The Macro Environment For Financial Markets

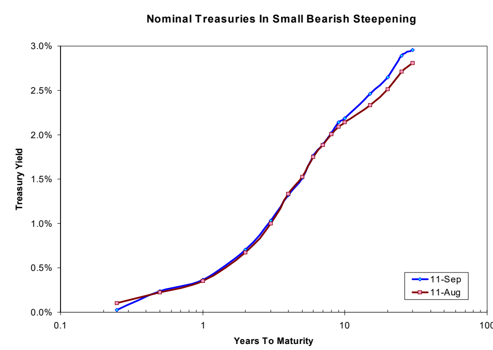
Franklin Roosevelt was on to something with that "fear itself" concept. The high levels of uncertainty about key policies, key data and key relationships are preventing markets from forming coherent signals. The result has been a series of disjointed interday reversals, wide intraday ranges and a silly global game of follow-the-previous-time-zone. This will end soon enough, but we might not like the results of greater certainty if it confirms all assets were overpriced and overpriced significantly during the long era of central bank balance-sheet expansion.

The causal chain now is:

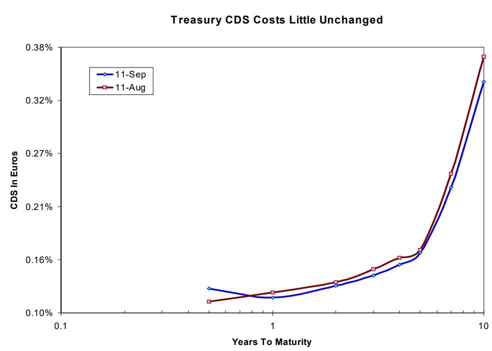
1. Short-term interest rates will remain artificially low globally. The timing of any rate hike in the U.S. has become far more problematic at this point;
2. Disinflationary pressures are dominating inflationary pressures;
3. Inflation expectations as measured by the TIPS market will remain low;
4. The U.S. yield curve retains its long-term trend toward a bullish flattening;
5. Short-term borrowers will shift back toward accepting rollover risk;
6. Swap spreads will remain tame until monetary policy indications turn more hawkish; and
7. Credit spreads will continue to rise under industry stresses in the energy, mining and media sectors.

Key Market Indications

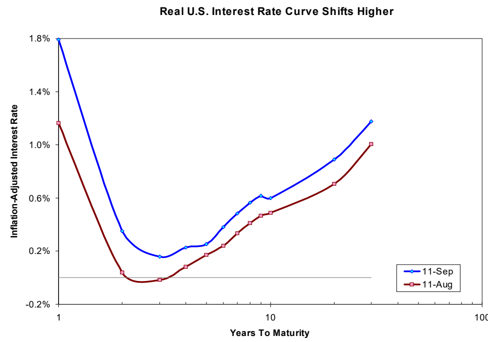
The yield curve has steepened bearishly over the past month as markets are backing away from a global collapse scenario. However, we will need to see the ten-year move over 2.57% to call an end to the long-term bullish flattening trend.



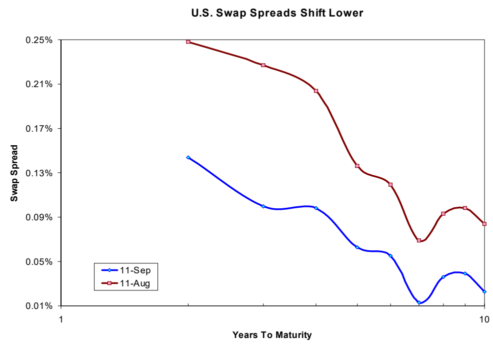
The changes in CDS costs for Treasuries remained small over the past month, which is notable given some misguided rumblings in Congress about a government shutdown, maybe just for old times' sake.



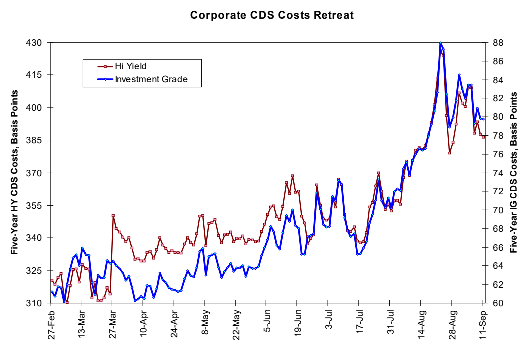
Pseudo-real rates continue to move higher at the short end of the yield curve. This pushed gold lower in the face of a diminished haven bid. Long-term pseudo-real rates have advanced over the past month. If this rise persists, it will constitute a headwind for risky financial assets.



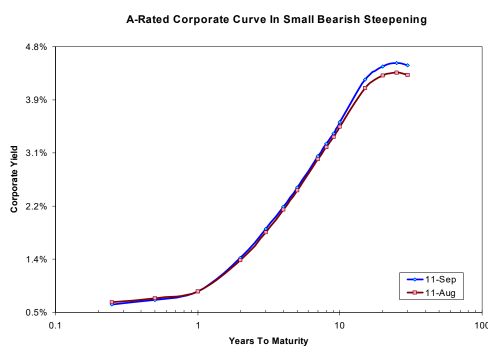
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined at both the short end of the yield curve over the past month. The decline at the short end reflects a growing sense any hike in short-term rates will be singular and may not occur at all. The decline at the long end is consistent with a strong demand for sovereign debt as equity markets continue to wobble.



CDS costs for both the investment-grade and high-yield indices declined, but there is no mistaking the secular uptrend in these critical measures. It would take a reversal of expectations for higher short-term rates in the U.S. and evidence of stronger global growth, an inconsistent combination, to alter this outlook.



The A-rated yield curve has steepened bearishly over the past month. While the move is not sufficient to raise concerns about the investment-grade market, it remains a negative, albeit still a modest one, for equities.



Market Structure

The volatility and lack of coherent signal have been sufficient to take all by Precious Metals and Livestock out of trending structures in the physical commodities and to keep all of the financial indices out of trending structures.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 14 - 18
BBerg	11	Transitional	-0.007	18.3%	
BBerg Grain	17	Transitional	0.064	20.1%	
BBerg Ind. Metl	16	Transitional	0.157	21.0%	
BBerg Pre. Metl	26	Trending	-0.133	14.8%	-0.12%
BBerg Softs	21	Trending	0.006	18.3%	
BBerg Nat. Gas	6	Sideways	-0.007	18.7%	
BBerg Petroleum	5	Sideways	-0.038	33.0%	
BBerg Livestock	23	Trending	-0.116	12.3%	-0.22%
Dollar Index	11	Transitional	-0.088	7.6%	
S&P 500 Index	9	Sideways	0.038	17.7%	
EAFE Index	9	Sideways	0.004	15.9%	
EM Index	8	Sideways	0.023	17.4%	
Ten-year UST (price)	13	Transitional	-0.019	6.4%	

Performance Measures

The Petroleum complex pushed lower as the current supply picture is overwhelming growing expectations for declining future supply. While Precious Metals moved lower on another dissipated haven bid, the Industrial Metals, Softs and Grains stabilized. These are consolidations within bearish trends, however.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.55%	-1.57%	-8.85%	-26.67%
Grains Sub-Index	4.26%	-1.41%	-6.68%	-5.99%
Corn	7.06%	3.07%	-5.05%	1.10%
Soybeans	0.55%	-4.60%	-8.04%	-10.85%
Wheat	4.25%	-5.22%	-5.16%	-6.47%
Energy Sub-Index	-3.48%	-2.61%	-11.54%	-48.10%
Petroleum Sub-Index	-4.43%	-1.24%	-12.44%	-52.02%
WTI	-4.56%	1.93%	-13.55%	-56.91%
Brent	-4.79%	-1.97%	-16.29%	-56.41%
ULSD	-4.03%	-0.94%	-10.88%	-42.99%
Gasoline	-3.87%	-6.04%	-5.44%	-42.54%
Natural Gas	-1.03%	-5.85%	-9.13%	-39.93%
Precious Metals Sub-Index	-1.75%	-1.93%	-5.27%	-14.07%
Gold	-1.88%	-0.84%	-4.59%	-10.85%
Silver	-1.37%	-4.96%	-7.18%	-23.15%
Industrial Metals Sub-Index	1.77%	2.44%	-11.60%	-25.10%
Copper	2.90%	4.28%	-8.36%	-21.28%
Aluminum	0.43%	3.13%	-10.53%	-23.24%
Nickel	2.93%	-2.91%	-27.66%	-44.92%
Zinc	0.13%	-0.91%	-10.58%	-21.85%
Softs Sub-Index	0.47%	-0.28%	-10.89%	-29.98%
Coffee	-2.51%	-17.42%	-15.38%	-42.83%
Sugar	1.78%	8.08%	-11.13%	-30.65%
Cotton	0.59%	-4.27%	2.99%	-6.71%
Livestock Sub-Index	-1.50%	-1.59%	-0.93%	-17.12%
Cattle	-0.78%	-4.32%	-4.39%	-7.79%
Hogs	-2.70%	3.45%	6.01%	-32.03%

A weaker JPY is a strong representation of a "risk-off" trade at present. It is important to note how the EUR has held support and remains within a secondary uptrend. Until some clarity emerges on U.S. monetary policy, however, no strong signal will emerge in the major currencies and the EM currencies primary downtrends will remain intact barring a strong dovish signal from the FOMC.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.70%	2.68%	7.50%	-12.28%
Chinese yuan	-0.30%	-0.78%	-1.76%	-3.84%
Japanese yen	-1.33%	3.76%	0.71%	-11.18%
British pound	1.71%	-0.92%	3.34%	-5.08%
Swiss franc	0.23%	1.95%	4.14%	-3.45%
Canadian dollar	0.14%	-1.13%	-3.88%	-16.80%
Australian dollar	2.66%	-2.90%	-6.64%	-22.07%
Swedish krona	2.43%	5.11%	4.91%	-13.45%
Norwegian krone	1.92%	1.54%	0.69%	-21.75%
New Zealand dollar	0.53%	-3.34%	-13.38%	-22.81%
Indian rupee	-0.11%	-3.51%	-5.65%	-8.43%
Brazilian real	-0.71%	-10.24%	-19.23%	-40.64%
Mexican peso	0.60%	-3.11%	-7.97%	-21.42%
Chilean peso	0.62%	-0.93%	-7.28%	-14.34%
Colombian peso	2.74%	-3.28%	-13.75%	-34.89%
Bloomberg-JP Morgan Asian dollar index (spot)	0.23%	-1.16%	-3.46%	-7.70%

If the August selloff began with confused policies in China, did it end in September with a self-serving declaration by Beijing they will get their house in order? The primary trend in the equity markets has turned lower and we need to be in a "sell rallies" mode until proven otherwise.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.02%	-6.77%	-3.55%	-4.04%
North America	1.99%	-5.76%	-3.38%	-1.58%
Latin America	-1.05%	-10.49%	-17.18%	-42.25%
Emerging Market Free	1.88%	-8.36%	-13.21%	-22.85%
EAFE	2.07%	-8.35%	-3.83%	-7.80%
Pacific	1.73%	-9.40%	-6.34%	-7.27%
Eurozone	1.92%	-9.15%	-4.06%	-9.39%

While CTAs managed to gain during the short week, hedge funds continue to struggle with the lack of strong signals in the equity markets and in the sovereign debt markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.19%	-1.35%	-4.32%	15.71%
Newedge Trend	0.02%	-1.55%	-4.30%	9.87%
Newedge Short-Term	0.07%	-0.01%	-7.04%	2.18%
HFR Global Hedge Fund	-0.10%	-2.28%	-2.48%	-3.76%
HFR Macro/CTA	-0.52%	-2.43%	-4.06%	1.87%
HFR Macro: Sytematic Diversified CTA	-0.55%	-1.50%	-3.84%	4.17%