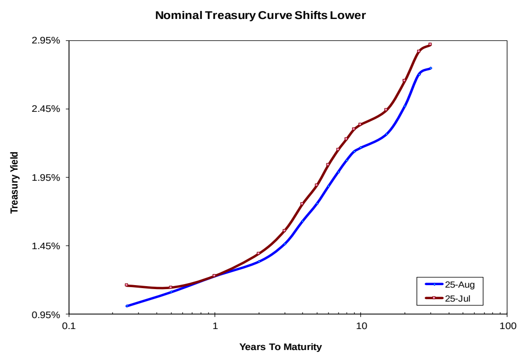
The Macro Environment For Financial Markets

Will the U.S. debt ceiling be raised quietly and will tax reform at least be introduced? In a normal world, the answers would be "yes" and "yes," but this is not a normal world. Still, markets have convinced themselves risk-on is the preferred path. Good. Even the attention-seeking central bankers talking to each other at Jackson Hole could not muster up a good scare story. The causal chain now is:

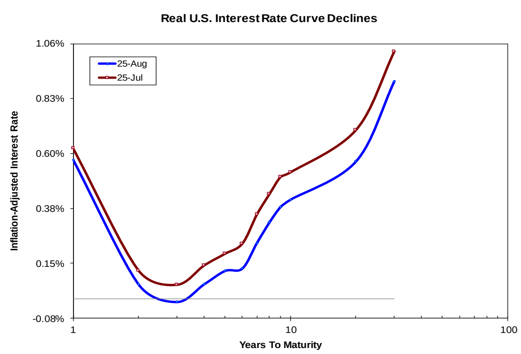
1. The market is pricing out expectations for another short-term rate hike in the U.S. in 2017 but has to deal with the prospects of a shrinking balance sheet;
2. Inflationary expectations are declining once again;
3. The secular flattening trend in the U.S. is resuming;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are declining; and
6. CDS costs declined in response to rising equities.

Key Market Indications

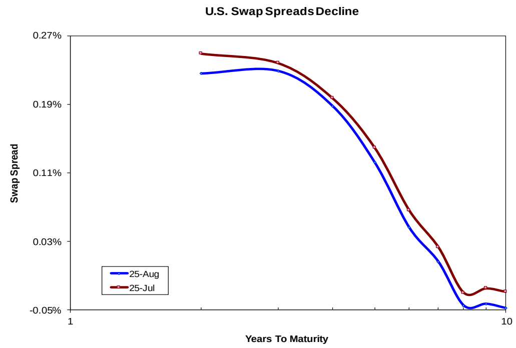
As noted last week, with inflation expectations declining and with overt tightening still in the uncertain future, the strong hands holding UST are not anxious to sell. The continued hints of higher short-term rates have started to push the yield curve back into a bullish flattening.



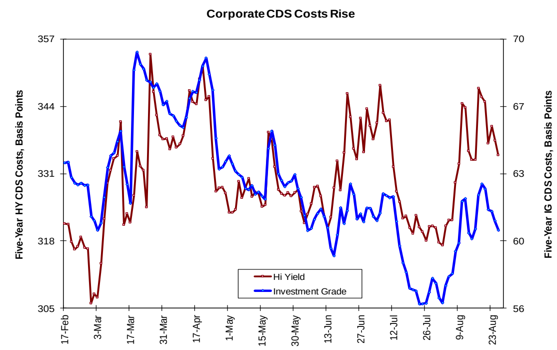
The pseudo-real yield curve declined across the maturity spectrum, with the strongest move at the mid-curve. The three-year remains negative. The shift is not as significant as it may appear as the market simply is pricing out some of its inflation protection taken out early in the year.



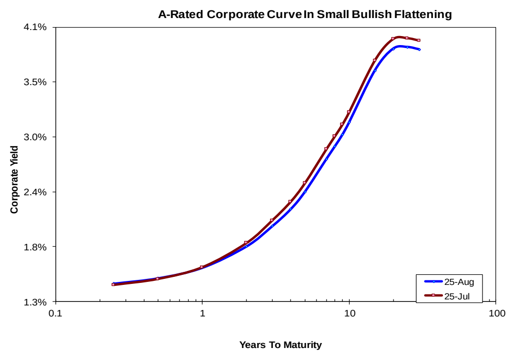
Swap spreads, which rise when floating-rate borrowers want to fix their payments, fell across the board, with the smallest shifts occurring mid-curve. Borrowers seem quite willing to remain floating-rate payors.



CDS costs moved lower for both the investment-grade and high-yield indices. This represents the unwinding of equity correlation trades emplaced over the previous two weeks.



The A-rated corporate yield curve is starting to flatten bullishly once again. However, this remains a bull market with limited upside potential.



Market Structure

Only Industrial Metals are in a structural uptrend amongst physical commodities, while Grains, Softs and Livestock all are in structural downtrends. The S&P 500 remains in a downtrend, while ten-year UST remain in an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Aug. 28 - Sep. 1
BBerg	17	Transitional	0.009	7.0%	
BBerg Grain	29	Trending	-0.355	17.0%	-0.52%
BBerg Ind. Metl	29	Trending	0.378	13.6%	0.30%
BBerg Pre. Metl	4	Sideways	0.031	9.7%	
BBerg Softs	29	Trending	-0.131	15.8%	-0.91%
BBerg Nat. Gas	5	Sideways	-0.053	19.3%	
BBerg Petroleum	14	Transitional	0.022	19.9%	
BBerg Livestock	29	Trending	-0.181	13.3%	-0.56%
Dollar Index	15	Transitional	-0.110	6.3%	
S&P 500 Index	29	Trending	-0.133	5.8%	-0.04%
EAFE Index	6	Sideways	0.060	6.1%	
EM Index	13	Transitional	0.251	7.7%	
Ten-year UST (price)	29	Trending	0.160	3.7%	0.04%

Performance Measures

The strong rally in Industrial Metals continued on the usual speculation about Chinese demand stabilizing. However, Grains, Energy and Livestock all retreated this week, leaving the main Bloomberg index largely unchanged.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.09%	-1.32%	-4.64%	-1.32%
Grains Sub-Index	-1.66%	-9.88%	-12.01%	-6.55%
Corn	-3.33%	-8.96%	-12.05%	-3.11%
Soybeans	0.74%	-6.69%	-10.06%	-6.21%
Wheat	-1.62%	-14.63%	-12.68%	-11.20%
Energy Sub-Index	-0.64%	-1.77%	-8.28%	-9.55%
Petroleum Sub-Index	-0.75%	-1.84%	-9.67%	-5.75%
WTI	-1.41%	-3.75%	-13.85%	-9.80%
Brent	-0.80%	-0.61%	-10.56%	-6.69%
ULSD	-0.13%	-1.11%	-3.47%	-0.41%
Gasoline	-0.05%	-1.47%	-5.96%	-0.50%
Natural Gas	-0.35%	-1.64%	-3.73%	-19.42%
Precious Metals Sub-Index	0.45%	1.94%	-0.24%	-5.02%
Gold	0.51%	1.86%	2.79%	-3.08%
Silver	0.28%	2.17%	-8.08%	-10.14%
Industrial Metals Sub-Index	1.81%	8.06%	8.32%	31.91%
Copper	3.23%	5.64%	11.18%	43.72%
Aluminum	0.38%	8.64%	6.51%	23.93%
Nickel	4.56%	12.45%	3.82%	15.35%
Zinc	-2.00%	10.41%	7.76%	30.46%
Softs Sub-Index	2.01%	-0.52%	-20.34%	-22.08%
Coffee	-0.21%	-6.92%	-12.72%	-17.12%
Sugar	4.64%	-2.29%	-27.74%	-34.37%
Cotton	1.31%	-0.86%	-8.44%	0.44%
Livestock Sub-Index	-1.08%	-4.91%	1.36%	7.45%
Cattle	0.99%	-4.81%	2.74%	12.68%
Hogs	-4.59%	-5.07%	-0.60%	-0.50%

The consensus from Jackson Hole is European interest rates will converge upward toward U.S. interest rates. Maybe; remember European commercial banks are stuffed with Eurozone sovereign debt used to prop up those same banks. Still, a weaker USD helps all commercial banks worldwide. Whether it is a stimulus to U.S. net exports is a far less clear proposition.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.39%	2.38%	12.63%	5.66%
Chinese yuan	0.36%	1.57%	3.37%	0.20%
Japanese yen	-0.16%	2.31%	3.05%	-8.07%
British pound	0.09%	-1.10%	3.54%	-2.35%
Swiss franc	0.79%	-0.48%	5.43%	1.12%
Canadian dollar	0.83%	0.22%	5.60%	3.53%
Australian dollar	0.04%	-0.06%	3.38%	4.12%
Swedish krona	1.90%	3.06%	13.79%	5.55%
Norwegian krone	1.98%	2.85%	7.97%	6.03%
New Zealand dollar	-0.98%	-2.37%	0.64%	-0.84%
Indian rupee	0.19%	0.48%	4.36%	4.79%
Brazilian real	-0.37%	0.43%	-1.54%	2.39%
Mexican peso	0.54%	0.89%	13.03%	4.26%
Chilean peso	1.82%	2.43%	1.83%	4.47%
Colombian peso	2.10%	3.57%	-1.00%	-0.98%
Bloomberg-JP Morgan Asian dollar index (spot)	0.45%	0.80%	2.47%	0.33%

The lowering of geopolitical concerns and the absence of overt central bank hostility reopened the path higher for global equities. The Latin American markets led the EM index higher.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.76%	-0.58%	7.28%	15.50%
North America	0.85%	-1.16%	4.18%	14.55%
Latin America	3.46%	5.77%	12.14%	22.81%
Emerging Market Free	2.46%	2.42%	17.07%	24.03%
EAFE	0.62%	0.39%	12.53%	16.86%
Pacific	-0.15%	0.03%	7.34%	14.81%
Eurozone	0.75%	0.48%	19.74%	24.53%

Both CTAs and hedge funds posted gains as they generally do during risk-on periods with a strong trend in both the USD and in energy markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.55%	1.08%	-6.11%	-10.93%
Newedge Trend	0.85%	0.83%	-3.56%	-7.64%
Newedge Short-Term	-0.27%	-0.86%	-2.38%	-10.84%
HFR Global Hedge Fund	0.34%	-0.17%	1.62%	4.84%
HFR Macro/CTA	0.28%	0.43%	-0.11%	-2.11%
HFR Macro: Sytematic Diversified CTA	0.59%	0.37%	-2.63%	-5.56%