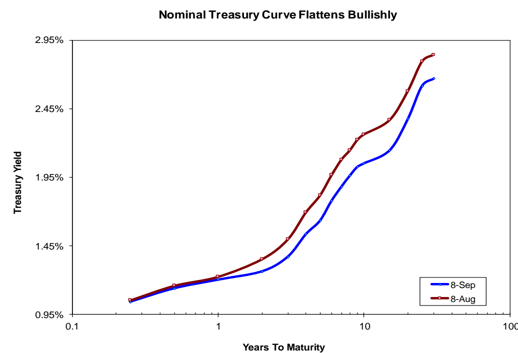
The Macro Environment For Financial Markets

Natural disasters often turn into financial market disasters after a short period of time. This happened after the 1871 Chicago Fire, the 1906 San Francisco earthquake and the 2004-2005 hurricanes. The frictional costs associated with rebuilding are great, productivity is lost and insurance firms have to liquidate assets to pay claims. Incredibly, central banks are talking about tightening credit in such an environment. Mao had party officials spend a little time in the countryside to maintain contact with reality. This might have been his only good idea. The causal chain now is:

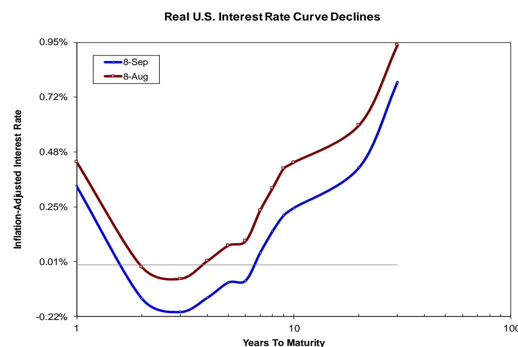
1. The market has priced out expectations for another short-term rate hike in the U.S. in 2017, but still has to deal with the prospects of a shrinking balance sheet;
2. Inflationary expectations are starting to rise;
3. The secular flattening trend in the U.S. is stalling;
4. Short-term borrowers are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

Key Market Indications

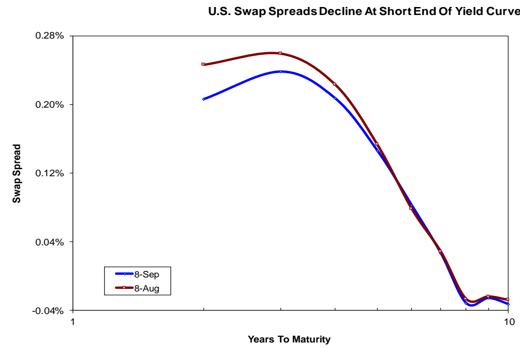
The bond market has been getting it right all year with its secular bullish flattening. The strong central bank holders of long-term bonds are not going to sell – and to whom? – and institutional investors who need to match long-term liabilities must hold long-term assets. Once inflation expectations decline and macro shocks arrive, you get a new low in ten-year yields.



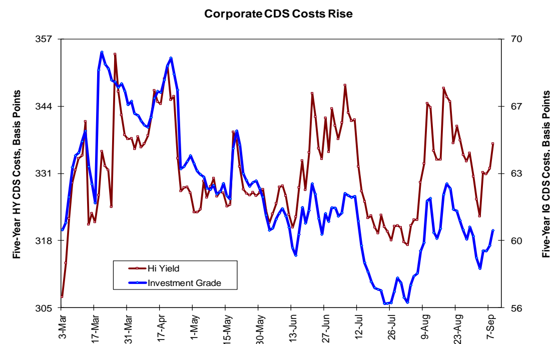
The pseudo-real yield curve declined across the maturity spectrum and is negative for maturities between two and six years. This curve was common during 2015-2016 period of accelerated global QE, but it is quite surprising to see during a period when central banks are talking about unwinding that QE.



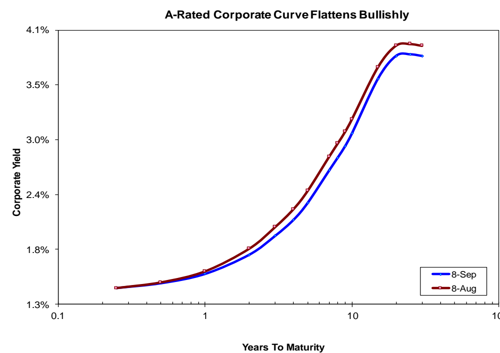
Swap spreads, which rise when floating-rate borrowers want to fix their payments, fell at the short end of the yield curve as the probability of another rate hike continues to diminish.



CDS costs moved higher for both the investment-grade and high-yield indices. This represents the emplacement of equity correlation trades and the shocks to both the energy sector and to the insurance industry.



The A-rated corporate yield curve has flattened bullishly over the past month. This remains a bull market with limited upside potential.



Market Structure

Natural Gas joined Grains in a structural downtrend, while Precious Metals, Petroleum and Livestock are in structural uptrends. Both the EAFE and EM indices joined the S&P 500 and ten-year UST in structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 11 - 15
BBerg	26	Trending	0.177	7.4%	0.07%
BBerg Grain	29	Trending	-0.117	14.0%	-0.52%
BBerg Ind. Metl	9	Sideways	-0.107	15.3%	
BBerg Pre. Metl	29	Trending	0.398	10.8%	0.26%
BBerg Softs	26	Trending	0.047	15.1%	
BBerg Nat. Gas	29	Trending	-0.041	19.1%	-0.06%
BBerg Petroleum	21	Trending	0.125	19.9%	0.30%
BBerg Livestock	29	Trending	0.102	13.1%	0.45%
Dollar Index	19	Transitional	-0.230	7.1%	
S&P 500 Index	29	Trending	0.021	6.2%	0.04%
EAFE Index	22	Trending	0.167	7.8%	0.11%
EM Index	21	Trending	0.238	6.7%	0.21%
Ten-year UST (price)	29	Trending	0.281	3.8%	0.04%

Performance Measures

The strong rally in Industrial Metals ended abruptly, as Chinese-related trades often do. Natural gas turned lower as production in the Gulf of Mexico was not affected severely by Hurricane Harvey. Precious Metals advanced on a combination of lower implied real interest rates and a weaker USD.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.15%	1.35%	1.07%	1.59%
Grains Sub-Index	0.69%	-3.09%	-8.87%	-7.51%
Corn	-0.26%	-4.73%	-8.91%	-6.78%
Soybeans	1.79%	1.88%	-5.72%	-5.71%
Wheat	0.77%	-6.19%	-11.51%	-9.78%
Energy Sub-Index	-0.62%	1.24%	-1.06%	-3.31%
Petroleum Sub-Index	0.74%	2.87%	2.68%	1.81%
WTI	0.23%	-2.06%	-4.46%	-6.27%
Brent	1.76%	3.62%	1.78%	0.85%
ULSD	1.81%	6.84%	13.34%	12.84%
Gasoline	-1.55%	6.39%	7.61%	9.41%
Natural Gas	-4.39%	-3.28%	-11.07%	-16.40%
Precious Metals Sub-Index	2.46%	4.82%	10.21%	-2.08%
Gold	2.22%	4.50%	11.72%	0.27%
Silver	3.14%	5.72%	6.15%	-7.98%
Industrial Metals Sub-Index	-1.87%	4.23%	13.71%	32.52%
Copper	-1.82%	3.78%	15.74%	42.50%
Aluminum	-0.97%	2.58%	10.59%	30.90%
Nickel	-1.80%	8.64%	16.31%	10.11%
Zinc	-3.67%	4.64%	11.41%	30.50%
Softs Sub-Index	0.74%	-2.26%	-15.38%	-21.61%
Coffee	1.03%	-9.10%	-12.43%	-21.01%
Sugar	-2.13%	6.83%	-23.39%	-32.05%
Cotton	5.18%	9.38%	-1.00%	8.29%
Livestock Sub-Index	1.63%	-3.52%	1.19%	9.92%
Cattle	1.85%	0.01%	3.56%	15.30%
Hogs	1.24%	-9.36%	-2.61%	1.52%

The USD declined heavily across the board as higher short-term rates were priced out for the rest of 2017 and as the ECB once again signaled an end to its QE program. The divergence trade of 2014-2015 has reversed with a vengeance.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.48%	2.42%	14.18%	6.89%
Chinese yuan	0.99%	3.26%	6.45%	2.66%
Japanese yen	2.23%	2.30%	6.04%	-4.96%
British pound	1.92%	1.60%	8.48%	-0.71%
Swiss franc	2.18%	3.18%	7.49%	3.01%
Canadian dollar	1.93%	4.18%	10.95%	6.40%
Australian dollar	1.07%	1.84%	7.07%	5.46%
Swedish krona	0.87%	3.09%	14.18%	6.44%
Norwegian krone	0.76%	2.81%	10.44%	5.79%
New Zealand dollar	1.49%	-0.87%	5.06%	-1.81%
Indian rupee	0.38%	-0.24%	4.57%	4.14%
Brazilian real	1.72%	1.27%	2.70%	4.12%
Mexican peso	0.58%	0.79%	11.07%	5.43%
Chilean peso	0.64%	4.53%	6.80%	7.06%
Colombian peso	0.84%	3.09%	3.01%	-2.20%
Bloomberg-JP Morgan Asian dollar index (spot)	0.47%	1.54%	4.37%	1.21%

While North American markets led the way higher last week, they fell this week on geopolitical stresses and the economic shock of the hurricanes. The decline in the USD has removed stress from non-U.S. commercial banks.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.03%	1.56%	7.95%	17.92%
North America	-0.55%	-0.13%	5.44%	14.92%
Latin America	1.03%	5.54%	16.72%	20.83%
Emerging Market Free	0.04%	1.42%	18.89%	20.77%
EAFE	0.83%	0.57%	14.29%	16.33%
Pacific	0.48%	0.67%	8.57%	14.61%
Eurozone	1.31%	3.05%	17.99%	25.86%

Both CTAs and hedge funds posted gains for a third week. The strong trends in the dollar and in fixed-income markets provided a stable trading environment. However, these are supposed to traders who excel in volatile markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.61%	3.76%	-1.66%	-8.73%
Newedge Trend	1.49%	2.95%	-0.19%	-5.67%
Newedge Short-Term	0.85%	0.34%	-0.80%	-9.71%
HFR Global Hedge Fund	0.03%	0.52%	2.33%	5.15%
HFR Macro/CTA	0.75%	1.78%	1.57%	-0.96%
HFR Macro: Sytematic Diversified CTA	1.86%	3.43%	1.60%	-3.01%

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.