MARKETFIELD
ASSET MANAGEMENT

# The Weekly Speculator

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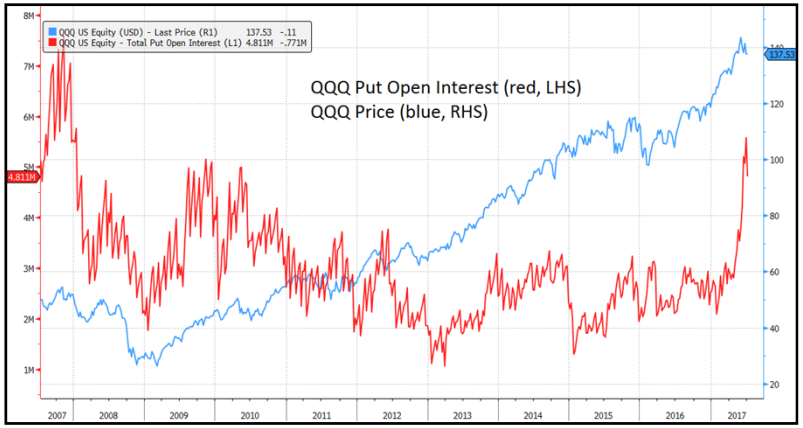
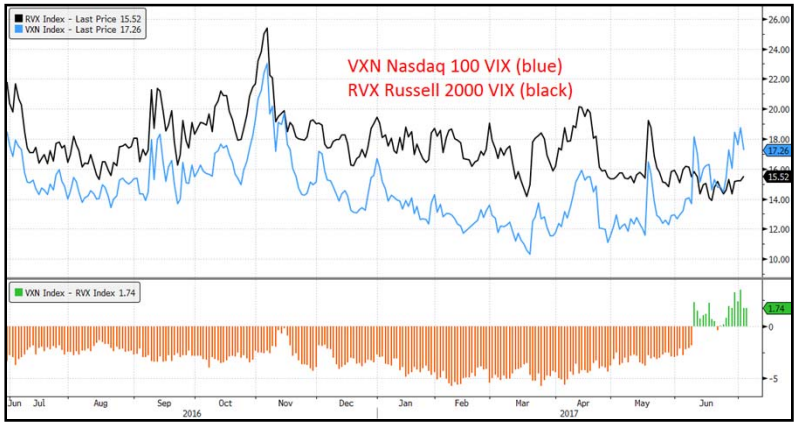
It has been an unusually short "Speculator week" since we last published although it did include the end of the quarter most of the re-allocation of capital would appear to have taken place before volumes trailed off at the end of last week. It is therefore unsurprising that little of note took place, although there were plenty of reminders that the placid nature of the overall market hides continuing bouts of local volatility in specific pockets. This is consistent with passive flows that remain positive in "broad index allocations" such as the SPX index or aggregate fixed income indexes while more active managers constantly rotate through countries, sectors and maturities in an attempt to generate positive performance.

Since making a new all-time high in early June the technology sector has been a loser in the rotation game, although it still managed to top the rankings for the first half of the year. There is some evidence that more than mere profit taking has been behind the decline and it is starting to look as if the technology sector has become the locus of "generic" hedging for equity exposure. Open put interest in the QQQ ETF (which tracks the NDX index) soared to 5.58 mln contracts at quarter end, the highest weekly total since January 2008. By contrast open put interest in the broader SPY ETF declined sharply, as did that in the IWM ETF, which has typically been used as the "go to hedge" in recent years.




Equally striking is the price paid for protection. The VXN index, which tracks implied volatility in NDX index options now trades at a substantial premium to both the VIX index, which follows the SPX index and the RVX index, which tracks volatility in the RTY index. The latter is extremely unusual, and in the 14 years of price history available to us has only taken place during periods of extreme volatility (2008 and the brief put powerful August 2015




sell-off) when pricing of volatility indexes tends to be very fluid. We have never before seen the VXN index trade above the RVX index during a period of modestly elevated volatility (the VXN has yet to close above 20, although it has spiked as high as 21.03 on an intraday basis) although we suspect that if pricing in the RVX index went back to before 2004 we would have seen similar instances in the 1999/00 period.

It remains to be seen if this is simply a brief interlude or a more long lasting shift in hedging activity. It is perhaps notable that since the initial crack took place the technology sector has been unusually correlated to longer term yields, generally declining whenever yields moved higher and advance as they declined. This is not normally a particularly interest rate sensitive sector, but it is possible that higher yields have encouraged a rotation into financial equities and that technology has been the most convenient source of capital. It is also possible that valuation driven models would seek to lower technology holdings as yields rise or that the strong outperformance of the sector in the first 5 months of the year encouraged some general profit taking.

From our perspective it seems quite important that the NDX index holds support around its current level of 5,648. Obvious round number support comes in at 5,600, and just below that at 5,568 where May's brief "impeachment" sell off terminated. Should the latter be breached then the risk of a quick move down to 5,400 looks real enough, and even though this would only take the index back to its level towards the end of April it would still have commentators rushing to employ the term "correction". We would not view a decline of this magnitude as terminal for the technology bull market, more as an example the inherent risks that come with the sort of dominance that technology has enjoyed. The sector would conceivably be able to repair damage of this magnitude quite quickly (by the end of summer) provided earning so no obvious sign of deterioration.

Of course it remains quite possible that the end of the quarter has effectively completed the majority of the rotation away from technology, in which case we would not expect to see the May low breached, which presumably would lead to an unwinding of some of the recent hedging activity.

As we mentioned above the sag of the technology sector has coincided with a backup of US and global yields. This looks to us to be a more long lasting development, and it seems quite likely that 2017 will follow the seasonal pattern of 2016 with yields bottoming in June and then rising through the remainder of the year. Unlike 2016, when Brexit led to a significant flight to safety, there has been no obvious political catalyst, unless you count the disillusionment of investors in Washington's ability to pursue any serious legislative activity.

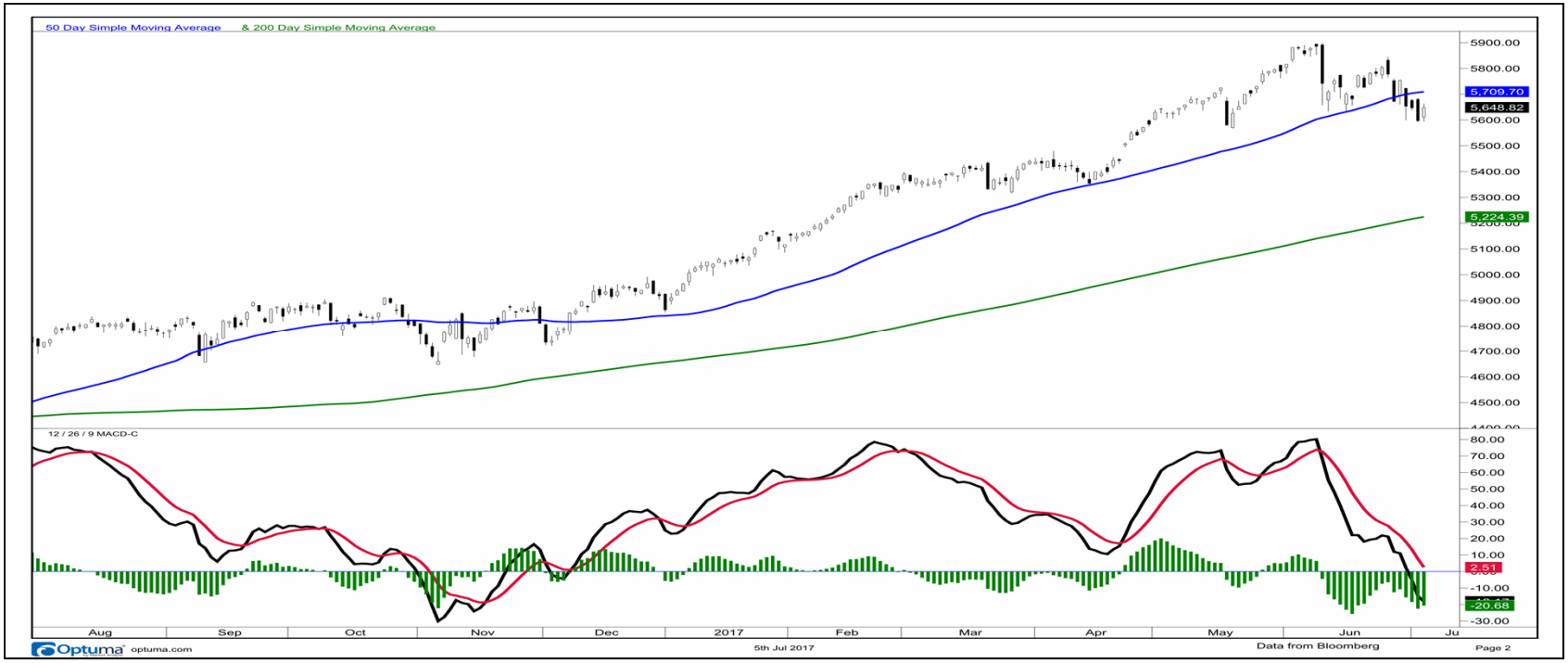
On the other hand the decline in global yields that took place earlier this year flew in the face of a significant amount of evidence that the global economy is finally enjoying a synchronous recovery in all its major regions, the first time this has been the case since the brief "V" shaped recovery of 2009/10. The primary reasons that yields continued to fall was the belief that most central banks would keep policies intact for a good while longer. However, the strengthening of labor markets (and to a lesser degree the recovery of inflation) has led to a reappraisal of the remaining lifetime for both asset purchases and negative interest rates. This seems likely to be one of the dominant themes for the second half of the year and although it is possible that this will be a smooth steady glide towards higher global yields it would not take much to deteriorate into a more global version of 2013's taper tantrum.

# S&P 500


Not much has happened to the technical condition of the SPX since we last wrote 3 ½ sessions ago but there are one or two technical features of note. On Thursday the large cap index tested support afforded by its 50-day ma and for all intents and purposes (despite a brief intra-day violation) support held and the index closed above the shorter term moving average. MACD remains in positive territory and is once again attempting to flatten out.

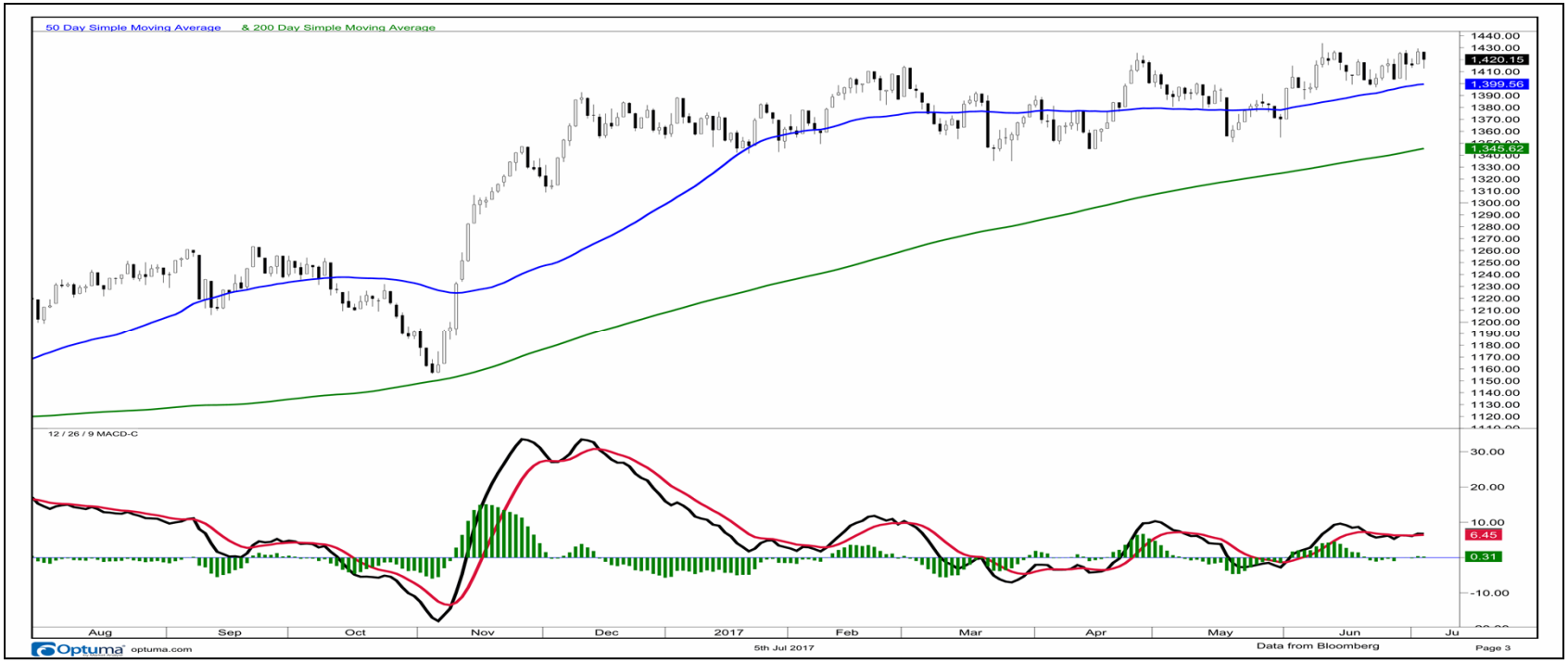
The index continues to churn sideways as sector rotation persists at an accelerated pace. We continue to believe that odds favor that the exit out of the consolidation pattern will be to the upside. That said, it will likely take a sustained thirty point move in either direction to get people excited about the broader index. We continue to mark first support at 2,400 and second at 2,350.

# NASDAQ 100




The NDX continues to have a difficult time shaking the nagging predicament of poor relative performance vs. the SPX that has plagued the index since early June. On Thursday the high tech index violated support the rising 50-day ma and although the index recovered a portion of its intraday loses the NDX closed below the shorter term moving average and has since been unable to retake the ground above it. MACD has entered negative territory and has gathered apace. Only if the NDX is able to re-take the ground above the lower high established on June 26th at 5,845.15 will we be able to say that the index is potentially out of the woods and that it has the ability to challenge the old highs. We now mark first support at 5,570 and second, worst case, support at 5,400.

# Russell 2000



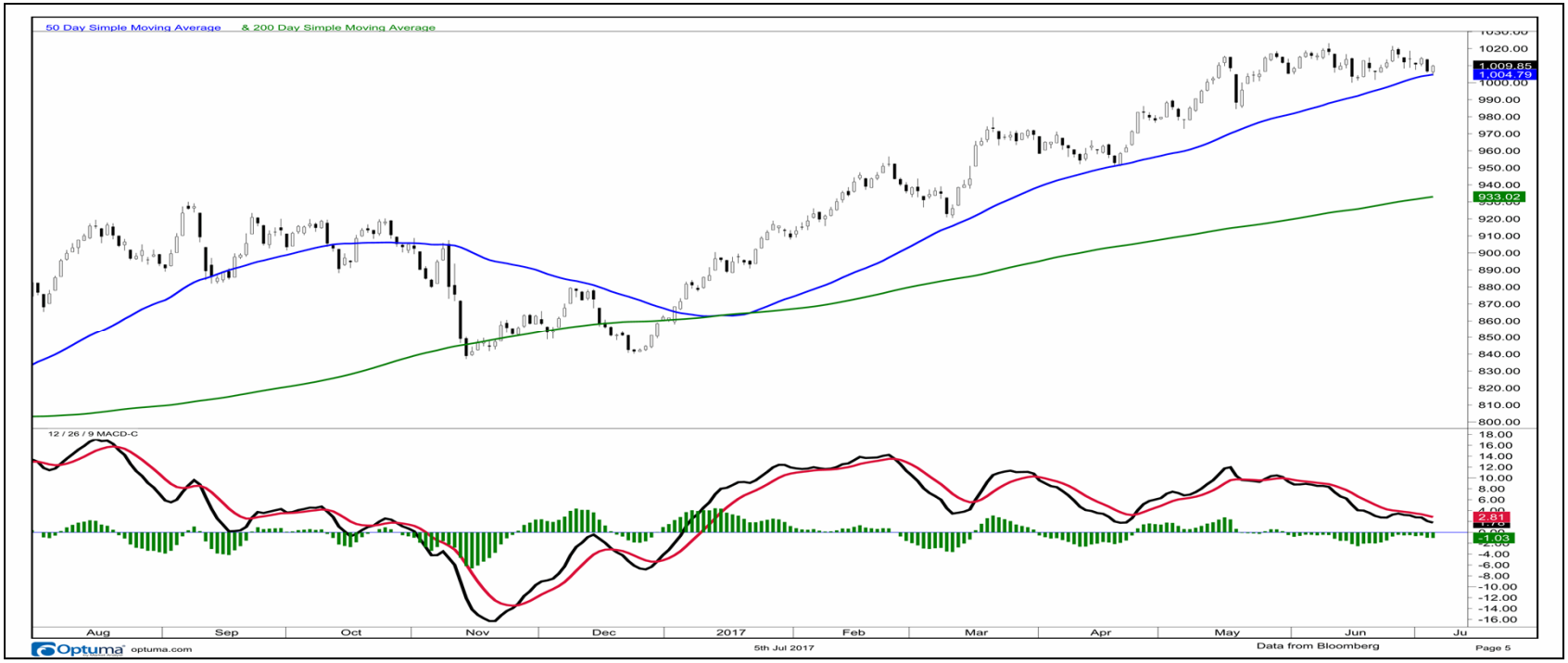

The RTY once again tested and held above important first support at the rising 50-day ma on Thursday. The small cap index is the closest to its intra-day record highs of the three US equity indexes we track in these pages. MACD is tracking quietly sideways in positive territory as the index continues to consolidate in the upper reaches of its 6 month trading range. We continue to mark first support at the rising 50-day ma (1,399.56 as of yesterday's close) and second at the confluence of support at the bottom of the longer term trading range and the 200-day ma at 1,350.

# VXO


Despite the recent spike of volatility in the technology sector little has changed as far the conditions in the overall equity market. The VXO index closed the quarter at 9.73, which is the second lowest quarterly close on record (June 2014 is the lowest at 9.56) while the trailing 12 month ma hit a new all-time low at 11.76. Despite a couple of spikes higher the VXO has rarely priced the 14 level in recent months and only the political confusion surrounding Brexit and the US election have pushed the index above 20 over the last 12 months.

We do not yet see an obvious catalyst for a change to the environment, although clearly there is a limit to the degree to which the volatility of the technology sector can diverge from that of the overall market. The back up in global rates could also conceivably have a role to play in forcing volatility higher, but at the present time we have no sense that an imminent change is likely.

# Morgan Stanley Emerging Markets




The MXEF has had a full five days of trading since we last wrote but the technical condition remains unchanged in that the index has continued to constructively consolidate its gains since the start of the year. The index briefly touched support yesterday at the rising 50-day ma but closed higher on the day. MACD continues to track lower in positive territory but the momentum oscillator remains in positive territory. We continue to believe that if the 1,020 level, marking the top of the range is surpassed, a measured move to 1,050 is obtainable. We continue to mark first support at 1,000 and second at 980.

# 10 Year Treasury Note


Despite the shortened trading week there was plenty of action in the long end of the treasury curve, with the 10 year yield reaching 2.355% on Wednesday morning, its highest level since the middle of May. Thus in little more than a week the 10 year yield has erased almost half of its December 2016 – June 2017 decline from 2.64% to 2.10%. We had set a potential target of 2.30% for the 10 year, and in the event this was met quite easily, with Monday's close at 2.35% and Wednesday a little below at 2.323%. Provided the recent move higher can survive Friday's employment report it would seem quite possible that a move back up to the top of the early 2017 range can take place over the summer.

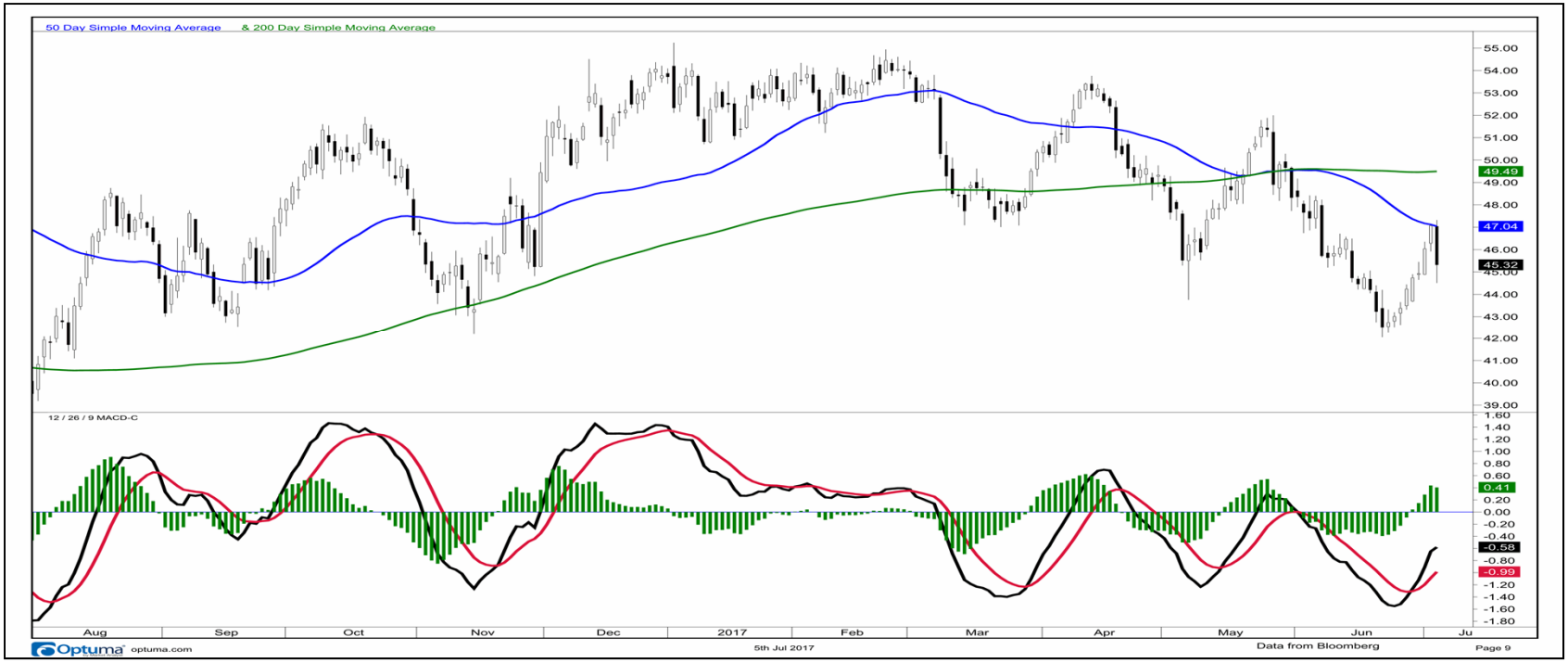
# US Dollar


Coming into the first week of Q3 we continue to see the DXY dominated by moves in the EUR. After plunging to a YTD low of 95.5 last week, the index proceeded to find some support at this point before going on to recapture the 96 level. With the current trend nonetheless tending toward weakness, the DXY would need to break past its 50-day ma in order for its six-month long trend of declines to stabilize. Should this not go on to be the case, we would look to the 94 level for the next big test of support .

# Gold


Gold continues to trade poorly, particularly when one factors in the weakness of the USD, and the metal failed to hold what we had viewed as useful support at the 200 day ma during an ugly start to the quarter on Monday. The metal has so far respected the May low at $1,214 but only has a 1% leeway given Wednesday's close at $1,226.98. Below this support level lied the January and March lows, the former of which at $1,180 represents last ditch support.

# Crude Oil




The continuation of crude oil's two-week long recovery rally came to an abrupt halt yesterday, in a session that witnessed a -3.42% plunge in price as the commodity found resistance at its 50-day ma. This once again serves us as a reminder of how prone crude has become to intraday volatility, but despite these large intraday moves, continues to remain range bound. We would continue to look to the 50-day ma for resistance, though with the commodity looking set to re-test the $42 level once again, our attention is for now drawn to the downside.

# Copper


Copper has gone on to make further gains since last week, benefiting in part from end-of-quarter flows. The metal then went on to find resistance at the key $6,000 level, as it has done several times over the past year. Despite this failure we would contend that the metal remains in a reasonably constructive technical pattern. Should prices find support at the $5,800 level in the near term, we would expect another re-test of the $6,000 level. A deeper pullback, on the other hand, will likely be held up by support at the 200-day ma.

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