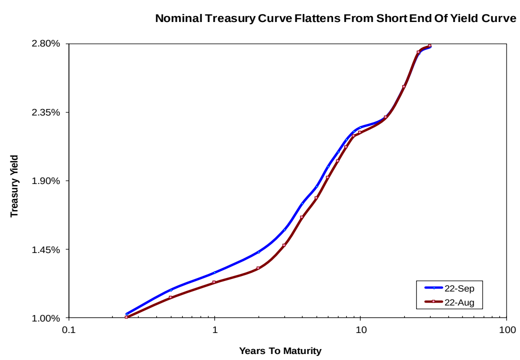
The Macro Environment For Financial Markets

Every parent learns the elegant simplicity of “Because I said so.” It comes in handy for central banks; no matter how much the market priced out another rate hike in 2017, the FOMC could put it back in. They own the tie-breaker, so another rate hike and an unwinding of QE it shall be. This is monetary contraction at a time when fiscal stimulus looks increasingly problematic. It is a good thing we have a service and information-based economy less susceptible to the depredations of ad hoc policy decisions. The causal chain now is:

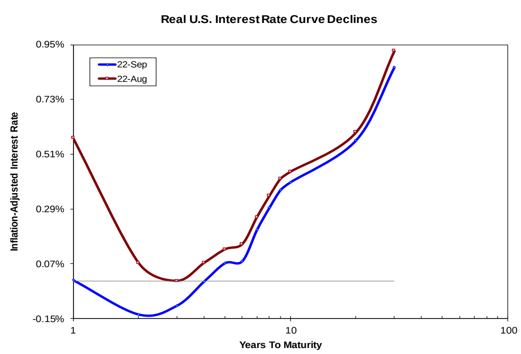
1. The market has been forced to start pricing in a December rate hike along with the shrinkage of the Federal Reserve’s balance sheet;
2. Inflationary expectations continue to rise;
3. The secular flattening trend in the U.S. is resuming;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are shifting higher; and
6. CDS costs are rising along with short-term rates.

Key Market Indications

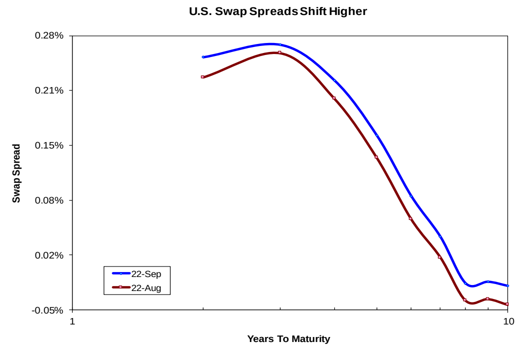
The rise in short-term rates may help banks and other financial firms, but they will start to affect floating-rate borrowers and flatten the yield curve. These factors are going to dampen credit demand and slow both economic growth and, eventually, inflationary expectations.



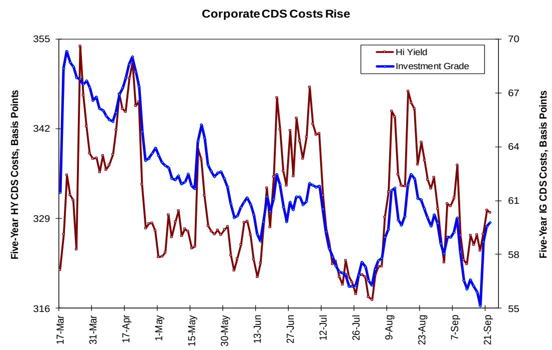
The pseudo-real yield curve once again declined across the maturity spectrum and is negative for maturities between two and four years. This curve was common during 2015-2016 period of accelerated global QE, but it is quite surprising to see during a period when the Federal Reserve is beginning to unwind QE and other major central banks are leaning in that direction.



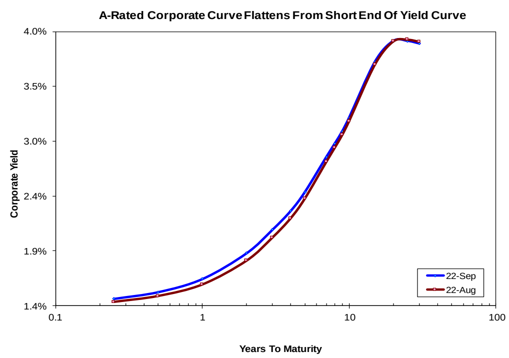
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across the maturity spectrum. Markets are anticipating a steady climb in short-term rates and are not anticipating a further decline in long-term rates.



CDS costs rose for both the investment-grade and high-yield indices. Unlike the lockstep correlation to equities we have seen for months, this one followed both the Toys 'R' Us bankruptcy and the realization everyone who has been a floating-rate payor at the short end of the yield curve is going to have to start paying real interest in the near future.



The A-rated corporate yield curve changed very little over the past month. This remains a bull market with limited upside potential.



Market Structure

Softs, Grains and Livestock remain in structural uptrends within the physical commodities, while Natural Gas reversed into a downtrend. All of the equity indices remain in structural uptrends, while the ten-year UST remains in a structural downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 25 - 29
BBerg	9	Sideways	-0.027	6.4%	
BBerg Grain	14	Transitional	0.063	13.6%	
BBerg Ind. Metl	12	Transitional	-0.095	17.7%	
BBerg Pre. Metl	29	Trending	-0.145	10.3%	
BBerg Softs	29	Trending	0.020	15.2%	0.23%
BBerg Nat. Gas	27	Trending	-0.009	18.4%	-0.03%
BBerg Petroleum	29	Trending	0.271	18.0%	0.30%
BBerg Livestock	22	Trending	0.173	12.5%	0.45%
Dollar Index	5	Sideways	0.002	7.1%	
S&P 500 Index	29	Trending	0.231	5.7%	0.04%
EAFE Index	29	Trending	0.238	7.5%	0.11%
EM Index	29	Trending	0.255	5.7%	0.21%
Ten-year UST (price)	29	Trending	-0.156	3.8%	-0.15%

Performance Measures

The continued gains in the Energy subindex remains a function of the hurricane disruptions intersecting with rising demand. Both the Softs and Industrial Metals had some major changes again as liquidity in those markets simply is not what it used to be. Precious Metals declined in the face of a stronger USD, but if implied short-term real rates continue to decline, these will find a bid.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.38%	1.96%	0.88%	1.38%
Grains Sub-Index	0.47%	2.34%	-5.08%	-5.23%
Corn	-0.33%	0.08%	-7.70%	-6.37%
Soybeans	1.62%	4.29%	-0.48%	-0.95%
Wheat	0.13%	3.36%	-5.76%	-7.62%
Energy Sub-Index	0.13%	6.20%	2.92%	1.60%
Petroleum Sub-Index	0.88%	8.09%	8.58%	9.83%
WTI	0.46%	5.36%	2.94%	3.23%
Brent	1.47%	8.66%	8.21%	10.25%
ULSD	1.01%	11.23%	17.69%	19.30%
Gasoline	0.31%	8.59%	10.93%	12.28%
Natural Gas	-2.05%	0.88%	-11.65%	-18.28%
Precious Metals Sub-Index	-2.58%	-0.17%	0.98%	-7.51%
Gold	-2.07%	0.05%	3.26%	-4.20%
Silver	-4.03%	-0.78%	-5.14%	-15.66%
Industrial Metals Sub-Index	0.10%	-1.97%	8.99%	25.62%
Copper	-0.13%	-3.59%	10.52%	31.19%
Aluminum	3.45%	3.91%	9.94%	29.36%
Nickel	-6.12%	-9.46%	4.73%	-3.82%
Zinc	0.27%	-0.82%	6.76%	31.87%
Softs Sub-Index	-3.44%	3.61%	-13.68%	-26.20%
Coffee	-4.90%	2.40%	-7.42%	-18.82%
Sugar	-3.47%	0.65%	-21.07%	-38.20%
Cotton	-0.86%	0.53%	-9.33%	-1.99%
Livestock Sub-Index	1.72%	1.06%	0.14%	14.17%
Cattle	4.10%	4.69%	2.92%	18.51%
Hogs	-3.14%	-5.85%	-5.70%	5.58%

The USD managed a bounce against all majors save the EUR as the Federal Reserve's rate-hike signal changed expected interest rate differentials, but not against the Eurozone. The year-to-date selloff in the USD is going to produce a fairly substantial retracement between now and the December FOMC meeting.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.05%	1.61%	10.69%	6.63%
Chinese yuan	-0.57%	1.10%	4.43%	1.13%
Japanese yen	-1.04%	-2.16%	-0.74%	-10.03%
British pound	-0.66%	5.30%	8.16%	3.26%
Swiss franc	-0.93%	-0.12%	2.28%	-0.06%
Canadian dollar	-1.14%	1.83%	8.02%	5.70%
Australian dollar	-0.50%	0.64%	3.70%	4.17%
Swedish krona	-0.21%	1.40%	10.26%	7.10%
Norwegian krone	0.65%	1.40%	8.49%	4.27%
New Zealand dollar	0.42%	0.70%	4.06%	0.23%
Indian rupee	-1.11%	-1.07%	0.99%	2.88%
Brazilian real	-0.47%	1.22%	-1.19%	3.06%
Mexican peso	-0.48%	-0.48%	7.22%	10.53%
Chilean peso	0.19%	2.67%	6.16%	5.59%
Colombian peso	-0.30%	2.72%	0.52%	-0.79%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.32%	0.66%	2.50%	0.59%

Can there be anything worse than being bullish on emerging markets and hear major asset managers echo your sentiment? No, but both the EAFE and EM indices are likely to benefit from any controlled rise in the USD.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.36%	2.71%	9.57%	18.21%
North America	0.16%	2.46%	7.86%	17.10%
Latin America	-0.13%	4.49%	16.12%	26.36%
Emerging Market Free	0.03%	3.02%	16.12%	22.85%
EAFE	0.70%	3.10%	13.06%	18.09%
Pacific	0.60%	1.55%	7.72%	13.50%
Eurozone	0.62%	3.46%	17.39%	28.43%

CTAs had another bad week, as did macro-oriented hedge funds. Traders were still leaning against the USD and appeared to have been long bonds as well.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.40%	1.59%	-2.70%	-8.16%
Newedge Trend	-0.33%	0.94%	-1.51%	-5.97%
Newedge Short-Term	-0.31%	-0.18%	-2.50%	-9.55%
HFR Global Hedge Fund	0.16%	1.44%	2.88%	5.96%
HFR Macro/CTA	-0.24%	0.49%	0.83%	-0.54%
HFR Macro: Sytematic Diversified CTA	-0.62%	0.62%	-0.08%	-3.97%