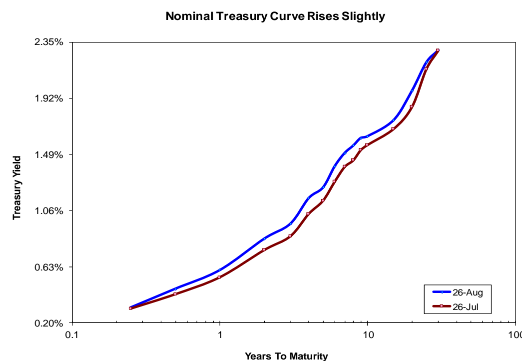
The Macro Environment For Financial Markets

If we review the bidding, we find 1) Central banks have admitted their policies did not work as intended, 2) They have created a multi-trillion dollar mousetrap ready to snap shut on the entirety of the global economy, and 3) They are pretty sure U.S. short-term interest rates should rise even though they have no idea of what the consequences of such an action will be. Did I mention they want unlimited power and no accountability? Sorry, I should have. The causal chain now is:

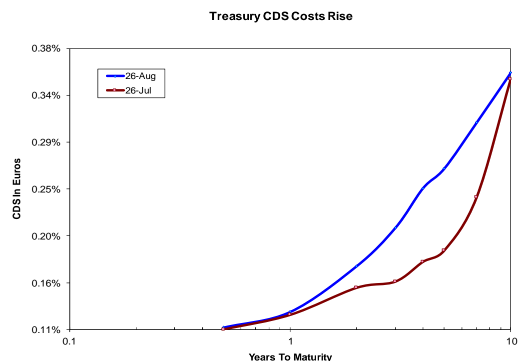
1. The market has no clear idea of when U.S. short-term rates will rise, although December seems the most likely date;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps have ended their downtrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are terming out short-term debt into the bond market;
6. Swap spreads have stopped rising; and
7. CDS costs remain suppressed as part of a global search for yield.

Key Market Indications

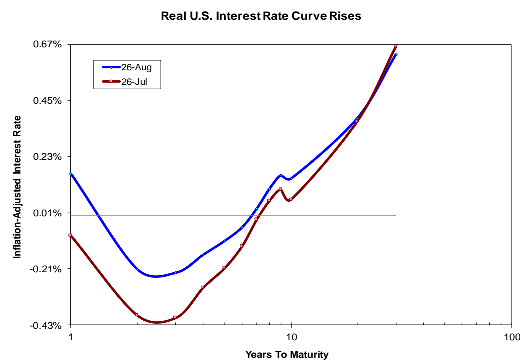
The ten-year can rise to 1.722% and still be within the context of a bullish consolidation. The yield curve is continuing to flatten via higher short-term rates, but this will be less of a consideration if those same short-term rates allow for cross-currency swaps into the UST market.



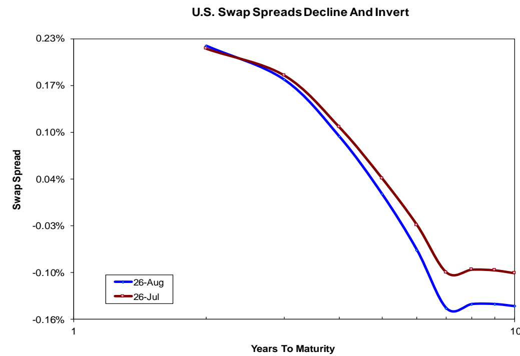
While the thinness of the sovereign CDS market is such we should not engage in over-analysis, the rise in CDS costs over the past three weeks is puzzling. At the risk of detouring into politics, this seems to be a better explanation than anything intrinsic to markets.



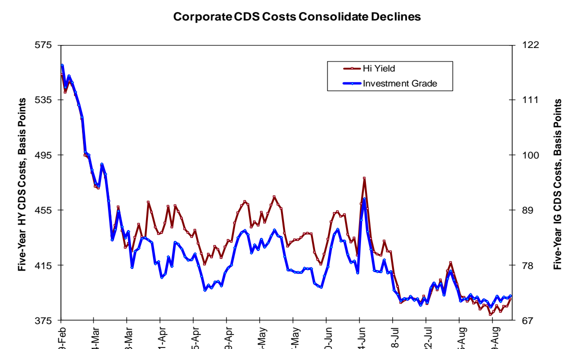
Pseudo-real rates at the long end of the yield curve have started to rise over the past month, and as these same rates outside of the U.S. have not been able to decline further, Precious Metals have lost some of their negative carry impetus.



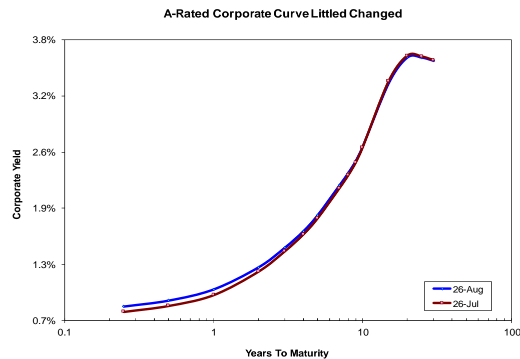
Swap spreads, which rise when floating-rate borrowers want to fix their payments, fell across the maturity spectrum. The market finds a reduced risk of rising interest rates from these modestly higher levels.



Both the investment-grade and high-yield CDS indices are consolidating their recent declines. So long as central banks are active in the corporate bond market, the ability of all credit spreads to rise will be limited. Moreover, as no credit shocks are imminent and even dodgy borrowers can refinance, why should CDS costs rise?



The A-rated corporate yield curve continues to mirror the UST curve as credit spreads remain in a narrow range. So long as both the European Central Bank and the Bank of England are in the market buying corporate bonds, it will be hard for U.S. investment-grade bonds to sell off very much.



Market Structure

Natural Gas and Softs both reversed into uptrends while both Industrial and Precious Metals entered downtrends. Ten-year UST and the dollar index remain in structural downtrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Aug. 29 - Sep. 2
BBerg	29	Trending	0.030	10.8%	
BBerg Grain	16	Transitional	-0.230	15.6%	
BBerg Ind. Metl	21	Trending	-0.192	12.3%	-0.23%
BBerg Pre. Metl	23	Trending	-0.224	13.0%	-0.31%
BBerg Softs	28	Trending	0.081	18.5%	0.45%
BBerg Nat. Gas	29	Trending	0.087	20.5%	0.92%
BBerg Petroleum	29	Trending	0.227	26.1%	1.75%
BBerg Livestock	19	Transitional	-0.180	12.1%	
Dollar Index	29	Trending	-0.038	6.8%	-0.04%
S&P 500 Index	18	Transitional	-0.081	5.8%	
EAFE Index	7	Sideways	-0.015	10.1%	
EM Index	8	Sideways	-0.053	8.5%	
Ten-year UST (price)	29	Trending	-0.126	5.2%	-0.09%

Performance Measures

With the exception of the economically unimportant Softs and Natural Gas, physical commodities had a very poor week. The economically important Petroleum and Industrial Metals indices remain in secular downtrends, and the best thing about being a farmer is the taxpayer picks up the tab for these lower prices in the form of greater subsidies. This is especially true in an election year. Rising implied real short-term rates are putting downward pressure on the precious metals.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.45%	0.86%	12.06%	-4.68%
Grains Sub-Index	-5.38%	-4.71%	-5.80%	-12.34%
Corn	-5.45%	-5.79%	-13.14%	-20.20%
Soybeans	-3.70%	-3.54%	13.44%	8.92%
Wheat	-8.37%	-4.79%	-17.31%	-23.66%
Energy Sub-Index	0.57%	8.74%	26.04%	-22.16%
Petroleum Sub-Index	-2.15%	13.31%	23.00%	-19.86%
WTI	-2.81%	12.20%	21.90%	-24.83%
Brent	-2.03%	14.06%	27.79%	-18.41%
ULSD	-1.92%	13.08%	28.63%	-19.87%
Gasoline	-1.19%	14.29%	10.70%	-17.05%
Natural Gas	8.97%	-2.67%	36.21%	-30.67%
Precious Metals Sub-Index	-2.12%	-4.15%	11.27%	19.10%
Gold	-1.50%	-2.30%	6.67%	16.09%
Silver	-3.61%	-8.39%	24.41%	27.10%
Industrial Metals Sub-Index	-2.63%	-3.39%	6.16%	-2.23%
Copper	-4.27%	-6.65%	-3.22%	-12.47%
Aluminum	-1.54%	-0.41%	2.88%	-1.43%
Nickel	-5.31%	-7.86%	14.21%	-3.97%
Zinc	1.34%	3.18%	30.57%	25.15%
Softs Sub-Index	2.94%	1.35%	31.74%	41.00%
Coffee	2.30%	-3.40%	19.26%	5.64%
Sugar	4.25%	8.21%	40.90%	71.82%
Cotton	0.01%	-8.10%	21.11%	7.47%
Livestock Sub-Index	-2.45%	-1.26%	-13.03%	-17.43%
Cattle	-3.53%	-4.79%	-13.09%	-20.17%
Hogs	-0.96%	3.88%	-13.15%	-12.85%

The Federal Reserve apparently has decided to risk a rising USD, for one week at least. With the sole exception of the recently weak GBP, the greenback rallied against everything else, major or EM. As the pattern has been for a rising USD to affect financial markets negatively and to put stress on all commercial banks with USD liabilities, the Federal Reserve will likely keep firing until they see the whites of their eyes.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.12%	1.93%	2.41%	-1.03%
Chinese yuan	-0.24%	0.04%	-1.94%	-3.90%
Japanese yen	-1.59%	2.77%	11.94%	17.75%
British pound	0.47%	0.05%	-5.29%	-15.04%
Swiss franc	-1.81%	1.45%	1.90%	-2.39%
Canadian dollar	-1.02%	1.42%	3.92%	2.22%
Australian dollar	-0.83%	0.83%	6.15%	6.21%
Swedish krona	-1.14%	2.10%	0.97%	0.11%
Norwegian krone	-0.61%	3.63%	5.02%	1.32%
New Zealand dollar	-0.50%	2.58%	9.16%	12.38%
Indian rupee	0.00%	0.32%	2.35%	-1.36%
Brazilian real	-1.86%	0.32%	22.49%	10.13%
Mexican peso	-2.00%	0.98%	-1.71%	-8.50%
Chilean peso	-1.17%	-1.04%	3.52%	5.82%
Colombian peso	-1.14%	5.80%	15.61%	12.82%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.35%	0.23%	1.65%	-0.34%

Weaker EM equities and weaker EM currencies go hand-in-hand. However, weaker EAFE currencies and stronger EAFE equities have gone hand-in-hand, too.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.25%	0.54%	13.37%	6.95%
North America	-0.61%	0.44%	13.31%	13.78%
Latin America	-1.69%	3.71%	39.08%	26.61%
Emerging Market Free	-0.95%	3.73%	24.09%	17.73%
EAFE	0.18%	3.13%	11.87%	3.19%
Pacific	0.28%	0.97%	16.46%	6.17%
Eurozone	0.16%	1.36%	9.89%	-2.74%

This week's performance looks very similar to last week's: CTAs apparently were on the wrong side of the petroleum complex and most likely equities. Worse, the choppy action is currencies and long-term interest rates apparently confused both CTAs and hedge funds.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.49%	-0.75%	-5.57%	-1.36%
Newedge Trend	-1.15%	-1.05%	-4.53%	1.83%
Newedge Short-Term	-1.13%	-1.74%	-2.93%	1.68%
HFR Global Hedge Fund	-0.24%	0.40%	4.25%	-0.86%
HFR Macro/CTA	-1.02%	-0.41%	-2.39%	-2.03%
HFR Macro: Sytematic Diversified CTA	-1.51%	-0.28%	-3.41%	1.12%