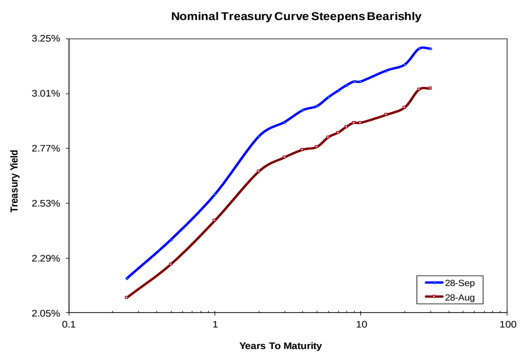
The Macro Environment For Financial Markets

Central banks in general and the Federal Reserve in particular have spent years trying to present themselves as omniscient. If Jay Powell continues to show humility, he will do the world a great service. The task of monetary policy is going to be complicated by the continued unnecessary trade wars, and this may keep the Federal Reserve from raising rates even more than its stated intention. The causal chain now is:

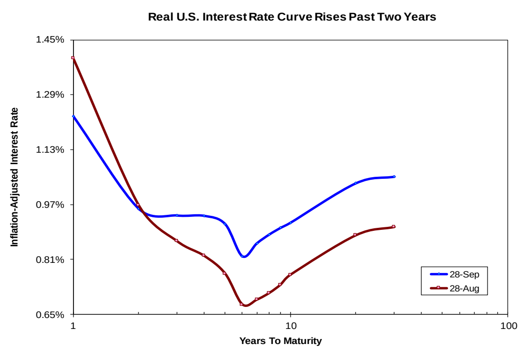
1. The market is pricing in December 2018 and March 2019 rate hikes;
2. Inflationary expectations are consolidating recent increases;
3. The yield curve is starting to exit its secular flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to invert bullishly; and
6. CDS costs are moving erratically, especially for high-yield bonds.

Key Market Indications

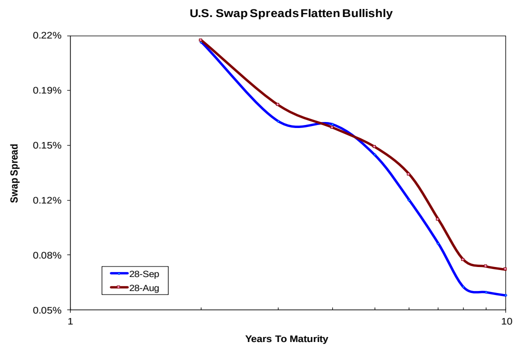
To repeat recent comments, central banks are the major holders of UST and banks required to hold "riskless" sovereign debt. This reduces the potential for a strong selloff. Moreover, the Federal Reserve appears content to keep policy accommodative, whether it wishes to characterize it as such or not. Accordingly, the selloff in USTs is proceeding at an unusually slow pace.



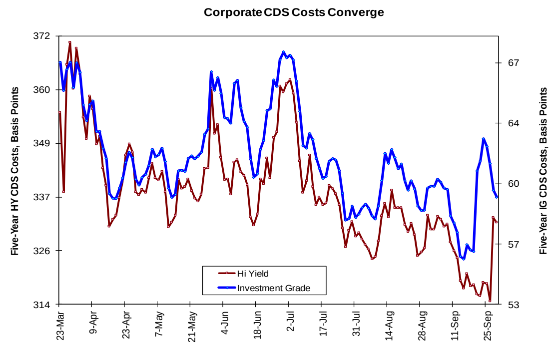
The pseudo-real yield curve rose at tenors past two years as nominal interest rates climbed faster than did breakevens. The rise at the long end of this curve is not yet a threat to risky financial assets.



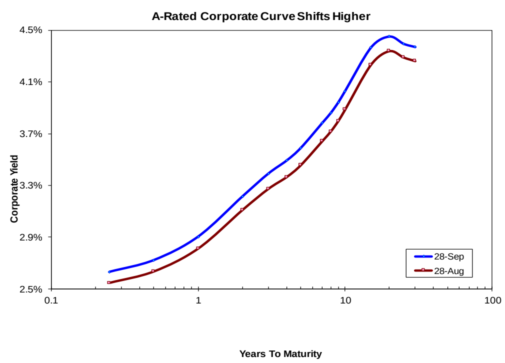
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to flattend bullishly. The swap market remains complacent about the prospect for higher long-term yields.



CDS costs diverged sharply, with the high-yield index jumping and the investment-grade index declining in a reversal of last week's trend. The high-yield index should be considered the primary indicator here as credit quality is set at the margin.



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

The main Bloomberg index, Industrial Metals and both Petroleum and Natural Gas are in structural uptrends within physical markets. Only ten-year UST are in a trending structure within financial markets.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 1 - 5
BBerg	29	Trending	0.209	7.4%	0.11%
BBerg Grain	29	Trending	-0.092	14.7%	-0.22%
BBerg Ind. Metl	29	Trending	0.105	17.3%	0.28%
BBerg Pre. Metl	17	Transitional	0.026	10.4%	
BBerg Softs	22	Trending	-0.111	15.6%	-0.50%
BBerg Nat. Gas	29	Trending	0.007	14.2%	0.21%
BBerg Petroleum	29	Trending	0.343	16.3%	0.07%
BBerg Livestock	7	Sideways	0.077	9.3%	
Dollar Index	29	Trending	0.050	5.6%	
S&P 500 Index	17	Transitional	0.059	6.6%	
EAFE Index	18	Transitional	0.131	8.3%	
EM Index	4	Sideways	0.017	6.3%	
Ten-year UST (price)	29	Trending	-0.300	3.0%	-0.09%

Performance Measures

The main Bloomberg index is moving higher on the back of higher Petroleum and Natural Gas; the rest of the complex remains surprisingly weak given strong growth trends in the U.S.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.99%	1.92%	-1.63%	2.59%
Grains Sub-Index	-0.94%	-2.97%	-12.42%	-10.73%
Corn	-0.24%	-2.24%	-14.58%	-11.39%
Soybeans	-0.16%	0.40%	-20.82%	-16.80%
Wheat	-2.40%	-6.54%	2.89%	-2.49%
Energy Sub-Index	3.78%	5.19%	15.59%	28.13%
Petroleum Sub-Index	4.67%	6.10%	18.59%	44.51%
WTI	3.53%	5.77%	16.92%	47.60%
Brent	5.67%	7.25%	23.45%	55.13%
ULSD	5.33%	4.74%	17.34%	33.25%
Gasoline	4.22%	5.62%	13.58%	30.27%
Natural Gas	1.19%	2.51%	7.23%	-11.88%
Precious Metals Sub-Index	0.25%	-0.28%	-10.18%	-8.83%
Gold	-0.38%	-0.71%	-10.22%	-7.66%
Silver	2.50%	1.23%	-10.06%	-12.58%
Industrial Metals Sub-Index	-1.10%	2.15%	-5.96%	-2.36%
Copper	-1.80%	5.19%	-8.19%	-6.55%
Aluminum	-1.03%	-2.47%	5.99%	0.33%
Nickel	-4.95%	-1.63%	-5.44%	19.54%
Zinc	5.56%	7.80%	-17.57%	-13.36%
Softs Sub-Index	-1.76%	-1.70%	-13.46%	-18.74%
Coffee	2.60%	0.81%	-17.85%	-26.92%
Sugar	-4.07%	-1.03%	-16.71%	-26.22%
Cotton	-3.45%	-6.96%	-2.91%	14.43%
Livestock Sub-Index	0.54%	7.90%	8.50%	0.85%
Cattle	0.38%	5.23%	12.32%	1.56%
Hogs	0.96%	15.12%	2.13%	-1.67%

The combination of higher short-term interest rates in the U.S., no worse news on trade and another irruption of political uncertainty in Italy helped push the USD higher against most majors. The selloff in emerging market currencies has abated for the time being.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.23%	-0.78%	-5.72%	-1.54%
Chinese yuan	-0.17%	-0.96%	-8.31%	-3.03%
Japanese yen	-0.98%	-2.21%	-6.02%	-1.20%
British pound	-0.31%	1.23%	-7.43%	-3.06%
Swiss franc	-2.34%	-0.55%	-2.55%	-1.17%
Canadian dollar	0.06%	0.19%	0.12%	-3.72%
Australian dollar	-0.91%	-1.55%	-5.72%	-8.04%
Swedish krona	-1.07%	2.79%	-6.05%	-8.74%
Norwegian krone	-0.05%	2.31%	-3.56%	-2.64%
New Zealand dollar	-1.02%	-1.34%	-8.22%	-8.54%
Indian rupee	-0.39%	-3.29%	-10.09%	-9.63%
Brazilian real	-0.01%	2.15%	-17.99%	-21.42%
Mexican peso	0.59%	1.94%	-2.21%	-2.98%
Chilean peso	1.11%	0.86%	-7.99%	-3.07%
Colombian peso	1.15%	0.74%	-5.78%	-0.77%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.10%	-0.67%	-6.19%	-2.17%

Brexit uncertainties and the Italian budget mess pushed Eurozone and EAFE equities lower. The U.S. declined slightly as the prospect of higher short-term interest rates led to profit-taking after last week's rally.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.63%	0.60%	7.13%	11.84%
North America	-0.51%	0.52%	12.57%	17.39%
Latin America	1.21%	3.03%	-12.34%	-7.74%
Emerging Market Free	-0.25%	-1.82%	-8.03%	0.44%
EAFE	-0.85%	-0.10%	0.65%	3.80%
Pacific	0.24%	1.90%	1.03%	8.51%
Eurozone	-2.34%	-0.12%	-2.56%	-2.41%

Both CTAs and macro hedge funds gained on the week, a rare development in a declining global equity environment. This suggests they were short bonds, long the USD and long the energy markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	1.10%	0.05%	-0.09%	4.22%
SocGen Trend	0.80%	-0.12%	-1.03%	1.74%
SocGen Short-Term	-0.06%	-0.14%	-0.74%	1.39%
HFR Global Hedge Fund	-0.33%	-0.62%	-0.62%	0.37%
HFR Macro/CTA	0.84%	-0.11%	-1.03%	0.73%
HFR Macro: Sytematic Diversified CTA	1.33%	0.29%	-0.89%	3.97%