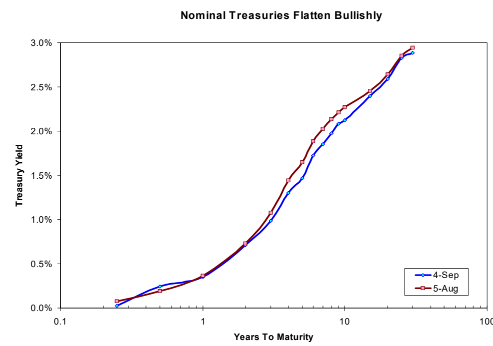
The Macro Environment For Financial Markets

If the U.S. were an island, you would be forgiven for saying things are not so bad. However, with countries ranging from Brazil to Canada in recession, with Chinese growth turning lower, with divergent monetary policies creating the sort of currency volatility that proved so corrosive in the 1980s and 1990s, the U.S. will feel the drag of external events and of the slowing of non-residential fixed investment in the energy and mining sectors. If we couple this with a monetary policy leaning toward tightening, we have an imbalance of risks to the downside and very little policy ammunition to counter an economic contraction.

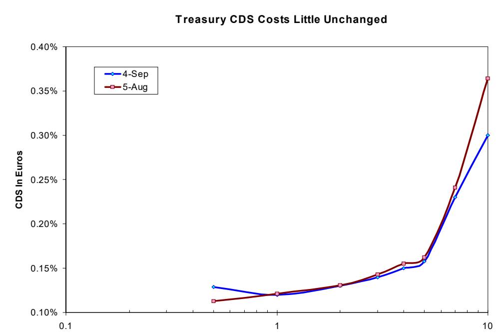
The causal chain now is:

1. Short-term interest rates will remain artificially low globally. The timing of any rate hike in the U.S. has become far more problematic at this point;
2. Disinflationary pressures are dominating inflationary pressures;
3. Inflation expectations as measured by the TIPS market will remain low;
4. The U.S. yield curve retains its long-term trend toward a bullish flattening;
5. Short-term borrowers will shift back toward accepting rollover risk;
6. Swap spreads will remain tame until monetary policy indications turn more hawkish; and
7. Credit spreads will continue to rise under industry stresses in the energy, mining and media sectors.

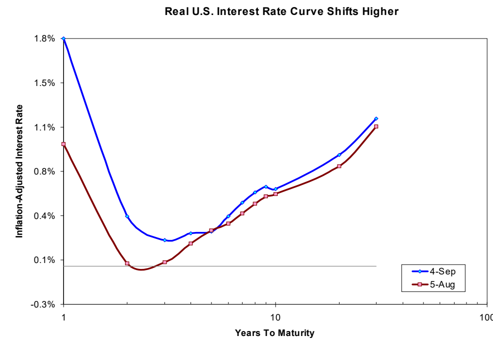
Key Market Indications
The secular bull market remains intact and will the yield curve flatten further if short-term rates are increased, but further gains will be grudging as memories of last April's sudden selloff remain fresh. The continued push lower in TIPS breakevens is a reflection of nominal risk aversion as much as it is any implied statement about inflation expectations.



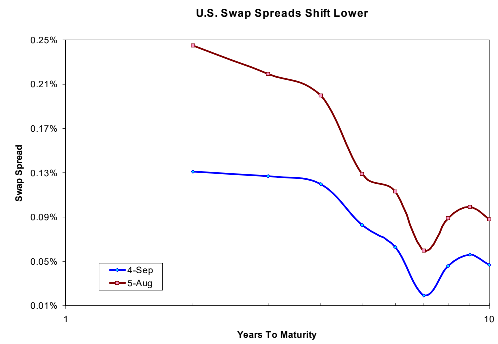
The changes in CDS costs for Treasuries remained small over the past month, which is just as well given how the fiscal outlook for the U.S. has not changed much over the past month, either. Either cooler heads are prevailing or the pool of participants in this market has diminished.



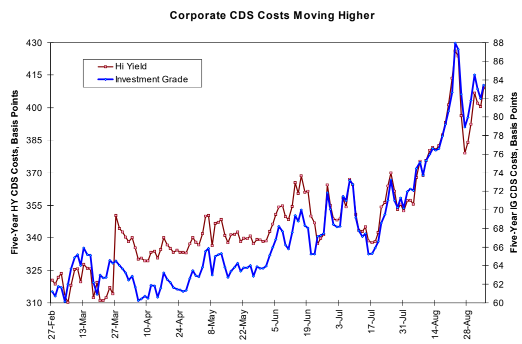
Pseudo-real rates continue to move higher at the short end of the yield curve. This pushed gold lower in the face of a diminished haven bid. Long-term pseudo-real rates have advanced over the past month, and while this did not cause the downturns in capital assets, it did not help matters, either.



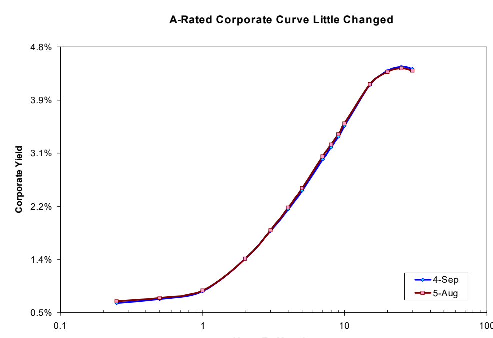
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined at both the short end of the yield curve over the past month. The decline at the short end reflects a growing sense any hike in short-term rates will be singular and may not occur at all. The decline at the long end is consistent with a strong demand for sovereign debt as equity markets continue to wobble.



CDS costs for both the investment-grade and high-yield indices have resumed their uptrend. This trend will remain intact so long as the yield curve flattens with higher expected short-term rates and global growth prospects continue to deteriorate.



The A-rated yield curve did not follow the UST curve in its small bullish flattening. Unless long-dated swap spreads or CDS costs decline unexpectedly, the potential for a bullish shift in investment-grade corporate bonds will remain slight. That in turn will cap the ability of equities to rise independently of actual earnings growth.



Market Structure

Precious Metals, Livestock and Natural Gas are in structural downtrends. The volatility in the equity indices forced them into bearish consolidations while ten-year UST moved into a bullish consolidation. The dollar index remains in a downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Sep. 7 - 11
BBerg	7	Sideways	-0.034	20.2%	
BBerg Grain	15	Transitional	-0.154	19.0%	
BBerg Ind. Metl	13	Transitional	0.031	20.9%	
BBerg Pre. Metl	22	Trending	-0.060	15.0%	-0.12%
BBerg Softs	5	Sideways	0.040	21.1%	
BBerg Nat. Gas	29	Trending	-0.214	17.9%	-0.09%
BBerg Petroleum	4	Sideways	-0.009	46.3%	
BBerg Livestock	23	Trending	-0.086	12.7%	-0.22%
Dollar Index	29	Trending	-0.022	9.8%	-0.17%
S&P 500 Index	7	Sideways	-0.106	16.5%	
EAFE Index	7	Sideways	-0.158	15.0%	
EM Index	7	Sideways	-0.134	16.1%	
Ten-year UST (price)	9	Sideways	0.043	6.8%	

Performance Measures

While the economically important Industrial Metals continued lower, expectations for reduced crude oil production managed to stabilize the Petroleum subindex. Grains continue to push lower into the harvest, although we could get at least one early-frost scare. Whatever haven bid gold enjoyed in August is gone.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.97%	-2.19%	-12.17%	-29.10%
Grains Sub-Index	-2.81%	-7.74%	-10.35%	-13.93%
Corn	-3.20%	-5.41%	-12.21%	-9.83%
Soybeans	-2.14%	-10.04%	-9.88%	-14.78%
Wheat	-3.31%	-9.26%	-4.84%	-15.31%
Energy Sub-Index	-0.07%	-0.53%	-16.20%	-47.78%
Petroleum Sub-Index	0.62%	1.87%	-17.06%	-51.75%
WTI	1.42%	2.42%	-18.39%	-56.15%
Brent	-0.71%	0.95%	-21.08%	-56.59%
ULSD	0.42%	2.93%	-15.79%	-42.99%
Gasoline	1.76%	0.82%	-9.10%	-42.47%
Natural Gas	-1.82%	-6.26%	-13.62%	-39.52%
Precious Metals Sub-Index	-0.83%	1.28%	-5.27%	-15.42%
Gold	-1.11%	2.50%	-4.03%	-11.95%
Silver	0.00%	-2.16%	-8.74%	-25.13%
Industrial Metals Sub-Index	-0.97%	-1.80%	-14.53%	-30.43%
Copper	-1.45%	-1.17%	-11.85%	-27.30%
Aluminum	0.05%	0.55%	-12.73%	-27.08%
Nickel	-1.11%	-7.93%	-31.25%	-49.99%
Zinc	-1.42%	-4.03%	-12.32%	-26.87%
Softs Sub-Index	0.16%	-1.11%	-14.37%	-34.23%
Coffee	-3.95%	-8.97%	-19.74%	-45.54%
Sugar	2.74%	5.73%	-18.00%	-36.39%
Cotton	-0.60%	1.35%	-1.85%	-2.15%
Livestock Sub-Index	-0.08%	-0.84%	-2.42%	-17.71%
Cattle	-2.43%	-5.41%	-5.07%	-9.54%
Hogs	4.10%	7.84%	2.98%	-31.14%

What a confused outcome! The ECB barely could drive the EUR lower while commodity currencies and nearly all of the EM currencies save the CLP declined. The JPY rallied on haven bids, as did the arguably overvalued CNY. The SEK rose when the Riksbank did not push rates down even further. If there is a monolithic theme here vis-à-vis the USD, I cannot find it.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.32%	2.46%	0.64%	-13.87%
Chinese yuan	0.53%	-2.29%	-1.34%	-3.42%
Japanese yen	2.29%	4.53%	0.58%	-11.53%
British pound	-1.44%	-2.53%	-0.62%	-7.11%
Swiss franc	-0.79%	0.73%	-0.84%	-4.07%
Canadian dollar	-0.62%	-0.67%	-6.44%	-18.12%
Australian dollar	-3.69%	-6.40%	-11.63%	-26.10%
Swedish krona	0.23%	3.25%	-1.29%	-16.24%
Norwegian krone	-0.28%	-0.20%	-6.40%	-24.62%
New Zealand dollar	-2.77%	-3.87%	-17.19%	-24.34%
Indian rupee	-0.46%	-4.08%	-6.32%	-9.18%
Brazilian real	-6.81%	-9.69%	-22.47%	-41.64%
Mexican peso	-1.12%	-3.78%	-11.13%	-22.38%
Chilean peso	0.03%	-2.06%	-10.51%	-14.32%
Colombian peso	-1.62%	-6.50%	-18.71%	-38.11%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.45%	-2.94%	-4.35%	-8.24%

Equity markets were unable to rally back to their breakdown points. The EAFE is close to retracing 50% of its 2012-2014 rally and emerging markets have taken out all support. While the U.S. may look good in comparison, the short-term path of least resistance remains lower.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-3.73%	-9.03%	-8.08%	-6.52%
North America	-3.32%	-7.96%	-7.87%	-3.55%
Latin America	-4.67%	-12.11%	-20.54%	-44.31%
Emerging Market Free	-3.79%	-11.48%	-17.68%	-26.34%
EAFE	-4.37%	-10.70%	-8.41%	-10.99%
Pacific	-5.51%	-11.66%	-9.83%	-10.13%
Eurozone	-4.05%	-10.68%	-8.15%	-12.20%

CTAs continue to perform poorly with the exception of the short-term index, and the only thing good we can say about hedge funds at present is they are losing less than equities. In both cases it would be nice if these allegedly non-correlated managers could gain when conventional assets lose.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.90%	-2.25%	-3.95%	15.66%
Newedge Trend	-0.86%	-2.23%	-4.12%	10.06%
Newedge Short-Term	0.21%	-0.38%	-7.11%	2.33%
HFR Global Hedge Fund	-0.21%	-2.50%	-3.01%	-3.81%
HFR Macro/CTA	-0.43%	-2.39%	-3.43%	3.19%
HFR Macro: Sytematic Diversified CTA	-0.80%	-2.09%	-2.91%	4.50%