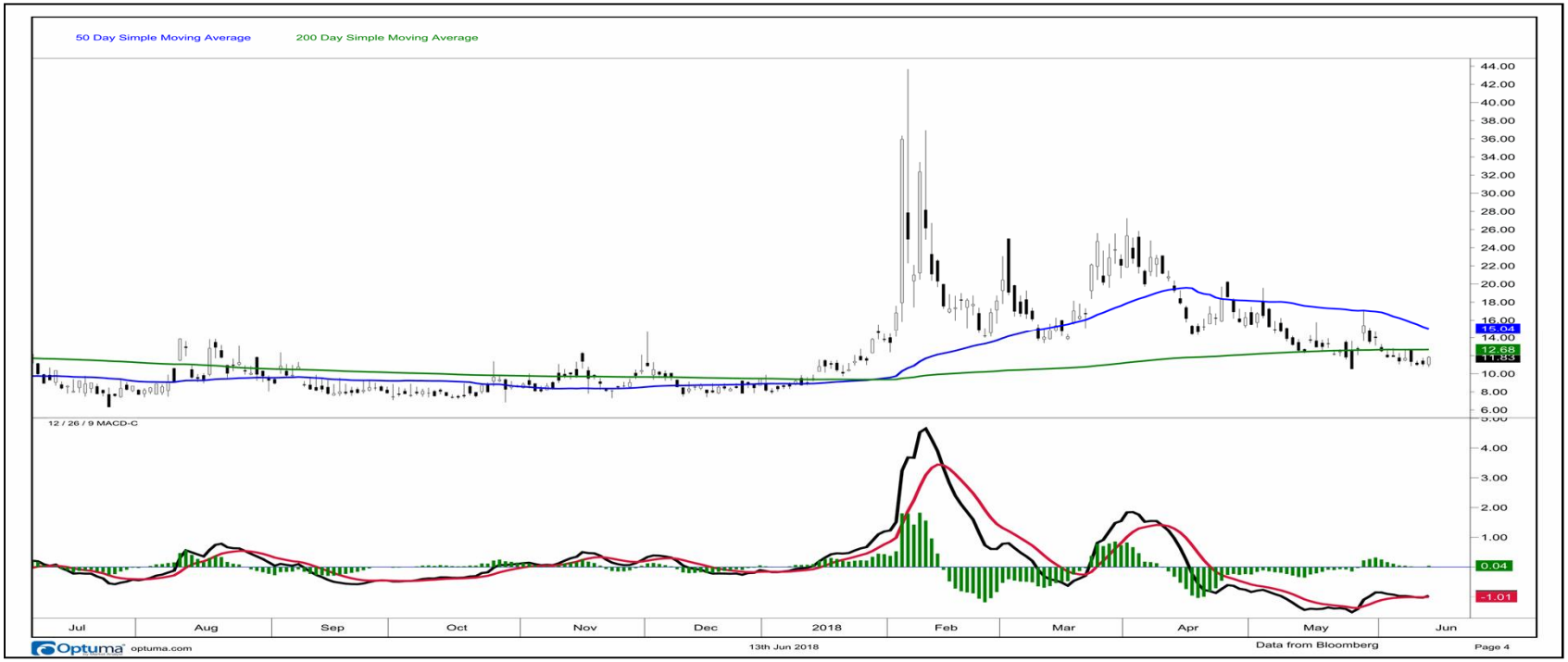
NASDAQ 100

After a brief and shallow pull back on Thursday and Friday of last week the bulls reasserted themselves and the NDX went on to mark a new intra-day high yesterday at 7,261.17 (this now marks short term resistance) before closing slightly lower on the day. Since the early May low the price action in the NDX has been constructive with each leg higher being followed by supportive backing and filling. After tagging its signal line at the beginning of the month, MACD is tracking higher in positive territory and is only a few good days away from confirming the new highs in price. We continue to mark first support at the 7,000 level and second at 6,750.

Russell 2000

Since the May 1st low the pullbacks in price in the RTY have been technically constructive. That trend has continued over the past Speculator week with the small cap index marking a new record closing high on Tuesday at 1,682.30. The index is a little stretched but we do not yet see a hint that upside momentum is waning and although MACD is flattening a little the momentum oscillator registered another high this week. The small cap index continues to target round number resistance at 1700. We continue to mark first support at 1,650 and second at 1,600.

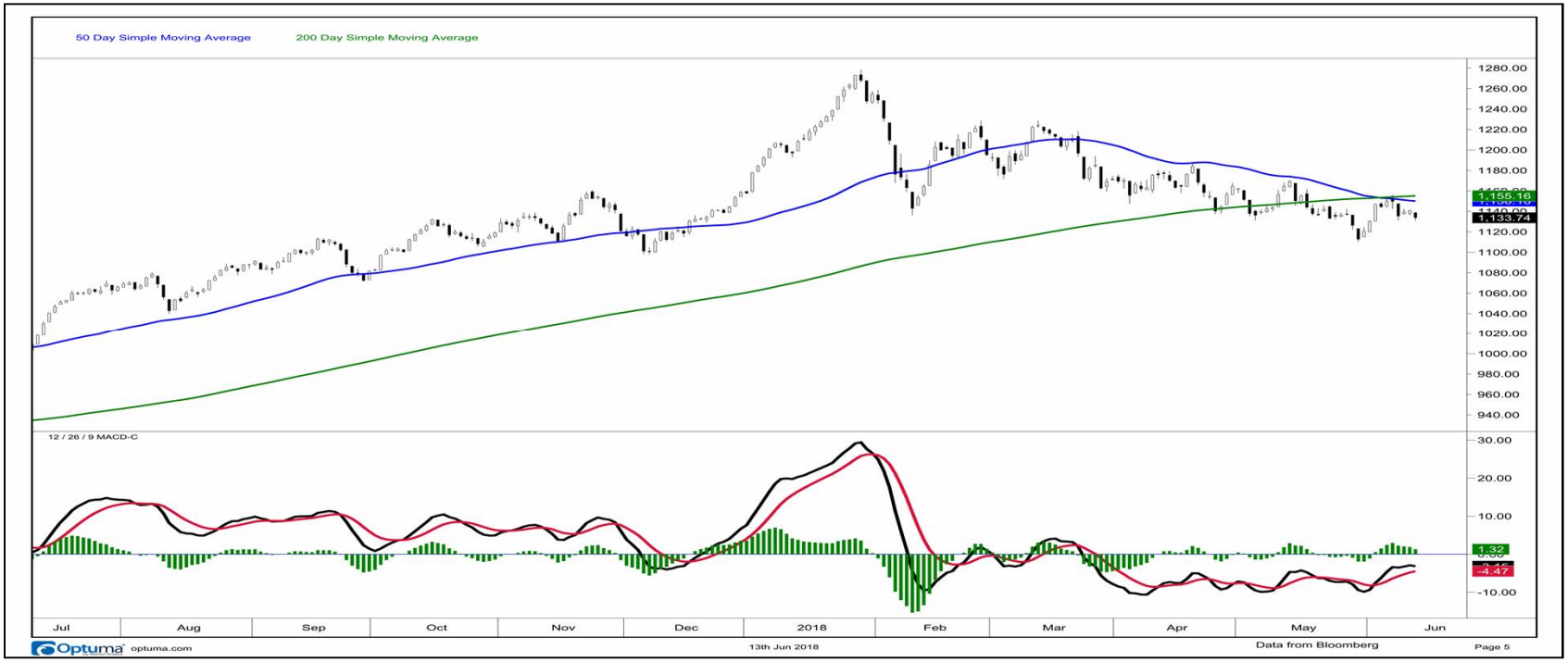
VXO



The VXO index spent the last week trading between 10.75 and 12.76, a range which is low enough to be consistent with a steady rise in the overall equity market but not low enough to signal a complete unwind of the effect of the steep correction that took place in the first quarter. We would note that the VIX index has been trading somewhat higher, reaching 12.94 at Wednesday's close compared to the VXO at 11.83, and this indicates that investors have probably been purchasing volatility products themselves rather than put options.

Overall the prices being paid for protection are consistent with a market that has not yet completely recovered from its sharp correction, but not really indicative of another leg higher in negative sentiment. 10 and 14 are the levels to watch for a measurable shift in the market's move, the former indicating a capitulation by the bears and the latter a move back into a corrective mindset.

Morgan Stanley Emerging Markets



On the day of our last note the short term rally in the MXEF was capped at the 1,150 level. That marked duel moving average resistance and the index has since pulled back. The MXEF still faces the headwinds of EM currency weakness which has crept back into the FX markets over the past few days. Although there has been a minor improvement in MACD the oscillator remains in negative territory. We continue to mark first resistance at 1,150 and second at 1,200. Key support remains at 1,100.

10 Year Treasury Note

The 10 year yield remains trapped between a rising short end and a 30 year bond yield that continues to show no intention of moving up to challenge key resistance at 3.25%. The Italy inspired downshift across the entire curve has been fully reversed by the 2 year note that notched a new cycle high at 2.60% on Wednesday straight after the FOMC statement was released, before trading back down to close at 2.57%, just below it May 16th closing high.

At the long end the story is different and 30 year yield has only rebounded to 3.09% and completely gave up its post FOMC spike by the end of the day. This only leaves a 52 bp gap between these yields with the 5 year yield almost exactly at the halfway point at 2.83% and the 10 year at the midway point between the 5 and 30 year yield. This is an unusually orderly state of affairs, but with the FOMC signaling its intention to keep marching higher the only way that it can be changed is by the long end of the curve breaking higher, something that it has not yet signaled a willingness to do.

US Dollar

After the sharp advance in the DXY that began in mid-April the index had become stretched and was set up for a pullback. Despite a three day counter trend rally the DXY has continued to drift lower and MACD continues to reflect the quiet loss of upside momentum. Even on a day when the release of the FOMC statement whose hawkish tilt should have propped up the DXY it closed lower on the day suggesting that the price retracement could extend lower. Saying that, we continue to mark first support at the 92 level and remain inclined to give the DXY bulls the benefit of the doubt unless that level is violated. We continue to mark first resistance at 95.

Gold

Gold has settled into a very narrow trading range since the middle of May and nothing of note took place in the last 5 sessions. We would consider the metal's non-response to the tightening of FOMC guidance as a minor plus, but not enough in itself to signal that its correction has run its course. The metal's price at $1299.32 remains exactly halfway between key support at $1280 and resistance at $1320 with any move between these levels being of limited significance.

Crude Oil

Crude oil futures have been able to build on last Tuesday's reversal and yesterday it closed at $66.65 in part bolstered by a larger draw down in crude oil inventories than was expected. The turn from that low last week and the move higher in price over the past 7 days has kept the trend of higher lows in place. MACD has begun to hook higher although it remains in negative territory. We now mark first resistance at $68 and move above would give give us confidence that the short term correction had run its course. On the other hand if last week's low is violated selling pressure could resume leading to a test of key round number support at $60, a level which has seen support strengthened by the 200 day ma.

Copper

Copper managed to record a marginal new recovery high on Thursday at $7348 but has spent the last 4 sessions consolidating these gains in a choppy fashion. Wednesday's close at $7257 keeps the metal close to its recent high but it remains unclear if we have simply witnessed a modest extension of the upside limit of the multi-month range or the start of a new leg higher for the post 2016 bull market.

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