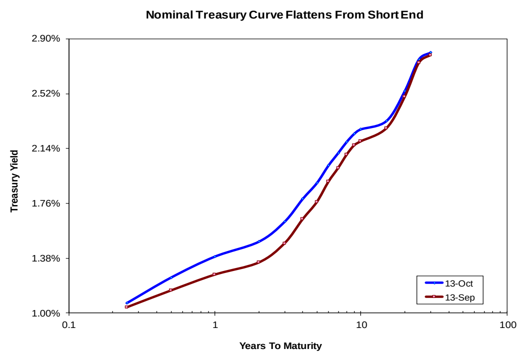
The Macro Environment For Financial Markets

Physicists just sort of grin when they have to admit they cannot account for the 95% or so of the universe that is either dark matter or dark energy. It inspires humility. Central bankers cannot account for inflation in terms of their monetary policies. It inspires arrogance. Now the FOMC, which has committed to a rate hike in December, has to justify its actions. It will, unconvincingly. The causal chain now is:

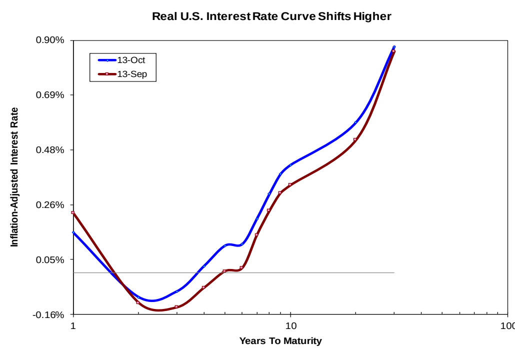
1. The market once again is questioning the inevitability of a December rate hike it had just accepted;
2. Inflationary expectations have failed at resistance;
3. The secular flattening trend in the U.S. continues;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are shifting higher; and
6. CDS costs remain at resistance.

Key Market Indications

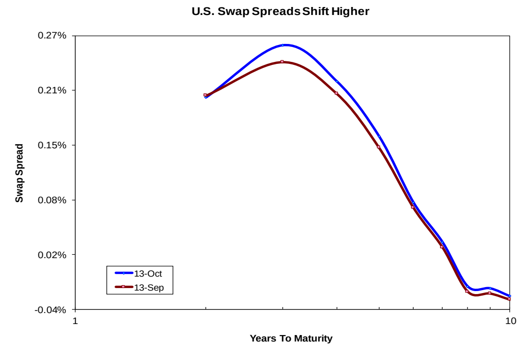
Long-term rates once again held support at 2.40%. As short-term rates rose again, the yield curve hit a new low in the post-November 2013 flattening. The gradual rise in inflation expectations as measured by ten-year TIPS breakevens reversed sharply following Friday's soft CPI data.



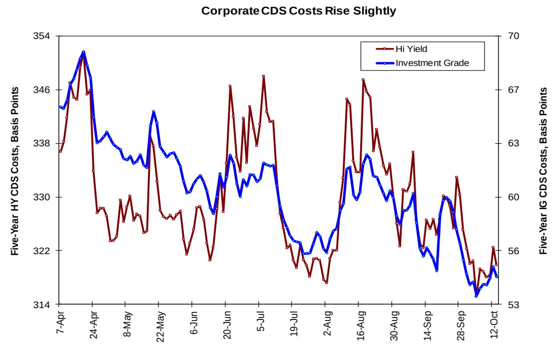
The pseudo-real yield curve flattened bearishly, rising at the long end of the yield curve and declining at one- and two-year maturities. It remains negative for two to four-year maturities. This curve was common during 2015-2016 period of accelerated global QE. The rise in implied real rates at the long end of the yield curve is insufficient to derail risk-seeking behavior in capital assets.



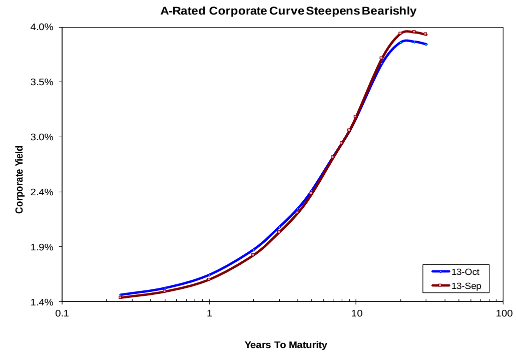
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across the maturity spectrum, with the largest shift at the shortest end of the yield curve. Markets are anticipating a steady climb in short-term rates and are not anticipating a further decline in long-term rates.



CDS costs rose slightly for both the investment-grade and high-yield indices. This is somewhat noteworthy given how it happened during a week of rising equities. The increase suggests last week's low in CDS costs might be strong long-term resistance.



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



Market Structure

Industrial Metals and Livestock are in structural uptrends, while Softs, Precious Metals and Natural Gas are in structural downtrends. The EM index and the dollar index remain into structural uptrends, while ten-year UST entered a structural downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 16 - 20
BBerg	17	Transitional	0.228	6.7%	
BBerg Grain	23	Trending	0.076	12.2%	
BBerg Ind. Metl	26	Trending	0.200	15.3%	0.28%
BBerg Pre. Metl	25	Trending	0.069	10.3%	-0.31%
BBerg Softs	29	Trending	-0.103	15.3%	-0.81%
BBerg Nat. Gas	29	Trending	-0.003	16.8%	-0.03%
BBerg Petroleum	11	Transitional	0.083	17.6%	
BBerg Livestock	29	Trending	0.267	12.0%	0.45%
Dollar Index	29	Trending	0.070	6.1%	0.16%
S&P 500 Index	4	Sideways	0.008	3.1%	
EAFE Index	29	Trending	0.275	6.3%	0.16%
EM Index	16	Transitional	0.378	6.5%	
Ten-year UST (price)	29	Trending	-0.056	3.8%	-0.82%

Performance Measures

Physical commodities have been going nowhere over the past year, but they managed to put in a very strong week on the back of lower short-term implied real rates, a stronger global economy, a promise by Saudi Arabia to reduce crude oil exports and another round of execution vacuums headed by a 10.2% gain in nickel. Fundamentals, nothing but fundamentals, folks. Most likely, this is simply a series of unrelated events within a broader trading range and not the start of a bull market in physical commodities.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	2.37%	0.90%	0.03%	0.26%
Grains Sub-Index	1.07%	0.30%	-6.41%	-8.21%
Corn	0.81%	-0.48%	-11.45%	-11.21%
Soybeans	2.81%	3.25%	3.27%	-0.19%
Wheat	-0.88%	-2.03%	-8.89%	-13.13%
Energy Sub-Index	3.52%	0.31%	-4.46%	-8.53%
Petroleum Sub-Index	3.44%	1.66%	-0.50%	-1.04%
WTI	4.24%	1.93%	-5.87%	-7.27%
Brent	2.89%	3.07%	-0.28%	0.01%
ULSD	3.05%	0.41%	6.54%	6.74%
Gasoline	3.57%	-0.37%	2.12%	1.48%
Natural Gas	3.72%	-3.68%	-15.25%	-26.75%
Precious Metals Sub-Index	2.70%	-1.50%	-1.21%	1.72%
Gold	2.35%	-1.47%	0.88%	2.98%
Silver	3.72%	-1.56%	-6.73%	-1.76%
Industrial Metals Sub-Index	2.61%	5.23%	17.93%	34.17%
Copper	3.47%	6.34%	20.39%	45.66%
Aluminum	-0.95%	2.14%	10.56%	25.07%
Nickel	10.18%	5.15%	18.88%	9.67%
Zinc	0.41%	7.64%	24.00%	43.07%
Softs Sub-Index	0.14%	-4.30%	-13.37%	-27.94%
Coffee	-2.71%	-10.50%	-13.76%	-25.58%
Sugar	3.10%	-4.93%	-16.94%	-39.70%
Cotton	-0.30%	-0.57%	-6.15%	-2.41%
Livestock Sub-Index	0.83%	4.74%	3.76%	31.48%
Cattle	0.19%	3.90%	1.02%	29.66%
Hogs	2.11%	6.46%	8.25%	34.37%

The USD declined across the board except against the MXN. The market has digested expectations for a rate hike in December and is in the process of walking those expectations back, to borrow a phrase from political punditry.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.77%	-0.55%	11.37%	6.91%
Chinese yuan	1.11%	-0.58%	4.72%	2.25%
Japanese yen	0.74%	-1.19%	-2.44%	-7.25%
British pound	1.68%	0.56%	6.25%	8.41%
Swiss franc	0.53%	-1.07%	3.23%	1.20%
Canadian dollar	0.49%	-2.37%	6.91%	5.81%
Australian dollar	1.55%	-1.24%	4.22%	4.20%
Swedish krona	0.14%	-0.92%	11.55%	8.42%
Norwegian krone	1.44%	-0.10%	8.86%	3.34%
New Zealand dollar	1.24%	-0.83%	2.62%	1.21%
Indian rupee	0.69%	-1.43%	-0.80%	3.09%
Brazilian real	0.30%	-0.34%	-0.06%	1.04%
Mexican peso	-2.01%	-6.15%	-1.75%	0.07%
Chilean peso	1.44%	0.61%	4.11%	7.65%
Colombian peso	0.17%	-0.79%	-2.23%	-0.56%
Bloomberg-JP Morgan Asian dollar index (spot)	1.01%	-0.22%	2.60%	1.72%

Global equities rose across the board, with the North American index rising least and the EM index rising most. The path of least resistance remains higher, and this seems to be the "pain trade."

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.71%	2.21%	12.14%	22.73%
North America	0.17%	2.31%	10.61%	21.88%
Latin America	0.41%	0.37%	15.33%	23.45%
Emerging Market Free	2.08%	2.52%	19.02%	29.75%
EAFE	1.63%	2.26%	14.62%	24.98%
Pacific	2.08%	3.13%	11.77%	18.76%
Eurozone	1.12%	1.43%	19.85%	32.17%

Both CTAs and hedge funds had a second straight strong week, suggesting they are maintaining the risk-on trades of being long equities, short sovereign bonds and long the USD.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.94%	-1.30%	-0.95%	-5.07%
Newedge Trend	0.53%	-1.28%	-0.86%	-3.43%
Newedge Short-Term	0.03%	0.14%	-0.94%	-7.16%
HFR Global Hedge Fund	0.02%	0.60%	3.15%	6.18%
HFR Macro/CTA	0.35%	-1.12%	1.06%	-1.35%
HFR Macro: Sytematic Diversified CTA	1.33%	-1.53%	0.38%	-2.72%