MARKETFIELD
ASSET MANAGEMENT

The Weekly Speculator

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The SPX index continues to crawl towards its January high, closing Wednesday at 2857.70, just under 1% from its peak at 2872.70. Having come this far it would be surprising if the index did not now complete the task and record a new all-time high, in the process completing the corrective move for the record books. Whether or not reaching a new high will act as a magnet for new capital remains to be seen. Over the short term the index looks a little extended and may be due a pause, but seven months is a reasonably long time for a corrective period during a bull market and new highs that are recorded after a pause like this are generally rewarded with follow through. If this proves to be the case this time around the big round number at 3,000 can be assumed to be a viable target, and it is interesting to realize that it is a little closer to the index's current price than the 200 day ma (still bull market trend support) at 2706.

The biggest issue in our minds is whether a breakout by the US equity market will act as a spur to global markets or not. The vast majority of global indexes remain well below their 2018 highs, although most developed markets have at least recovered a good portion of their losses and both Canada's SPTSX and Australia's AS51 index have both already completed their recoveries. Perhaps surprisingly given the ongoing Brexit saga, the UK's UKX index is the next most likely index to break out, being within 2% of its own cycle peak, with France's CAC index a little further away (both indexes made their highs in May rather than January). Within Asian markets, Japan's NKY index looks to be the best positioned, but still needs to contend with what has been tough resistance at 23000.

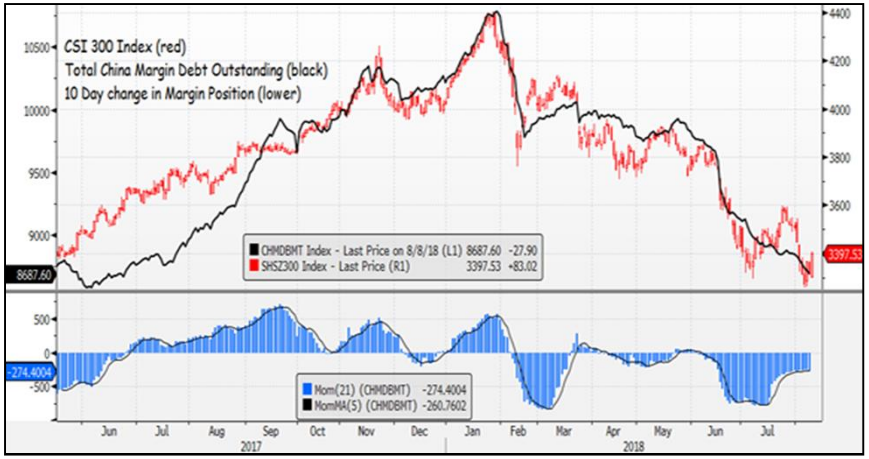
Most emerging markets of course remain far below their 2018 peaks, with China's local market still recording new lows (more on this below). However, the weakness is not universal. India's SENSEX has broken out to a series of new highs in July, probably reflecting its use as a haven from dedicated EM investors fleeing China and associated markets. Mexico has had a much longer trade dispute with the US, but of course looks much closer to a settlement and both the MEXBOL index and MXN reflect this. Although both remain below their 2018 peaks a USD investor in Mexico would have experienced a YTD return of 7.58%, slightly above that generated by the SPX index.

Taiwan's TWSE index has also generated a small positive return, which is interesting given the close relationship this market has with China. The index is roughly 2% below its January peak and continues to perform much

better than Korea's KOSPI index. This is quite unusual given that both markets are very technology sensitive and generally trade in a similar manner (see chart). Both countries are also US allies and have a complicated if ultimately symbiotic relationship with China. However, the Korean market has been much more sensitive to the US/China trade dispute, particularly since the start of the quarter. We doubt that this divergence will continue and so optimists should probably buy Korea and pessimists sell Taiwan.

This is just one example of the distortions that the reaction to the trade dispute has wrought on global markets. Given that this really is a new concern for most investors (it is 30 years since the US and Japan duked it out over trade) the lack of a cohesive market response is hardly surprising. To some extent it is governed by the degree to which a market is dominated by local or foreign flows (in most cases the former have been more stable), and the stability, or lack thereof, of the underlying currency has also been important in countries such as Brazil.

This brings us to China, which has of course experienced the hardest few months of any major market. There seems no doubt that fears of the impact of a trade dispute have had a major effect on investor psyche and there is plenty of evidence of significant investor repositioning. One obvious example is outstanding margin debt used for equities, which has declined from a January peak at 1.078 trln CNY to 871.5 bln CNY today. A corollary of this is the massive flows into local money market funds. China's 2 largest YTD ETF flows are both into money market funds, and together represent over 40% of all global flows into China focused ETFs ($11.2 bln out of $25 bln according to Bloomberg).



However, the trade dispute has not been the only factor at work in China, since the PBOC has spent the last few months restricting the shadow banking industry, which has itself been a powerful conduit of funds into Chinese asset markets. The central bank has attempted to counter this tightening with a looser policy for the regulated bank sector and corporate bond issuance. Thus funding has remained quite freely available for much of the country's underlying economic activity, and much less so for its financial markets.

Therefore when looking at the moves in China's equity and currency markets, how much one should ascribe to the trade dispute and how much to the PBOC's war on shadow banking is hard to say, but it is our belief that the second factor

has generally been underestimated in most commentary and analysis. This is quite important, since it implies that China may have the ability to reverse at least a portion of the weakness in its asset markets even without reaching a resolution to the trade dispute.

There have certainly been some signs that the PBOC is starting to run a significantly looser overall policy mix. This is most obvious when looking at short term interest rates, with 3 month SHIBOR dropping from 4.35% to 2.85% in less than two months. Even allowing for the volatility of SHIBOR this is an unusually sharp drop and unlike the 2015 experience has not taken place against a backdrop of significant economic deterioration. Of course this decline is partly a function of investor flight from risk assets and into cash instruments, but it does represent a significant change in local funding costs that is likely to filter through to both economic activity and investment markets eventually. Recent sessions have at least shown that volatility can work both ways. Over the last 5 days the SHSZ300 index advancing by 2.9% on Tuesday and 2.50% last night, while declining -1.6%, -1.3% and -1.7% on the other 3 days, for a small net advance of about 80 bp over this period.

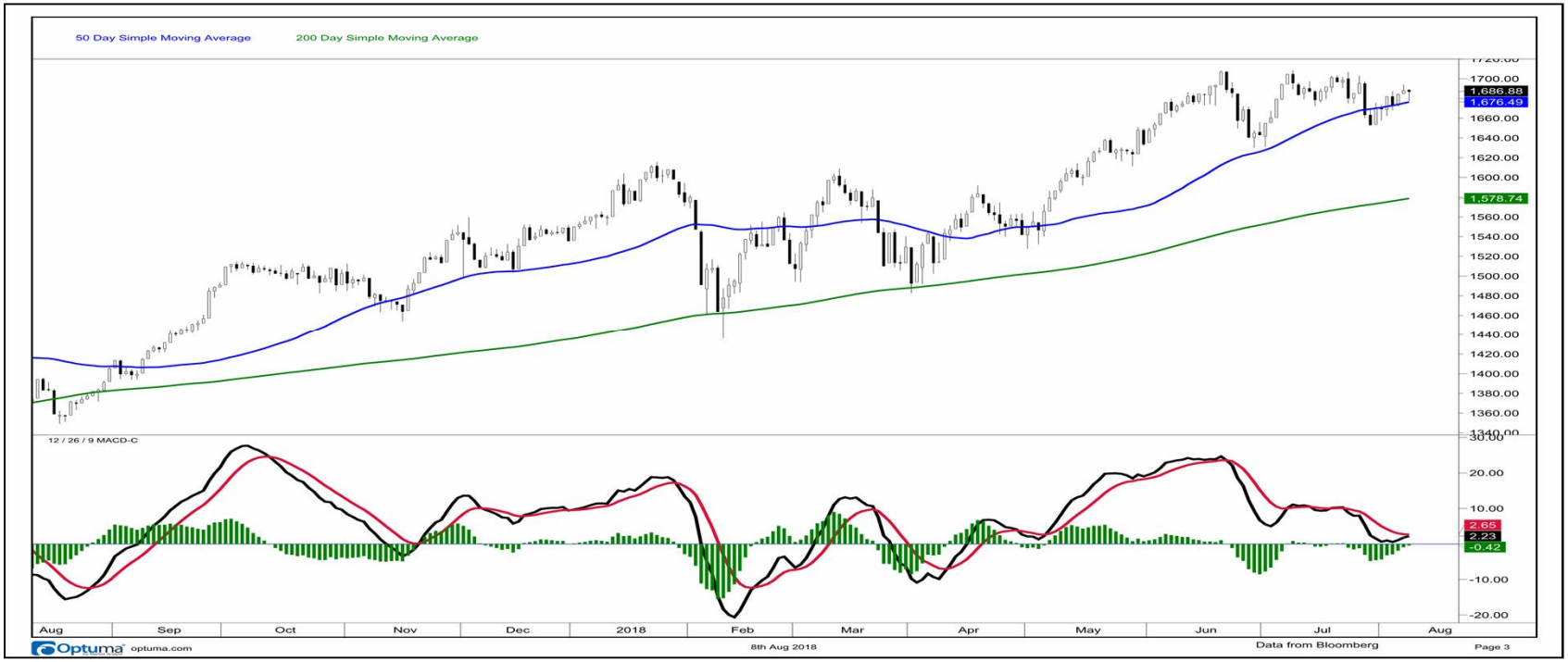
S&P 500

On the day of our last published note the SPX opened on the back foot briefly breaking support (the low was 2796.34 on Thursday) but the index re-took the ground above 2,800 quickly and by noon time the index turned positive. The intra-day reversal extended to higher levels with the SPX up +13.86 points or +0.46% closing at 2,827.77 producing a bullish outside day or an "engulfing candle" in technical jargon. The SPX has added to those gains and on Monday the large cap index traded above first resistance at 2,850 opening the door for a challenge of the all-time high at 2,872.87. MACD has crossed back above its signal line and the index closed yesterday's trading session at 2,857.70. We continue to mark first support at 2,800 and second at the rising 200-day ma (2,705.95 at yesterday's close).

NASDAQ 100

The NDX is up +2.70% versus a gain of +1.58% in the SPX since last Wednesday and the high tech index is closing in on the July 11th record closing high of 7,508.59. The rising 50-day ma proved to be reliable support once again and last Thursday the index lifted off from the shorter term moving average closing up +99.26 points or +1.36%. MACD has managed to turn at a higher low and is just crossing its signal line to the upside. We continue to mark first support at the 50-day ma (2,779.69 at yesterday's close) and second at 6,950.

Russell 2000



Even though the RTY has been able to re-take the ground above the 50-day ma and remain above it on a closing basis the past five trading sessions the small cap index continues to be range bound. As we stated last week the RTY has had a pattern of alternating out-performance and under-performance in recent quarters and the recent underperformance against its larger cap brethren has continued. MACD has temporarily stabilized at just above neutral and continues to offer little clue as to which way the now almost "coiling" price pattern will be resolved but our sense is that if the other two US equity indexes we track in these pages make new highs the RTY will likely be dragged higher to new highs. The 50-day ma (1676.49) is key support and second is at 1,600.

VXO

The VXO index has managed to record three consecutive closes in single digits and this to our eyes is enough to finally complete the volatility episode that began back in January. This does not of course rule out another surge higher, but we would be inclined to treat this as a new episode rather than a continuation of the disturbance that took place in the early part of 2018. We would note that the VIX index continues to trade somewhat higher, remaining above 10 and indicating that direct purchasers of volatility remain willing to pay slightly more for protection, but the spread between the two measures no longer looks abnormally wide.

Arguably the only anomaly is the VXN, which remains quite elevated at 14.83, above the RVX (which tracks the RTY index) at 13.78. Looking at the gains to date by many technology companies the willingness to pay a little more for protection looks reasonable enough, and even this measure reached a 7 month low at Wednesday's close.

Morgan Stanley Emerging Markets

The MXEF slipped lower last Thursday but managed to hold at a higher low and since has edged its way back to key resistance at the 50-day ma. MACD has stalled at just below neutral but has not violated its signal line and the momentum oscillator is curling slightly higher. The MXEF needs to move above its shorter term moving average to suggest that the six month correction may have run its course but only a move through the 200-day ma which also marks a 50% retracement level of the selloff from the January highs would allow us to declare an "all clear". We continue to mark first support at the June lows at 1,040 and second at 980.

10 Year Treasury Note

The 10 year note yield traded in a very narrow range between 3.00% and 2.92% over the last five sessions with Wednesday's close coming exactly at the midpoint at 2.96%. In other words nothing was resolved over this period despite the publication of some key economic data. The 30 year bond yield acted in a similar manner, with its range between 3.06% and 3.15% and a close at 3.11%. We view 3.15% as a realistic target, above which much more important resistance at 3.25% would come into play.

US Dollar

We continue to classify the DXY as range bound and neither technically weak or strong. MACD continues to not offer any clue as to the resolution of the price pattern as it is tracking sideways at just above dead neutral. We will point out that the momentum oscillator has crossed above its signal line but it has not made a higher high. With the continued trade and tariff headlines the recent calm could quickly end. We now mark first support at 94 and the 96 level remains key resistance.

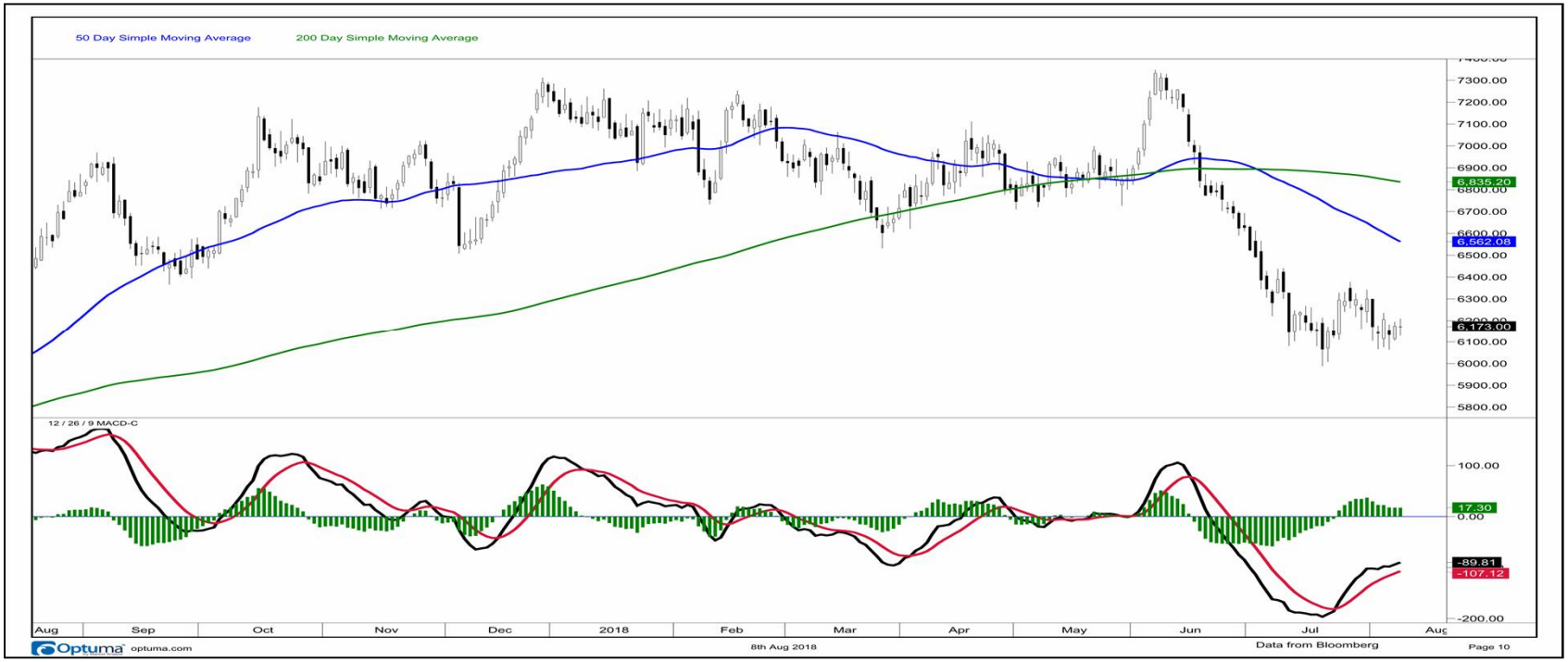
Gold

Gold has managed to avoid a full test of the $1200 level, with the metal hovering just above this level in recent sessions, touching a low at $1203.72 on Monday morning. Overall trading has been very quiet, helped by the fact that the USD has moved in a very small range against its peers. Although there are finally some signs that the selling pressure is abating, the metal has yet to make any credible move to the upside. $1220 would be a start in this regard, with $1240 and the falling 50 day ma (currently $1252) more important levels to reach.

Crude Oil

Yesterday was a nasty day in the oil markets. The oil price as measured by the front month WTI futures contract was down -$2.41 or -3.48%. The one positive technical feature is that even with the sharp selloff oil did not establish a lower low but $75 is starting to seem like a long way away. That said, we are inclined to give oil prices the benefit of the doubt as long as it remains above its 200-day ma which we now mark as first key support.

Copper



Copper looks to have bottomed for the time-being and notably failed to respond to the most recent tariff headlines. Key support at $6000 remains intact, but the metal at $6173 remains almost 4% away from its first serious upside target at $6400. Which one of these targets gives way first will tell us a great deal about the metal's prospects. We still believe that fundamental conditions argue for an upside break, but we need to see this confirmed by actual price action in the days ahead.

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