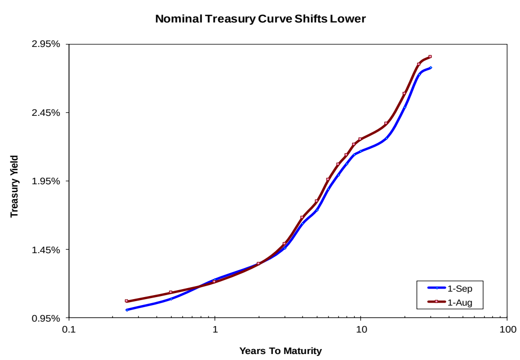
The Macro Environment For Financial Markets

I identified the statistical end of the "Trump trades" in everything but U.S. equities back in February. What was not identifiable at that time was the end of the Yellen/Fischer trade; no matter how much the Federal Reserve wants to renormalize rates and shrink its balance sheet, events keep getting in the way. This is very upsetting to academic economists. What it does, though, is maintain the long-running environment of monetary ease and slow growth. This rewards financial markets more than it does the real economy; let's hope your local populist fails to recognize this. The causal chain now is:

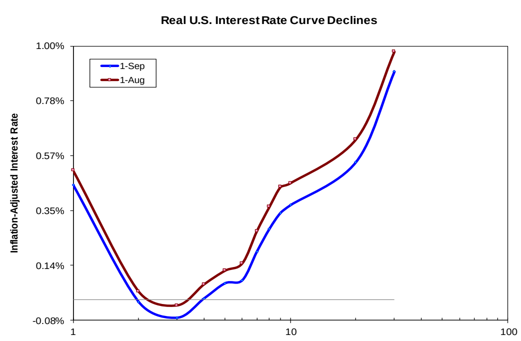
1. The market has priced out expectations for another short-term rate hike in the U.S. in 2017, but still has to deal with the prospects of a shrinking balance sheet;
2. Inflationary expectations have stopped declining;
3. The secular flattening trend in the U.S. is resuming;
4. Short-term borrowers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

Key Market Indications

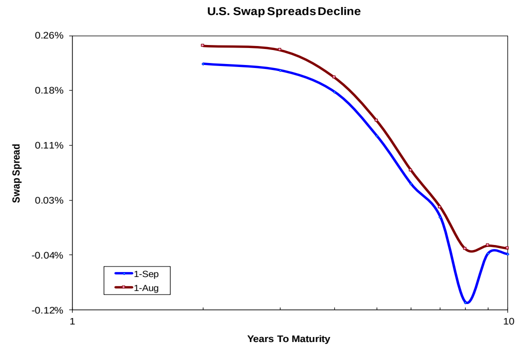
The ten-year UST's yield had moved to its 2017 low before the market had to start pricing in the costs of Harvey and increased speculation over aggressive tax cuts. The idea higher deficits lead to higher interest rates almost seems quaint, like something from the 1970s; experience has shown very little impact of deficits on either long-term rates or inflation expectations.



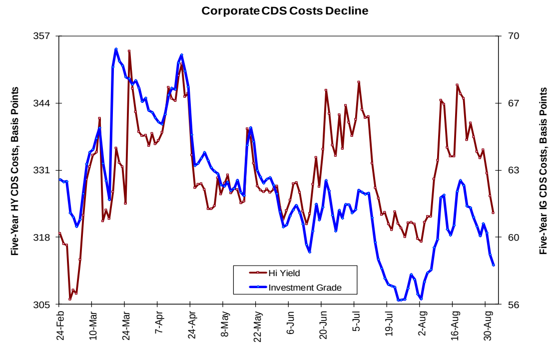
The pseudo-real yield curve declined across the maturity spectrum, with the strongest move at the mid-curve. Both the two- and three-year tenors remain negative. The shift is not as significant as it may appear as the market simply is pricing out some of its inflation protection taken out early in the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



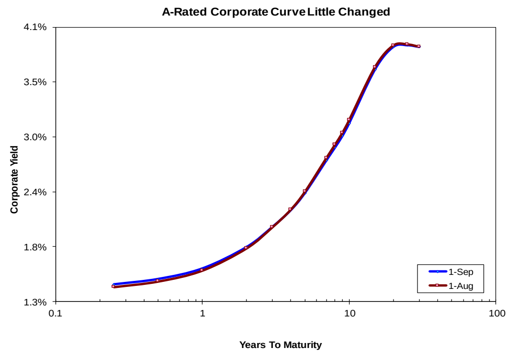
Swap spreads, which rise when floating-rate borrowers want to fix their payments, fell across the board. Borrowers seem quite willing to remain floating-rate payors.



CDS costs moved lower for both the investment-grade and high-yield indices. This represents the unwinding of equity correlation trades combined with reduced expectations for higher short-term interest rates.



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



Market Structure

Both Precious Metals and Natural Gas moved into structural uptrends, while Grains and Softs remain in structural downtrends. The S&P 500 reversed into an uptrend, joining ten-year UST remain in an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 5 - 8
BBerg	17	Transitional	0.259	7.4%	
BBerg Grain	29	Trending	-0.221	15.0%	-0.52%
BBerg Ind. Metl	6	Sideways	0.135	12.2%	
BBerg Pre. Metl	29	Trending	0.333	11.0%	0.26%
BBerg Softs	29	Trending	-0.126	16.3%	-0.91%
BBerg Nat. Gas	29	Trending	0.172	18.9%	0.18%
BBerg Petroleum	17	Transitional	0.137	20.0%	
BBerg Livestock	6	Sideways	0.026	13.0%	
Dollar Index	18	Transitional	-0.050	7.0%	
S&P 500 Index	29	Trending	0.108	6.2%	0.04%
EAFE Index	18	Transitional	0.088	8.0%	
EM Index	18	Transitional	0.271	7.0%	
Ten-year UST (price)	29	Trending	0.113	3.8%	0.04%

Performance Measures

The strong rally in Industrial Metals continued on the usual speculation about Chinese demand stabilizing. All of the energy markets save for natural gas moved higher on the back of Harvey, and Precious Metals moved higher on declining short-term implied real rates. Cotton rose on the disruptions to the U.S. market from Harvey.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	2.04%	2.12%	-2.08%	3.11%
Grains Sub-Index	0.65%	-5.51%	-12.63%	-5.44%
Corn	0.51%	-6.57%	-13.23%	-3.65%
Soybeans	0.55%	-0.68%	-9.73%	-4.24%
Wheat	0.82%	-8.98%	-13.86%	-8.63%
Energy Sub-Index	3.23%	2.79%	-4.46%	-0.47%
Petroleum Sub-Index	2.72%	0.73%	-5.40%	3.95%
WTI	-0.25%	-3.76%	-13.04%	-3.46%
Brent	1.50%	0.63%	-8.23%	1.42%
ULSD	6.36%	4.66%	5.48%	13.33%
Gasoline	6.89%	5.26%	4.85%	15.58%
Natural Gas	4.66%	9.11%	-1.62%	-11.83%
Precious Metals Sub-Index	2.91%	6.26%	5.48%	-3.24%
Gold	2.52%	5.29%	7.74%	-0.70%
Silver	4.01%	9.15%	-0.46%	-9.54%
Industrial Metals Sub-Index	3.00%	10.80%	12.70%	36.12%
Copper	2.03%	7.39%	14.17%	47.09%
Aluminum	3.15%	11.89%	11.76%	31.97%
Nickel	4.77%	17.33%	8.69%	17.90%
Zinc	3.95%	13.35%	14.07%	32.81%
Softs Sub-Index	-0.19%	-5.47%	-19.90%	-21.36%
Coffee	-1.77%	-10.09%	-14.68%	-22.11%
Sugar	-1.98%	-2.68%	-30.23%	-34.30%
Cotton	5.49%	1.87%	-5.46%	6.33%
Livestock Sub-Index	-1.97%	-7.82%	0.89%	8.54%
Cattle	-1.64%	-7.77%	2.75%	16.01%
Hogs	-2.56%	-7.90%	-1.92%	-2.13%

I noted in early August currency markets were going to have very little theme, and this has been the case. Moreover, this is likely to continue as the prospects for significant shifts in monetary policy for the remainder of the year are weak. One of the more noteworthy developments is the continued strength in the CNY; whether this is a Chinese concession to the U.S. is unknowable, but it seems likely.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.54%	0.49%	12.45%	5.92%
Chinese yuan	1.34%	2.43%	4.93%	1.78%
Japanese yen	-0.81%	0.10%	3.16%	-6.37%
British pound	0.54%	-1.91%	5.35%	-2.39%
Swiss franc	-0.81%	0.09%	4.57%	1.59%
Canadian dollar	0.70%	1.16%	7.51%	5.72%
Australian dollar	0.54%	0.08%	3.88%	5.62%
Swedish krona	-0.45%	1.37%	13.12%	6.92%
Norwegian krone	-0.60%	1.66%	7.83%	6.87%
New Zealand dollar	-1.15%	-4.14%	0.20%	-1.72%
Indian rupee	0.01%	0.08%	4.37%	4.58%
Brazilian real	0.59%	-0.44%	-1.48%	3.72%
Mexican peso	-1.12%	0.43%	11.21%	5.24%
Chilean peso	1.69%	4.54%	4.22%	9.01%
Colombian peso	-0.17%	1.28%	0.13%	2.06%
Bloomberg-JP Morgan Asian dollar index (spot)	0.59%	1.10%	3.31%	1.09%

The lowering of geopolitical concerns and the absence of overt central bank hostility reopened the path higher for global equities. Gains were strongest in North America, probably on reduced expectations for higher short-term rates.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.14%	0.12%	7.85%	16.18%
North America	1.48%	0.33%	4.62%	16.27%
Latin America	0.66%	4.96%	12.93%	24.72%
Emerging Market Free	0.65%	2.34%	18.43%	25.74%
EAFE	0.58%	-0.47%	12.54%	18.02%
Pacific	0.52%	0.15%	8.67%	15.65%
Eurozone	0.19%	-0.67%	17.96%	23.49%

Both CTAs and hedge funds posted gains for a second week. This is common 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	2.00%	2.45%	-3.86%	-8.38%
Newedge Trend	1.30%	1.87%	-1.97%	-5.79%
Newedge Short-Term	-0.35%	-0.89%	-1.81%	-10.07%
HFR Global Hedge Fund	0.40%	0.29%	2.15%	5.59%
HFR Macro/CTA	0.55%	0.76%	0.73%	-1.01%
HFR Macro: Sytematic Diversified CTA	1.07%	1.08%	-0.91%	-3.51%