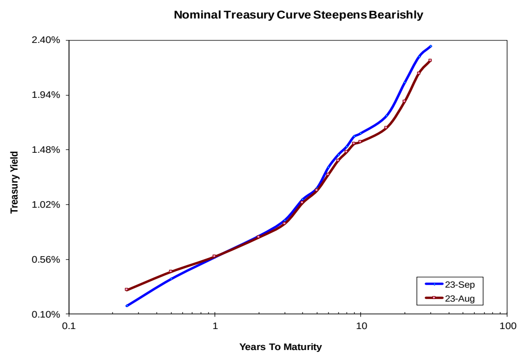
The Macro Environment For Financial Markets

A good habit to form when you are uncertain of how to do something is to practice away from the real action. Central banks have demonstrated, conclusively, they cannot produce deterministic outcomes. And yet the Bank of Japan thinks it can target the yield curve when they have failed at everything in the Kuroda era. The Federal Reserve persists in believing its actions are tied somehow to the real economy instead of simply to the portfolio gains of those who have financial assets. The more they are proven incapable, the more political power is ceded to them. The causal now is:

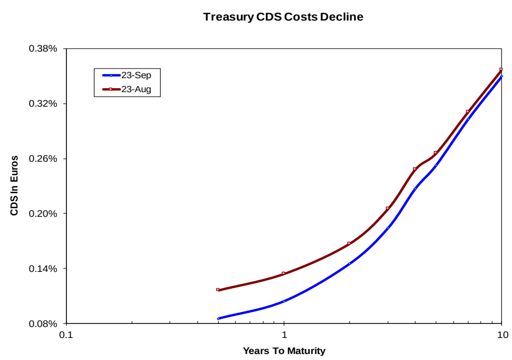
1. The market is back to speculating about a December increase in U.S. short-term rates;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps are in a defined uptrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are terming out short-term debt into the bond market;
6. Swap spreads have stopped rising; and
7. CDS costs fell after the threat of higher short-term rates was removed.

Key Market Indications

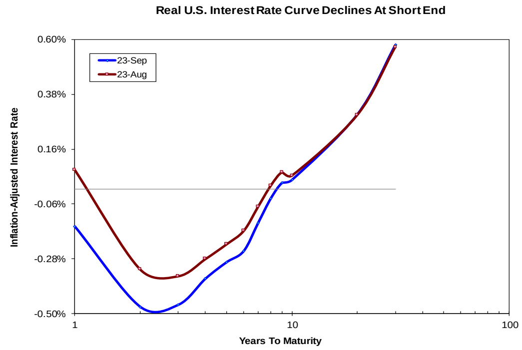
While TIPS breakevens rose following the dovish FOMC meeting, nominal yields fell. Did the Federal Reserve drive implied real rates lower by not raising the target federal funds rate lower within a heavily over-reserved banking system? Of course not, but that is the outcome seen on the screen.



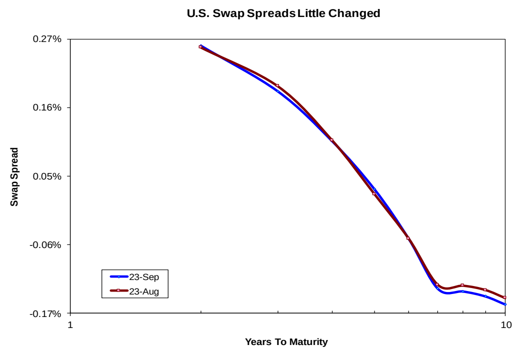
CDS costs on UST continued to decline. This suggests markets are looking at two years or more of a Republican-controlled Congress thwarting the next President, whomever or whatever that may be.



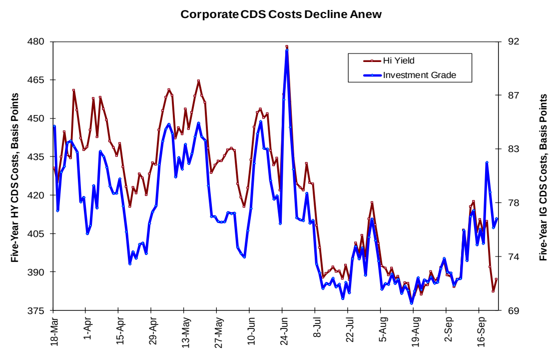
The pseudo-real yield curve declined at the short end of the yield curve and helped push precious metals higher. Long-term implied real rates have yet to increase to the point where they pose a direct threat to risky financial assets.



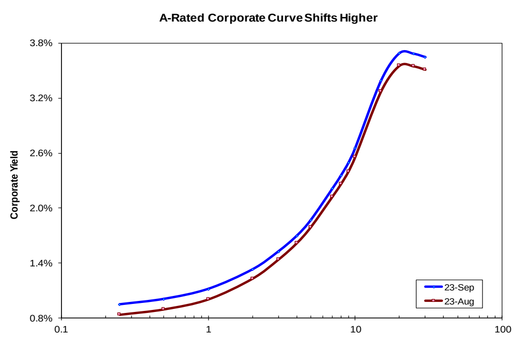
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to invert bullishly. This has been a very persistent pattern for the past five years. Floating-rate payors are not in any demonstrable hurry to fix their payments.



High-yield CDS costs declined swiftly after the FOMC meeting on the theory every bad business model can and will have access to cheap credit. Investment-grade CDS costs did not match these declines.



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

Natural Gas and Industrial Metals joined Softs in a structural uptrend. The S&P 500 and ten-year UST remain in structural downtrends while both the EAFE and EM indices entered uptrends amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 26 - 30
BBerg	29	Trending	-0.013	9.5%	-0.39%
BBerg Grain	8	Sideways	-0.015	14.5%	
BBerg Ind. Metl	29	Trending	0.223	10.1%	0.35%
BBerg Pre. Metl	12	Transitional	0.126	11.3%	
BBerg Softs	29	Trending	0.250	18.8%	0.45%
BBerg Nat. Gas	29	Trending	0.087	20.9%	0.26%
BBerg Petroleum	29	Trending	-0.160	24.2%	-1.27%
BBerg Livestock	4	Sideways	-0.017	15.6%	
Dollar Index	14	Transitional	0.008	6.3%	
S&P 500 Index	27	Trending	-0.007	8.2%	-0.13%
EAFE Index	20	Trending	0.099	11.0%	0.06%
EM Index	22	Trending	0.146	11.8%	0.05%
Ten-year UST (price)	29	Trending	-0.017	5.0%	-0.09%

Performance Measures

The thinness of the industrial metals markets was on display again; in one-sided markets nickel and aluminum can rise 9.6% and 4.0%, respectively. The Federal Reserve is pressing for an even more complete exit of commercial banks from physical commodities markets. Precious Metals rose on increased monetary stimulus; they keep falling for the trick these markets gain therefrom even though the post-2011 experience is definitive otherwise.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.31%	-0.75%	6.55%	-4.48%
Grains Sub-Index	-0.35%	0.91%	-8.64%	-14.05%
Corn	-0.14%	3.57%	-13.22%	-20.33%
Soybeans	-1.13%	-1.24%	5.92%	7.11%
Wheat	0.38%	-0.65%	-19.59%	-27.74%
Energy Sub-Index	0.33%	-5.47%	9.38%	-23.90%
Petroleum Sub-Index	0.56%	-7.24%	3.44%	-23.88%
WTI	1.98%	-7.94%	1.16%	-30.37%
Brent	0.58%	-8.03%	6.67%	-21.02%
ULSD	0.11%	-7.14%	9.89%	-22.65%
Gasoline	-2.03%	-3.77%	-3.93%	-20.73%
Natural Gas	-0.25%	-0.53%	30.12%	-26.82%
Precious Metals Sub-Index	3.18%	2.52%	14.32%	20.01%
Gold	2.41%	1.22%	9.01%	16.31%
Silver	5.03%	5.71%	29.06%	29.36%
Industrial Metals Sub-Index	3.70%	2.94%	8.62%	4.46%
Copper	1.90%	5.62%	-2.23%	-5.03%
Aluminum	4.03%	-0.45%	9.68%	1.05%
Nickel	9.64%	8.58%	22.28%	5.53%
Zinc	2.81%	-1.88%	26.13%	36.49%
Softs Sub-Index	1.81%	4.68%	21.85%	51.41%
Coffee	2.03%	4.55%	12.44%	11.65%
Sugar	1.03%	6.88%	36.24%	75.38%
Cotton	4.15%	3.03%	22.12%	15.03%
Livestock Sub-Index	-1.48%	-4.89%	-16.84%	-20.16%
Cattle	-1.10%	-0.45%	-12.75%	-15.38%
Hogs	-2.10%	-11.27%	-22.93%	-27.59%

Everyone wants their currency to weaken; only the U.S. seems able to pull this off at will. Last week's near-uniform gains were reversed this week with the exceptions of the GBP, NZD and the newest political polling tool, the MXN.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.64%	-0.70%	0.40%	0.36%
Chinese yuan	0.08%	-0.43%	-2.44%	-4.28%
Japanese yen	1.26%	-0.77%	11.25%	19.07%
British pound	-0.28%	-1.76%	-8.15%	-14.95%
Swiss franc	1.03%	-0.73%	0.49%	0.96%
Canadian dollar	0.30%	-1.97%	0.24%	1.12%
Australian dollar	1.76%	0.11%	1.21%	8.85%
Swedish krona	0.28%	-1.91%	-3.26%	-1.24%
Norwegian krone	2.44%	1.25%	4.52%	1.94%
New Zealand dollar	-0.33%	-0.67%	7.99%	15.43%
Indian rupee	0.50%	0.61%	-0.03%	-1.00%
Brazilian real	0.58%	-0.27%	13.59%	28.80%
Mexican peso	-0.90%	-6.16%	-11.12%	-13.50%
Chilean peso	2.11%	1.58%	2.55%	6.48%
Colombian peso	1.41%	0.19%	5.28%	6.86%
Bloomberg-JP Morgan Asian dollar index (spot)	0.48%	-0.01%	-0.13%	0.59%

Markets are not supposed to be this predictable, but central banks keep forcing the TINA trade. Pensions, insurers, endowments and other long-term investors need to maintain strong equity allocations if they have any prayer of meeting their liabilities.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.99%	0.35%	8.11%	11.37%
North America	1.31%	-0.82%	8.09%	13.68%
Latin America	4.35%	-1.97%	15.94%	31.74%
Emerging Market Free	3.65%	1.45%	13.84%	19.08%
EAFE	3.16%	0.43%	6.83%	7.31%
Pacific	3.73%	2.73%	11.30%	14.63%
Eurozone	3.73%	0.32%	6.11%	3.87%

Both CTAs and hedge funds managed gains this week, suggesting they switched into the dovish monetary policy trades in time.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	2.85%	-2.23%	-3.20%	-2.23%
Newedge Trend	1.87%	-1.33%	-1.50%	2.00%
Newedge Short-Term	0.30%	-1.43%	-2.43%	0.92%
HFR Global Hedge Fund	0.38%	0.04%	3.16%	-0.68%
HFR Macro/CTA	0.42%	-1.34%	-1.81%	-1.85%
HFR Macro: Sytematic Diversified CTA	1.51%	-1.08%	-0.77%	1.41%