Monthly Market Overview
July 2018

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Highlights for June: The Thomson-Reuters commodity index finished lower over the course of June, but were it not for the sizable 2nd half June rally in oil, the index would have fallen much harder, and perhaps even retested the 2018 lows. As a number of markets buckled under escalating trade tensions in June, crude is flying somewhat under the radar, more influenced by OPEC micromanagement of output, along with occasional supply shock(s) that hit the system. Pushing back against OPEC', is the relentless surge of oil and gas supply coming from non-OPEC countries, predominantly the US. Over the past few months, it seems that the OPEC side has been winning out, as concerns about supply -- whether it is Iranian sanctions, continued Venezuelan production declines, Canadian maintainance-related outages or a reduction in Libyan output -- have all combined to send prices higher, with Brent hitting $80 at one point in June, a 3 1/2 year high. Saudi promises to increase production in response to market concern about Iranian export cuts have doused the rally somewhat, but the tone remains nervous.

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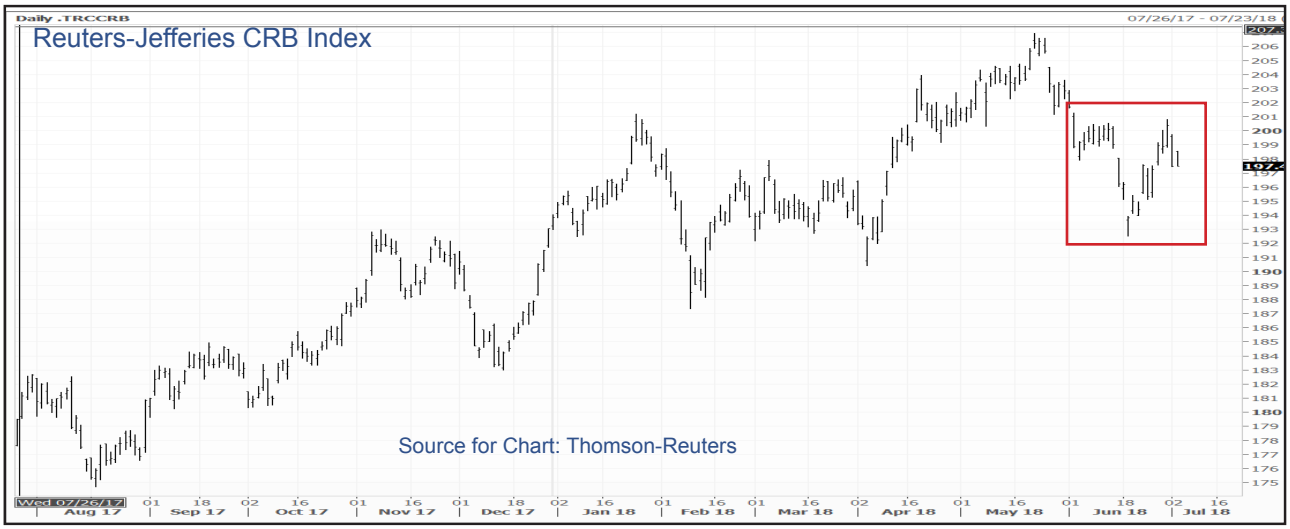
WTI had an even better showing in June than Brent did, gaining about $7 on the month and significantly narrowing the arb to about 5.5 from 11 over the course of the month. WTI's run was attributable to many of the variables mentioned above, coupled with sharply declining inventories. In this regard, US crude stocks drew by 16 mb in June and now stand at 92 mb below last year and 27 mb below the 4-year average. Cushing declined by 8 million this past month and so after years of excess stocks both on the national and global level, the oil markets seem to be legitimately balanced.

Products did not participate in the crude rally we saw set in during late June, with both heating oil and gasoline finishing just about flat on the month. As a result, crack spreads fell sharply. Natural gas also disappointed; after reaching five-month highs on the 18th on a combination of falling inventories and soaring temperatures in the US Northeast, prices dipped to a six-week low after funds trimmed back length heading into cooler US temperatures.

Outside of crude, we saw red practically everywhere else on our screens in June. Base metals closed much weaker, but really got pummeled heading into July as well. Copper sank to an eleven-month low of $6230, aluminum cracked $2100 for the first time since April, while zinc crashed to a one-year low, finishing last week at $2735. Even nickel lost resiliency, breaking a two month winning streak and finishing below $14,000 going into July. The selloff in tin also accelerated on account of rising Indonesian exports. The relative standout was lead; although it finished lower on the month, it did not drop as hard.

In the ferrous markets, Chinese steel rebar prices ended flat in June, but turned lower going into the early days of July. Iron ore prices closed the month at three-month lows. In the US HRC complex, spot prices held up well, but forward quotes dropped substantially over the course of the month, widening the backwardation.



The precious metals group did poorly although for reasons that were not entirely clear to us, particularly for gold where prices ended at a 6 1/2 month low. Most of the forces that gold typically interacted with in June should have been constructive for the complex, including a general dollar index that flatlined in June (and started declining in July), US 10-year yields that pushed lower during the month, higher inflation readings out of the US and Europe and wobbles in global equity markets. But despite all this, gold could not get a bid and was engulfed instead by the overall commodity rout (outside of oil). Silver had a very impressive first half of June, getting to a high of $17.35 at one point and significantly improving the gold-silver ratio in the process, but prices subsequently crashed below the $16/ounce mark by month-end, posting a fresh 2018 low in the process. Palladium ended down about 4% on the month to a three-month low, while platinum was the worst performer in the group, briefly sinking to $800/ounce at one point last week, a ten year-low.

The general dollar index ended slightly higher in June, but started to sell off more significantly over the course of the last week when the trade war rhetoric really started to heat up. However, the greenback did see some hefty gains against a host of emerging market currencies, including the Turkish lira, the Argentine peso and the Chinese yuan. The three major currencies we typically follow -- the yen, sterling and the Euro -- did not do all that much in June and all ended slightly lower.

Finally, US stocks continue to tread water. Although the S&P 500 hit four-month highs at one point in the June, a second-half selloff took the index down to 2718, essentially forcing an unchanged close on the month. However, the action in a host of emerging equity markets was far more brutal, with the Chinese stock exchange now in bear market territory (-23% y-t-d) and steep declines seen as well in Indonesian and Turkish markets. Finally, the US credit markets saw yields push lower, with the 10-year ending the month at 2.82%, down from a June high of 3%.

Trade Wars...I'll see your $50b and raise you another $100b. Last month we wrote that we detected an unusual amount of complacency in various markets as investors did not seem to be taking the trade threats all that seriously. We cited a number of reasons as to why this was the case, including 1) The relatively small amounts of tariffs being proposed, 2) The belief that President Trump's proclamations should not be taken at face value since they could be reversed 3) The notion that the Trump tariffs were part of a negotiating ploy that would eventually result in some sort of "deal" and finally, 4) Optimism that the North Korean summit could speed up a possible US-Chinese rapprochement as both parties would need each other to resolve this lingering crisis.

The sharp selloff we saw in June across a number of markets put a rest to this complacency. Tariffs have now officially kicked in, with the US approving $34 billion on Chinese goods on the 15th of June, while another $16 billion awaits to be imposed at some later date. As noted earlier, China imposed $34 billion last week on mostly US agricultural products and European duties kicked in as well in response to Section 232 tariffs. Several other counties, including Mexico, Canada, Turkey and India all rolled out duties as well. So far the dollar amounts for the tariffs are fairly small, but what is being proposed down the road by the Trump administration is truly staggering, including a 20% levy on European car and auto parts (a $192 billion market) and duties on $500 billion of Chinese goods -- practically all of the country's exports to the US.

More troubling, negotiations do not seem to be taking place (at least not that we are aware of) and companies as a result are taking up matters in their own hands in ways that the Trump administration did not have in mind when it started this exercise. Harley Davidson, for example, said last month that it would shift some production overseas to avoid the EU's retaliatory tariffs. GM wrote to the Commerce Department last month saying that proposed tariffs on vehicles could impact domestic production and "lead to a smaller G.M., a reduced presence at home and abroad for this iconic American company, and risk less — not more — U.S. jobs". A number of US business councils have also expressed opposition to the tariffs as well, with the VP at the Association of Equipment Manufacturers telling *AMM* that tariffs were "terrible news" for his sector and that "it will effectively wipe out all of the gains that our industry has seen from tax reform and regulatory relief".

What can be done? Certainly, nothing by Congress where a resolution to require the President to obtain Congressional approval before raising tariffs on "national security" concerns failed to get introduced. Affected US companies have a bit more recourse, as they could seek tariff exclusions on Chinese goods imported into the US that they could claim they need. They have 90 days to file exemption requests and to date, roughly 20,000 have been submitted. The administration has thus far approved only seven (this was only one week's tally in late June), agreeing to exemption applications made by razor maker Schick and Nachi America, a maker of cutting tools, bearings and hydraulics. Commerce denied 56 others, including those submitted by Seneca Foods, Bekaert, a steel wire maker and Mills Products, a metals fabricator. The rule of thumb is that if products cannot be readily made in the US, exemptions will be granted, but if a US company (usually Nucor in the steel space) opposes a request, the application will get rejected. One steel distributor has made 90 requests and has not been informed on the status of any of them; he is still waiting to submit 2,000 more.

In the Chinese market, Ford said last week that, for now, it will not hike prices of imported Fords and higher-margin Lincoln models going into China, but Germany's BMW said it is unable to "completely absorb" new Chinese tariffs on imported U.S.-made models that it exports and will raise prices. Other multinationals, such as Apple and Boeing, are watching the

situation with great concern as well. Apple makes a whopping 500,000 IPhones a day at the Zhengzhou Foxconn factory and so ensnaring the company in additional red tape (a favored Chinese tactic) could wreak havoc in the Iphone supply chain. More ominously, it could limit further American foreign direct investment into the country or could even ask American multinationals to scale back operations. Ironically, this latter approach would be one way of reducing the trade deficit, although the consequences for American companies would be disastrous.

The prospect for an agreement with respect to NAFTA also looks quite bleak; the stakes are high considering that the three countries conduct about $1.1 trillion in trade and $840 billion of cross-border investments. It remains to be seen whether the new Mexican president will move things along during his transition period as he does not formally assume office until December. Meanwhile, the US-Canadian relationship is rocky, not helped by the tense back and forth between President Trump and Canadian Prime Minister Justin Trudeau at the conclusion of the G7 meeting in Quebec last month. Having said that, there has been some progress made on autos. The US dropped its demand that all cars made in the bloc should have 50% US content and instead agreed that a certain percentage can be made in "higher wage labor markets" (i.e., the US). However, other areas of disagreement remain; the US is seeking concessions from Canada on dairy, is seeking the elimination of "dumping panels" and is also insisting on a "sunset" clause, limiting NAFTA to five years.

Should President Trump decide to leave NAFTA, he must provide formal notice of his intention to withdraw before he can exit 6 months later. Once the agreement ends, trade among the countries will be the governed by WTO rules, essentially meaning that US tariffs of 3.5% would apply, while Canada and Mexico would each impose tariffs of 4.1% and 7% respectively, all higher than is currently the case. Presumably, bilateral trade deals will then be negotiated to bring duties down, but as the *Wall Street Journal* noted, "Major trade negotiations frequently take place over several years and several administrations. The big question is whether Mr. Trump will have the patience to see these trade negotiations through according to those traditional standards". We don't think he does, which is why we suspect he will ultimately pull out of NAFTA.

Outlook For July: Needless to say, it is difficult to forecast future trends through a prism of a trade war, not the usual macro variable we typically look at. There are several studies predicting that the impact of such an event would be minimal, but we are dubious that any kind of econometric modeling could adequately quantify the psychological impact that a full-blown trade war will have on consumer spending and business investment. Moreover, as mentioned in earlier commentary, global supply chains have now become so integrated and transnational, that tampering with them (let alone monitoring their inputs for applicable tariffs) will be extremely disruptive. Having said that, there clearly are legitimate concerns about the current global trade set-up, but these are best addressed by negotiations and full positional transparency by all parties.

At this stage, we do not see President Trump "changing his mind" with respect to his tariff strategy, as some were expecting him to do earlier in the year. As a result, we see a steady ratcheting up of the spiral as the US leads other countries deeper into the trade war. Solutions will be elusive, as short of laborious negotiations, they will not be achieved within the short span of a news cycle or a soundbite. Eventually – we don't know when exactly – consumer spending will slow and business investment will start to recede as companies will not be able to make long-term plans knowing that whatever the current rules are could easily be reversed by presidential decree some years later.

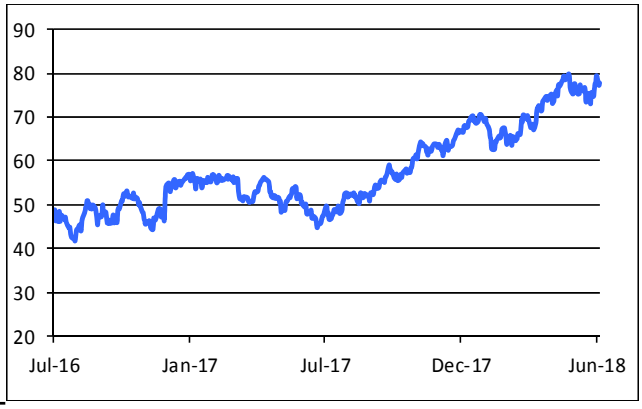
We think two scenarios are possible at this stage: The first would be a truce in the trade war, with countries freezing their duties in place as multi-national or bilateral trade talks get underway. This development would be very bullish for the markets and is a possibility, although a remote one. A second more likely scenario would see trade negotiations start in the wake of a major selloff in the US equity market, as investors get a sense that the US economy is indeed slowing, joining the more pronounced slowdowns we are seeing elsewhere. A stock market correction will not happen imminently, as US economic indicators are currently very strong and corporate earnings remain robust, thanks to favorable earnings comparisons to last year on account of the tax-bill. However, Q2 (and 2018 as a whole) could very well be the high water mark for the US economy, as towards year-end and perhaps earlier, we should start to see the impact of tariffs and higher rates start to weigh more noticeably on the economy. Under such a scenario, commodities could fall along with stocks, but both markets should stabilize and move higher as trade talks begin. But all this may not happen as quickly as July, which is what we are more concerned in the writeups that follow. Because of time constraints, we will not summarize the individual sector outlooks that we usually do in this section, but will resume doing so next month.

With that, we present our thoughts on the individual markets in the pages that follow and as usual, welcome reader feedback or comments.

BRENT NEARBY CONTINUATION

Nearby Brent closed June at 79.44, $1.81 higher on the month. June was an eventful month for the market, as supply and geopolitical uncertainty both served a heady brew for traders. The June 22nd OPEC meeting followed by the OPEC + non-OPEC follow-up resulted in the market being notified that additional supply was forthcoming, although how much exactly was not clear. The Saudi/Iranian conflict, however, was more a front and center market feature, particularly after the US announced that it was pressuring Iranian buyers of crude to reduce their purchases to zero by the November 6 deadline for reimposing sanctions. In fact, buyers have already begun to reduce purchases as the US said it was not going to issue sanction waivers as was the case under the Obama administration (although there have been signs of some waffling lately). Our expectation is that sanctions would result in a 0.5 mbd loss of Iranian crude, but we now believe the number will be closer to 1.0 mbd to 1.2 mbd. Not coincidentally, Saudi Arabia has told OPEC it had already increased output by 0.4 mbd in June and was going to add another 0.6 mbd in July. The Trump administration is pressuring Saudi to add more barrels, but that is unlikely in our opinion. Meanwhile, Kuwait and the UAE have the capacity to increase another 0.3 to 0.4 mbd. OPEC PG producers can probably increase 1.4 mbd, which makes up for the Iranian shortfall, but it does not make up for a continuing loss of Venezuelan barrels, which the IEA says could be another 0.3 to 0.4 mbd by year's end. Furthermore, Libya declared force majeure on 850,000 b/d of crude owing to a factional government dispute. Significantly, increasing OPEC PG output concomitantly reduces spare capacity. Spare capacity could drop to under 2.0 mbd, leaving the world vulnerable to any unanticipated supply outage like the one facing Canada presently. To add to anxieties, global inventories are now below five year averages, removing yet another cushion. After accounting for a fairly quick 0.2 mbd increase from Russia ,we think that Q3 will see a slight global stock draw, but that Q4 could see a more substantial draw of 0.7 to 1.0 mbd should demand remain strong through the second half. In any event, the market looks finely balanced near term, which is why we see Brent well supported and trading within a fairly wide $76-$84.50* range in July.

BRENT CRUDE OIL Last: 77.77 **07/03/18**



WTI NEARBY CONTINUATION

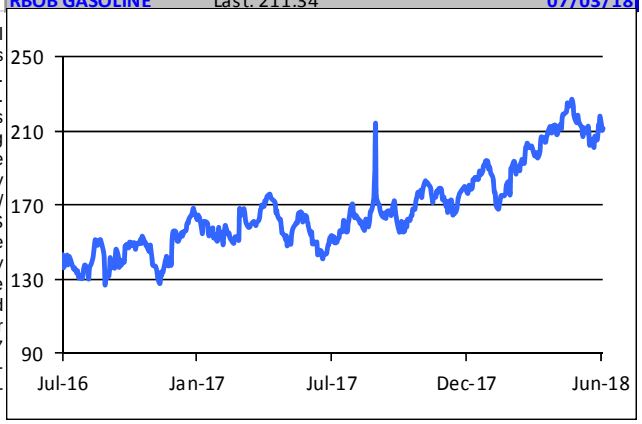
Nearby WTI rallied fiercely during June in response to bullish global developments (SEE BRENT) as well as on account of its own dynamics. Nearby futures closed the month at $74.15, up $7.11 on the month. Domestic crude stocks drew sharply last month, as crude demand reached a record level in terms of runs plus exports. After hobbling back from turnarounds, refiners finally got their act together and ran a record 17.82 mbd through their plants on June 22. The four-week average crude run is 0.4 mbd over last June and a startling 0.9 mbd over May. In the same week, shippers exported a record amount of crude (3.0 mbd). Four-week average exports through June 29 was 2.3 mbd, or a whopping 1.5 mbd over last year. For all the hype about US crude production, production and crude imports cannot cover the growth in runs and exports -- not even close actually. Stocks in June drew 16 mb to total 416 mb, or 92 mb below last year and 27 mb below the 4-year average of 447 mb Midcontinent stocks have drawn by 12 million since the end of May and Cushing stocks have declined by 8 million. Cushing stocks are only at 28 mb, half of last year's level and 60% of the 4-year average. In July of 2014, Cushing stocks dropped to below 18 mb, which has been pointed out to be the near operational minimum for the storage site. At 12 million over that, stocks are still too low for comfort. Separately, the North American market was jolted in June by the loss of 360,000 b/d of Canadian syncrude production due to a power failure. At press-time, there was no definitive news on a restart, but end July was sees as a possibility. With crude markets tightening up, the loss of that much supply is quite bullish and we don't really see the US crude deficit improving all that much in July. Exports in the first half July should continue to be fairly robust owing to a weak WTI/Brent arb in May and June. Perhaps in 2H July, exports will slow as WTI/Brent has narrowed substantially of late. For now, crude production plus imports will not cover crude runs. Refined margins may be squeezed in July, but not enough to reduce runs significantly. We see crude stocks declining another 10-15 mb barrels in July, keeping prices firm. We expect to see a $71-$78.50* trading range prevailing in WTI this month.

LIGHT CRUDE OIL Last: 74.55 **07/03/18**

RBOB NEARBY CONTINUATION

Nearby gasoline gained only 1.81 in June despite WTI reaching a four-year high. The complex's fundamental picture is wholly uninspiring and we don't see much to change this outlook going into July. Gasoline inventories built by over 5 mb barrels during June, as refiners cranked up runs (SEE WTI) while gas demand remains soft. Stocks totaled 240 mb as of June 29, or right around last year's levels and 13 million over the 4-year average. Days' supply are running at 25.4 mb vs. the 4-yr average for end June of 24.1. So far gasoline demand this driving season is basically flat with last year. July and August are going to really have to show some strong gains in demand in order to begin to drain gasoline inventories. AAA expects that the July 4th holiday will see an increase of 5.1% of drivers taking the road after a 5% increase this Memorial Day(YOY). That certainly should help. While pump prices have come down around 10 c/gln from their highs this year, they are still 55 c/gln more than last year. At 2.83 c/gln end-June average, they probably will not be a deciding factor for US driving habits, but nevertheless the price is nowhere near as enticing as last year's 2.25 c/gln number. We don't see pump prices coming off all that much in July as crude prices should remain elevated. We think July gas demand will come in around 9.67 mbd., about 0.1 mbd over last July, but not nearly high enough to make a dent in the gasoline surplus. While gasoline cracks have declined dramatically as a result of spiking front end sweet crude, refiners will still run full out in July, making too much gasoline in the process. Imports will be lower in July and exports a bit higher, but we see gasoline stocks flat for July, leaving them right around 240 mb or 7 mb over last year. Last year, Hurricane Harvey was the chief factor in drawing the gasoline surplus and unfortunately, it looks like we might need that type of event to bail gasoline out again. Our range for July is 207.50-220.00*.

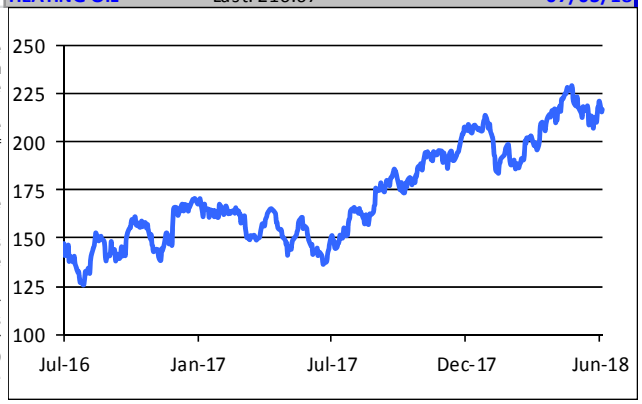
RBOB GASOLINE Last: 211.34 **07/03/18**



HEATING OIL NEARBY CONTINUATION

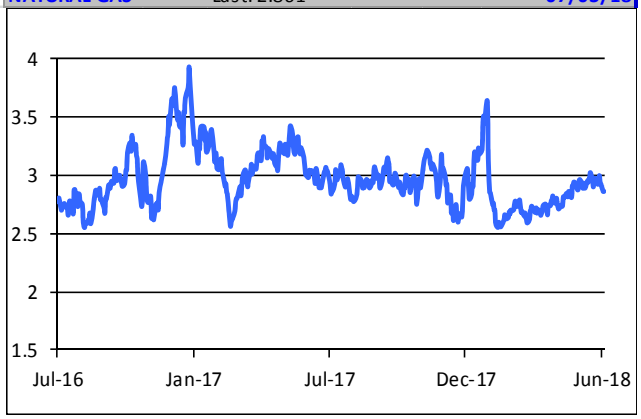
Nearby diesel traded in a wide range during June and ended the month only slightly higher despite the strength in WTI. The fundamentals for diesel remain relatively bullish as inventories remain low. As of June 29th, distillate stocks were 117.6 mb, or 33 mb below last year and 23 below the four-year average. Days supply this year are 29 days vs. an average of 36 for end June, both suggesting that refiners need to rebuild stocks. The four year average peak for the summer distillate stock build is 147 mb, which usually is reached at the end of August. This will be impossible to reach as there is no way that we will build 15 mb in July and again in August, although we do think that there will be some rebuilding going on. After struggling to increase runs after turnarounds this spring, refiners reached a record run level of 17.82 mbd on June 22. We anticipate runs will remain historically high as margins, while softening, are still good enough to run hard. We will see if refiners will be able to increase distillate yields. So far in 2018, yields have been running about 0.5% below last year. (Its possible that the waxy nature of shale crude is yielding less distillate). We are raising our yield projection slightly, but owing to high runs, distillate output this summer should be almost 0.3 mbd higher than last. We see imports picking up later in the month as Europe rebuilds its distillate supply and any surplus heads to the NYH. Exports from the USG to Europe may be slightly lower in the month for the same reason. On the demand side, June was basically unchanged vs last year and the first month which did not register solid gains y-o-y. We don't see that as a trend yet, as the underlying economic picture surrounding diesel usage remains strong. However, any slowdown in growth owing to tariffs will directly affect diesel demand. Trade disruption is another matter as bunker fuel will probably be most directly affected, but in 2020, this becomes a distillate matter with changing bunker specs on deck. For July, stocks should build around 1 mb a week and should close the month at around 122 mb., or 29 mb below last year and 21 mb below the 4-year average. Inventories will still be too low and diesel should therefore be well supported during the month, trading in a 211-227* range.

HEATING OIL Last: 216.67 **07/03/18**



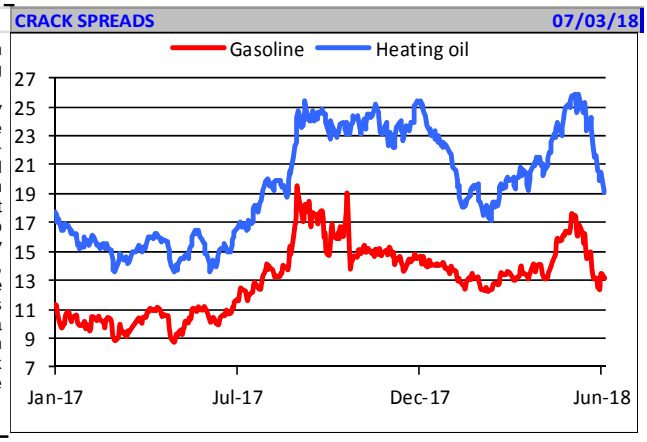
NATURAL GAS NEARBY CONTINUATION

Natural gas prices hit five-month highs on June 18th, as a combination of falling inventories, coupled with soaring temperatures in the US Northeast, pushed values higher. During June, prices fluctuated between $2.88-$3.05, inside our projected $2.85-$3.20 range. During the last two weeks, the complex has given up much of June's advance and prices actually dipped to a six-week low of $2.82 on Friday. With temperatures in the US North East breaking, it seems that some funds have decided to abandon the long side for the time being, which could explain the recent decline. While weather is always an imponderable, inventory levels need less figuring out and these point to a convincing bullish case for the moment. Stocks on hand during the beginning of June stood at their lowest level in some four years and for the month as a whole, they could be reaching a 10-year low for the month. Looking ahead, storage index futures traded on ICE suggest that by October, inventories will be around 3.525 tcf, the lowest since 2008. As stocks remain under pressure, demand is running strong, best reflected by the solid manufacturing readings we have been seeing out of the US over the last month. Buoyant exports have also helped boost demand. On the supply side, production is increasing, but apparently not enough to replenish stocks. S&P Global Platts estimates that US dry production came in at around 78.2 bcf in May, while the EIA sees 2018 natural gas production averaging 81.2 bcf. All this sets up the complex to be in good shape going into the winter, but we are not sure the fireworks are necessarily over as far as the summer is concerned either. With the return of warmer weather, we could see prices push back towards $3.00 again. For the month as a whole, we see a $2.75-$3.00* trading range as being a reasonable estimate.



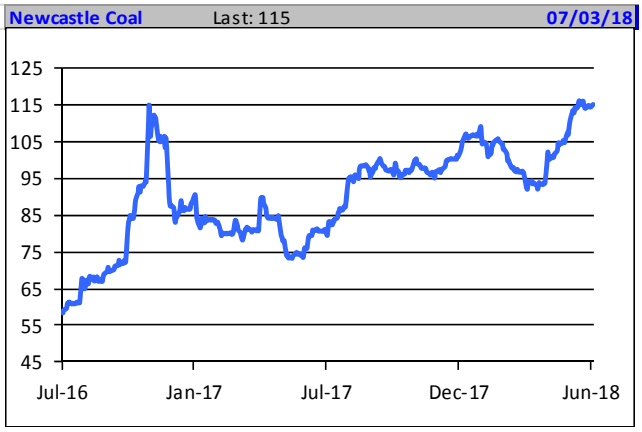
CRACK SPREADS

The September diesel crack was under severe pressure during June losing over $6/ barrel to close at 20.62, down 5.70. The weakness of both the diesel and gasoline cracks were primarily a function of the spike in WTI as Cushing stocks declined and Canada suffered a serious production problem in manufacturing syncrude, a light sweet crude. (SEE WTI). Cushing stocks fell to 28 mb on June 29, or half of levels reached a year ago. Prospects for a timely rebuild at Cushing will be hindered by the loss of syncrude and this will continue to place near term pressure on the crack. Northern Atlantic distillate stocks, meanwhile, remain tight with Pad 1 US stocks at 34 mb, or 14 below the 4-year average. In Europe, ARA gasoil stocks are 1 million tons below average. In all likelihood, Europe will rebuild much more quickly than Pad 1. Reuters reports that over 2 million tons of distillates are heading into Europe from Asia and the Middle East in July. Presumably this will pressure European gasoil prices and in the process, back out USG barrels and make exports to the NYH more attractive. This will be something to watch for later in July and into August. We would see that as a bearish development, but diesel cracks have already more than discounted any bearishness for distillates owing to the Cushing price spike. September gasoline cracks were also pummeled in June, losing 6.26 to close at 17.08. Similar to the diesel crack, the weakness was brought on by the strength of WTI. We think gasoline cracks were heading lower in any event as gasoline's fundamentals are lackluster at best. Pad 1 stocks are average at 66 million barrels, while in Europe, ARA gasoline stocks are 150,000 tons above the 4 year average –a very slight surplus. The arb from Europe to the US has been closed, so imports into the NYH will be lower and this in turn could tighten the balances in Pad 1 a bit and maybe lend some support to this crack. However, the gasoline crack is really a function of Cushing at present and until Cushing is sorted, we would be hesitant to be buying either the gasoline or diesel crack for the moment and prefer to watch the action from the sidelines for now.



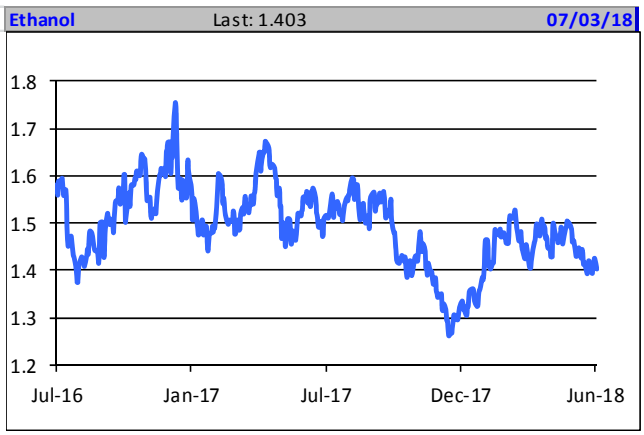
COAL

Our chart alongside shows prices taking out their one-year highs in June and continuing their march higher going into July, settling this past week at a six-year high of $120.10 basis the Australian Newcastle spot price. A major heat wave gripping parts of China has led to a surge in power usage and is driving prices higher. In fact, in one case last month, power demand was so high in the Chinese city of Wuhan, that the authorities started rationing electricity. Hefei, the capital city of Anhui province, is contemplating doing the same and we would not rule out other Chinese cities following suit. Meanwhile, China's seaborne coal imports have surged by around 14% in the first half of the year, the strongest so far this year. However, there are signs that higher prices are hurting demand somewhat; Bloomberg reports that some Indian and Chinese power companies have stopped chasing the market higher and notably, Glencore's talks with Japanese power company Tohoku Electric Power collapsed last month, as the two sides were apparently unable to agree on pricing for a new supply contract. Still, with the summer barely three weeks old, we likely will see more need for coal, not less, and see valuations pushing higher over July and August.



ETHANOL

Amid indications that the US ethanol import tariff could rise from 30% to 70% is contributing to weaker trade with China, while a deflated corn market of $0.60/bu is not helping the ethanol bulls either. Futures ended down $0.04/gal for June. The June average physical Chicago price was calculated at $1.412 compared to $1.46 in May and $1.5134 the previous year. Otherwise, some of ethanol's other fundamental variables remain relatively stable. Ethanol stocks are at 910 mg., unchanged from a month ago. Blend Days of Supply are at 22.9, very similar to a year ago as well. However, based on current trends, it does appear that the fundamentals will start to get more bearish; production is trending higher while demand is moving lower, leading to stock builds; the 4-week average production rate is at 44.42 mg/d versus a 4-week average total disappearance rate of 43.80 mg/d. US domestic demand or blending appears to be stagnant y/y, leaving exports as the key market mover for now (besides corn). The big hope here though was China and now that they appear to be serious about a 70% tariff, the outlook for ethanol remains uninspiring. *Contribution by Mike Blackford of INTL FCStone.*



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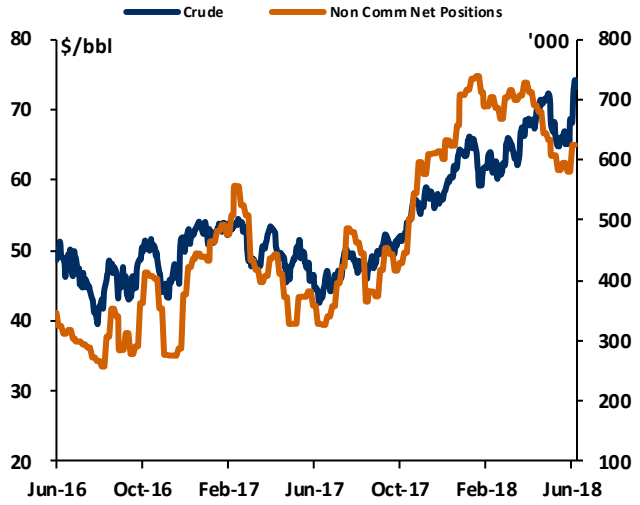
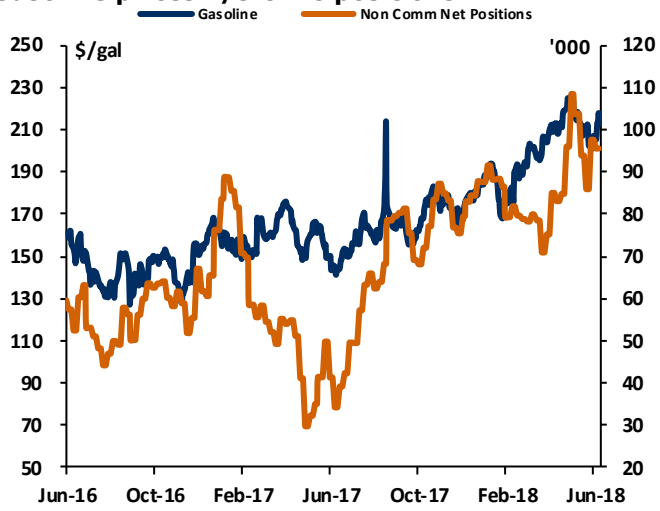
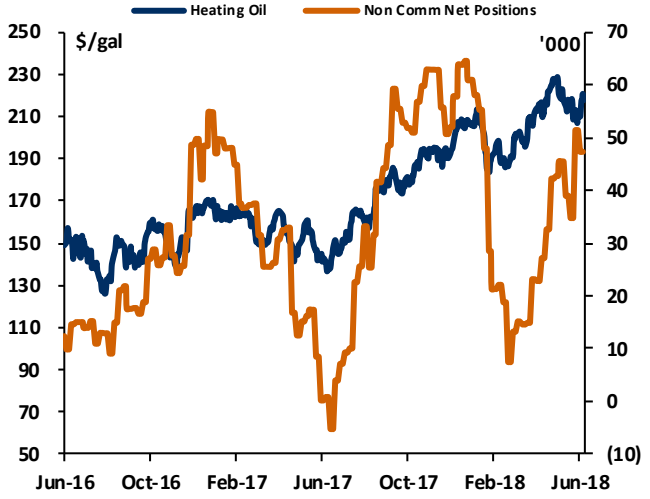
Crude Prices v/s CFTC positions



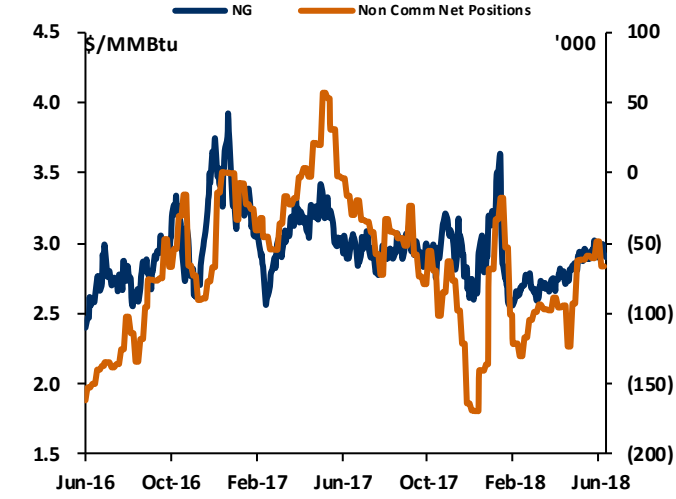
Gasoline prices v/s CFTC positions



Heating Oil prices v/s CFTC positions



Natural gas prices v/s CFTC positions



Source for Charts: Bloomberg

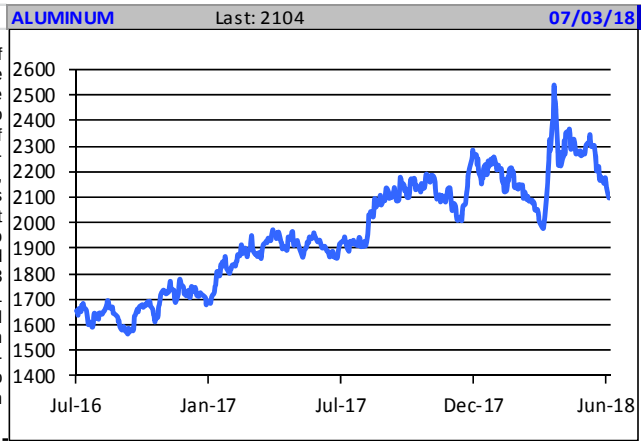
LME BASE METALS - Page 7

COPPER

Of all the crazy moves we have seen in copper over the years, the weeklong $450/ton spike to a 4 1/2 year high of $7348 that set in during the first week of June has to rank as one of the more baffling. The move was triggered by Escondida's union #1 outlining its demand for its forthcoming contract, one perceived to be too aggressive by investors. The union asked for a $34,000 bonus (equivalent to 4% of the dividends paid by the company to shareholders) and a 5% salary increase for the yet-to-be-determined duration of the contract. Both demands were well in excess of what was granted to nine other union groups that have already settled. (In fact, CRU notes salary increases of anywhere between 1%-3% made to other unions, while bonuses averaged at half of what Escondida's union was asking). As things now stand, the two sides are currently in talks but are said to be "far from reaching agreement". The company now has until the 24th of July to make an offer; the union will then vote between the 27th and 31st and if the offer is rejected, government mediation would take place. If no agreement is reached, a strike would probably begin around mid-August. While all this sounds ominous, it certainly did not justify the strong June rally that basically discounted a worst-case scenario even before the negotiations started. And so it was not surprising that by the end of June, copper's rally was rolled by in its entirety, as prices ended at $6626, down $226 on the month. The selloff continued into July as well on account of growing trade concerns have subsumed labor-related worries and concern that China's economy could be slowing as well. In other news, Sterlite's Tuticorin smelter in India remains closed and will likely be out of commission for an extended period of time; the closure has been partly responsible for the recent uptick seen in concentrate treatment charges. Elsewhere, China's scrap policy continues to make waves, with the government announcing this past month that it is planning to ban *all* scrap imports by 2020. We suspect that if the authorities go through with this, we should see higher local scrap production offset some of this loss. In addition, the country will be importing more refined metal and concentrates. But over the short-term, trade frictions between the US and China is all that matters for the moment, for copper. Until this cloud lifts, we remain concerned about upside prospects going into July and see a much wider $6000-$7000 trading range setting in this month to better incorporate the ups and downs (mostly downs lately) of the emerging trade wars. Prices could perk up later in the month as the Escondida talks come into sharper focus. During July, we see copper trading between $6000-$6500*.

ALUMINUM

After trading roughly between $2130–$2350 during June, aluminum broke down and sank to a three-month low of $2080 this past week. Although the situation with Rusal remains unresolved, the company's bullish hold on the market seems to be slipping. Investors seem to be reassured by the fact that Rusal units are flowing again, as are alumina shipments (where the Chinese apparently have also stepped up to fill the void). Moreover, there seems to be an active dialogue going on between the US Justice Department and Rusal, suggesting that the stand-off could be nearing a resolution. We should also not forget that Presidents Trump and Putin will be meeting in mid-July and Rusal is bound to come up in the talks. In fact, the market could be selling off in advance of this meeting, as investors are perhaps bracing for an off-the-cuff reprieve the US President could conceivably throw Putin's way, as he did with China's ZTE after President Xi asked him to intervene. Separately, declining ali prices are not resulting in softer premiums, as the theory would typically have it. Instead, we are seeing premiums continuing to slide in most geographies, with Midwest standing at 21c, off the 22-23 cent level hit on April 10th. Duty-unpaid was at $80-90 this past week, off another $10 on the week, but MJP bucked the trend, last quoted at $132 for Q3 and up for a third consecutive quarter. On the supply side, global primary aluminum output in May rose to 5.441 million tons from 5.303 million tons in April, as Chinese output (and exports) ticked higher, but aluminum demand remains strong and is absorbing the increased output for now. During July, we see ali prices trading between $1980-$2210*, with prices at their weakest as the Trump/Putin summit approaches. However, despite the market's rather complacent view with regard to Rusal, we are not out of the woods yet; Oleg Deripaska has yet to reduce his stake in the company and there is always the chance that negotiations with the DOJ could break down and so this issue remains as intermediate support for both prices and premiums.

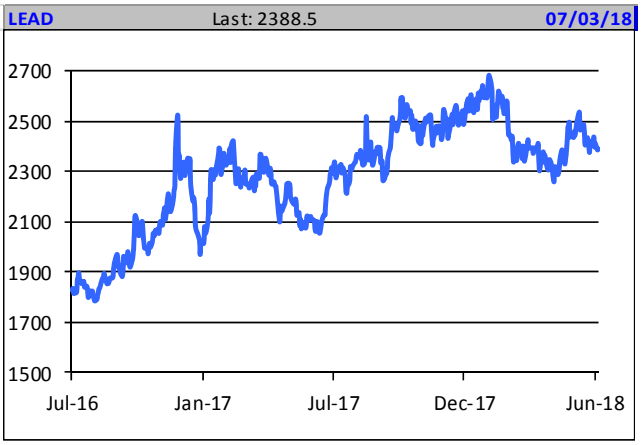


ZINC

After being the darling of the metals group earlier this year, zinc has been a profound disappointment of late, sinking to a one-year low this past week and dropping well below our forecast low of $2970 during June. For June as a whole, prices traded between $2815-$3220 before sinking further still (to $2687 on the 4th of July). LME inventories are keeping zinc prices under pressure, as stocks are hovering around 250,000 tons, a seven-month high (and up some 37% so far this year). Shanghai stocks have compensated somewhat, dropping by roughly 10,000 tons during the period, but not offering meaningful support. A more comfortable supply/demand balance is also pressuring valuations; in this regard, the latest ILZSG numbers has the market in a surplus of 18,000 tons for the first four months of the year, a far cry from the substantial deficits that were expected at the start of 2018. During the January-April period, the ILZSG has refined zinc production rising 2.9% year-on-year to 4.43 million tons, while it sees refined zinc usage dropping 0.5% year-on-year to 4.42 million tons. China's refined zinc output fell 5% to 457,000 tons in May due to smelter maintenance, but for the January-May period, China's zinc output was still up some 1.6% to 2.345 million tons. With signs that the maintenance checks are easing (if not completed altogether), we could see Chinese output continue to rise over the summer months, a view CRU agrees with it, noting in its recent report that "looking forward to the third quarter, ... improving mine supply will enable smelters to lift utilization rates and, with global demand growing only modestly, we anticipate that the refined metal market will return to balance". (CRU had the zinc market in a substantial deficit in both Q1 and Q2 of this year, but we suspect that in light of falling prices and rising stocks, these numbers will be revised to show less of a shortfall). The sorry state of affairs has prompted China's leading zinc producers to call for coordinated production cuts last month, but the impact of these (if they are implemented) will likely not make itself felt for some time. Last month, we wrote that we thought we would see a measure of support for zinc at around $3000 mark, but clearly that is not happening given the more comfortable supply/demand balances. As a result, we could see the weaker tone continue over the short-term and see valuations trading between $2630–$2930* during July, especially if trade tensions between the US and China continue to persist.

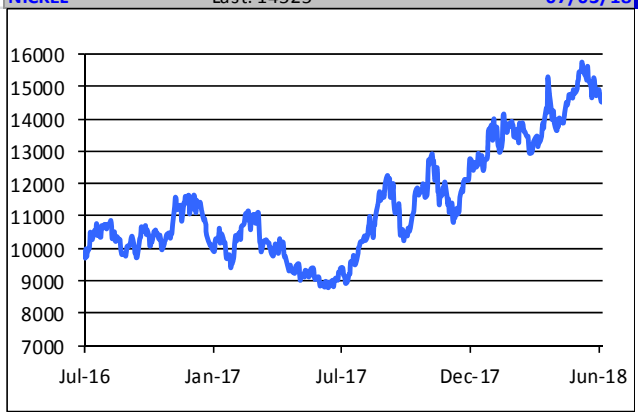
LEAD

Lead sold off during June, but the decline was not as pronounced as the rest of the group. Values traded between $2365-$2555, not far off our forecast $2325-$2520 range. For the most part, the market remains tight on the supply side, particularly from China. In this regard, Andy Home from Reuters notes that the coordinated cuts announced by China's zinc producers last month was "conspicuous by its absence [regarding] any similar statement of intent to cut lead output, even though many of the zinc producers ... are also lead producers". Home also notes that lead concentrates availability seems "to be more problematic than in zinc right now" in that zinc concentrates were lately assessed in a $20-$30 range, while lead treatment charges are a little lower, at $15-$25 per ton. "Both are painfully low for Chinese smelters" Home writes, "but the strength of the outright refined lead price affords some breathing space". Meanwhile, the ILZSG calculates that the global refined lead market was in a 42,000-ton deficit through April of this year and sees refined lead output rising slightly by 0.2% year-on-year to 3.815 million tons through April of 2018, while refined lead usage grew by 0.8% year-on-year to 3.857 million tons for the same period. Lead mine supply rose 4% year-on-year to 1.603 million tons. Separately, the ILZSG notes that China's refined lead output rose 15% year-on-year to 413,000 tons in May, lifting January-May output up by some 9.6% (to 2.015 million tons). However, the refined increase does not seem to match the realities on the ground where most analysts continue to see tight supply conditions persisting, so we would have to take the ILZSG numbers with a grain of salt. Looking ahead, CRU writes that "under the stricter environmental inspections this year, lead smelter output has been disrupted in every key lead-producing province [so far this year] and we believe that more rolling checks around the country will continue to impact" the supply chain during the second half of 2018. CRU suspects that the tight conditions will "lift a little in July as some big primary lead smelters in Henan are expected to resume production" but notes that "it may not completely ease the situation as many secondary lead smelters may not resume production until late 3Q2018" . So for now, lead should remain somewhat well supported and if it were to drop with the rest of the group, it could conceivably give up less ground. During July, we expect to see a $2241-$2480* range prevailing.



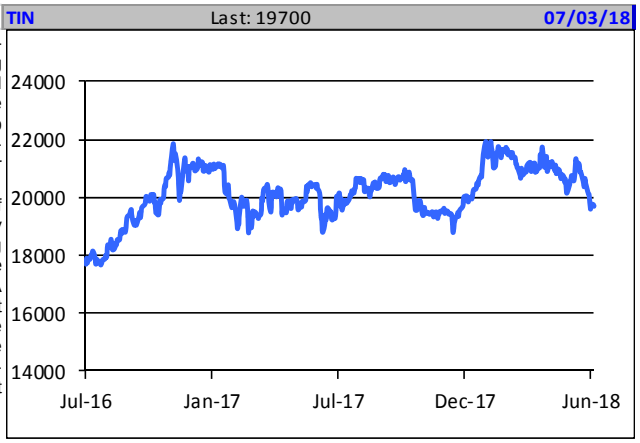
NICKEL

For June as a whole, nickel fluctuated between $14,760-$15,845, close to our forecast band of $14,750-$15,875. However, prices have been shaky this past week, taking out the $14,000 level on Friday. Although a continued decline in LME nickel stocks in June provided support early on in the month, weakness in the rest of the base metals exacerbated by ongoing trade tensions was too much of the complex to withstand. Easing supply was also a factor, particularly out of the Philippines where a government panel cleared 23 of 27 mines to resume production. Miners are urging the government to lift a six-year ban on new large-scale mining as well. Despite this, the government continues to have an ambivalent attitude towards mining, with President Duterte saying last month that he could see activity in the sector coming to an end "one of these days". Meanwhile, the nickel deficit narrowed to 13,100 tons in April from a revised deficit of 16,600 tons in the previous month, this according to the INSG. During the first four months of the year, the deficit widened to 52,600 tons from 37,800 tons in the same period of 2017 and the group now sees a 117,000 ton shortfall for 2018 as a whole. On the NPI side, CRU notes that Chinese NPI production fell in May to below 39,000 tons, down 5.6% m/m and is now off some 10% on a year-over-year basis. This is attributable mostly to Chinese environmental inspections that will likely last until Q3 2018 so things could remain fairly tight until then. Also helpful to nickel, is the fact that LME inventories are continuing their decline; stocks fell by another 17,000 tons in June and now stand at just under 267,000 tons. All in all, there is little in the way of meaningful change in nickel's fundamentals. Investors continue to position themselves for increased nickel consumption emanating from the EV sector (al beit a little early in our view) and stocks are heading in the right direction against an ongoing structural deficit. But having said that, nickel could fall prey to rising trade tensions that could do a lot to dent stainless demand, already turning somewhat wobbly of late . During July, we see nickel trading between $13,555-$14,500*.



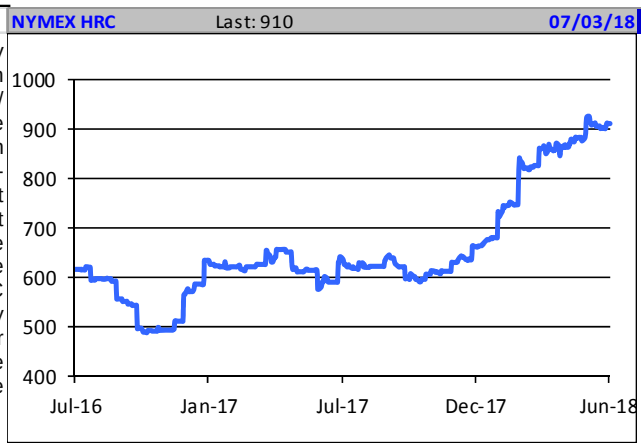
TIN

After holding up fairly well for much of 2018, tin fell sharply in June. For the month as a whole, prices traded between $19,560-$21,325 well below our forecast range of $20,200-$21,100. Values continued to lose ground during the early days of July, getting to an intraday low of $19,300 this past week, itself a 2018 low as well. As mentioned in earlier commentary, tin is very susceptible to what is going on with Indonesian tin exports and in this regard, the May numbers out of the country were a whopper. Specifically, May exports surged to just under 12,500 tons, up 79% from the year before and about triple year-ago levels. Much of this increase could be attributable to shipments going out ahead of the Muslim Eid holiday which started in June. ICDX trading volumes in June, a proxy for Indonesian refined tin exports, totaled just 5,255 tons, down from the May spike, but still higher than January, March and April. Meanwhile, European tin premiums remain under slight pressure, trading at a four-month low of $310-340, while in the US, in-warehouse Baltimore premiums were quoted steady at $500-600 per ton. In industry news, the ITA notes that "tinplate producers Tata Steel and ThyssenKrupp have finalized merger plans by signing definitive JV agreements, with potential implications for the domestic tinplate industry". The deal has yet to receive European Commission approval and tin-plate asset sales may be required to fulfill anti-trust requirements. The ITA writes that the "merger comes amid oversupply and intense competition in the European tinplate market in recent years… and that "these challenges have been amplified by the 25% tariff on US imports of tinplate from Europe and competition from Chinese tinplate producers". Looking at July, we suspect that the lower Indonesian June export figures will be mildly supportive for prices, but the complex will continue to be buffeted by exogenous variables, including ongoing trade tensions and prospects for a stronger dollar, particularly against emerging market currencies like the Indonesian rupiah. We see prices trading between $19,050-$19,800* this month.



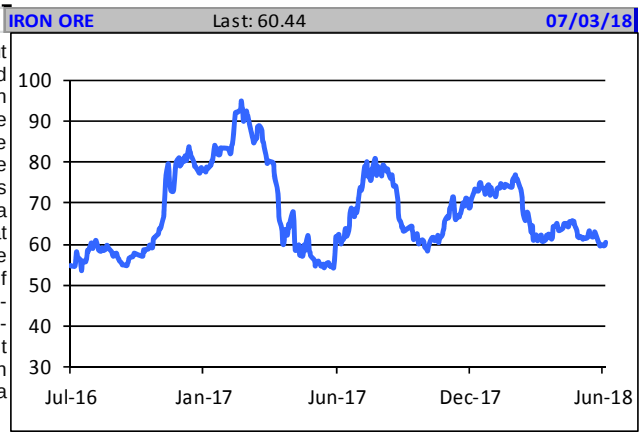
NYMEX HRC

June was another month in which we saw the forward months in the futures market completely disconnected from the direction of the spot market. Spot index prices moved from $895/ton in the first week of June to finish at $917/ton by month end. The first week of July saw a slight $5/ton dip, the first decline in 5 weeks. So with all this spot market momentum, we could expect the forward markets to be heating up, right? Wrong; forwards have in fact crashed substantially, with December falling from a peak of $855/ton on May 31st to just $791/ton at the time of this write-up, a drop of $64/ton even as the spot price rose over $25/ton during the same period. We might expect 2019 to be trading at or around the $800/ton level (about $110/ton below the last spot index print) as buyers are simply uninterested in locking in long-term commitments at what are historically high levels, but the backwardations we have seen in the nearer 2018 months are again head scratching. We note this often, and we believe it reflects a general bias in the HRC futures market wherein sellers far outnumber buyers, and the scarcity of bids seems to regularly encourage these steep backwardations. We hear very few mills with significant tons available for August (July order books are long closed) and those who have tonnage on hand are heard to be quoting around a $920/t base price. For July, we see spot month support at $900/ton, resistance at $920/ton*. *Contribution from Spencer Johnson of ONTL FCStone.*



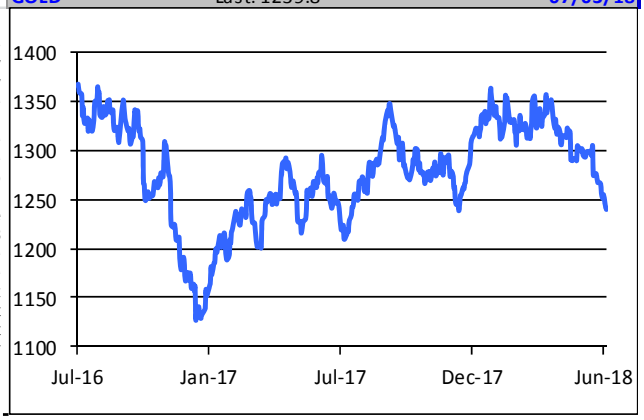
IRON ORE

Iron ore futures are down by 11% so far this year amid well-supplied markets and on concern about growing trade tensions between the US and China. Prices nudged lower in June as well and closed the month close to a three-month low (coming within a whisker of taking out a seven-month low). In addition to trade issues, slowing Chinese manufacturing activity is also weighing on prices, as is the fact that weekly steel inventory levels in China are now longer declining as quickly as they once were (and in fact increased several times in June). Moreover, Chinese construction tends to slow over the summer months, with this summer being particularly hot. Outside of weather, much of what happens to both iron ore and steel will rest very much on how the trade disputes between the US and China are ultimately resolved. If we continue to see a round of tit-for-tat tariff escalations, we suspect that overall global steel demand could suffer on account of foreign markets no longer being as hospitable to Chinese steel as they once were; this is bound to have an impact on iron ore as well. However, if some sort of trade "deal" emerges, we could see a rather solid rebound across most commodity complexes. For the moment, we are not holding our breath that an imminent breakthrough is on the horizon, which may be why we think both Chinese steel and iron prices will continue to experience a bit more pain going into July. Separately, an Australian government report projects Chinese overall iron ore imports will dip by 0.6% per this year, but considering all that is going on, that is hardly much of a decrease.



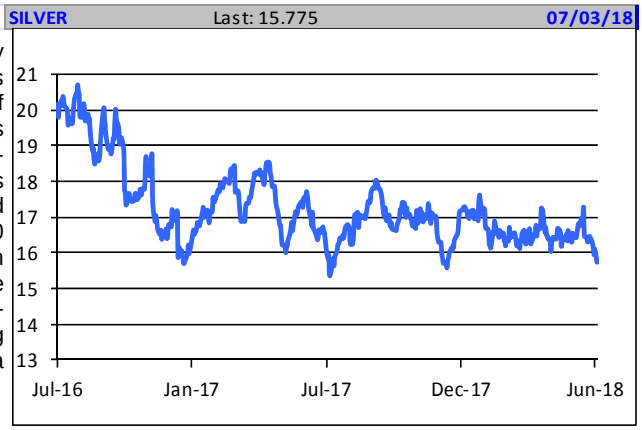
GOLD

Goal had a miserable June and came within $.50 of taking out its December 2017 low of $1238.30 before recovering slightly this past week. For the month as a whole, prices fluctuated between $1238.80–$1313, well outside our $1280-$1335 forecast range. We have to admit that gold's disappointing performance baffled us given that there were hardly any variables that adequately explained its decline. If anything, most of the market developments that were on display last month were constructive to slightly bullish. For starters, the general dollar index ended just about flat in June, while US 10-year yields pushed lower as well. In more "normal" circumstances, both these trends would be supportive for gold. Secondly, significant wobbles in global equity markets, particularly in the emerging market space, hardly did much for the precious metal either. Finally, inflation readings are ticking higher, with US and European price gauges both being close or above central bank targets. So all in all, we really cannot find a reason that could explain gold's June slide and have to suspect that it was largely attributable to a number of "stale longs" bailing out. We also think that unlike previous down moves, physical buying did not materialize in sufficient quantities to arrest the price decline. In this regard, Chinese offtake has been restrained so far this year after a very strong 2017 and Indian gold imports during the first half of 2018 have slumped by some 40%, with the bulk of the drop concentrated in June when the rupee was particularly weak. Here in the US, American Eagle gold came in at 19,500 ounces in June, down almost 19% from May, but year-to-date, Eagle sales are about 40% lower compared to the first half of 2017. More broadly, global demand for gold in Q1 fell by about 7% vs. year-ago levels to 973.50 tons, the weakest since 2008. In terms of our outlook, we are loathe to pick market bottoms, particularly when prices are falling, but have to suspect that gold will do somewhat better in July and doubt that the same set of aforementioned variables factors (should they persist) will contribute to another leg lower. In fact, so far in July, gold's tone has improved somewhat and we see that continuing as we head deeper into the month; we see prices trading between $1225-$1295* in July.



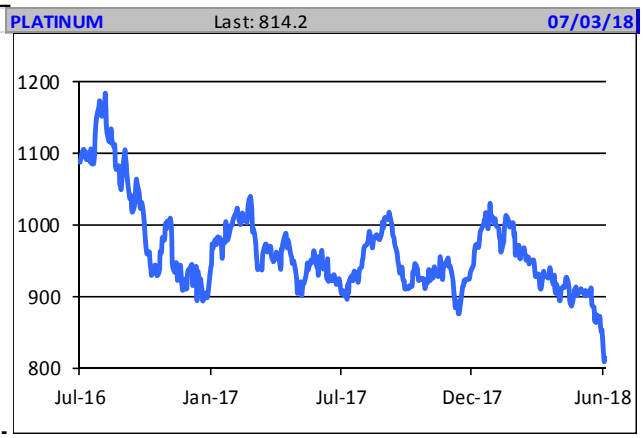
SILVER

Silver did quite well over the first half of June, improving its ratio against gold significantly after getting to a high of $17.35 on the 14th. However, the relentless selloff in gold was too much for the complex and by the close of the month, prices crashed to a low of $15.88, down almost $.60 on the month. (For the record, our forecast range for June was $16.10-$16.85). As per our gold comment above, we failed to see what was behind silver's decline, but unlike gold, we have to suspect that silver's industrial application was more of a pressing negative, as the complex is more vulnerable to trade tensions and accompanying growth worries. Meanwhile, the US Mint reported that it sold 380,000 ounces of American Eagle silver coins in May, down sharply from 2.5 million ounces from a year earlier. In the first five months of the year, sales were also off some 43.2% from the same period a year ago, and so here too and like in gold, physical markets are not responding to lower prices, at least not yet. Over the course of July, we see silver doing somewhat better, in line with the expected better tone we are calling for in gold and see a $15.60-$16.60* trading range prevailing*.



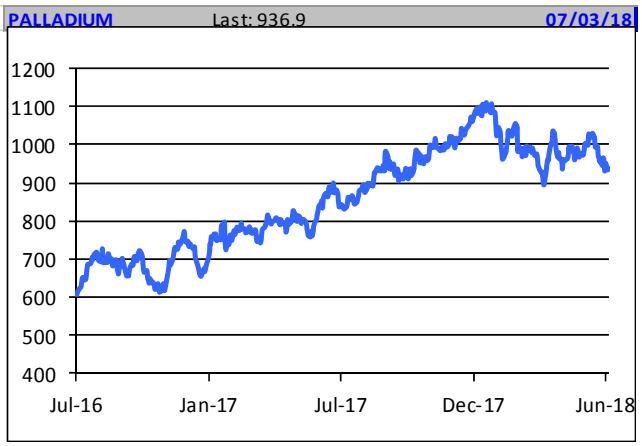
PLATINUM

Platinum had a horrible June and an early part of July, sinking to a 10-year low of just above $800 this past week. For June as a whole, prices traded between $846.40-$914.80, below our $870-$935 forecast range. People have asked us to explain platinum's poor performance vs. palladium, which although down in June as well, did not fare as badly. We would venture to say that rising trade tensions are to blame for platinum's underperformance, especially once attention shifted to imposing duties on European car and part imports coming into the US. Under higher tariffs, European car sales could suffer, but even if the issue were ultimately resolved, a decrease in European duties (which is what Washington is after) could theoretically see more US cars flow into Europe, tipping the platinum/palladium mix more towards the latter. Meanwhile, funds have piled onto platinum's short side; the CFTC reports that as of June 26th, bearish bets exceeded bullish ones by the biggest amount ever. In addition, platinum-backed ETFs saw their largest monthly outflows since November 2015, this according to the *Wall Street Journal*. Outside of all this, platinum's fundamentals, at least based on European car sales, seem good, although they have done little to stop the rot. In this regard, European April sales were up by a robust 9.6% year-on-year to nearly 200,000 units, helped by strong growth in Spain (+22.0%) and Germany (+14.5%). In the first four months of the year, commercial vehicle sales in the region rose 4.3% to 822,481 units. Sales of passenger cars in Europe where diesel's market share is declining but still sizable, also posted steady growth. Despite the June bloodbath, we think the complex is quite oversold and likely due for a modest short-covering bounce, especially if gold tracks higher going into July, as we expect it to. We see platinum trading between $800-$920* over the course of the month.



PALLADIUM

Palladium worked lower in June, ending the month at $936.70, but prices did not experience the same degree of turbulence that other precious metals (particularly platinum) did. For the month as a whole, values traded between $925-$1005, inside our forecast range of $960-$1030/ounce. The complex is faring better on a relative basis vs, platinum on account of the fact that palladium is being perceived by the markets as being a relative "winner" in the tariff war. Moreover, car sales from both China and the US continue to track higher, although car companies are rightly worried about futures sales. In this regard, General Motors warned in a letter to the Commerce Department that proposed tariffs on vehicles could impact domestic production and "lead to a smaller G.M., a reduced presence at home and abroad for this iconic American company, and risk less — not more — U.S. jobs," the automaker wrote. Meanwhile, Chinese automobile sales in May rose 9.6% from a year earlier to 2.29 million vehicles, this according to CAAM, while in the first five months of the year, sales increased 5.7% y-o-y to 11.8 million units. CAAM is predicting 3% market growth this year, not a huge jump, but better than the flat to down readings most were predicting at the start of 2018. In the US, auto sales in May, including those to commercial and fleet customers, dipped to an annual rate of 16.91 million units, down from 17.17 million in April, this according to Autodata. However, we did see a bounce in June, with sales rising by 2.1% year-over-year, this according to Cox Automotive. Edmunds is projecting a y-o-y increase of 3.4% in car sales. IHS is maintaining its forecast at 16.9 million, a decline from last year's 17.2 million, but still a healthy rate for the industry as a whole. Over the course of July, we see palladium prices trading between $915-$995*.



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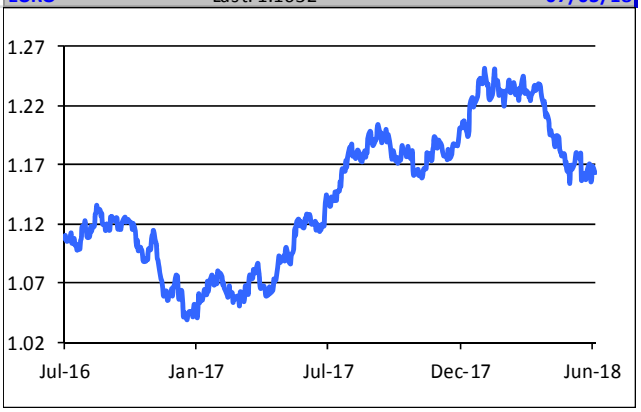
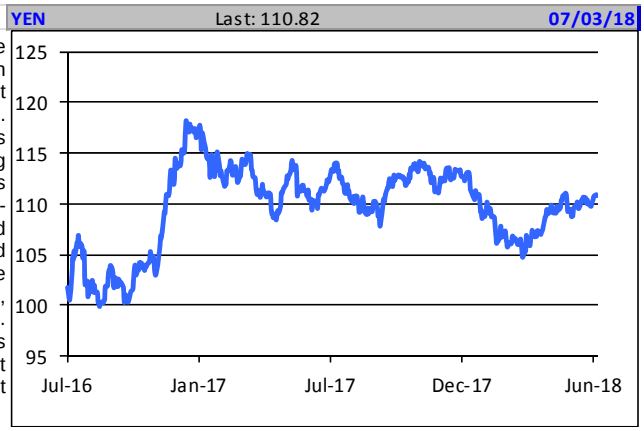
EURO



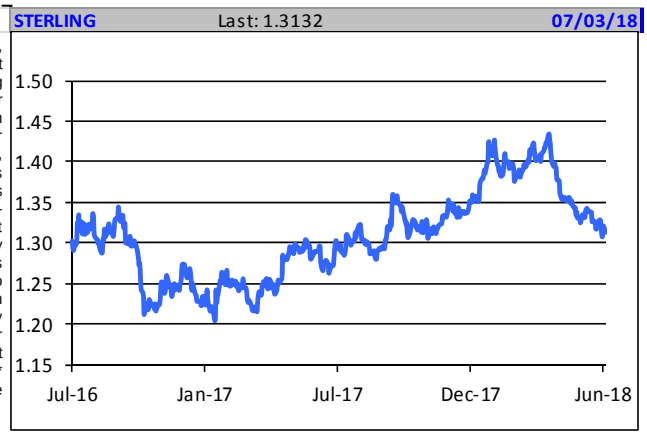
After spending much of May working steadily lower, the Euro stabilized in June, finishing the month practically unchanged after trading roughly between 115–118.50. The lows were reached in mid-June when Chancellor Angela Merkel's coalition was deemed to be in trouble after her interior minister threatened to quit over a migration deal that he was not enthusiastic about. He eventually came around, leading to a modest bounce in the currency, but the incident only illustrated the shaky control the German Chancellor has over her coalition. In Italy, the new government was finally sworn in and although deemed to be Eurosceptic, the country's finance minister said that the government does not intend to rock the boat for now. Also hurting the Euro was the decision by the ECB to halve its asset purchases as of October, but qualified that by saying that any rise in interest rates was unlikely to happen before mid-2019. Separately, European macro readings have been mostly mixed. We learned this week that Eurozone business growth accelerated in June, with IHS-Markit's final composite PMI rising to 54.9 in June from May's 54.1, but the number is off much higher levels seen at the start of 2018. PMI services accelerated, with June jumping to a four-month high of 55.2 from 53.8. However, manufacturing PMI sank to an 18-month low (to be expected given that it is more vulnerable to trade tensions). Separately, Eurozone inflation readings rose to 2% in June, the highest rate in more than a year and now at the ECB's target. In terms of our outlook, it is difficult to make any kind of forecast as to where things will go from here, as much depends on the resolution (or a lack thereof) of the trade spat now going on with the US. We suspect the trade issue will linger on for a little while longer, in which case, we should see the Euro remain under pressure, especially as sentiment readings continue to sour and perhaps spread to the Eurozone's more vibrant service sector. During July, we see the Euro trading between 11550 –11900*.

YEN



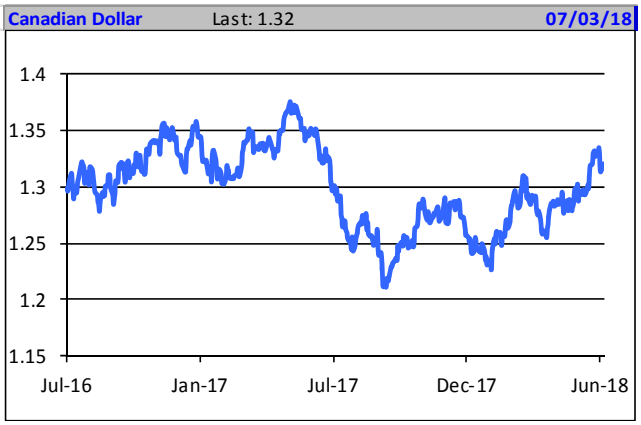
The yen weakened steadily over the course of June, but its trading range was very narrow. For the month as a whole, it traded between a high of 108.70 hit on June 1st to a low of 111 reached later in the month. Trading so far in July has been uneventful, with the currency closing the week at 110.46. It seems the yen has been taking all that has been going on with the trade issue somewhat in stride. Although it has also been targeted for higher duties on its exports to the US, Japan is no longer as critically dependent on the US market as it once was. Moreover, similar to China, Japan is running consistent trade surpluses, but unlike China, its currency is freely convertible, meaning that investors seek it out as a reliable "safe haven" during times of market turmoil. In terms of macro news, the Japanese economy remains somewhat sluggish; Q1 GDP contracted for the first time in nine quarters and Q2 readings, while improving, are not reflecting a sharp rebound. In this regard, the widely watched Tankan survey came in at +21 in June and fell more than expected. However other readings are more upbeat; investment is picking up, as is domestic demand, but inflation readings are hardly budging, meaning that for now the Bank of Japan is content to stay the course and may not move until 2020. Over the course of July, we see the yen trading between 109.20-111.30*, with rising trade tensions deemed to be a slight positive for the currency (as opposed to the Euro). The Korean situation might also be mildly supportive for the currency, as Mike Pompeo's talks with the North Koreans this past weekend did not go all well, at least according to Pyongyang's version of events.

STERLING



Sterling traded between 1.3050-1.3473 in June, hitting an eight-month low before ending the month at $1.3207. This past week, sterling moved up on account of general dollar weakness as well as on remarks made by BoE chief Mark Carney who said that he thinks the economy will bounce back after a slow start to 2018. Said Carney: "A number of indicators of household spending and sentiment have bounced back strongly from what increasingly appears to have been erratic weakness in Q1. The UK labor market has remained strong, and there is widespread evidence that slack is largely used up. Pay and domestic cost growth have continued to firm broadly as expected. Headline inflation is still expected to rise in the short term because of higher energy prices." That seems to be a good summary as to what is going on, but Brexit woes are still casting a shadow. Indeed, Mr. Carney alluded to this, noting that since the 2016 referendum, the economy has grown by 1% *less* than what the BoE was forecasting prior to the vote, Carney also added that the UK's experience with Brexit should serve as a wake-up call to leaders who are seeking to put up trade barriers. Meanwhile, as we went out with this note, PM Theresa May secured a cabinet agreement to keep Britain bound to the EU single market and customs union, beating back Eurosceptic opposition. "The silent majority — the people you never hear from — just want her to get on with this" a senior official told the FT. Foreign Secretary Boris Johnson and five other ministers sought to preserve a harder break, but concluded they did not have support. May's proposal allows Parliament to break a future accord, but this would trigger severe reprisals if it did. May's package would also comprise of "a business-friendly customs model" intended to secure an open Irish border while allowing Britain to strike its own trade deals. The agreement does allow the European Court of Justice to have a role in overseeing the new common regulatory framework, buy Parliament would have the main oversight. Services and financial services would be covered by a looser framework and thus enjoy less access to the EU. We will have to see what the EU response will be, but we suspect this will not come immediately as there still are lots of details to hash out. As a result, we are looking for a fairly wide $1.3050–$1.3450* trading range in sterling this coming month, as the proposal is batted back and forth. Some support for the currency will also be evident from an August rate hike now looking a little more likely.

CANADIAN DOLLAR



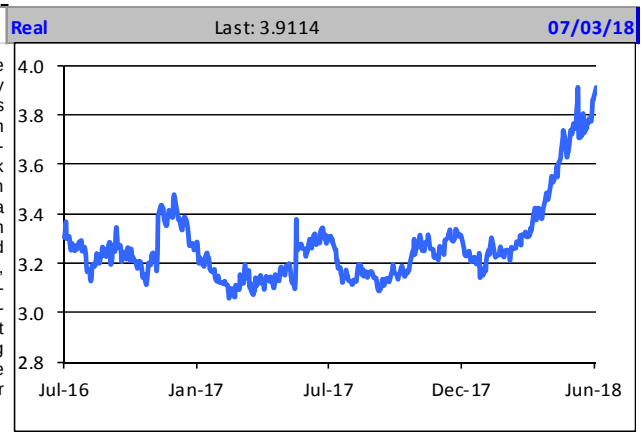
The C$ sank to a one-year low of $1.3380 at one point during the 2nd half of June before rallying this past week to end at just under $1.31. The high on the month was $1.2853, and so for June as a whole, the currency was notably weaker than our forecast range of $1.2750-$1.3100. The loonie's selloff actually started shortly after the G-7 summit was over on June 10 -11 As our readers recall, President Trump and PM Justin Trudeau had predictable disagreements over tariff policy, but what unnerved investors more, was the rancor that followed the meeting. In this regard, PM Trudeau defended Canada's trade policy and said it would "not be pushed around" by the US. For his part, President Trump, who was en route to meet the North Korean leader, refused to sign off on the conference's joint communique, saying that Trudeau was "dishonest and weak". All this dovetailed with the general strength we were seeing in the dollar anyway and continued to push the loonie to fresh lows. The selloff continued after Canada went ahead and imposed $16 billion of tariffs on US imports. It was not until the release of some key macro numbers later in the month did we see the decline in the C$ finally abate. In this regard, reports showed Canada's economy expanding by .1% from the prior month (vs. an expected flat reading), marking a third consecutive month of gains, including strong advances seen in both March (.3%) and February (.4%). Outside of the GDP numbers, manufacturing rose by .8% in April, while the real estate sector, which has been struggling lately, continues to show signs of stabilization; real estate agent and broker activity was up 0.5% in April, the biggest gain since tighter mortgage regulations were implemented at the start of the year. On Friday, we learned that 32,000 more jobs were created in June, substantially more than expected and the biggest jump in months. The economy is now expected to accelerate to about 2% growth in Q2 and as a result, investors are now thinking that the Bank of Canada could put rate increases back on the table, with the odds of a move at the July 11th meeting now at about 54%. On the negative side, retail sales fell by 1.2% in April, the largest drop in more than two years, but weather could have played a role here. Inflation is running somewhat higher than late year (now at about 2.2%) another reason the Bank may move. During July, we see the currency trading between $1.2950-$1.3300*.

INDIAN RUPEE

The Indian rupee plummeted to an all-time low against the dollar in late June, sinking below the 69 mark at one point on the 29th. For the year as a whole, the Indian currency is down some 8%, making it the worst performing Asian currency so far this year. However, the rupee was not the only currency to get hit hard in June; the Turkish lira, the Argentine peso and the Indonesian rupiah all experienced major selloffs, as higher oil prices, rising US interest rates and escalating trade tensions weighed on the group. Because India imports 80% of its energy needs, the rupee (and the trade account) feel the impact of higher energy prices more acutely than other emerging economies. In fact, it is estimated that with every US$10/bbl rise in oil prices, GDP growth slows by 20-30bps, while consumer inflation moves up by .4%-.5%. As we went into early July, the rupee regained some lost ground, helped in some part by RBI intervention. The central bank apparently spent $700-$800 million propping up the currency late last week, but we suspect this was a relatively small sum and will likely be followed up with more buying. With more than $450 billion in reserve, the RBI can afford to spend more. However, a better way to lend a currency support is to raise interest rates, but the government is reluctant to do so lest this slows growth. As it is, the Indian economy is the fastest growing among the world's majors and so clearly the government wants to preserve this state of affairs as long as it can. In the meantime, it has to make sure that that a plunging currency does not scuttle its plans. *Contribution by Hitesh Jain in Mumbai.*

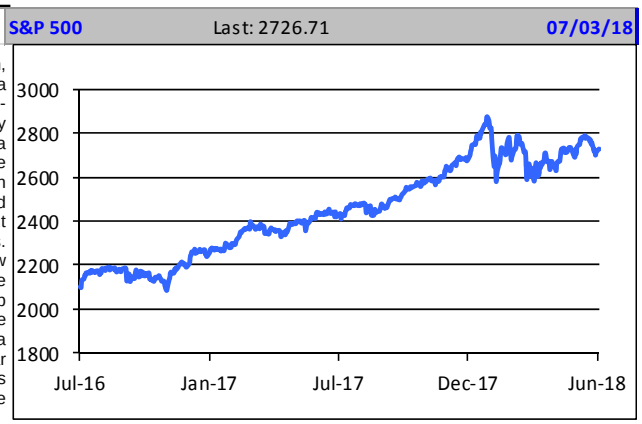
BRAZILIAN REAL

The real was not immune to the general market selloff that hit a number of emerging market currencies in June and hit a fresh 2018 low instead. The government also has had to deal with the double-whammy of an economy picking itself up from the devastating trucking strike that lasted for about 10 days in late May. Official data about its impact is just starting to come in, with the most significant release showing the country's industrial production plunging by almost 11% in May compared to April, the biggest drop since of December 2008. Still, overall industrial production grew by 2% in the first five months of the year, but clearly the May contraction shaved a good chunk off the advance. GDP is also expected to suffer, with the central bank slashing its 2018 growth rate to 1.6% from 2.6% previously. Meanwhile, other facets of the economy are not doing that badly; jobs continue to be created at a decent clip and the government posted a smaller-than-expected fiscal deficit in May. Inflation is trending lower (in fits and starts) and is now projected to come in at 4.2% this year before falling to 3.7% in 2019. Growth is expected to reach 3% next year, but for that to be realized, much depends on how the fall elections play out. This past week, polls showed that the far-right candidate Jair Bolsonaro as ahead in the polls and this helped rally the real somewhat, but the projections are quite squishy at this stage and could swing wildly between now and October. Commenting on the contest, the *FT* writes that "many still expect Brazil to swing back to the center. Polls show most voters as yet undecided. Centrists backed by strong parties ...would also have the advantage once campaigning begins in terms of television time and funds. But for "an angry electorate, the fiery Mr. Bolsonaro may be the perfect candidate — a human grenade with the pin out, ready to throw at Brazil`s moribund political system". For now, both the currency and the economy are hurtling towards an uncertain future.



S&P 500

The S&P 500 hit four-month highs in the June, getting to a peak of just under 2800 before a second-half selloff set in, taking the index back down to 2718, essentially unchanged for the period. If June's action (and that of the year as a whole is any indication) it seems that the stock market, just like a host of other complexes, is treading water, as investors wait for greater clarity on a number of issues. Investors are no doubt pleased to see stocks well supported by strong US economic growth; in fact, GDP readings this quarter are expected to grow by a rather hefty 3.3%-3.7%, a direct result of the gains we are seeing in manufacturing, consumer spending and employment. But on the negative side, and far less quantifiable, is what kind of impact the current US trade spat will have on multinational earnings. In addition, we have two more rate increases to get through this year and by next week, we will also start to see second quarter earnings roll in. The earnings themselves will not be much of a surprise (these will likely be quite strong) but forward guidance CEOs will provide will be of more interest given the murky trade outlook and rising input costs. *FactSet* projections suggest that Q2 and Q3 readings will come in at 19% and 17% higher than last year, but below Q1's sizzling 25% advance. Companies have been easily matching or beating estimates for some time now, but we worry that this will become harder to do as we enter the second half of the year, especially as trade tensions heat up and the impact of higher interest rates start to take their toll. Moreover, going into 2019, the market will not have the benefit of seeing earnings goosed up by lower corporate taxes so comparisons will be far less impressive. (In fact, a study by a California asset management firm calculates that earnings would have risen by only single-digits this year were it not for the tax cuts). As things currently stand, the S&P 500 is trading at about 16.6 times expected earnings for the next 12 months; this is above the 10-year average, but down from 18.6 seen in late January. We expect to see more churn over the course of July and expect the S&P 500 to trade between 2700–2825*.



US 10-YEAR YIELDS

The 10-year rate moved lower in June, ending the month at about 2.82%, down from an intraday monthly high of 3%. (The range for the month a whole was fairly close to our 2.7%-3.0% forecast). At first glance, one would think that the strong US economy and the most recent Fed meeting whereby investors were told in no uncertain terms to look for four rate hikes this year (as opposed to three) would be enough to send rates sharply higher. Indeed, the recent spate of numbers out of the US are in and of themselves enough to make the case for higher rates. To wit, Q2 GDP is expected to come in close to 4% according to some economists — the strongest reading in years. Growth should also benefit from a jump in exports seen in both April and May (possibly in advance of European tariffs kicking in). However, we think that the recent escalation in US-originated trade spats are more than offsetting the impact of these stronger macro readings as far as the bond market is concerned. Investors are sensing that by "pushing the envelop" on the trade side, chances are good that the US economy could slow, prompting the Fed to de-emphasize its more aggressive rate campaign. We should note that the trade situation is having a far greater impact on European yields where most long-term yields are now actually *lower* than they were at the beginning of the year. The thinking here is that a trade war would be far more serious for Europe than it would be for the US. And so as long as we have the trade issue to deal with, we could see rates remaining on the softer side going into July. In addition, the market might be perceiving Q2 to be the high-water mark for the economy as most growth estimates for the balance of 2018 and 2019 are calling for much lower growth (which also explains the flattering of the yield curve). Finally, continued wobbles in global equities could also increase the rush into safe havens like the Treasury note and so we cannot get too excited by another upward rate spike materializing in July and see a 2.65%-3% range prevailing.