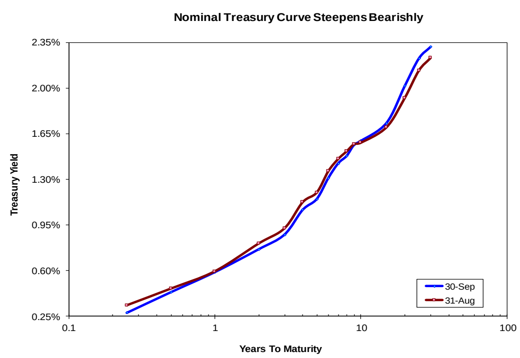
The Macro Environment For Financial Markets

Regulators on both sides of the Atlantic seem to be enjoying their new blood-sport of hitting the other continent's companies with multi-billion dollar fines. That is a great way to annihilate civilization. Cooler heads prevailed by the end of the week, but the ongoing reality is excessive monetary accommodation is killing commercial banks, especially in the Eurozone. Paradoxically, these stresses are being met by a continuation of monetary accommodation. Meanwhile, the Federal Reserve is poised to raise short-term rates in the U.S. after GDP grew at a lusty 1.4% rate. No one knows what the outcome of any other their decisions will be, but they will decide anyway. The causal now is:

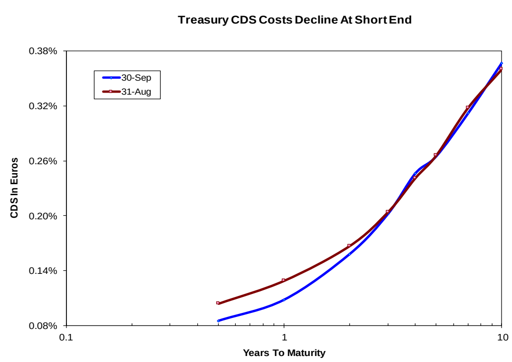
1. The market is pricing in a December increase in U.S. short-term rates;
2. Disinflationary pressures will persist globally;
3. Inflation expectations as measured by TIPS and inflation swaps are in a defined uptrend;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term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

Key Market Indications

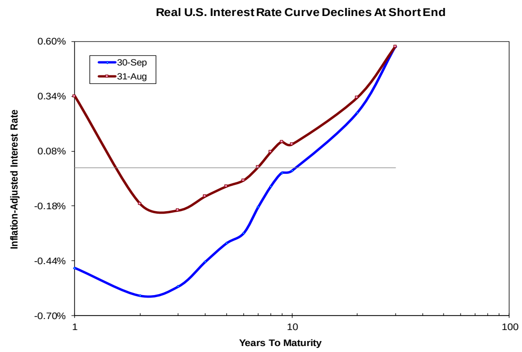
The combination of stable yields and rising inflation expectations combined with the threat of rising short-term rates is an odd one indeed. The demand for UST is so high in a risk-averse world that nominal yields can become the sun around which everything else orbits. This will end one day, but not in the immediate future.



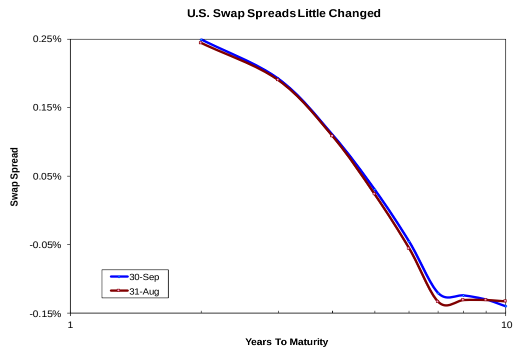
CDS costs on UST continued to decline. This suggests markets are looking at two years or more of a Republican-controlled Congress thwarting the next President, whomever or whatever that may be.



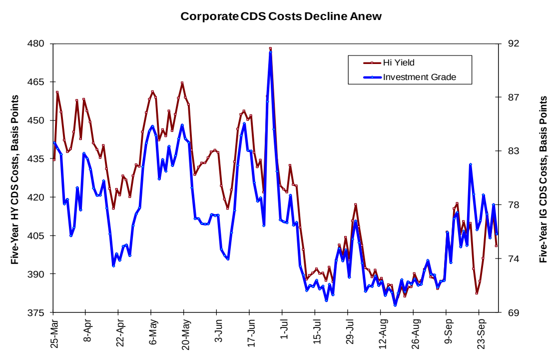
The pseudo-real yield curve declined at the short end of the yield curve, however, this was insufficient to push gold prices higher. Long-term implied real rates have yet to increase to the point where they pose a direct threat to risky financial assets.



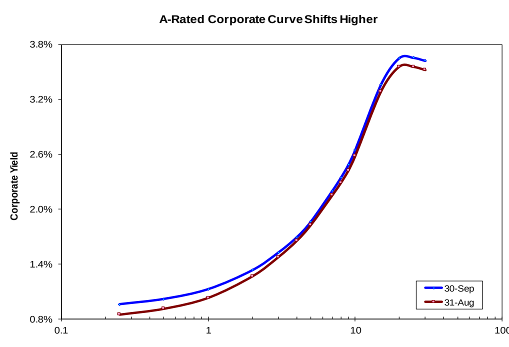
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain bullishly inverted. This has been a very persistent pattern for the past five years. Floating-rate payors are not in any demonstrable hurry to fix their payments.



CDS costs did not rise with the Deutsche Bank or Wells Fargo dramas nor did they rise with the ongoing assault on the biotech and pharmaceutical sectors. Investors continue to look at wildly overpriced corporate bonds as being a risk-averse trade.



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

Only Industrial Metals remain in a structural uptrend within the physical commodity markets. The dollar index entered a structural downtrend while ten-year UST entered a structural uptrend with the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 3 - 7
BBerg	27	Trending	0.145	10.2%	
BBerg Grain	18	Transitional	-0.006	16.1%	
BBerg Ind. Metl	29	Trending	0.324	10.9%	0.35%
BBerg Pre. Metl	12	Transitional	-0.064	11.7%	
BBerg Softs	5	Sideways	-0.056	20.7%	
BBerg Nat. Gas	29	Trending	-0.043	20.9%	
BBerg Petroleum	29	Trending	0.153	26.5%	
BBerg Livestock	29	Trending	-0.621	15.8%	-0.87%
Dollar Index	25	Trending	-0.009	6.6%	-0.05%
S&P 500 Index	29	Trending	0.029	8.5%	
EAFE Index	26	Trending	0.014	11.5%	0.06%
EM Index	27	Trending	0.004	11.5%	0.05%
Ten-year UST (price)	29	Trending	0.025	5.0%	0.07%

Performance Measures

Hogs fell more than 10% this week, another example of illiquidity. The economically important petroleum markets rallied on the news OPEC may agree on production discipline going forward; experience shows this will be anything but a smooth path. The broad Bloomberg index looks to have formed a rounded bottom of significance on the weekly chart; if so, the present 85.34 level could advance easily to 103.04 by the end of 2017:Q1.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.21%	2.86%	9.65%	-2.65%
Grains Sub-Index	-0.20%	1.24%	-7.94%	-13.99%
Corn	0.08%	2.54%	-9.24%	-20.32%
Soybeans	-0.10%	0.18%	4.91%	8.84%
Wheat	-0.67%	0.71%	-22.28%	-29.00%
Energy Sub-Index	4.94%	5.75%	19.70%	-17.89%
Petroleum Sub-Index	8.21%	7.76%	19.38%	-16.63%
WTI	8.46%	7.13%	17.67%	-24.22%
Brent	7.94%	6.30%	22.05%	-13.85%
ULSD	8.53%	7.83%	27.50%	-14.64%
Gasoline	7.93%	12.87%	10.56%	-12.03%
Natural Gas	-3.55%	0.31%	20.74%	-24.24%
Precious Metals Sub-Index	-2.18%	-0.72%	12.12%	17.77%
Gold	-1.83%	-0.70%	7.01%	15.09%
Silver	-3.00%	-0.76%	26.45%	24.22%
Industrial Metals Sub-Index	1.45%	4.63%	10.32%	4.85%
Copper	0.44%	6.40%	1.18%	-6.34%
Aluminum	2.15%	4.98%	7.68%	4.22%
Nickel	-0.85%	5.04%	26.15%	3.85%
Zinc	4.48%	0.40%	26.31%	38.25%
Softs Sub-Index	0.30%	7.67%	28.72%	41.71%
Coffee	0.10%	0.12%	12.82%	10.33%
Sugar	1.33%	10.60%	44.32%	63.00%
Cotton	-2.83%	0.45%	15.68%	12.70%
Livestock Sub-Index	-7.70%	-9.54%	-21.99%	-24.17%
Cattle	-6.29%	-2.36%	-17.05%	-17.31%
Hogs	-10.07%	-19.45%	-29.41%	-34.48%

Currency markets moved in a more traditional risk-on fashion, which is unusual considering how global equity markets in general and non-U.S. markets in particular were weak. It also was unusual to see haven currencies such as the JPY weaken as systemic risk rose during the week. The last person to trade the MXN off of U.S. political polls is going to get hammered.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.08%	0.69%	-1.27%	0.52%
Chinese yuan	-0.04%	0.11%	-3.27%	-4.73%
Japanese yen	-0.33%	2.05%	11.07%	18.28%
British pound	0.05%	-1.26%	-9.67%	-14.25%
Swiss franc	-0.10%	1.29%	-0.99%	0.20%
Canadian dollar	0.34%	-0.17%	-0.94%	1.42%
Australian dollar	0.54%	1.96%	0.09%	9.20%
Swedish krona	-0.37%	-0.16%	-5.32%	-2.38%
Norwegian krone	1.61%	4.30%	3.56%	6.65%
New Zealand dollar	0.61%	0.50%	5.46%	13.86%
Indian rupee	0.07%	0.53%	-0.55%	-1.53%
Brazilian real	-0.56%	-1.09%	10.11%	21.00%
Mexican peso	2.08%	-3.10%	-10.87%	-12.73%
Chilean peso	0.57%	3.43%	1.58%	5.94%
Colombian peso	1.21%	3.12%	4.17%	7.13%
Bloomberg-JP Morgan Asian dollar index (spot)	0.11%	0.51%	-0.84%	0.33%

The relative strength of the North American index probably is an artifact of the mid-day news on Deutsche Bank. However, equity investors still are primed for a negative-sum game eight years after the Lehman bankruptcy.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.12%	-0.31%	6.77%	10.25%
North America	0.20%	-0.08%	6.72%	15.14%
Latin America	-0.78%	-1.30%	10.56%	29.03%
Emerging Market Free	-1.50%	0.74%	10.40%	17.21%
EAFE	-0.65%	1.08%	4.70%	7.06%
Pacific	-1.01%	1.91%	12.88%	12.40%
Eurozone	-0.57%	-1.27%	4.79%	2.99%

CTAs had another losing week, suggesting they found themselves on the wrong side of volatility in the equity and petroleum markets. Hedge funds managed some small gains, but this will not be able to end the ongoing reduction of public pension exposure to hedge funds.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.41%	-2.22%	-3.98%	-3.15%
Newedge Trend	-0.44%	-1.16%	-2.35%	1.30%
Newedge Short-Term	-1.12%	-1.38%	-3.92%	0.29%
HFR Global Hedge Fund	0.00%	0.29%	3.21%	1.01%
HFR Macro/CTA	0.35%	-0.28%	-1.66%	-1.44%
HFR Macro: Sytematic Diversified CTA	0.13%	-0.21%	-0.96%	0.90%