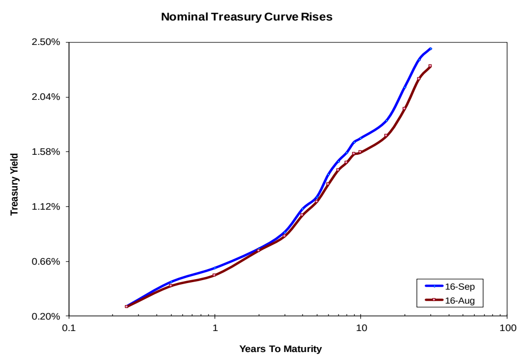
The Macro Environment For Financial Markets

The breakaway gap to the downside in U.S. equities has remained open for one week, and the downturns outside of the U.S. have been noticeable. If equities' July-August rally was propelled by increasingly negative interest rates, then the pullback to levels prevailing in June should be expected. There are worse things. In the meantime, U.S. economic data have been maddeningly inconsistent. The labor market's upturn has pushed personal income growth higher, and this really should have received more notice than it did. The causal chain remains:

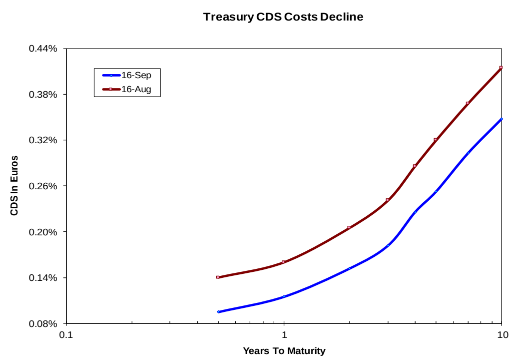
1. The market has no clear idea of when U.S. short-term rates will rise, although December seems the most likely date;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps have ended their downtrend;
4. The U.S. yield curve retains its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

Key Market Indications

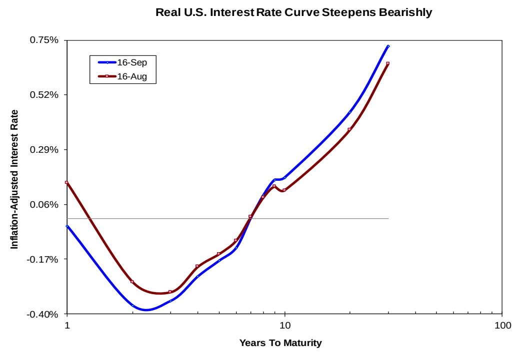
Sometimes the simplest strategies are the best ones: Until the ten-year exceeds 1.98%, the bull market is intact. The global retreat away from the extreme levels seen in sovereign debt post-Brexit is a sign the world is functioning normally. More amusing, though, has been the habitual behavior of bond investors to buy high and refuse to buy lower in the face of the recent upturn in yields.



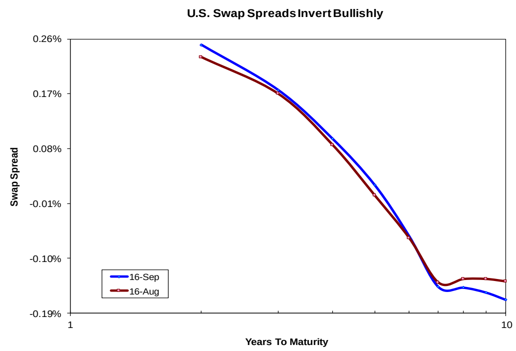
Did the sovereign credit quality of the U.S. government improve markedly over the past month? Probably not, but it is interesting to note how CDS costs fell significantly in the face of rising UST rates. Perhaps rising debt service costs will not matter.



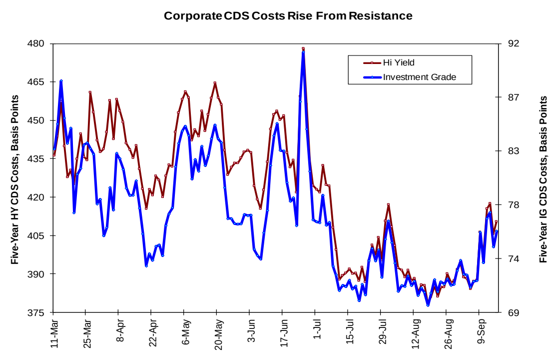
The pseudo-real yield curve has steepened bearishly over the past month. This has helped support gold in the face of rising implied short-term real rates outside of the U.S. The rise at the long end of the yield curve has not been strong enough to affect risky financial assets yet.



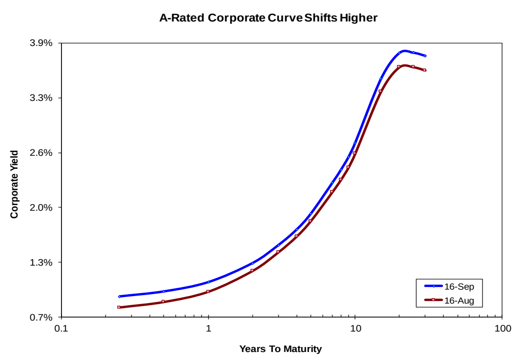
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to invert bullishly. This has been a very persistent pattern for the past five years. Floating-rate payors are not in any demonstrable hurry to fix their payments.



The increases in corporate CDS costs have been very minor. What they are doing is retreating from their unnatural lows of two months ago. The simple reality is low funding costs, high corporate cash levels and steady but unspectacular growth are not conducive to any sort of retreat from corporate bonds as an asset class.



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

Softs are the only physical commodity subindex in a structural uptrend. The S&P 500 and ten-year UST remain in structural downtrends amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 19 - 23
BBerg	26	Trending	-0.148	9.9%	-0.39%
BBerg Grain	27	Trending	-0.027	16.1%	-0.25%
BBerg Ind. Metl	8	Sideways	-0.015	12.1%	
BBerg Pre. Metl	29	Trending	-0.181	12.0%	-0.31%
BBerg Softs	28	Trending	0.248	17.4%	0.45%
BBerg Nat. Gas	17	Transitional	0.077	22.6%	
BBerg Petroleum	28	Trending	-0.171	25.7%	-1.27%
BBerg Livestock	29	Trending	-0.315	13.9%	-0.27%
Dollar Index	16	Transitional	0.102	6.8%	
S&P 500 Index	25	Trending	-0.181	8.0%	-0.13%
EAFE Index	17	Transitional	-0.189	10.5%	
EM Index	17	Transitional	-0.135	12.0%	
Ten-year UST (price)	28	Trending	-0.164	5.1%	-0.09%

Performance Measures

The Petroleum markets had very strong downturns as did economically sensitive industrial metals such as nickel and zinc. Some other tributes to illiquidity include sugar and it 9% gain and hogs with their 6.2% loss. The loss of bank proprietary trading desks is being felt in a large number of physical markets; just wait until liquidation begins in corporate bonds.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.93%	-3.45%	3.22%	-4.89%
Grains Sub-Index	-1.03%	-4.18%	-7.53%	-11.00%
Corn	-1.17%	-1.94%	-12.39%	-17.73%
Soybeans	-1.45%	-3.81%	8.69%	11.09%
Wheat	-0.06%	-9.31%	-19.89%	-24.91%
Energy Sub-Index	-1.52%	-5.23%	5.96%	-23.40%
Petroleum Sub-Index	-3.70%	-9.74%	0.71%	-22.75%
WTI	-6.11%	-12.26%	-4.85%	-30.69%
Brent	-4.52%	-10.41%	4.00%	-19.91%
ULSD	-2.39%	-9.03%	6.32%	-21.08%
Gasoline	2.37%	-2.94%	0.33%	-16.60%
Natural Gas	4.54%	8.66%	23.43%	-27.87%
Precious Metals Sub-Index	-2.05%	-2.75%	7.58%	16.79%
Gold	-1.81%	-2.65%	3.73%	14.35%
Silver	-2.61%	-2.99%	18.12%	22.74%
Industrial Metals Sub-Index	-0.37%	-3.35%	2.32%	-2.68%
Copper	3.23%	-0.78%	-6.31%	-10.81%
Aluminum	-0.18%	-5.78%	2.20%	-6.70%
Nickel	-6.27%	-6.22%	11.38%	-1.01%
Zinc	-3.47%	-3.29%	19.26%	28.25%
Softs Sub-Index	3.80%	5.42%	25.13%	41.66%
Coffee	-1.81%	4.83%	4.67%	13.45%
Sugar	9.01%	10.30%	34.02%	84.13%
Cotton	-2.60%	-1.08%	18.40%	10.61%
Livestock Sub-Index	-1.00%	-5.82%	-18.32%	-18.74%
Cattle	2.57%	-2.90%	-14.32%	-15.29%
Hogs	-6.19%	-10.25%	-24.14%	-24.16%

Only the JPY and BRL prevented the USD from scoring a clean sweep this past week, and this is with only poor conviction as to the timing and magnitude of any rate hike in the U.S. The trend of using the MXN as a scorecard on Donald Trump is silly. Those involved will regret it soon, but not as much as everyday Mexicans exposed to higher-cost imports from the U.S.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.69%	-1.10%	-0.61%	-1.20%
Chinese yuan	-0.18%	-0.55%	-2.62%	-4.60%
Japanese yen	0.39%	-1.94%	10.04%	17.87%
British pound	-2.00%	-0.34%	-8.82%	-16.08%
Swiss franc	-0.49%	-1.90%	-0.36%	-0.94%
Canadian dollar	-1.23%	-2.64%	-0.87%	-0.30%
Australian dollar	-0.66%	-2.65%	-0.82%	4.09%
Swedish krona	-0.85%	-1.77%	-4.10%	-3.62%
Norwegian krone	-0.72%	-1.39%	1.74%	-2.02%
New Zealand dollar	-0.79%	-0.21%	8.06%	14.12%
Indian rupee	-0.46%	-0.33%	0.37%	-0.78%
Brazilian real	0.34%	-1.86%	14.70%	17.37%
Mexican peso	-3.63%	-7.90%	-10.25%	-15.62%
Chilean peso	-0.66%	-3.46%	1.67%	0.32%
Colombian peso	-1.31%	-1.88%	6.85%	0.28%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.18%	-1.26%	-0.67%	-0.86%

Weaker equity markets will increase demand for short-term debt. That will push short-term rates lower and stymie any effort by central banks to end their easy-money policies. Then investors will look around and decide, once again, equities remain the better place to be.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.64%	-1.92%	4.63%	6.80%
North America	0.47%	-1.62%	7.22%	8.95%
Latin America	-3.46%	-8.25%	17.47%	15.51%
Emerging Market Free	-2.59%	-3.07%	14.11%	10.62%
EAFE	-2.48%	-2.16%	4.55%	-0.40%
Pacific	-2.12%	-1.52%	6.65%	7.77%
Eurozone	-3.71%	-2.48%	-0.91%	-3.25%

CTAs had a very bad week, suggesting they were still long on crude oil and probably remained short on stock index futures. The latter would explain another week of losses by hedge funds.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-4.40%	-7.06%	-4.72%	-3.80%
Newedge Trend	-2.74%	-4.85%	-2.85%	0.81%
Newedge Short-Term	-0.64%	-3.24%	-2.78%	1.13%
HFR Global Hedge Fund	-0.59%	-0.47%	3.49%	-1.65%
HFR Macro/CTA	-1.17%	-2.47%	-1.50%	-2.14%
HFR Macro: Sytematic Diversified CTA	-1.84%	-3.78%	-1.01%	1.33%