MARKETFIELD
ASSET MANAGEMENT

The Weekly Speculator

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There are currently two competing forces at work in global markets. On the positive side is the evidence that this remains a strong and broad advance for the global economy with aggregate demand for goods and services reaching a new cycle high and export activity in particular remaining strong enough to indicate no material deterioration in recent weeks. All of the above suggests that this will overall be another very strong earnings season not just in the US but elsewhere. This remains the dominant force as far as the US equity market is concerned, with the SPX index managing to test key resistance at 2800 this week, the NDX test its all-time high and the RTY index briefly record a new one. Thus overall the US equity market remains range-bound, but is somewhat nearer to breaking out than breaking down at the time of writing. Key support for the SPX remains at the 200 day ma (now 2677) and the index deserves the benefit of the doubt above this level.

At the same time geo-political fears in general and the increasingly robust trade dispute in particular have generated enough concern to overwhelm many foreign markets, especially emerging markets where currency weakness has also contributed to losses. We had expected this force to dominate allocations made at the half-year point, and the late June plunge was accompanied by flow data that showed very substantial repositioning by investors. As is often the case this then reversed quickly in early July, with powerful gains being registered in many of the markets that had been most under pressure.

Unfortunately before this recovery could repair more than a portion of recent damage, Tuesday's post-market release of $200 bln worth of new proposed tariffs against Chinese imports was announced. Not surprisingly this led to another bout of concentrated selling in international markets and a smaller decline in US equities. The most violent losses were recorded in commodity markets with crude oil declining over -5.0% and industrial metals particularly weak. However, although emerging market currencies were weak overall, the degree of decline was not as severe as we saw in much of June, and there were some pockets of relative strength, particularly in Latin America where Mexico's MEXBOL even managed to record a small advance.

Our view remains that however regrettable the trade dispute may be its potential impact is being significantly overstated by current market moves, many of which reflect the understandable wish to sell-out of positions that

have hurt portfolio performance. In some case this has probably been forced upon investors, with Wednesday's commodity market price action having the look of hurried forced liquidation. Wednesday's decline was broad and brutal, with the Bloomberg Commodity Index experiencing the largest once day decline since July 2015 at -2.70%. However, while the losses in commodity markets may be real, they are not reflective of a dramatic shift in underlying supply/demand conditions (as was the case in 2014 and 2011).

In emerging markets most of the economic data released in recent weeks has been on the positive side of expectations, with capital account and trade data being supportive in many of the countries that have experienced extreme FX weakness (Turkey is a key exception in this regard). And the quality of economic data means that we would also expect corporate earnings to generally be strong for the first half of the year.

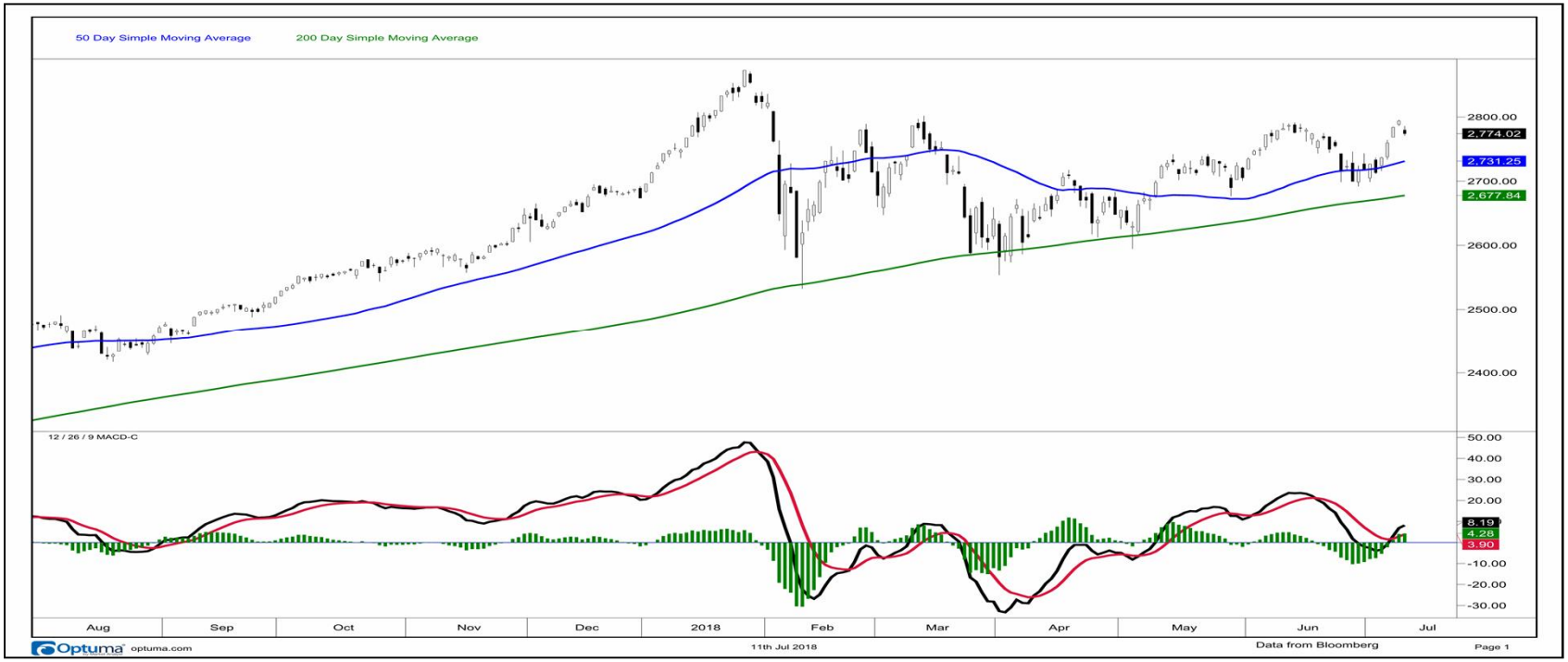
Of course none of the above would count for much if a trade dispute was to undermine the global economic cycle in the manner that market price action suggests may be the case. Fortunately this still seems to be an unlikely outcome. Far more likely is substantial shift in the sourcing of goods and services between the main protagonists (the US and China), be it China that is importing soy beans from Brazil rather than the US or the US buying televisions produced in Malaysia to give a couple of examples. This process may be chaotic, inefficient and potentially inflationary but it seems unlikely to lead to a collapse in activity across emerging markets or for industrial commodities.

The experience of the 1930's (a period notorious for the introduction of trade restraints) seems to us to be misleading, since aggregate demand had already collapsed before the restraints were put into place. No doubt they delayed a recovery further, but the situation is very different today with demand starting to outstrip supply in a number of key sectors. We would accept that for the time being the trade headlines will be in control of the markets, but the large declines experienced are starting to generate significant value and quite under-populated markets.

Liquidation of emerging market positions in late June approached levels only seen in the recession led bear market moves of 2008, 2011 and 2014/16, which to our eyes seems excessive. We would also note that Mexico and Russia both broke down well before the overall emerging market complex due to country specific issues. Both have subsequently managed to recover the majority of

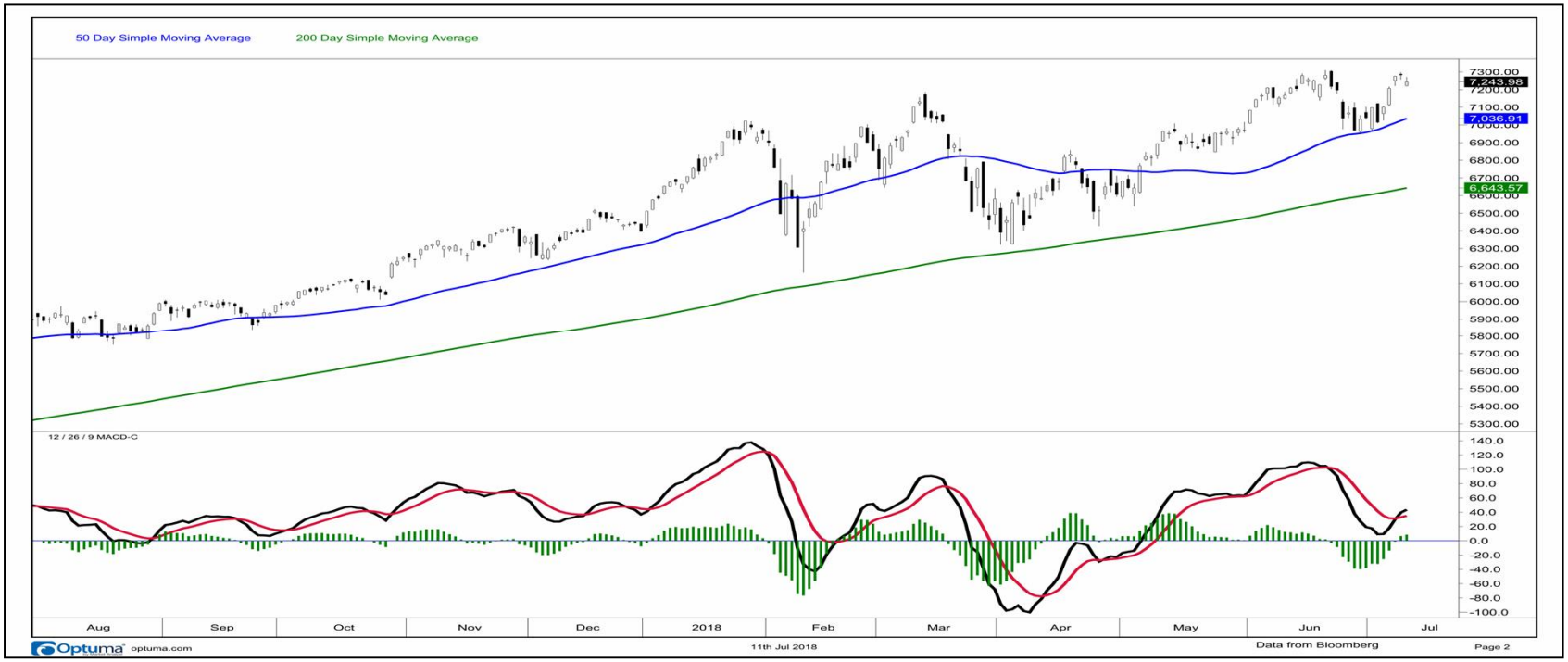
2018 losses. No doubt they are helped by relatively small index level allocations, but their strength in recent weeks is at least a reminder that rapid recoveries can take place after periods of violent decline in the emerging markets complex.

S&P 500



Since our last published note on the SPX two weeks ago the Index is up +2.12%. The large cap index established a short term base at a higher low above the rising 200-day ma and challenged first resistance at the 2,800 level on Tuesday. The SPX could not extend the rally the following day after Tuesday's post-market release of $200 bln worth of new proposed tariffs against Chinese imports. MACD briefly probed negative territory two weeks ago but the momentum indicator has recovered by re-entered positive territory and crossing above its signal line last week. We now mark first support at 2,700 and second at the rising 200-day ma which closed yesterday's session at 2,677.84.

NASDAQ 100

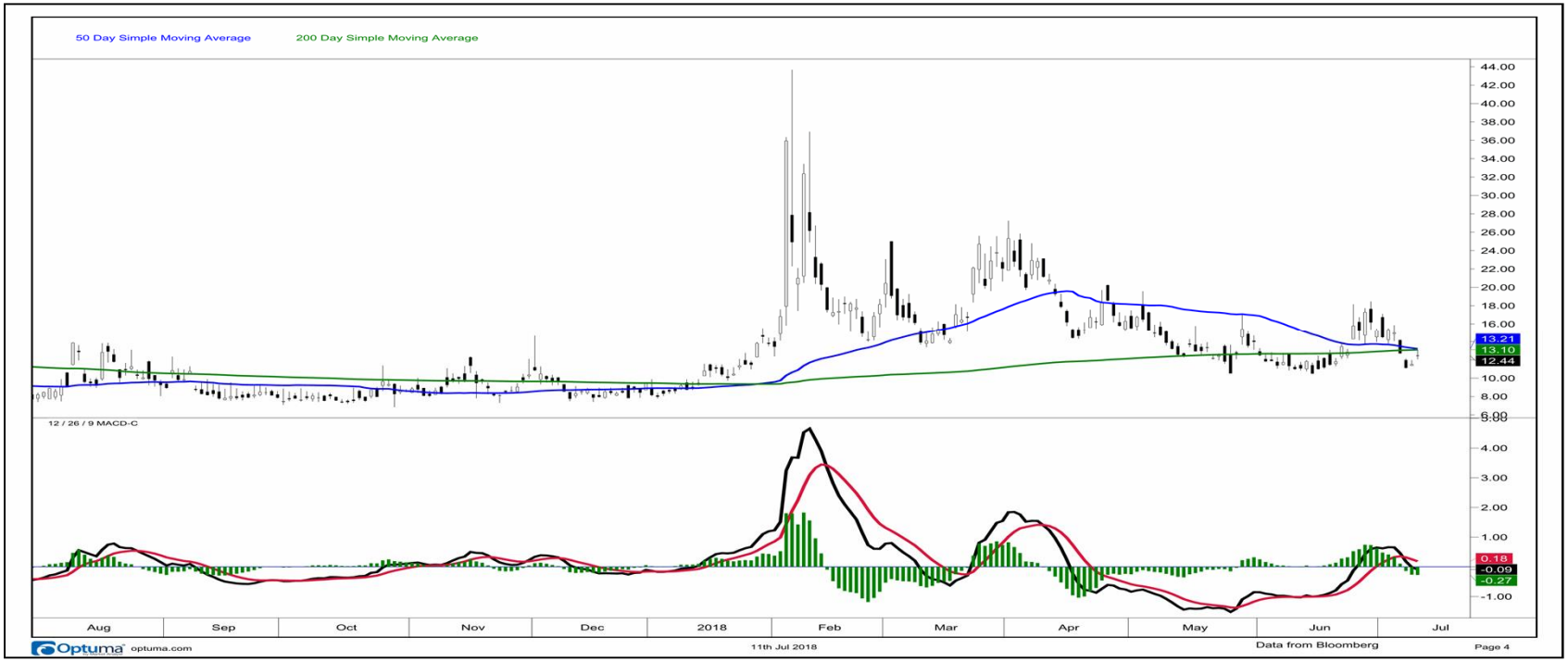


Since we last wrote on June 29th the NDX index is up +3.02% helped in part by strength in a number of issues in the index that are biotech companies (the NASDAQ Biotech Index was up +7.78% over that period). The 50-day ma has come into play acting as support as the index built its own short term base which acted like a launch pad last Friday and the index challenged its record highs on Tuesday. Like the other world equity indexes the NDX turned lower yesterday and was down -0.55% by the close versus a -0.71% sell off in the SPX. MACD never fell into negative territory like the SPX and it has crossed its signal line and is tracking higher. We now mark first support at the rising 50-day ma (7,036.91 at yesterday's close) and second the May 2nd low at 6,883.75.

Russell 2000

The first measurable correction in the RTY since early May found support at its rising 50-day ma. We had said in our last note that if the small cap index could hold support at 1,600 and resume its advance we would consider it a big technical win (it held 30 points above that level). The price action since finding that support held true to our words and rallied higher notching a new record intra-day high on Tuesday (1,708.56) before turning lower. Like the NDX, MACD avoided entering negative territory before hooking higher. We now mark first support at the rising 50-day ma (1,643.76) and second at 1,600. First resistance remains at 1,710 and a rally above that level will put the RTY in blue sky territory.

VXO



Despite the turmoil in many global markets the US equity market remains quite calm and this is reflected by the VXO index only rising to 12.44 at Wednesday's close and the late June sell-off never forcing the index above 20, a level which was breached in each prior period of declining equity prices in 2018.

At the same time we would acknowledge that the VXO has not looked comfortable below 12 since the market peaked in late January, reflecting the fact that the SPX index has not managed to clearly signal that it is back in full bull market mode by rising and staying above the 2800 level. In other words the VXO is consistent with underlying market activity and suggests that the mood of investors (at least towards the US market) is consistent with conditions being experienced.

Morgan Stanley Emerging Markets

During the two trading session following our last note the MXEF put in a short term bottom and after some backing and filling the EM index was able push a little high until yesterday when the index rolled over again. The MXEF will need to retake the ground above the 50-day ma for us to be convinced the we have witnessed a sustainable recovery. On a positive note Mexico and Russia, which both broke down well before the overall emerging market complex, have both managed to recover the majority of 2018 losses. If the other EM markets follow the lead the MXEF may have finally reached a point of being washed out. We now continue to mark first support at 1,020 and second at 980, which marks a 50% retracement of the rally from the 2016 lows.

10 Year Treasury Note

The 10 year note yield continues to trade in a very compressed range which is capped by the 30 year bond yield, currently at 2.95% and supported by the 2 year note at 2.58%. The former has been probing lower in recent weeks, dragged lower by weak global long term yields, while the latter is back at the high end of its range and is being nudged higher by FOMC guidance that now leans towards another two rate hikes in 2018.

With only 37 bp separating these two yields the 10 year's range of movement is considerably narrower than this extreme and the entire curve has a congested feel to it that can only be resolved either by a breakout of longer term yields or a clear change in FOMC policy. Neither looks likely to occur in the immediate future and so we would expect more of the same for the time being.

US Dollar

The DXY tried to overtake the 95.50 level for a second time but rolled over and for the first time in weeks it looked like the rally in the greenback was in for a deeper pullback then we have seen since the rally form the April lows. The DXY did pullback back but found support at around the 94 level and its 50-day ma on Monday and yesterday it rallied +0.60%. Despite the non-confirmation of the recent highs by MACD we are still are inclined to give the USD the benefit of the doubt. It may be that the momentum oscillator reflects a working off the overbought condition as the index tracks sideways in a consolidation pattern. This thesis relies on the DXY holding support at the June lows at 93.20. That said key support remains at the 92 level. We continue to mark first resistance at 96.

Gold

Gold has finally been sucked into the growing weakness in the commodity complex with the metal taking out support around the $1280 level and moving down to test support at the $1240 level, which effectively held back in December. A failure to hold this support level would set up a test of deeper support at $1200, which held both in September and March 2017. We do not believe that anything worse than this is on the cards, but the damage done in recent weeks for probably take some time to repair. It will require gold to rally back above $1280 to suggest that the sell-off has run its course, with the falling 50 day ma reinforcing the importance of this price level.

Crude Oil

Yesterday's -5.38% decline in oil as measured by the front month WTI futures contract was the worst one day drubbing in oil since March 8,2017. That was when oil was at $50 and was tracking sideways in long period of consolidation after the rally off the lows of the bear market. We had suggested that crude had gotten ahead of itself and was having difficulty advancing farther through the $74 level but yesterday's sharp reversal was more extreme than we expected but in our view the move is not reflective of underlying supply and demand conditions. We now mark first support at $70 and second at $64.

Copper

In our experience whenever one of our Speculator members becomes trapped in a long and tedious range something explosive takes place once it is completed. In copper's case it initially looked as if this would be a violent upside breakout, when the metal took off in early June to reach a 4 year high at $7348. However, the rally was short lived and by the end of June copper was testing the low end of its trading range. The metal's price has continued to bleed into July with Tuesday's tariff news leading to a particularly ugly session on Wednesday, with the metal closing at $6145, its lowest level since last July.

News reports suggest that much of the recent weakness has been caused by the forced unwind on a large levered fund in China, and certainly the size and speed of the decline is consistent with this outcome. Assuming that the selloff has not been completed we would look for support at $6000 to hold the metal. Despite the fears of what a trade dispute would bring, the current balance of supply and demand is supportive for the metal and we do not believe that the recent damage will prove to be permanent.

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Charts are courtesy of Optuma, data feed courtesy of Bloomberg Finance L.P.