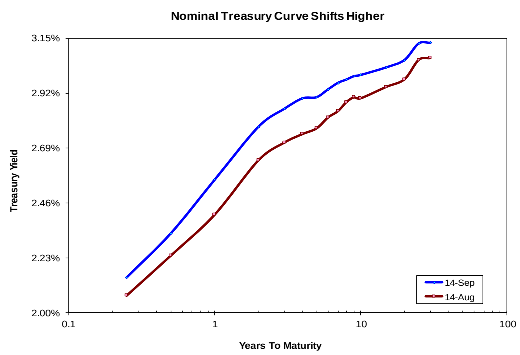
The Macro Environment For Financial Markets

Markets are having a tough time accommodating good news. Even justifiable declines in volatility are seen as a cause for concern. If the unnecessary trade conflicts could be eliminated, who knows how high risky financial assets could go? What is undeniable as the European Central Bank promises, once again, to start exiting QE, is we remain in stimulative fiscal and easy monetary policies within a high-growth environment. The causal chain now is:

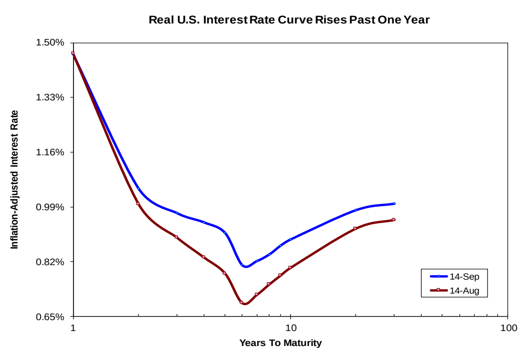
1. The market is pricing in September and December 2018 rate hikes;
2. Inflationary expectations are steady;
3. The yield curve is starting to exit its secular flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to invert bullishly; and
6. CDS costs are declining separate from equity movements.

Key Market Indications

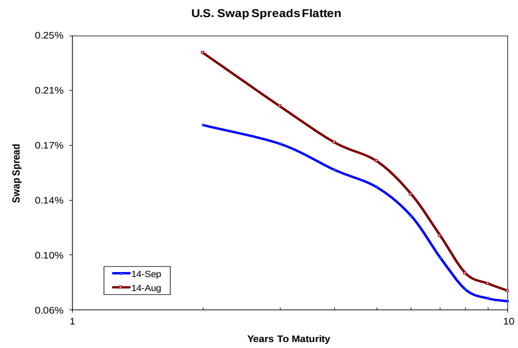
While it feels as if ten-year yields have moved significantly higher, we simply are in the post-January range. The more significant movement continues to come at the short end of the yield curve. In pre-crisis days, long-term yields would be much higher, but now that central banks are the major holders and banks must hold "riskless" sovereign debt, the potential for a strong selloff has been diminished greatly.



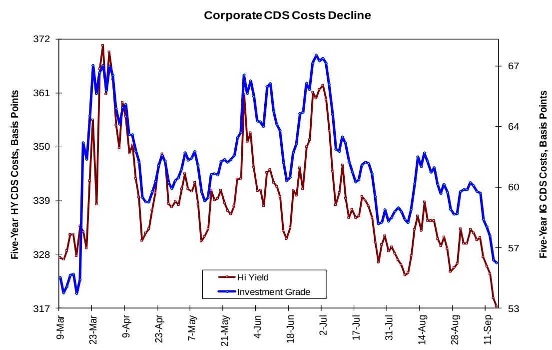
The pseudo-real yield curve rose at the long end of the yield curve as nominal rates rose and breakevens remained steady. The rise at the long end of this curve is not yet a threat to risky financial assets.



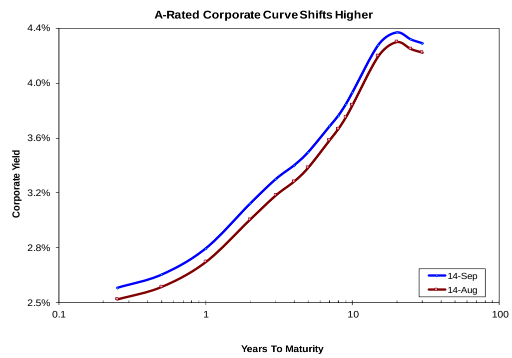
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined at the short end of the yield curve despite the continued rise in two-year yields. The long end of the curve declined slightly.



CDS costs declined significantly as declining reported inflation rates remained tame. The removal of the threat of an overly aggressive Federal Reserve reduces forward credit risk.



The A-rated corporate yield curve shifted higher in parallel to the Treasury curve. However, this market remains as confined as credit spreads and long-term UST rates are offsetting each other.



Market Structure

Only Petroleum and Livestock are in structural uptrends within the physical markets, while Grains, Industrial Metals and Natural Gas are in structural downtrends. Ten-year UST remain in a downtrend while the dollar index and all of the stock indices are in non-trending structures.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 17 - 21
BBerg	15	Transitional	-0.105	8.0%	
BBerg Grain	29	Trending	-0.311	15.7%	-0.22%
BBerg Ind. Metl	27	Trending	-0.131	18.2%	-0.32%
BBerg Pre. Metl	15	Transitional	-0.071	10.0%	
BBerg Softs	14	Transitional	0.023	14.8%	
BBerg Nat. Gas	29	Trending	-0.404	12.4%	-0.04%
BBerg Petroleum	29	Trending	0.122	18.1%	0.07%
BBerg Livestock	29	Trending	0.404	12.3%	0.12%
Dollar Index	10	Sideways	-0.028	5.8%	
S&P 500 Index	9	Sideways	0.081	7.0%	
EAFE Index	17	Transitional	-0.027	8.4%	
EM Index	17	Transitional	-0.088	10.1%	
Ten-year UST (price)	29	Trending	-0.263	3.1%	-0.09%

Performance Measures

Bearish WASDE data and the never-ending trade tussle with China pushed Grains lower, offsetting gains in Petroleum and in Livestock. It is phenomenal that the main Bloomberg index has lost 1.61% over the past year while the Petroleum subindex has gained 37.64%. This speaks to excess production capacity globally far more than it does economic weakness.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.11%	-0.90%	-4.70%	-1.61%
Grains Sub-Index	-1.98%	-8.60%	-13.94%	-11.53%
Corn	-4.12%	-6.98%	-14.57%	-12.43%
Soybeans	-1.56%	-6.82%	-22.59%	-18.35%
Wheat	0.09%	-11.63%	-0.33%	-2.22%
Energy Sub-Index	0.58%	2.80%	11.49%	20.04%
Petroleum Sub-Index	1.21%	6.69%	16.22%	37.64%
WTI	1.85%	6.07%	14.20%	41.89%
Brent	1.64%	8.48%	21.35%	49.00%
ULSD	-0.28%	5.23%	16.54%	26.85%
Gasoline	0.50%	5.57%	10.12%	20.02%
Natural Gas	-1.36%	-7.71%	-1.33%	-21.46%
Precious Metals Sub-Index	0.04%	0.37%	-10.21%	-12.78%
Gold	0.10%	1.59%	-9.23%	-10.15%
Silver	-0.16%	-3.80%	-13.58%	-20.87%
Industrial Metals Sub-Index	-0.10%	-1.32%	-12.26%	-6.52%
Copper	0.94%	0.11%	-15.69%	-11.70%
Aluminum	-1.35%	0.53%	0.14%	-0.74%
Nickel	2.42%	-6.16%	-7.23%	13.57%
Zinc	-3.53%	-2.08%	-26.89%	-20.09%
Softs Sub-Index	-0.04%	0.34%	-13.27%	-19.82%
Coffee	-2.64%	-4.62%	-20.01%	-35.62%
Sugar	2.13%	10.59%	-12.75%	-26.44%
Cotton	-0.15%	0.70%	2.27%	21.46%
Livestock Sub-Index	2.93%	0.91%	0.46%	2.01%
Cattle	3.35%	2.61%	2.46%	3.07%
Hogs	1.89%	-3.12%	-3.39%	-1.45%

Performance remains mixed as the ECB's threat to raise rates has not turned the EUR higher decisively. Many other majors, including the CHF, CAD, AUD and NOK moved higher as did Latin currencies outside of the BRL.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.62%	2.48%	-6.01%	-2.47%
Chinese yuan	-0.35%	0.24%	-8.00%	-4.54%
Japanese yen	-0.95%	-0.81%	-5.12%	-1.62%
British pound	1.15%	2.71%	-6.40%	-2.47%
Swiss franc	0.08%	2.66%	-2.43%	-0.54%
Canadian dollar	0.96%	0.17%	-0.62%	-6.68%
Australian dollar	0.65%	-1.24%	-9.19%	-10.64%
Swedish krona	0.08%	0.97%	-9.59%	-11.74%
Norwegian krone	2.37%	1.92%	-6.38%	-4.65%
New Zealand dollar	0.58%	0.00%	-10.37%	-9.00%
Indian rupee	-0.16%	-2.73%	-9.77%	-10.76%
Brazilian real	-2.81%	-7.33%	-21.85%	-25.21%
Mexican peso	2.27%	-0.03%	-1.61%	-6.48%
Chilean peso	0.46%	-3.25%	-12.53%	-9.16%
Colombian peso	1.15%	-0.36%	-5.95%	-4.10%
Bloomberg-JP Morgan Asian dollar index (spot)	0.02%	-0.13%	-6.33%	-3.53%

While the Latin American index declined, the EM index in general gained as Pacific stocks moved higher. All equity indices have ignored numerous reasons to sell off sharply.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.40%	1.49%	2.97%	11.66%
North America	1.20%	2.24%	6.45%	17.75%
Latin America	-0.74%	-5.70%	-20.14%	-15.02%
Emerging Market Free	0.60%	-1.11%	-13.94%	-3.97%
EAFE	1.78%	0.36%	-3.11%	2.19%
Pacific	1.73%	-0.48%	-4.02%	5.25%
Eurozone	2.22%	1.68%	-5.05%	-2.46%

CTAs managed a small gain on the week, but macro CTAs had significant losses, suggesting they remain biased to the long side on both the USD and on equities in general.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	0.03%	-0.08%	-0.25%	1.29%
SocGen Trend	0.26%	0.12%	-0.98%	-0.44%
SocGen Short-Term	-0.06%	-0.84%	-1.01%	0.62%
HFR Global Hedge Fund	0.12%	0.02%	-1.80%	0.50%
HFR Macro/CTA	-0.42%	-0.74%	-0.59%	-0.25%
HFR Macro: Sytematic Diversified CTA	-0.75%	-0.99%	-0.44%	1.54%