MACRO Voices
with hedge fund manager Erik Townsend

David Rosenberg: The top is probably in already

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Erik: Joining me next on the program is David Rosenberg, famously the author of "Breakfast with Dave," a newsletter that has persisted through, I think, three or four different job changes.

Dave, thanks so much for being with us on the program. Listeners, we've got a great slide deck that Dave put together a few months ago. This is dated from March, but it is every bit as relevant today as the day that it was published in March of 2018. You'll find the download link in your Research Roundup email and I strongly encourage you to download it as we'll be referring to it throughout this interview.

Dave, the first few slides you've got here – you've done such a brilliant job as always at getting together some of the smartest people in the industry and quotes from – all kind of on the same theme, which is we should be pretty much coming to an end of this cycle.

But I was particularly caught by Jeremy Grantham's comment on Slide 3 where he says this thing ought to be over but, on the other hand, as a historian, there's also the possibility that we're just going to see a great big blow off or melt-up phase at the end of this bull market. And he's saying the potential of maybe another 60% surge up before it's finally over.

So where does that bring us? This was a few months ago. What's the current update on your outlook on the market? Are we looking at maybe that last hurrah? Or is this cycle finally ending?

David: Well, I think it's probably more the latter. It's interesting that Jeremy Grantham made that comment just as we were hitting that January 26 peak in the S&P 500. I think, actually, the blow off already had happened in January. When heading into the all-time highs, the S&P 500 was up almost 8%. That doesn't happen every single day. That was in less than a month.

And I remember all the headlines saying at the time that this was the best start to the year, the best January we've ever seen since 1987. And my retort was, well, when I go back and poll people about 1987, January was not the month that they remembered. It was October.

So I would actually say I don't know where 60% increase in the stock market from where we were in January – where that would possibly come from – but my sense is that the blow off phase already happened after the tax cuts were announced in December and into January.

I think that was the last parabolic move to the highs. And we've just put in a classic topping formation ever since.

This market is looking very toppy. The breadth measures are looking increasingly less impressive. And the yield curve is flattening, not inverted yet. But my sense is that – some indices like the NASDAQ put in a high very recently. You can look at the Russell 2000. To me the S&P500 is the bellwether. And, until otherwise notified, it's been a good seven months since we last saw a high. Until we revisit that, to me this is a classic choppy trading pattern of the market.

Erik: You've got absolutely fantastic content throughout this slide deck. Listeners, I strongly encourage you to enjoy every page of this.

But, in the interest of time, I'm going to skip ahead to Slide 42 where you get into this huge overhang of corporate debt that is just one ratings downgrade away from being downgraded to junk status.

And, of course, there is a reinforcing cycle that always kicks in there. If things get downgraded to junk, institutional holders are forced to sell them. They don't have a choice, because they're no longer investment grade. And that just pushes the price down further.

But a whole lot of people have been speculating that that's what's going to really give out next, the junk bond market. But I just saw this week that we've got record high short interest in the junk bond ETFs. And, of course, that could be a setup for a short squeeze.

So do you think this junk bond market is finally ready to let go here? Or do we maybe still have more time to wait?

David: What's interesting is that the real excess might not even be in the high-yield market but actually more in the investment-grade market. Because at the peak of the last credit bubble, over a decade ago, only 30% of outstanding debt in the investment-grade universe was Triple B. Today, that ratio is 50%. So it's really the junkiest investment-grade universe that we've ever seen.

The reality is that a lot of the energy companies, and the high-quality ones, during the downdraft in oil prices a couple of years ago, they got pushed in to the high-yield index already. And, with oil over $70 a barrel than, say, $30 or $40, they are pretty well allowing the high-yield index to hang in relatively well, when you consider they're 20% of the high-yield market.

The real excesses actually are in the investment-grade universe this time around. And my sense is that the Fed seems to have this very rosy scenario. You know, steady she goes. Chief Powell told us that he doesn't lose sleep at night over the economy. It sounds a lot like Ben Bernanke talking about how the problems with subprime were going to remain contained.

And it's not a matter of timing. It's really a matter of understanding where we are in the Fed timing cycle.

At some point, given how much leverage there is in the corporate bond market (not just high-yield but the investment grade) and the volumes (the record volumes of debt refinancing taking place in the next two years), because we will be paying the piper at higher interest rates, the default rate is going to rise, credit spreads are going to widen out, financial conditions are going to tighten. And that's going to generate the inevitable recession.

It's not a matter of if; it's a matter of when. And I could be early on the call as I was back in 2007, but I am suggesting that, if you don't open the umbrella, just make sure you have one on you.

Erik: Well, I think you make an excellent argument where the excess is really in the Triple B rated corporates as opposed to what's already been downgraded to junk. Is there a way to play that?

You know, the ETFs, JNK and HYG, are such an easy way to short junk bonds. Is there a similarly easy way to short these Triple B rated corporates?

David: I would say that it's very difficult to short anything that's naked in terms of, that earns a carry. Because you take that negative carry if you short it. So you really have to benchmark it against something else.

My sense is to go long within the credit space. Go long the high-quality, more defensive names that have strong balance sheets. Go long those names and go short the low-quality names. And I think that's how you're going to be able to at least hedge against interest rate exposure.

But also, I think, capture the lack of quality and the lack of, basically, debt repayment prospects down the road. I would be shorting the low-quality stuff but go long the high-quality against it. That's how I would hedge that situation right now.

Erik: Moving on just a couple of slides – you've got into the subject of inflation, Core PCE inflation peaking lower and lower. This is a subject we've heard quite a bit about from recent guests on the program, some people are very much committed to deflation has got to be the name of the game (or disinflation), Russell Napier recently telling us that story.

On the other hand, other people are saying, yeah, but look at some of these number like PCE starting to turn up. We're maybe on the cusp of a return – according to some people – of secular inflation.

How do you see this, short, medium, and long term? What's going to happen with respect to the inflation or deflation trend? And how do you play it?

David: I'm not going to try and obscure what is secular and what is cyclical. To me that's a complete waste of time.

We had secular deflationary forces in play in the last cycle. Whether it was China's ascension to

WTO, the same story about aging demographics, technology was still advancing – you could argue even more so now. It didn't stop underlying inflation in the mid-2000s from going from 1% to 3% and headline [inflation] almost got to 5%.

These cyclical inflation pressures, they don't last one or two months or one or two quarters. They could last a couple of years.

If you look at the chart, you'll see there's a long-term sector downtrend, that much is true. But it gets punctuated by these late-cycle inflationary pressures that only a fool would ignore, because I don't think anybody can afford to not have at least a one-, two-, or three-year view.

The data are the data. And inflation is going up. Every single piece of measured inflation data are rising. The New York Fed's underlying inflation index, which is a great leading indicator, has already broken out to a cycle high and is suggestive that underlying inflation is going to be rising.

The demographic story hasn't changed. Technology hasn't changed. Certainly, debt constraints on aggregate demand globally, that hasn't changed.

What has changed is the trend towards globalization. What is new is that we have the risk of a global trade war. Tariffs are already going up. That's creating cost push inflation at a time where there is very little slack, if any, left in the US economy. That's going to be inflationary.

Really, for the first time since the Vietnam War, we're running a pro-cyclical fiscal policy at the peak of the cycle. We know how that ended up after the Vietnam War. It ended up years later with higher inflation.

So, if you're taking a look at the shifts in the United States towards fiscal policy, you're looking at the shifts towards global trade policy at a time of 4% unemployment. You can't ignore these other powerful offsets. So my sense is that the secular story still may be intact because of technology and demographics.

But I think that, for the next several months of quarters, maybe even the next couple of years, the trend is going to move towards moderately higher inflation. And I'm not so sure the markets have really priced for that.

Erik: Let's skip ahead to Slide 52 in the deck here, where we talk about the US dollar trend. We're hearing so many different views on this recently.

Do you think that the current bounce in the dollar has legs? Are we seeing a reversal of trend? Or are we still headed down, as a lot of people – it seems like everybody is predicting the crash of the dollar, but it's not happening.

David: I don't know why people would be predicting the crash of the dollar. But I would say that, so long as the Fed is the only game in town, in terms of raising interest rates, and everybody else is on hold – maybe outside of the Bank of Canada, in the developed world – interest rate differentials are going to continue to work in the favor of the US dollar.

My sense is that the path of least resistance, in my view – at least, say, in the next 6 to 12 months – I'd be very surprised if the US dollar were to succumb to a downtrend. Unless something happens that causes the Fed to back off or something happens that causes the ECB or the Bank of England or the Bank of Japan to start increasing interest rates.

The ECB, which is a key part of this relationship with the trade-weighted dollar, has already told us that, although there is going to be tapering, their balance sheet, their interest rate increases are way off into the horizon.

So my sense is that the interest rate differential, which is the most important component in determining exchange rates, is going to remain in favor for the US dollar for some time.

Erik: Let's move on to the 10-year Treasury yield. There were so many smart people predicting there's a magic line in the sand, 3.05 on that 10-year yield. If we go past that, baby, it's no return. it's the end of the world at that point.

Of course, we did go past 3.05 all the way to 3.11 I think. And now we're right back down to 3 80s again. What's going on here? And where do you see it headed?

David: We're in a very tight range now, for the better part of the past four months, and I think you were correct in saying you know 3.1% at the high end, and call it roughly 2.8% at the low end. Very tight range.

And it's a tug of war, really, between concerns over economic growth, once the tax cuts subside and the impact on the real economy purchasing power – for the consumer in particular but also margin squeeze for the corporate sector – what that means for economic growth. At a time when the Fed continues to take the carry away. So we're really in this tug of war right now.

I think that what's very interesting is how investors are positioned. You were talking about the short position in high-yield ETFs. If you go to the latest Commitment of Traders report, you're going to see that in the futures and options pits, there's almost a record net short position on the 10-year Treasury note. Almost 350,000 net short contracts. For the long bond it's actually at a record of over 190,000 contracts.

So if you adhere to Bob Farrell's Rule #9 – about all the experts and forecasts agreeing, then something else is going to happen – you've got to start thinking that the sellers of Treasuries have already exhausted themselves. We've hardly ever seen such a huge net short position for 10-year and 30-year bonds.

That tells me that even a small piece of adverse news could cause a lot of these shorts to cover.

And yields actually would be aggressive going down. People always talk about the risk of the Fed inverting the yield curve. What might happen instead is that Treasuries may rally and cause that inversion from the longer end to the curve.

Erik: Moving on to Slide 63. Now, of course, this was four months ago that this slide was put together. It says here that we're past the seventh-inning stretch. Four months later, are we all the way to the ninth inning? Is this really at the end? Or do we still have maybe a little ways to go?

David: No, I wouldn't say that it's – it's not the ninth inning. I think that we're still past the seventh-inning stretch. And that's it in the context of an economic expansion that's the second longest on record, heading into its tenth year. You could even be into the ninth inning right now and it would still tell you that we have about a year left in the tank.

It's just basically – not trying to time things, but trying to figure out what segment of the cycle that we're in.

We did a report looking at 15 different indicators, both market and macro variables, to examine the degree of capacity in the economy. How the pattern of the economy this cycle is evolving relative to what it's done in the past since the end of World War II. And we were able to ascertain that we're about 90% into the cycle, which means probably closer to the eighth inning than, say, the seventh. Maybe not quite the ninth.

But what's important for investors is that there is early-cycle investing, mid-cycle investing, and late-cycle investing. It's not really about recession. A recession will come – I think more next year's story than this year's story. So you don't want to be too early, even though you don't want to be late.

But the major point is that, across the whole continuum of the business cycle, there is an optimal asset mix and an optimal sector representation in your equity portfolio across that continuum. And late-cycle is the antithesis of early-cycle.

So it really means you want to have some cash on hand, you want to be very defensive, earnings visibility and predictability in the stock market. And you really want to trade up in quality in the debt market. And you want to be focused on protecting the portfolio from late-cycle inflation and rising short-term interest rates.

There's a variety of ways of doing that without having to have too much cash on hand. Although, having cash on hand right now for optionality purposes to put to work at better valuation levels – say 12 months from now – is a prudent thing to do in my opinion.

And, again, that's classic late cycle. Whereas early cycle you don't want to have any cash at all. It's a lot different this time around.

Erik: Along those lines, Dave, we've seen year-to-date that cyclical stocks are still outperforming defensives. Do you expect that to turn around as we go into the second half of the year?

David: It depends on how you want to define cyclical stocks. We've got – technology has been the clear leader, up 15% year-to-date. And that, to me, is a classic growth story and a prevailing view that this is one area that is not going to be hurt by the rising tide of populism and the reversal of globalization. That will be put to the test, but that's the view. Tech is classic growth and they have remained the leaders.

Going down the list, you can count energy as being an outperformer for sure. But energy is benefiting from the fact that OPEC and the other suppliers got their act together with the OPEC cut agreement, bolstered the price. So it wasn't a demand story; it was a supply story.

Outside of that, there's not a lot of cyclical stocks that have outperformed. You look across the board and you see that the materials are still down 4% for the year, industrials are down 3% for the year.

If this economy was really booming like everybody says it is, you'd have to ask yourself the question, why would financials be down 2%? Why would the relative performance of the bank index be down to its lowest level in 12 months?

So, actually, it's a very bifurcated market. If you stripped out the growthy tech index, the median sector so far this year is down 1% or 2%. And that includes the bounce-back we've had over the course of the past couple of weeks.

Erik: You're in Canada and we also have quite a few listeners in Canada. Let's touch on the Canadian economy a little bit, starting with the Canadian dollar. Is there more downside to the loonie in store as you see this situation continue to develop with respect to the late-stage market and everything else that's going on in the economy?

David: A lot of that depends on what happens with NAFTA [North American Free Trade Agreement]. For a country that is so trade-dependent as Canada, how NAFTA goes, how this looming global trade spat that could turn into a war, countries like Canada, Australia, New Zealand, countries that have high trade orientations, are going to get hit pretty hard.

There's a lot of bad news already priced into the Canadian dollar at 130–142. But I don't think that a worst-case scenario that would evolve with NAFTA being abrogated is priced in. I think things would get a lot worse.

I think right now, from a market-positioning standpoint – and you always have to take a look at how the markets are positioned – there is a huge net speculative short position right now on the Canadian dollar in the futures options pits, over 50,000 net shorts. So a lot of the positioning right now would lead me to the view that the Canadian dollar could embark on some sort of near-term rally. But it would be more technical than anything else.

My sense is that, whatever the Fed does, and the Bank of Canada does, the Fed is going to hike rates more than the Bank of Canada is going to do. The Bank of Canada is not confronting massive fiscal stimulus at the peak of the cycle. The Fed is.

So I think that the interest rate differentials we talked about before are going to work increasingly against the Canadian dollar. I'm not bearish on the oil price, but I don't see us doing a lot better than $70 on the WTI. So I think a lot of the energy story, while positive, a lot of that is behind us.

And I think people haven't factored in the fact that the US cut corporate taxes this year. The government of Canada did not cut Canadian tax rates. So we have a competitive disadvantage with the US right now, for the first time in decades, where corporate tax rates south of the border are lower than they are in Canada.

That's fiscal diversion, which leads me to believe that the Canadian dollar is going to have to remain a weak currency to act as some sort of a competitive crutch offset to that. So I would say, beyond the prospect that we get some sort of short squeeze that could help the Canadian dollar on a near-term basis, I'd say that the list of negatives outweigh the list of positives and leads me overall, I would say, slightly net bearish on the currency.

Erik: A lot of people have declared the Canadian housing market to have peaked, saying, that's it, it's over and it's all downhill from here. Yet, the downhill hasn't been very steep if it's coming, at least so far.

First of all, do you agree with that view that Canadian housing has peaked? And, regardless of whether you do or you don't, what do you see next in terms of what happens with Canadian housing?

David: I think that, unlike the US in the housing bubble back in '04–'05–'06–'07 – that was a national bubble. When you're talking about the excesses in Canadian housing, it's not really about Halifax, Ottawa, or Winnipeg, or even Montreal – although Montreal has turned into a hot market. Really, the bubbles were Vancouver and Toronto, which is not 100% of the Canadian market. It's 35% of the Canadian housing market.

So this was not a national bubble. It was in two very large cities. I would have to say two very desirable cities to live in, that's for sure. And the source of support that you've been seeing is coming from large-scale immigration, especially skilled immigration coming into the country and supporting the markets.

Any serious household formation in Canada is running much stronger than it is in the United States because we have a much more, shall we say, open immigration policy. And that's a huge impact on housing demand. But, when you take a look at the valuation metrics, still, in

Vancouver and Toronto, it would be hard to suggest, hard to claim, that we've seen bottom yet.

You asked the question about has housing peaked. In Vancouver and Toronto they both peaked 18–24 months ago. So housing here has definitely peaked. Fails on pricing have rolled over. There hasn't been any destabilizing collapse. But there is no question that the housing sector has weakened off. And I think will remain very weak. This is not going to be a provider of growth for Canada for a long period of time. That story is well behind us.

When you consider that roughly half of the outstanding residential mortgages in Canada are short-term mortgages – they roll over in the coming year – the question is going to be, how far will the Bank of Canada go in terms of raising interest rates? That is the real elephant in the room. Because these real estate cycles can turn pretty nefarious, as we found out in the US – not just in the last cycle, but go back to the late '80s, early '90s – central banks and interest rates have a lot to do with how far housing markets can go down.

So has housing peaked in Canada? Certainly, in Vancouver and Toronto the answer is yes. The question I get more isn't about whether they peaked, but have we hit bottom yet? And my sense is that, net on net, we're probably only about 2/3 of the way through this corrective phase. There is more to go.

Erik: Dave, finally, I want to touch on a two-decades-old institution, which is "Breakfast with Dave." Although I suppose two decades ago it had a different name. You were one of the pioneers of doing a daily newsletter, not just weekly or monthly. And that started back in 1998 with the Bank of Montreal when you moved to Merrill, first in Canada and then in New York. It really got super-famous, I think, when you were with Merrill and it's still with you to this day. And it's just fantastic reading.

We've got a super deal. Normally, you have to pay a subscription fee to get this newsletter. We were able to get a one-month free trial, for our MacroVoices listeners only.

Listeners, in order to take advantage of that, all you have to do, there is no credit card required, no signing your life away, just send an email to Marcel Aulls at Gluskin Sheff. Marcel's email is linked in your Research Roundup. Tell them that you are a MacroVoices listener and you can get a free one-month trial subscription.

Dave, tell them a little bit about the history of this newsletter and what they can expect to find when they read it during their free one-month trial.

David: It actually started in 1998 when I was in the economics department at the Bank of Montreal. The person who took over the treasury operations at the time, Bill Downe, who ultimately became the CEO of the Bank of Montreal, pulled me aside one day and said, your morning meetings at the treasury are great, but you speak too fast (as everybody here probably can understand after listening to me for the past half an hour).

And he said, why don't you get down your thoughts on paper every day. We'll market it. To prevent broken telephone, write down your thoughts on paper, call it something snazzy. And that was really the start of "Breakfast with Dave." (It was called something different back then. I think it was called A.M. Notes.) And then from there, basically, it took me to Merrill Canada, then to Merrill New York, and then Gluskin Sheff.

It's a daily distillation of my views on politics, on economics, on the markets, what's already happened that's going to shape the outlook, what I think is going to happen in terms of the data in the coming days. So it's basically small picture and big picture.

There's two companion reports. There's one that comes out a little earlier called "Espresso with Dave" and then there's "Breakfast with Dave," the bigger publication. And, like I said, it's just how my views are evolving every single day. And it combines a lot of small picture with big picture, which is really something that focuses on the forest and focuses on the trees simultaneously.

Erik: Well, Dave, I can't recommend it highly enough. And, best of all, the first month is a free trial. You can't beat free, folks. Again, all you need to do is identify yourself as a MacroVoices listener by sending an email to Marcel Aulls. Marcels' email is in your Research Roundup email. And you'll be able to get signed up for the free subscription.

Dave, thanks so much for joining us on the program. Patrick Ceresna and I will be back as MacroVoices continues right here at macrovoices.com.

Post Game interview Continued with Angie Setzer

Patrick: Erik, what a great interview with David Rosenberg. I want to get back to that interview in just a moment.

But, joining us in today's postgame is Angie Setzer, also known as The Goddess of Grain, because we really wanted to touch on these grain markets a little bit. How you doing, Angie?

Angie: I'm doing good.

Erik: Angie, thanks so much for joining us. Before we get into the specific grains, the question that is on my mind is just what the heck is going on big picture here? Because grains have been selling off for a few years now. And everybody who thinks they've got a macro explanation for it weighs in with what it is and, okay, they've got to be bottoming now.

And it seems like every time we think they're bottoming, for a while it was, okay, as soon as inflation picks up its going to be all over. Grains are headed straight up from there. That lasted a little while. Now we've got inflation signs still ticking up, grains selling off to new lows.

Is there a macro driver here? Is there a technology change? Did somebody just build a whole bunch of new farmland that didn't exist before? What's going on? What's the big picture?

Angie: You know, you think that the last option you gave is the funny one, right? But it's reality. High prices cure high prices, in commodities for sure.

One thing that we saw take place is, if you look prior to 2005–2006 timeframe, you'll see that the grain markets tend to trade in a pretty solid range. You could tell, kind of, where the low was and you could tell, kind of, where the high was. And, unless there was a extenuating circumstance, with weather or some sort of other outside demand driver, you would see a continuous back and forth sort of pattern.

Well, you look at 2006, and corn specifically, you saw the ethanol boom take place. So we introduced, basically, one third of new demand. About 5 billion bushels' worth of new demand came into play between about 2006 and 2012. So to look at the 2012 high of the market is a bit disingenuous. Because, not only did you have that new demand come in via ethanol for corn and the protein sectors for China – you saw the Chinese imports really, really pick up – we also had a generational drought take place that year.

So we see a lot of conversation pointing back to what happened in 2012, as though that's an indicator that we should be heading back in that direction. And the reality is those high prices that we saw, those lifetime, once-in-a-lifetime sort of pricing opportunities that a lot of farmers experienced, helped create new supply.

You saw Brazil – if you look at what South American bean production and corn production was, prior to 2010, and you look at Black Sea regions prior to that 2010 timeframe, you'll see that their production was relatively benign. It wasn't something that could really step in. And I think a lot of folks thought the US would be, really, the only provider to the world when it came to grain and oilseed demand.

The fact is those high prices really encouraged producers that wouldn't have otherwise thought to do so to grow, and put some of that arable land that may have been sitting idle or in pasture to use. So we did see an increase in supply happen that, basically, outstripped the increase in demand.

And inflationary pressures should come into play. It really did in – if you look between 2008 and 2010 – but it's really hard to ignore the overall supply and demand fundamentals that tend to trump that inflationary desire to see these markets move higher.

Patrick: Angie, I want to move on here and look more specifically, not just big picture, but specifically at some of these individual grains. Particularly, I want to talk about wheat. Now, wheat has held up much better than corn and soybean.

So far, obviously, 2017 through to 2018 we saw lows come in around the 400 level. And we're nowhere near that at this stage, so we haven't seen that big throwback here.

What's a little bit different about wheat from the other grains?

Angie: Right now, supply differences. If you look at the global supply and demand situation in wheat right now and remove China, a lot of folks will say that the overall global supply situation – or if you look at ending stocks from a global standpoint – there's been this attitude that they've been burdened so much pushed us down below that $4 level and beyond into lows that we hadn't seen since prior to that 2006 timeframe.

But, once you start to look at the overall supply economics, or who is holding on to the world's supply, China has 52% of the world's wheat. Before, we could ignore that simply because we had an overabundance of supply. The Black Sea region was providing a significant amount of wheat, and their production seemed to be growing every year. Russia became the #1 wheat supplier to the world last year. Australia, same thing. They had grown in production.

But now we're starting to see these areas that we had relied upon to really push the US into the residual supplier role are having these production issues.

Russian production looks to be significantly lower than a year ago. We're still trying to get a finger on what that looks like as they work their way into harvest.

There's been a lot of extreme issues with drought in Europe, Germany specifically. And they're a large provider of soft red wheat. As is France, where their quality is dwindling.

Australia has had the driest summer that they've had in quite some time, actually. It does look as though last year they had a drought-crippled crop come through. And it looks as though the start to their crop this year is much worse. Of course they'll harvest this winter sometime, so we're a ways away from knowing what that looks like.

But these countries that have been big producers are now starting to see some production issues. And that's definitely helping keep wheat supported, simply because we don't have that safety net we had had.

And when it comes to world wheat demand, we really are only one crop scare away from – not only chewing through that surplus in supply that we thought we had – but actually creeping into where we may have to ration some demand. So it's definitely a hair-trigger-type situation in wheat right now.

Patrick: Angie, in a bigger picture, do you feel that the lows of wheat are in? Is it really more upside here from these lows where we're currently trading?

Angie: The potential is there, yes. We could see some downside pressure start to take place if outside market watchers pay attention. The spring wheat market has a little bit more of a negative tilt to it versus your winter wheat markets – your Kansas City and your Chicago, who have the three different types of markets there, and there are different supply and demand setups for each. However, you can see the spring wheat interchange with the Kansas City.

To me, looking specifically at Chicago wheat, which is what you will see trade for the European wheat and a lot of the Australian wheat, I feel that the lows are in place. Not saying that we won't retest some of that 483-type action, maybe even 475 if you look at the front month.

But, to me, I think the lows are in place and we'll find support as we work our way through and get a feel for what we're actually looking at when it comes to overall production potential globally.

Erik: Angie, as Patrick described in the last question, we've seen wheat looking like maybe it's bottoming here. It's pretty much held its own all year. And if I look at corn and soybeans, they looked the same way too until about the last week of May. And then, holy cow, at the same time both corn and beans just took a nosedive, plumbing new lows now.

Did something happen the last week of May? What's going on here?

Angie: Yeah, it became a very painfully obvious trade that started to develop. So there's a plethora of things that you could point at. Of course, the most obvious being the trade war, the concern over what was going on. We could not come to an agreement when it came to NAFTA [North American Free Trade Agreement]. And you actually saw the Trump administration heat up the rhetoric that was going on when describing the NAFTA negotiations.

Canada and Mexico are #1 or in the top five when it comes to ag [agriculture] exports across the board. So they are very important allies to have and there was a concern that came into play with that.

A lot of folks thought that we would have the Chinese trade spat put to bed much earlier than June 1. And especially didn't think we'd actually see the tariffs come into play and actually be put in place, let alone see them ramped up with that additional $200 billion added a couple of weeks back.

So you really started to see two things.

First of all, over the last couple of years, if you shorted grains and soybeans early and went home, you were far better off. We've seen, over the last couple of years, earlier lows. So we would see – first it used to be the middle of July. And then it was the first week of July. And then it became the last week of June.

We did see a weather pattern indicate that we would see substantial rainfall throughout much of the Midwest. So you saw the idea that weather was going to be conducive to record production. Many market analysts out there were already adding yield to their production estimates mid-June.

You had negative headlines – I call it a slow motion black swan event for grains, where every headline, every article that you read is negative. And you don't have to know much about commodities to think that shorting them would make sense, based on the trade rhetoric, good weather conditions, all of these things that we're seeing.

So you really saw the market really trip over itself to get short. And in soybeans, when that starts to happen, it's really easy to liken it to a boulder rolling down a hill. And that's what we saw. We have lost over $2 in beans, and 60-some cents, 70 cents in corn.

It's simply because of the negative headline tone and the concern over what could happen as we work forward when it comes to trade. Because agriculture seems to be the bullseye, at least at this point in time when it comes to China specifically.

But we saw that happen and then we saw the idea of good conditions. We're now starting to see some transition in thought take place. But it's like turning the Titanic at this point in time unless we see some sort of really exciting announcement come from the Administration about what we're seeing with trade.

Patrick: Angie, we have to really ask the question – how have these tariffs that Trump is putting in impacted the grain markets? Is this really the driver? Or is it something else?

Angie: I definitely think it's the driver. You could ask five different people and get five different answers. Of course, weather played a role – the idea that yields were increasing. But I feel that it's much too early to know what we're going to see from an overall production standpoint, especially when it comes to soybeans.

The tariff issue is a big one. And we really don't know. To me, I think what we've seen is a result of short-term headline risk. I think, long term, we find that it weighs out. And that, while the issues are there and there are long-term concerns with what could happen with our Chinese trade, I think the demand that we see for protein worldwide – developing countries continue to grow.

Wealth in developing countries also grows. So, even if China doesn't remain our #1 customer, I think we'll find that the demand for our soybeans remains relatively strong as we move forward.

So I feel that, long-term-wise, the impacts may remain or may be visible. But I don't think they are going to be near as deep as what a lot of folks are thinking they will be at this point in time.

I think, when it comes down to it, once a population discovers meat and other protein sources like they have, it's very difficult to go backwards when it comes to your dietary preferences. So I think that they are going to play a major role in what we see happen as we move ahead.

But it's definitely something in the short term until we find a different thing in the trade to focus on. Perhaps if we start to discover that there are production issues or something like that, you'll see people pay attention and come in on the buy side.

At the same time, we are starting to see volume tick down a little bit as we work towards these lows, which indicates that the trade is just not exciting as what it was before. At least to me. So I think we'll start to see people get bored with the idea that they need to short grains every time they see a tariff headline. And we probably, at least hopefully, will be able to get up off of the mat here.

Erik: Angie, let's tie this all together. Grains have been selling off awfully hard for a long time now, for six years or so. Are we at the point now – because it seems to me like you could make a macro argument here that, boy, we've got profound selloff over the last few years that's been exacerbated – particularly in corn and beans – in the last couple of months with this trade talk stuff. And we do think that maybe inflation is not too far around the corner.

Seems like maybe there's an argument to be made for, hey, grains are bottoming. It's time to make that long-term strategic play.

And I guess that part one of the question is, Is it that time? Or do we have further to go to the downside? And, if it is that time, are the grains themselves the place to make the play? Or do you want to be in the equities?

Because, obviously (as you know), if you get into longer term, something like the DBA ETF tends to get eaten up in contango tracking error so much that you're maybe better off in the grain-producing equities than the grains themselves. Unless you're trading them with a shorter time horizon.

So is it strategically long-term time to get bullish on ags? And, if so, are the grains the place to do it? Or are there better places to invest?

Angie: To me, I think so. Corn is really what I'm paying attention to, when it comes down to it.

Looking at corn, for one, the Chinese trade issue that we have developing will not have as big of an impact on corn as it could on soybeans, if you're looking at a long-term trade war developing where we start really sharing blows with one another. Corn is a little bit more open to going other places.

On top of that, looking at the current supply and demand situation – without any sort of reduction in our current production outlook – you look at the global supply and demand setup, right now the US is the only supplier, really, with available supply of corn to the world.

Secondly, you look at expected supply and demand economics and carryout, what's left over at the end of the marketing year next year (which will be September 1, 2019), looking ahead. And we have the tightest available supply of corn since the mid-'70s. We're using and chewing through those stocks.

So from an overall – if you're a supply and demand fundamentalist and looking at what is taking place – what is shaping up with the current market structure, I think corn long term is a good one.

I also think, though, if you don't want to get into the agriculture or the grain specifically, getting into the handlers of these grains would definitely, I think, pay off. Perhaps long-term. Maybe looking at some of these outside market structures.

I specifically trade in the commodities themselves and I would not be afraid of owning December corn at these levels, simply because you're really five months away from having to make that decision on the roll into the carry market setup.

Soybean is a little bit different, simply because we're still about four weeks away from knowing what we're looking at production-wise. August is the month that will make or break the soybean crop. So we'll definitely want to keep an eye on weather there. If it does look as though the weather is going to stay warm and dry through the next four-week timeframe, then soybeans definitely should also see a significant move higher.

The problem with soybeans right now is that the USDA did take a big chunk of export demand out, saying that it was a result of the tariffs. So there's a lot of unanswered questions there. And uncertainty always favors the bear. At least it seems to in grains and oilseed markets.

If you were to say: Angie, what do you think is the best long-term trade? (And by long-term I mean six months to a year, and maybe you guys look at long-term as a different market setup than we do.) Corn is where I think the real bullish excitement could come into play.

Especially if we start to discover that the crops out there, which we're starting to see there has been a lot of production issues. We had the warmest June on record in a lot of places. Overnight temps have been really high, which tends to limit corn production. So there's a really good possibility to see an explosive move higher here over the next couple of months.

Erik: Well, Angie, thanks so much for joining us on the program. Before we let you go please tell our listeners your Twitter handle so they can follow your work.

Angie: It's @GoddessofGrain. That's where most of my information comes from on Twitter and that's where you can find me.

Erik: Thanks so much.

Angie: Thanks for having me.