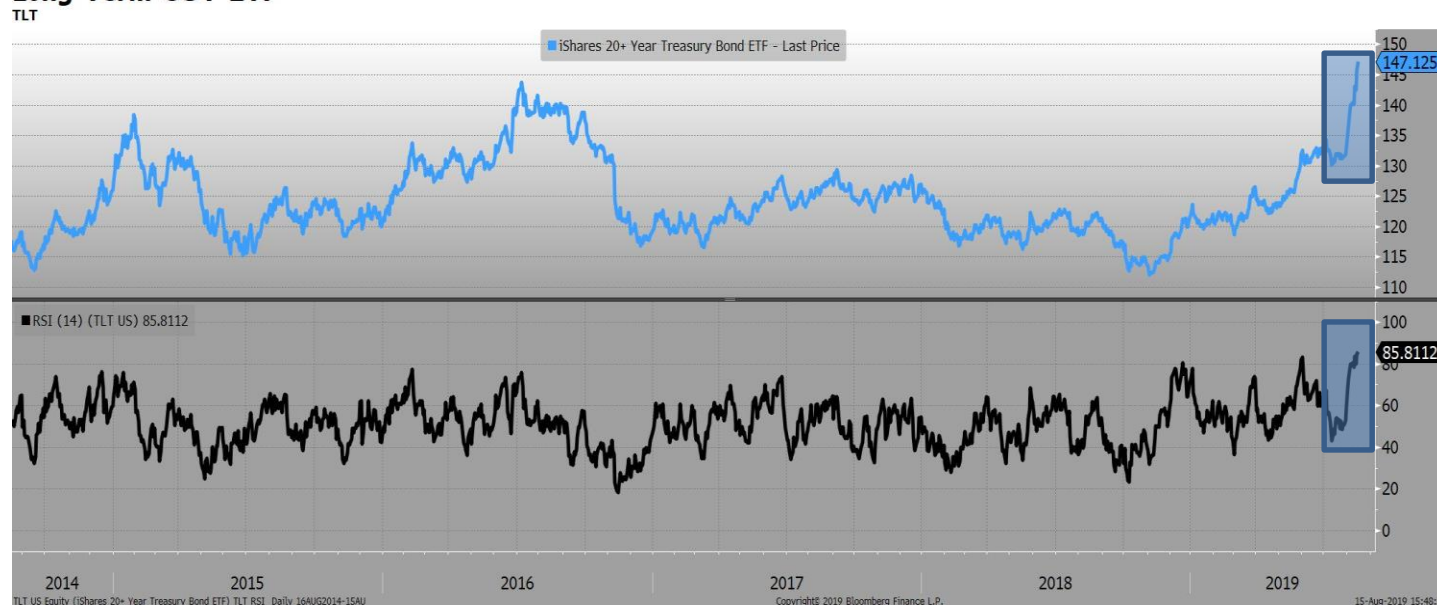


The Week in Pictures: 10 Notable Charts

RATES, EQUITIES, COMMODITIES, FX & CREDIT

30-Year Sector Leads Bond Prices Higher

Long Term UST ETF

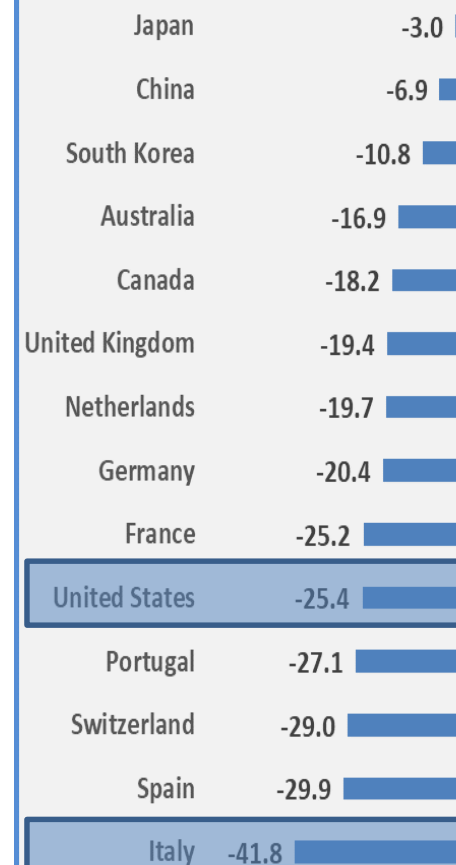


Source: Bloomberg LP, III Capital Management

The stock market plunge and subsequent rebound may have dominated the news headlines; but the big story in the rates markets was the dramatic plunge in 30-year rates. The iShares 20+ Year Treasury Bond ETF (ticker: TLT), that, as its name suggests, provides exposure to long-dated US Treasuries, surged more than 5% on the week. With an RSI reading of 85, the momentum in the market is extremely high (and may be hard to maintain). The rally in long end bond prices was not isolated to the US; Italian 30-year yields were 42 bp lower on the week.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

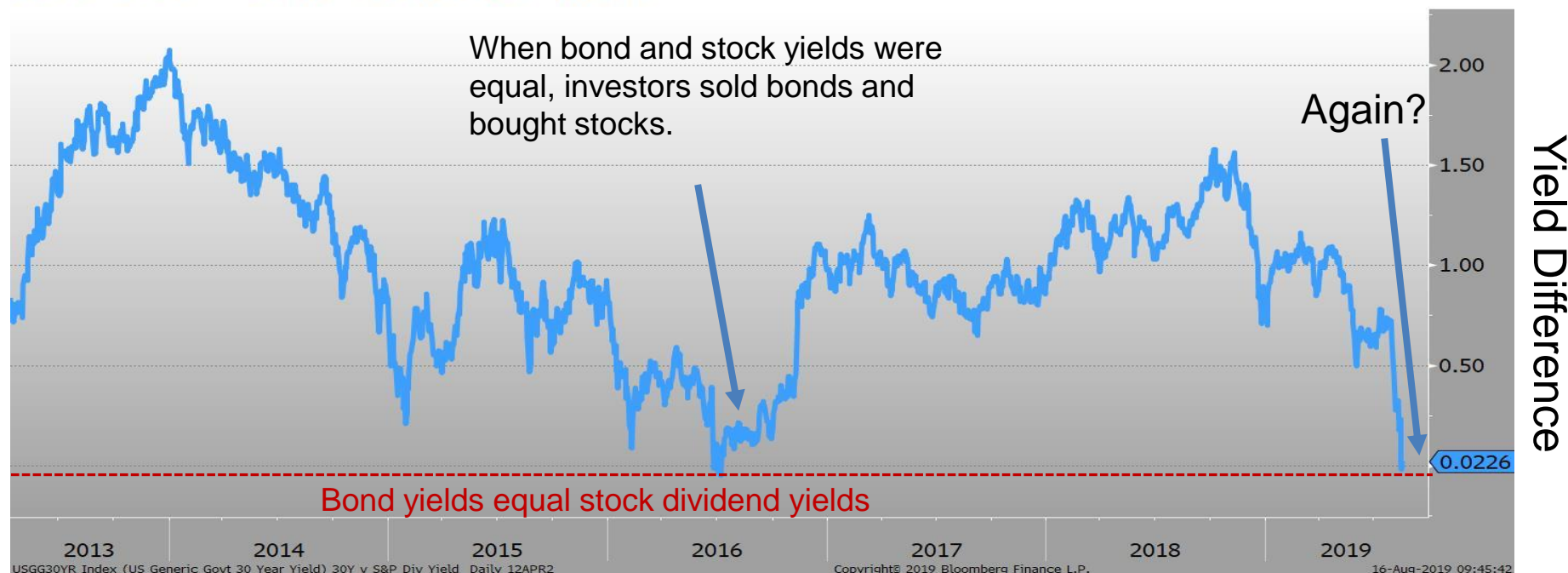
1-Week Change in 30Y Yield



Source: Bloomberg LP, III Capital Management. Data as of close 8/15/19.

30Y Bond Yield declines to match S&P Dividend Yield

30Y UST - S&P Dividend Yield

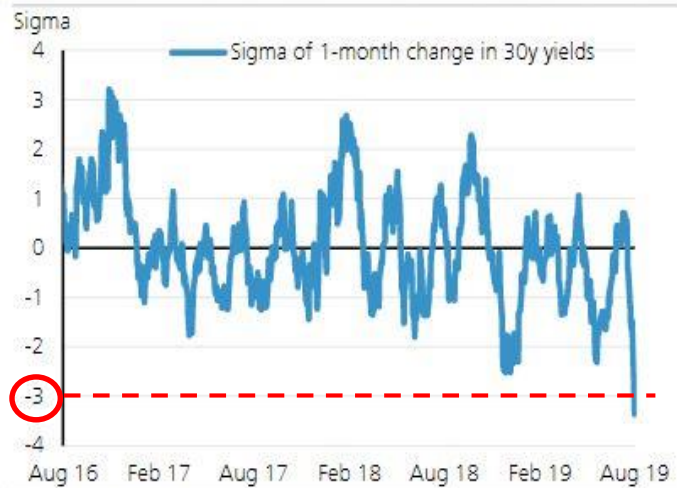


Source: Bloomberg LP, III Capital Management

What would you rather own for the next 30 years-- the S&P 500 or a 30-year government bond? The yield on both instruments is now the same at approximately 2%. Yet, dividends receive better tax treatment and potentially grow over time, providing some protection against inflation. When the dividend yield for the broad stock market matched the yield on long-dated government bonds in 2016, investors clearly saw the relative value. Even though earnings may decelerate over the coming quarters, it is hard to imagine the long-term total inflation-adjusted return for stocks won't surpass that of 30-year bonds.

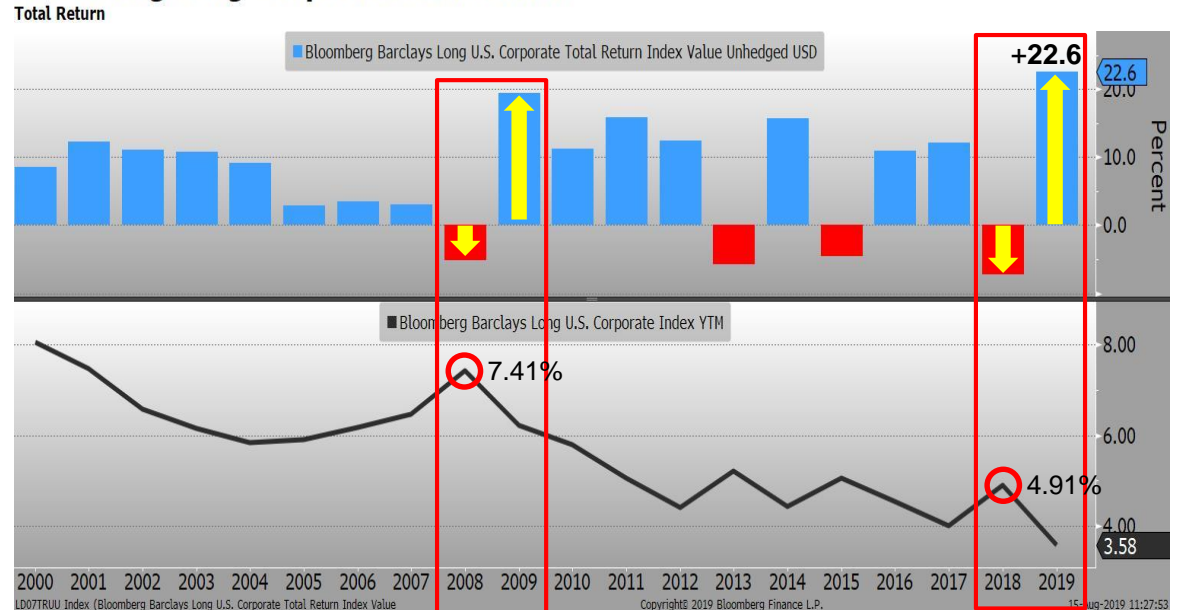
Long-Dated Corporate Bonds on Track for Record Returns

The recent monthly change in 30-year Treasury yields is a three-sigma event. Such a move has happened only rarely.



Source: UBS, Bloomberg

Bloomberg Long Corporate Bond Index

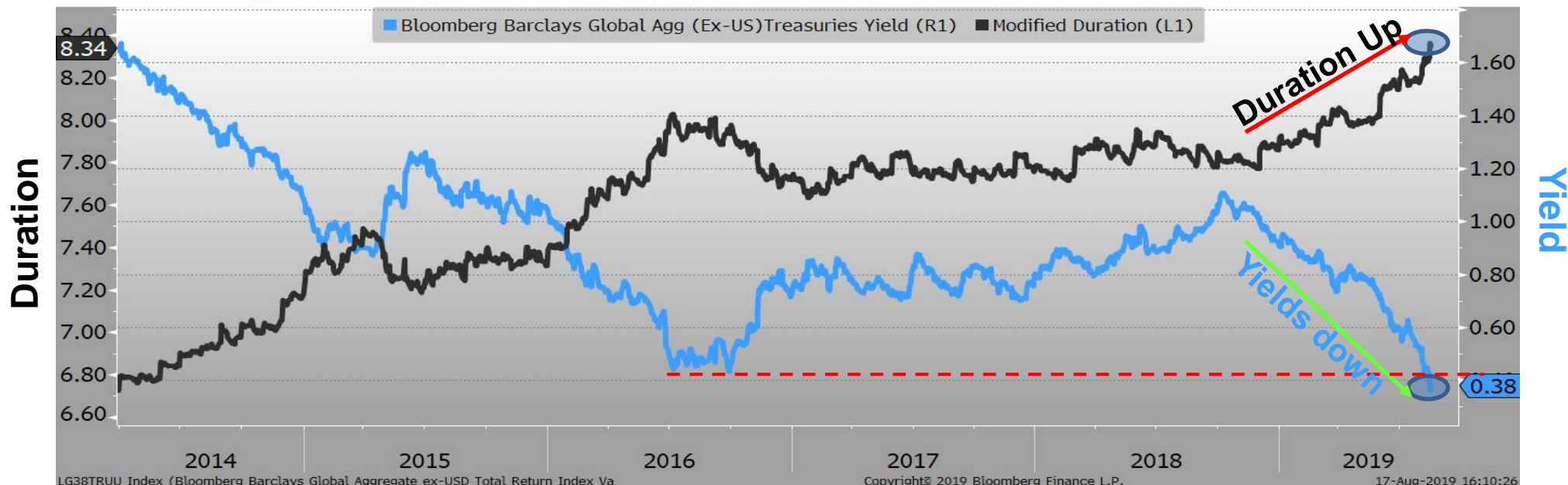


Source: Bloomberg LP, III Capital Management

The three-sigma drop in yields in 30-year UST rates spilled over to the investment grade corporate market. The YTD total return on the Bloomberg Barclays Long US Corporate Index is 22.6%. If current levels hold, 2019 will be the best year on record for the index-- even better than 2009 when the corporate bond market recovered from the 2008 blowout of credit spreads. What makes the move this year even more impressive is that it started with an average index yield of 4.91% compared to a starting yield of 7.41% in 2009.

Global Non-US Rates Reach New Lows

Bloomberg Barclays Global Agg (Ex-US) Yield

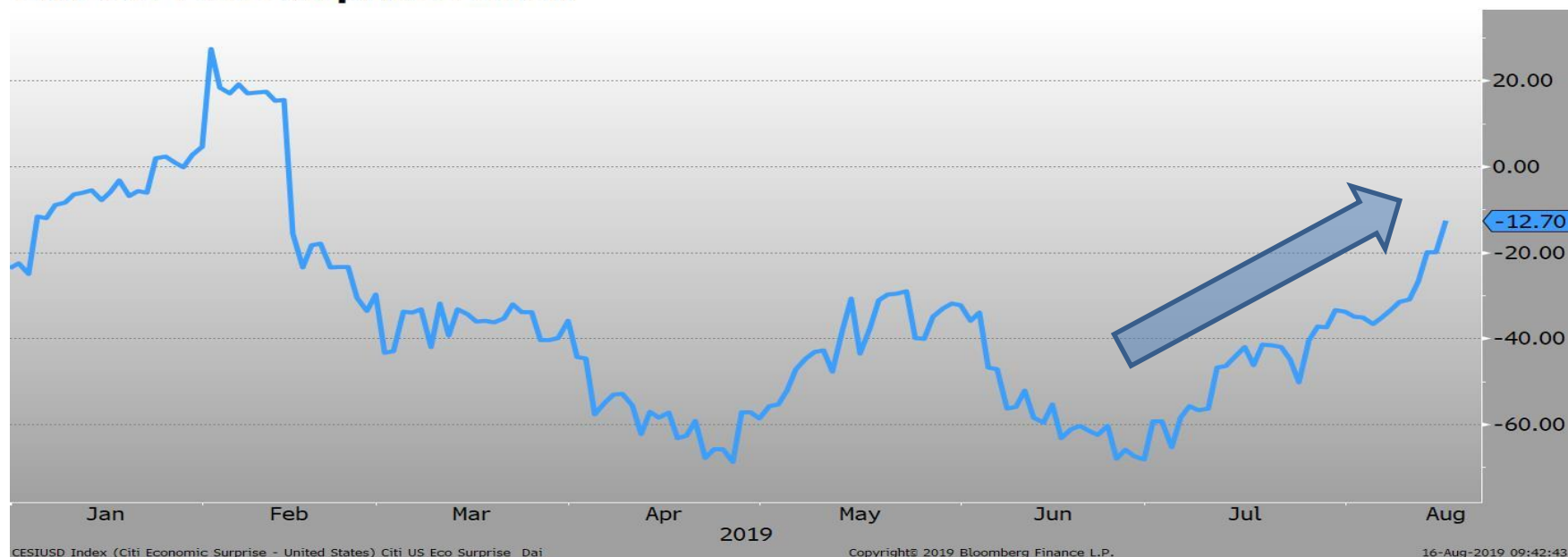


Source: Bloomberg LP, III Capital Management

Global interest rates, excluding the US, are now lower than in 2016. The Bloomberg Barclays Global Ex-US Aggregate index offers a mere 0.38% yield. With an [average inflation rate](#) for 40+ advanced economies of 1.6%, investors are forced to accept substantial negative real yields in exchange for the “safety” of government bonds. Safety is what investors want, but increased risk is what they get: the duration of the index has extended to 8.3 years, and there is almost no coupon to offset any rate rise. Yet, most people appear to be only worried about the equity market...for now.

US Data Not Supportive of Rate Cuts

Citi US Eco Surprise Index

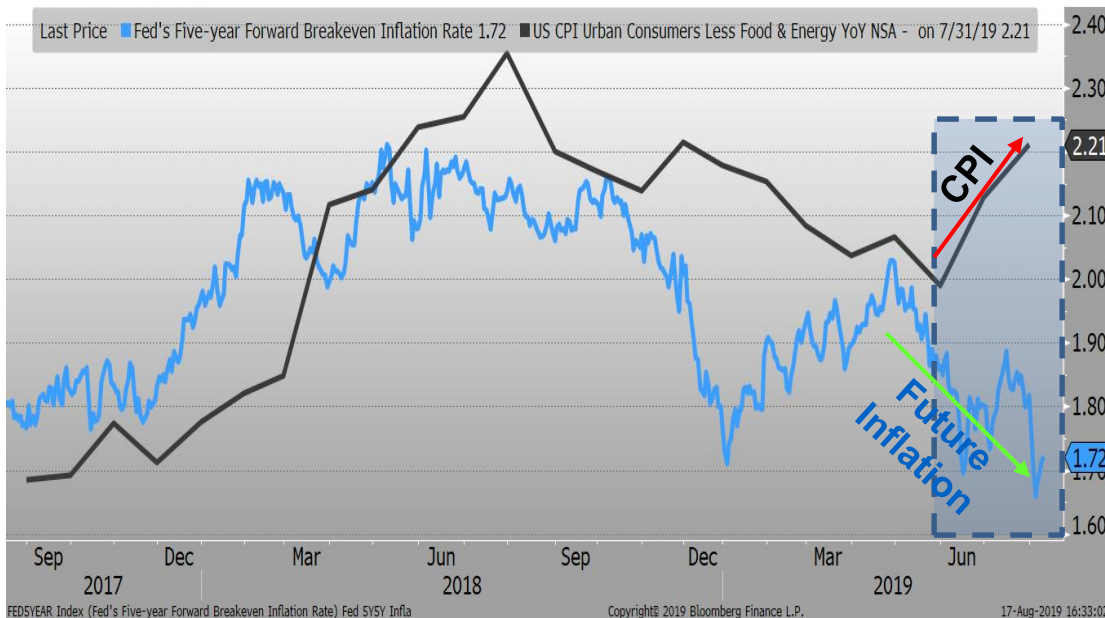


Source: Bloomberg LP, III Capital Management

The Fed is in a tough place. Recent domestic data has been strong, beating expectations from most economists. This is evidenced by the turnaround in the Citibank Surprise Index in the last two months. While manufacturing remains weak, the consumer (employment/retail sales) is not showing many signs of weakness. Indeed, with lower mortgage rates, another wave of refis could add more spending power to homeowners. The picture outside of the US does not look nearly as rosy. The next Fed decision will need to weigh the relative impact of a decelerating external environment with a US economy that probably does not need additional monetary stimulus.

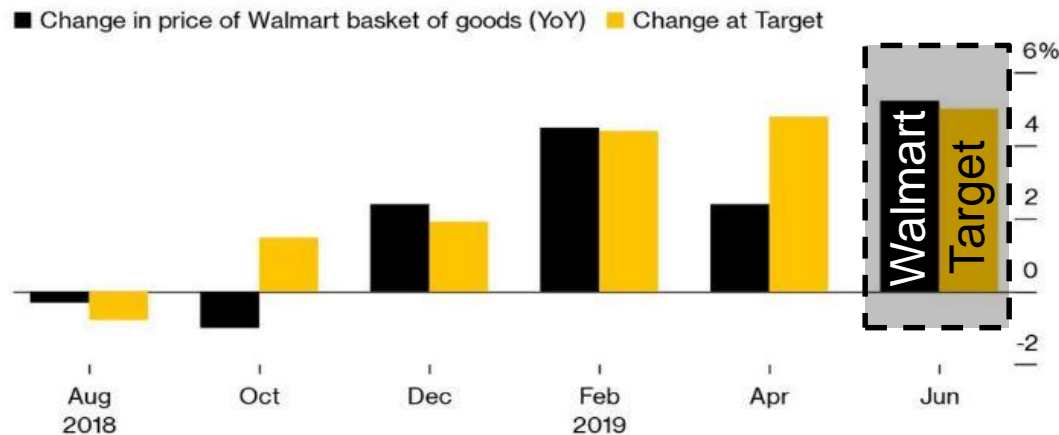
Can Inflation Hand-Cuff the Fed?

5Y5Y Inflation Rate



Rising Tide

A trip to Walmart and Target has gotten more expensive in recent months



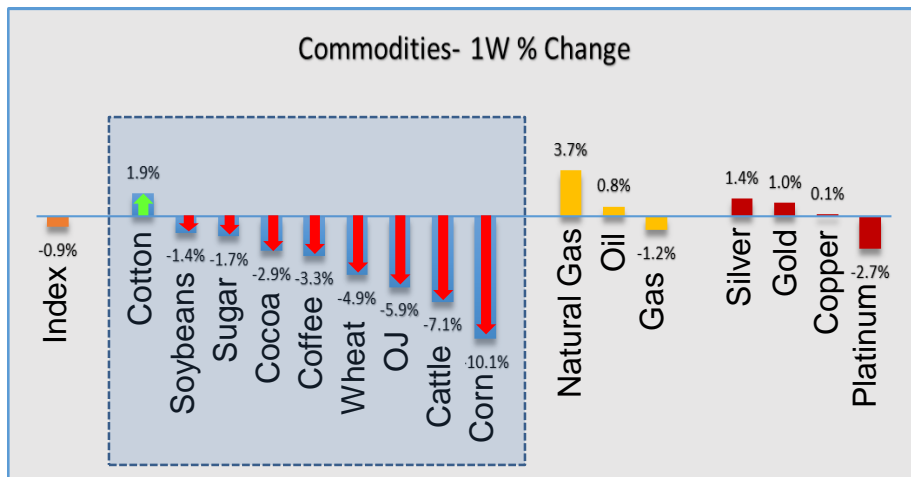
Source: Gordon Haskett Research Advisors

Note: Price calculated for shopping trip composed of about 76 items at Target and Walmart locations in five U.S. cities in June 2018 and June 2019

Bloomberg

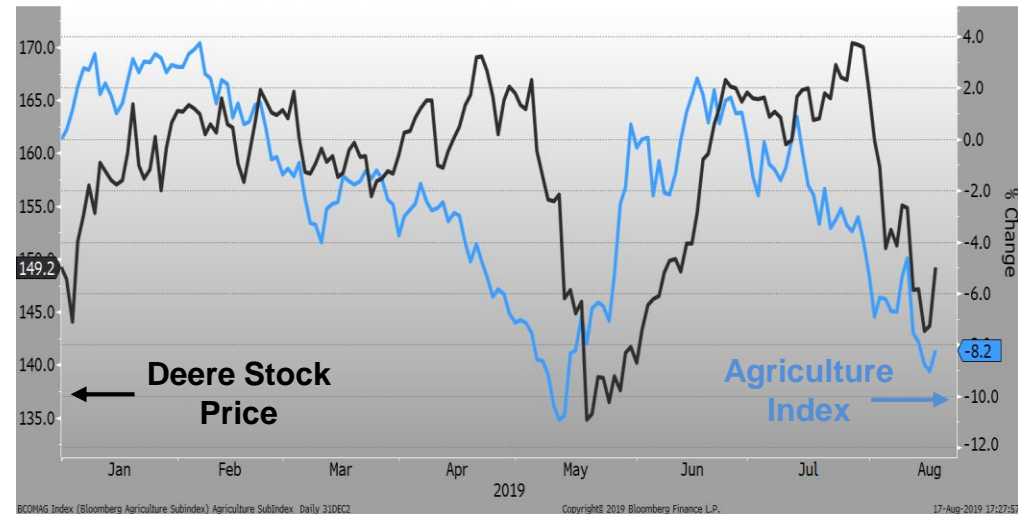
Another problem for the Fed is inflation. The market's clear expectation is that inflation will decrease, but core CPI has gone the other direction. Another way to gauge inflation is to track a constant basket of goods bought from Target and Walmart. Using that measure, inflation is running even higher (more than 4%). Additional tariffs on imports from China will not help. Walmart's CFO in a May interview confirmed the importance of its Chinese supply chain when he said: "Increased tariffs lead to increased prices." The US consumer may be strong today but could be tested soon.

Agriculture Sector Leads Commodities Lower

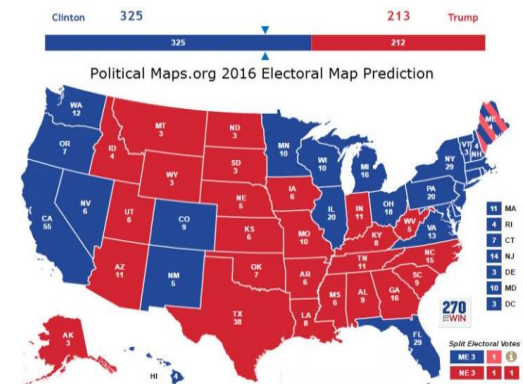


Source: Bloomberg LP, III Capital Management

Bloomberg Agriculture SubIndex
(coffee, corn, cotton, soybeans, soybean oil, soybean meal, sugar and wheat)



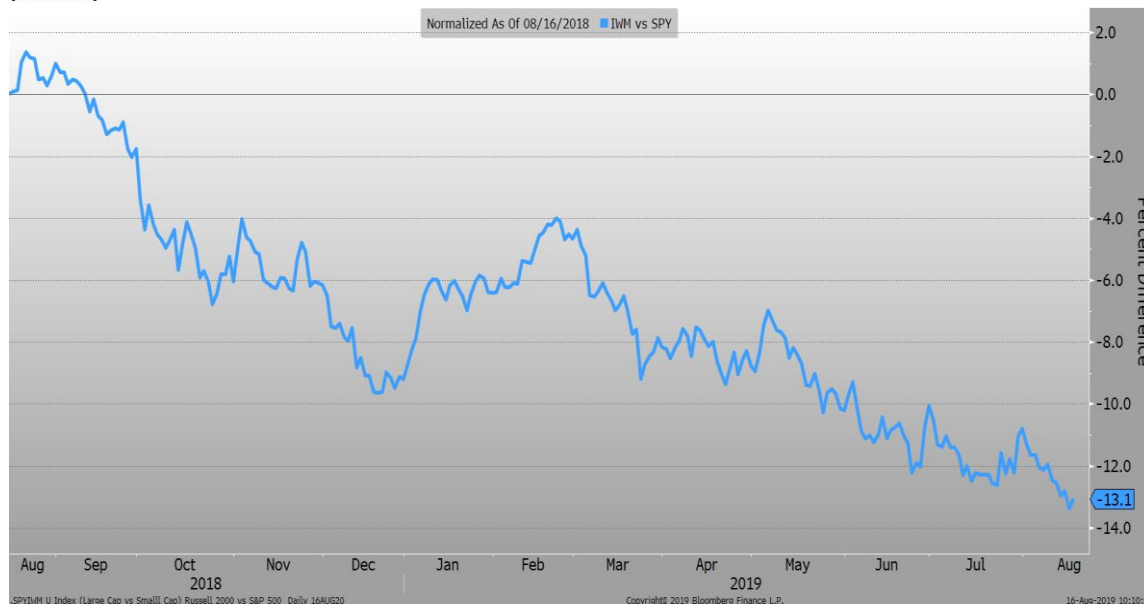
The agricultural sector led commodity markets lower last week and is down 10% over the last two months. Corn futures had a brutal week-- dropping 10%-- thanks at least in part to a USDA report that suggested the Midwest floods did not have a large an impact on supply as predicted. The fortunes of farm equipment maker Deere & Co closely follow the performance of the agricultural sector. The company lowered earnings guidance for the second straight quarter. The health of the farming sector will be critical as we approach the 2020 elections.



Source: politicalmaps.org

No Love for Small Cap Equities

Russell 2000 vs S&P 500
(IWM vs SPY)



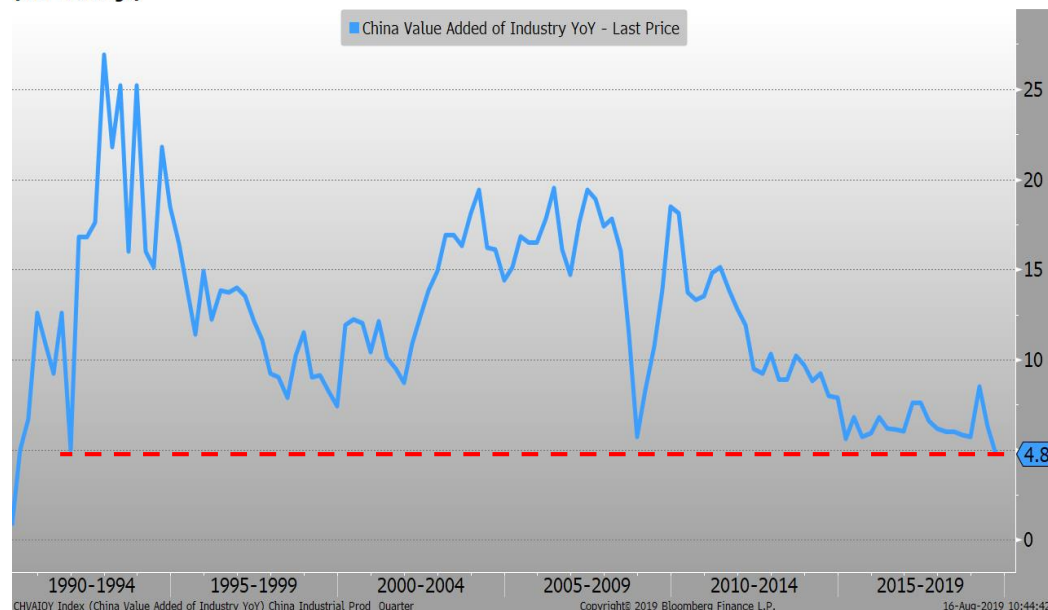
Sector	IWM +/-	1Y TRR +/-
Financial	8.14	-10.38
Consumer, Non-cyclical	1.48	-18.73
Industrial	4.58	-11.31
Consumer, Cyclical	3.28	-24.91
Technology	-7.21	-2.02
Communications	-10.84	-10.45
Utilities	0.45	-3.60
Energy	-0.94	-25.79
Basic Materials	0.82	-18.69

Source: Bloomberg LP, III Capital Management

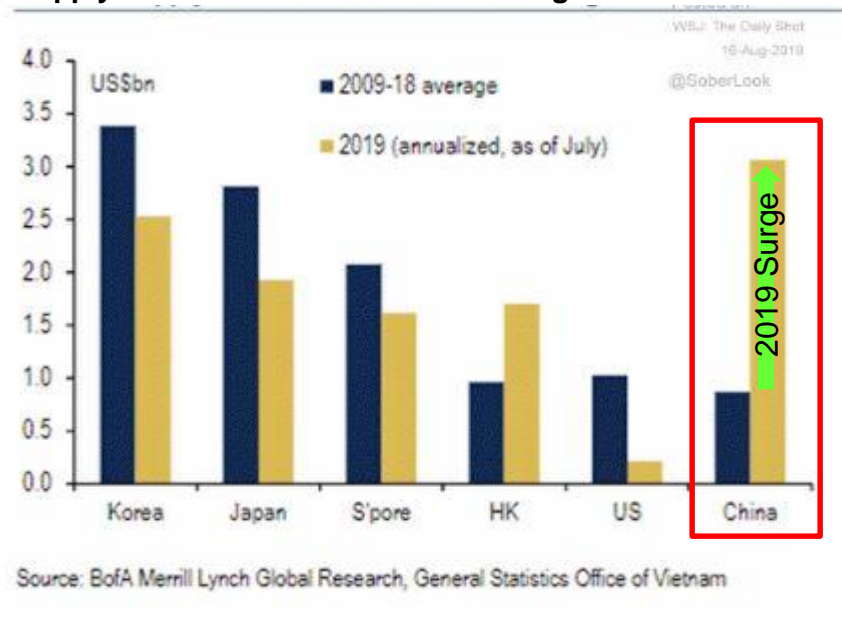
Small cap equities are struggling to keep pace with the S&P 500. The Russell 2000 index has underperformed the S&P 500 by more than 13% over the last year. With the massive drop in interest rates, one might attribute the underperformance to the 8% overweight to the financial sector in the Russell. However, that is unlikely to be the sole or even primary contributor. Russell stocks have lagged the S&P 500 in every sector, with the consumer cyclical and energy sectors causing the most drag. The cheapening of small caps is surprising given the strength of the dollar (most small caps have limited international exposure). Bottom line: there is no good explanation for the weakening trend.

Chinese Economic Data Disappoints

China Industrial Production (YOY % Change)



Supply Chain shifts have caused a surge in FDI from China



Weak industrial production data out of China last week confirmed that the global slowdown in manufacturing is hurting the world's second-largest economy. Industrial production slowed to a YoY rate of 4.8%, the slowest rate in almost 20 years. Manufacturing has been moving away from China for years due to labor cost differentials with other Asian countries; but is accelerating in 2019 due to the imposition of tariffs. Vietnam, for example, is on pace this year to receive more foreign investment from China this year than any other country, and far greater than the 10-year average level of FDI.

Argentina Bond Market Collapses

Argentina 7.125% 2117 Bond



Source: Bloomberg LP, III Capital Management

Investors were rocked last week in Argentina following the country's primary elections, where current President Macri lost in a surprise result. The people of Argentina, experiencing a jump in the poverty rate and 50% inflation, appear to have lost faith in Macri's plan to modernize Argentina's economy. Under Macri's leadership, the country was able to issue \$2.7 billion of 100-year USD-denominated bonds to international investors in June 2017 that was four times oversubscribed. Those bonds tumbled almost 30 points early last week before recovering slightly by Friday. The market is pricing in a high probability of yet another debt restructuring over the next couple of years.

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