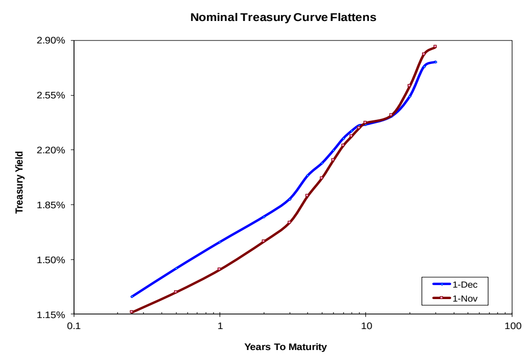
The Macro Environment For Financial Markets

Perhaps a future bookshelf will be loaded with PhD theses on how the growing domination of algorithmic trading and the depopulation of the trading industry contributed to low volatility; after all, I wrote on how changing trading regiments affected day structures back in 1998. For now, we have grinding equity bull markets, torpid bond markets and a crude oil market barely affected by an OPEC meeting. We also have too much excitement over cryptocurrencies, and that, too, may load future bookshelves alongside an old Pets.com sock puppet. The causal chain now is:

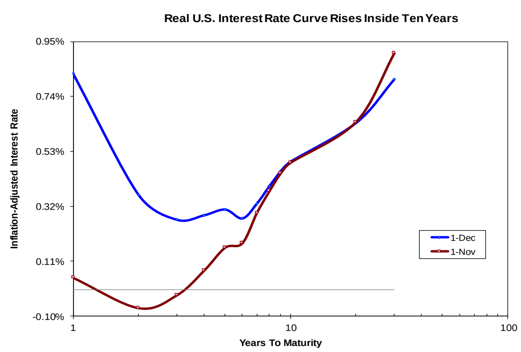
1. The market has priced in a December rate hike but is divided over the March 2018 meeting;
2. Inflationary expectations are confined to a narrow range;
3. The secular flattening trend in the U.S. yield curve continues;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are inverting bullishly; and
6. CDS costs have resumed their decline, especially for the investment-grade index.

Key Market Indications

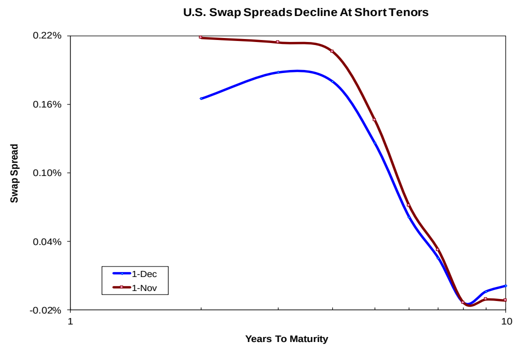
To repeat verbatim from the last two weeks: The ten-year UST is continuing to hold support. Lenders realize existing holders are not going to liquidate their portfolios. Such is not the case at the short end of the yield curve, however. Short-term rates continue to move to levels not seen since 2008. As a result, the secular flattening trend in the yield curve remains intact. These markets are not supposed to be this quiet.



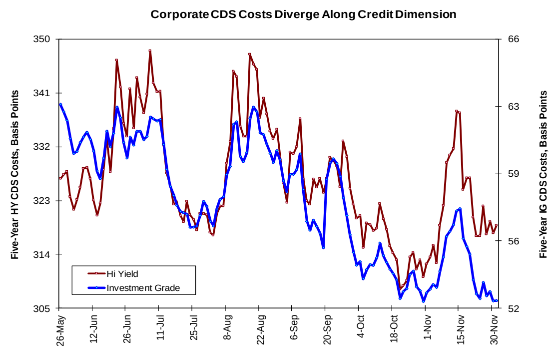
The pseudo-real yield curve shifted higher at the short end of the yield curve, but is starting to decline at the long end of the yield curve. The combination favors risky financial assets over precious metals.



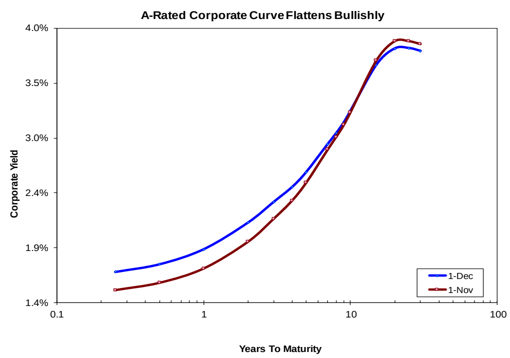
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined at shorter tenors and barely rose at the long end of the yield curve. This remains bullish for corporate credit and for equities.



CDS costs declined, but are differentiating along a credit dimension with investment-grade costs at their lows for the year while high-yield costs have yet to retrace their recent selloff. Unless equities decline and produce correlation trades, there is no reason for CDS costs to rise.



The A-rated corporate yield flattened bullishly. This remains a bull market with limited upside potential.



Market Structure

Only Softs are in a structural uptrend within the physical markets while both Precious and Industrial Metals are in downtrends. Within the financials, the dollar index remains in a downtrend while all of the major stock indices exited structural trends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Dec. 4 - 8
BBerg	12	Transitional	0.011	6.4%	
BBerg Grain	29	Trending	0.019	9.4%	
BBerg Ind. Metl	21	Trending	-0.090	13.5%	-0.18%
BBerg Pre. Metl	24	Trending	-0.115	9.4%	-0.07%
BBerg Softs	29	Trending	0.115	14.2%	0.29%
BBerg Nat. Gas	19	Transitional	-0.096	16.3%	
BBerg Petroleum	13	Transitional	0.083	15.7%	
BBerg Livestock	16	Transitional	-0.082	10.2%	
Dollar Index	29	Trending	-0.229	5.4%	-0.11%
S&P 500 Index	16	Transitional	0.207	7.9%	
EAFE Index	16	Transitional	0.026	7.0%	
EM Index	29	Trending	-0.139	8.0%	
Ten-year UST (price)	24	Trending	-0.014	3.8%	

Performance Measures

The Industrial Metals, always subject to the vagaries of Chinese policies, turned lower, while Precious Metals declined on the continued rise in implied short-term real rates. One of the odder developments this past week was relatively small ranges in the Petroleum markets in light of the OPEC meeting. An obligatory deal few expect to be honored was reached, and that was that.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.57%	-0.36%	5.62%	0.24%
Grains Sub-Index	0.75%	-0.26%	-6.06%	-8.98%
Corn	1.08%	-0.66%	-11.99%	-8.90%
Soybeans	0.13%	0.86%	6.64%	-7.15%
Wheat	0.89%	-0.93%	-9.92%	-9.39%
Energy Sub-Index	0.63%	1.89%	14.56%	-2.15%
Petroleum Sub-Index	-0.62%	2.82%	24.50%	8.23%
WTI	-0.98%	4.58%	19.73%	3.45%
Brent	0.47%	2.95%	26.97%	11.65%
ULSD	-0.70%	2.87%	29.45%	12.32%
Gasoline	-2.18%	-0.72%	23.36%	6.19%
Natural Gas	5.00%	-1.07%	-10.69%	-27.54%
Precious Metals Sub-Index	-1.58%	-0.21%	-2.11%	4.65%
Gold	-0.71%	0.79%	-0.21%	7.94%
Silver	-4.10%	-3.10%	-7.39%	-4.01%
Industrial Metals Sub-Index	-2.92%	-3.53%	17.48%	14.59%
Copper	-3.08%	-1.35%	18.62%	15.44%
Aluminum	-2.81%	-5.25%	6.11%	18.58%
Nickel	-6.24%	-11.41%	25.72%	-2.91%
Zinc	0.31%	0.84%	29.70%	22.21%
Softs Sub-Index	-0.26%	3.73%	-1.95%	-17.01%
Coffee	1.59%	1.90%	-3.14%	-19.01%
Sugar	-3.02%	4.27%	4.17%	-24.81%
Cotton	1.90%	6.42%	-0.23%	4.24%
Livestock Sub-Index	-0.68%	-6.43%	-8.20%	19.54%
Cattle	-2.06%	-8.50%	-11.74%	16.66%
Hogs	1.93%	-2.34%	-2.05%	23.94%

The USD traded without a strong theme as markets awaited the conclusion of the tax bill. We have two more weeks of active trade before books are closed for the year, and barring events the currency markets are poised to be quiet until January.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.31%	2.38%	6.09%	11.58%
Chinese yuan	-0.22%	-0.22%	2.90%	4.07%
Japanese yen	-0.57%	1.79%	-0.71%	1.72%
British pound	1.05%	1.75%	4.62%	7.04%
Swiss franc	0.34%	2.78%	-0.48%	3.52%
Canadian dollar	0.21%	1.42%	6.54%	5.00%
Australian dollar	-0.05%	-0.82%	3.24%	2.67%
Swedish krona	-0.90%	0.58%	4.08%	10.39%
Norwegian krone	-1.87%	-1.63%	2.03%	1.63%
New Zealand dollar	0.22%	0.07%	-2.39%	-2.78%
Indian rupee	0.17%	0.44%	0.07%	6.09%
Brazilian real	-0.79%	0.25%	-0.23%	6.34%
Mexican peso	-0.41%	2.35%	0.06%	11.51%
Chilean peso	-2.01%	-1.85%	3.85%	4.24%
Colombian peso	-0.53%	2.22%	-3.51%	2.48%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.01%	0.77%	2.26%	4.75%

Neither the EAFE nor EM index gained this past week, which almost raises an eyebrow these days. The U.S. continued to gain and even managed to shrug off more political stress. The uptrend should continue through the end of the year.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.52%	1.38%	8.04%	24.09%
North America	1.40%	2.64%	9.82%	22.65%
Latin America	-3.08%	-2.16%	8.37%	25.64%
Emerging Market Free	-3.30%	-1.10%	12.41%	33.40%
EAFE	-0.94%	-0.11%	6.88%	26.71%
Pacific	-0.39%	1.31%	9.25%	22.51%
Eurozone	-1.84%	-1.68%	4.70%	35.29%

Both CTAs and hedge funds lost money, as has been typical whenever equities stall or decline. Once again, the closure of major hedge funds is in the news. The message is simple: Either beat index funds after fees or else.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.41%	1.42%	3.39%	1.29%
Newedge Trend	-0.34%	0.97%	2.06%	2.30%
Newedge Short-Term	-0.03%	-0.70%	-0.27%	-4.86%
HFR Global Hedge Fund	-0.09%	0.31%	2.91%	6.12%
HFR Macro/CTA	-1.06%	0.24%	2.28%	2.16%
HFR Macro: Sytematic Diversified CTA	-0.93%	2.19%	4.81%	3.64%

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.