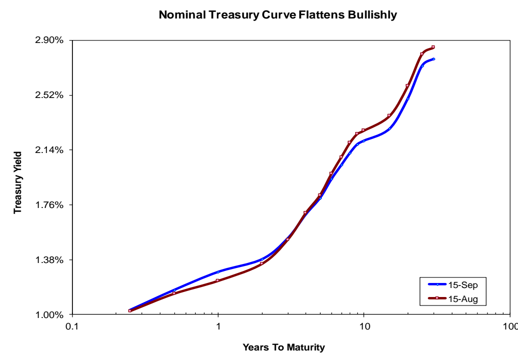
The Macro Environment For Financial Markets

Markets ended 2016 expecting a stronger USD, higher inflation and interest rates, a steeper yield curve and lower taxes. If you need more evidence for the aphorism, "Markets do not forecast, they measure," please let me know. What has materialized globally has been the sort of moderate growth with low stresses capable of fueling a strong equity rally regardless. Now that the consensus is for this to continue forever if not longer, that will be the least likely outcome. The causal chain now is:

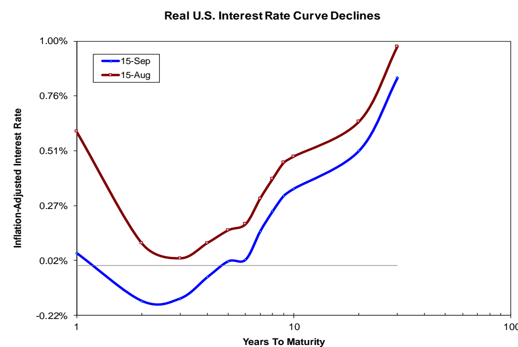
1. The market has priced out expectations for another short-term rate hike in the U.S. in 2017, but still has to deal with the prospects of a shrinking balance sheet;
2. Inflationary expectations are starting to rise;
3. The secular flattening trend in the U.S. is stalling;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are steepening bearishly; and
6. CDS costs are falling again as the expected macro shocks dissipated.

Key Market Indications

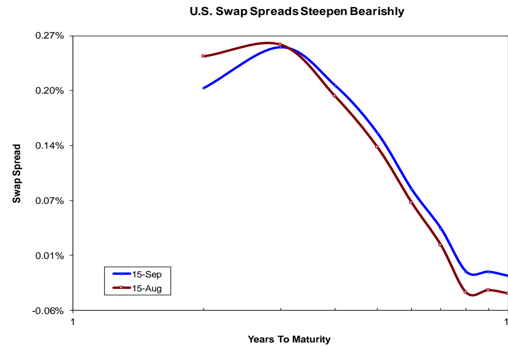
The combination of higher inflation data and a dissipation of the haven trade contributed to a bounce in long-term yields. We probably should be careful about confusing reported inflation data with inflation expectations; the secular forces keeping a lid on the latter remain intact. As an aside, the core PCE index so beloved by the Federal Reserve has been trending lower since the late 1980s through various monetary policy regimes. The connection between their policies and inflation is much weaker than they would like to admit.



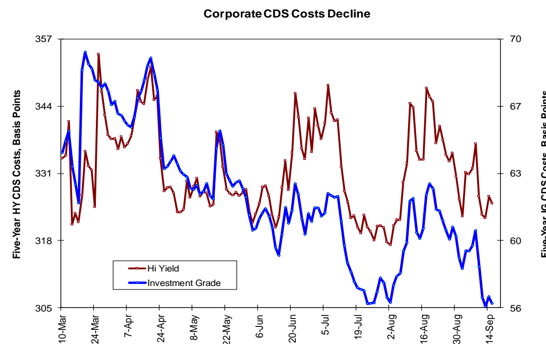
The pseudo-real yield curve declined across the maturity spectrum and is negative for maturities between two and four years. This curve was common during 2015-2016 period of accelerated global QE, but it is quite surprising to see during a period when central banks are talking about unwinding that QE.



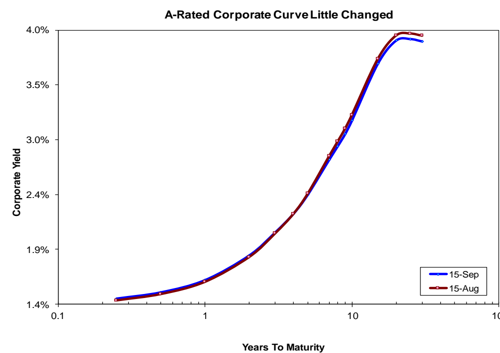
Swap spreads, which rise when floating-rate borrowers want to fix their payments, fell at the short end of the yield curve as the probability of another rate hike continues to diminish. However, they rose at the long end as buyers backed away from recent lows in long-term yields



CDS costs declined for both the investment-grade and high-yield indices. This represents the unwinding of equity correlation trades and a belief the recent hurricanes will not produce enduring macro shocks.



The A-rated corporate yield curve changed very little over the past month. This remains a bull market with limited upside potential.



Market Structure

All of the physical commodity subindices save for Grains and Industrial Metals are in structural uptrends. All of the equity indices remain in structural uptrends, while both ten-year UST and the dollar index shifted into structural downtrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 18 - 22
BBerg	26	Trending	0.200	7.5%	0.07%
BBerg Grain	6	Sideways	0.042	14.8%	
BBerg Ind. Metl	12	Transitional	-0.182	16.5%	
BBerg Pre. Metl	29	Trending	0.146	10.4%	0.26%
BBerg Softs	28	Trending	0.223	15.3%	0.23%
BBerg Nat. Gas	25	Trending	0.079	19.0%	0.23%
BBerg Petroleum	26	Trending	0.257	19.2%	0.30%
BBerg Livestock	29	Trending	0.141	12.9%	0.45%
Dollar Index	24	Trending	-0.127	6.9%	-0.08%
S&P 500 Index	28	Trending	0.250	6.2%	0.04%
EAFE Index	27	Trending	0.196	7.6%	0.11%
EM Index	26	Trending	0.331	6.3%	0.21%
Ten-year UST (price)	29	Trending	-0.064	3.8%	-0.15%

Performance Measures

The strong gains in the Energy subindex were to be expected as a result of the hurricane disruptions intersecting with rising demand. The Softs had some major changes; nothing like an 8% gain in coffee or a 7% decline in cotton to let you know we live in a world of execution vacuums now. The pullback in the Precious Metals subindex was attributable to the rebound in the USD.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.53%	2.44%	0.54%	3.09%
Grains Sub-Index	0.58%	0.17%	-8.30%	-6.00%
Corn	-0.54%	-2.93%	-10.21%	-6.19%
Soybeans	0.72%	3.39%	-4.43%	-3.64%
Wheat	2.59%	1.55%	-8.35%	-7.40%
Energy Sub-Index	3.68%	5.37%	2.90%	1.80%
Petroleum Sub-Index	3.55%	6.34%	5.90%	9.47%
WTI	4.97%	3.40%	-0.30%	4.79%
Brent	3.47%	6.24%	4.64%	9.29%
ULSD	2.28%	9.97%	15.67%	18.23%
Gasoline	2.61%	8.19%	10.64%	9.66%
Natural Gas	4.06%	2.63%	-5.32%	-16.78%
Precious Metals Sub-Index	-2.01%	2.94%	5.34%	-2.04%
Gold	-1.90%	2.68%	7.04%	0.18%
Silver	-2.31%	3.68%	0.76%	-7.70%
Industrial Metals Sub-Index	-2.15%	-0.29%	7.37%	30.15%
Copper	-3.02%	-0.34%	8.20%	33.87%
Aluminum	-0.80%	0.83%	7.74%	30.09%
Nickel	-4.39%	0.84%	7.29%	12.32%
Zinc	0.01%	-3.06%	4.56%	35.22%
Softs Sub-Index	2.68%	6.72%	-12.59%	-18.90%
Coffee	8.25%	7.45%	-5.69%	-12.91%
Sugar	3.78%	9.11%	-20.29%	-35.31%
Cotton	-7.38%	2.74%	-9.57%	2.97%
Livestock Sub-Index	-0.40%	-1.72%	-0.63%	10.58%
Cattle	0.16%	1.57%	1.75%	12.58%
Hogs	-1.38%	-7.26%	-4.60%	6.73%

The USD managed a bounce against all majors save the GBP as the damage from Hurricane Irma was much less than feared. The GBP rose on an overt signal from the Bank of England it would raise interest rates to defend it. The USD is likely to retrace a significant portion of its recent weakness on the back of firmer inflation data.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.76%	1.79%	11.28%	6.23%
Chinese yuan	-0.89%	2.03%	5.53%	1.86%
Japanese yen	-2.70%	-0.14%	2.30%	-7.88%
British pound	2.98%	5.63%	10.60%	2.68%
Swiss franc	-1.68%	1.27%	4.16%	1.20%
Canadian dollar	-0.32%	4.58%	9.07%	7.89%
Australian dollar	-0.72%	2.31%	3.80%	6.48%
Swedish krona	-0.44%	1.35%	11.26%	6.48%
Norwegian krone	-1.42%	1.44%	8.21%	4.85%
New Zealand dollar	0.47%	0.87%	3.61%	-0.23%
Indian rupee	-0.46%	0.06%	2.51%	4.59%
Brazilian real	-0.75%	1.92%	-0.22%	6.18%
Mexican peso	0.29%	0.83%	8.84%	9.54%
Chilean peso	-0.83%	3.79%	7.19%	7.29%
Colombian peso	0.33%	2.37%	2.53%	1.08%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.38%	1.24%	2.95%	1.33%

The U.S. reversed the previous week's downturns related to hurricane fears, and both the EAFE and EM indices continued their grinds higher.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.22%	3.12%	8.19%	20.13%
North America	1.62%	1.94%	6.11%	18.69%
Latin America	1.57%	7.83%	17.06%	31.86%
Emerging Market Free	1.06%	4.98%	19.02%	27.26%
EAFE	0.56%	2.56%	13.43%	20.93%
Pacific	-0.06%	0.80%	6.71%	17.03%
Eurozone	1.29%	3.58%	17.32%	32.39%

CTAs had an especially bad week, as did macro-oriented hedge funds. This suggests both classes of traders were ill-positioned for the selloff in long-term bonds and a USD bounce. Not only were these crowded trades, they *should* have been crowded trades.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-2.92%	2.99%	-3.58%	-5.24%
Newedge Trend	-2.25%	2.05%	-1.81%	-3.74%
Newedge Short-Term	-0.79%	-0.24%	-2.23%	-9.16%
HFR Global Hedge Fund	0.17%	1.06%	2.69%	6.05%
HFR Macro/CTA	-0.75%	1.10%	1.06%	-0.41%
HFR Macro: Sytematic Diversified CTA	-2.05%	1.81%	-0.04%	-2.39%

Futures trading involves the substantial risk of loss and is not suitable for all investors. Each investor must consider whether this is a suitable investment since you may lose all of or more than your initial investment. Past performance is not indicative of future results.