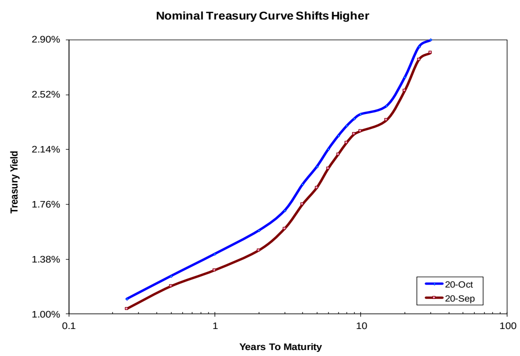
The Macro Environment For Financial Markets

One of the more memorable moments of self-awareness in cinematic history was Colonel Nicholson's "what have I done?" in *The Bridge on The River Kwai*. As even the pedal-to-the-medal Peoples' Bank of China is warning about credit bubbles and Minsky Moments (can black swans be far behind?) investors continued to push all manner of corporate securities higher and measures of volatility lower. The party is likely to last through the end of the year as tax rates in 2018 have a good chance of being lower and who has major unrealized losses to capture? The causal chain now is:

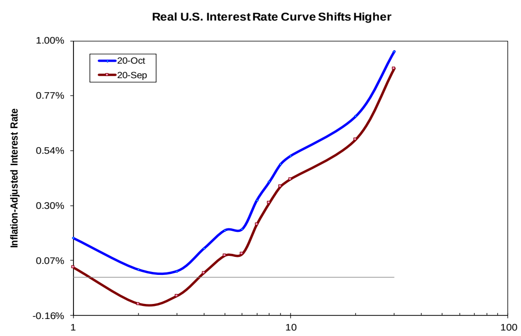
1. The market once again is pricing in a December rate hike;
2. Inflationary expectations have failed at resistance;
3. The secular flattening trend in the U.S. continues;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads have stopped expanding; and
6. CDS costs have broken resistance.

Key Market Indications

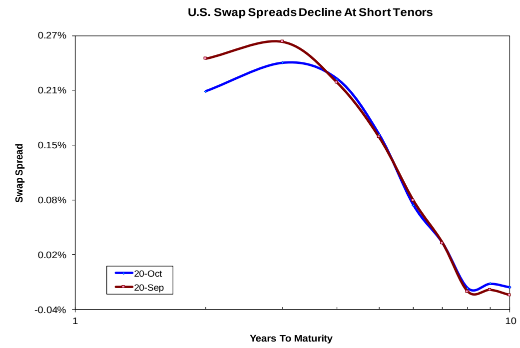
Long-term rates once again held support at 2.40%. Even though short-term rates have reached a post-crisis high, the rise to resistance at the long end of the yield curve prevented a further flattening of the yield curve.



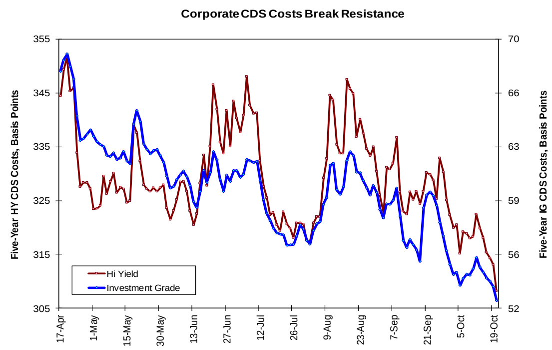
The pseudo-real yield curve shifted higher across the maturity spectrum and moved out of negative territory for all maturities for the first time in a month.



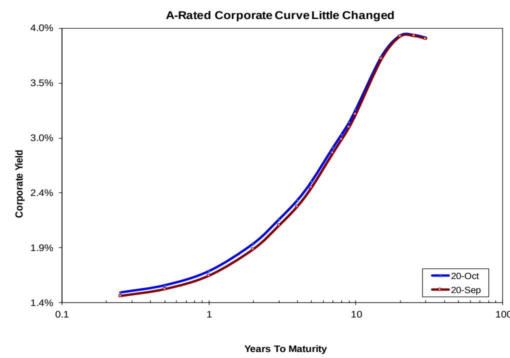
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose slightly at the long end of the yield curve but declined at the short end. This is bullish for corporate credit and for equities.



CDS costs broke through resistance rather emphatically as the search for yield continues. Both high-yield and investment-grade bond yields have declined further and faster than have UST yields since the start of September as default risk is getting priced out of the bond market. Bond investors are becoming just as risk-seeking as equity investors.



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



Market Structure
Industrial Metals and the main Bloomberg index are in structural uptrends, while Softs, Precious Metals, Softs and Natural Gas are in structural downtrends. The EM and EAFE indices are in structural uptrends, while the other financials have moved into consolidations.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 23 - 27
BBerg	29	Trending	0.075	6.5%	0.13%
BBerg Grain	27	Trending	-0.115	11.6%	-0.07%
BBerg Ind. Metl	28	Trending	0.165	15.2%	0.28%
BBerg Pre. Metl	29	Trending	-0.094	10.2%	-0.31%
BBerg Softs	29	Trending	-0.178	15.3%	-0.81%
BBerg Nat. Gas	26	Trending	-0.035	16.9%	-0.03%
BBerg Petroleum	15	Transitional	0.096	18.0%	
BBerg Livestock	7	Sideways	0.057	8.6%	
Dollar Index	9	Sideways	0.082	5.4%	
S&P 500 Index	4	Sideways	0.109	3.8%	
EAFE Index	29	Trending	0.164	5.8%	0.16%
EM Index	21	Trending	0.214	6.4%	0.18%
Ten-year UST (price)	9	Sideways	-0.131	3.4%	

Performance Measures

All of the talk about Chinese stimulus failed to propel the Industrial Metals subindex higher. The Petroleum subindex is moving back into a bull market, albeit grudgingly. The rise in implied short-term real rates was bearish for Precious Metals. The strong rally seen in physical commodities last week looked like a singular event, and that does in fact appear to be the case.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.71%	0.57%	2.14%	-0.18%
Grains Sub-Index	-2.42%	-2.60%	-5.80%	-10.80%
Corn	-2.32%	-2.47%	-10.13%	-12.84%
Soybeans	-2.06%	-0.49%	1.70%	-4.42%
Wheat	-3.05%	-5.15%	-7.12%	-14.46%
Energy Sub-Index	0.47%	0.65%	1.81%	-7.43%
Petroleum Sub-Index	0.96%	1.74%	7.64%	-0.46%
WTI	0.21%	1.68%	1.79%	-7.39%
Brent	1.13%	2.72%	8.38%	1.04%
ULSD	0.63%	0.04%	14.09%	7.27%
Gasoline	2.39%	1.70%	10.70%	2.42%
Natural Gas	-0.90%	-2.54%	-13.30%	-24.84%
Precious Metals Sub-Index	-1.84%	-0.75%	-2.15%	-0.93%
Gold	-1.83%	-1.23%	-1.03%	0.12%
Silver	-1.89%	0.64%	-5.21%	-3.91%
Industrial Metals Sub-Index	-0.08%	5.04%	19.04%	36.68%
Copper	1.04%	7.59%	23.30%	48.72%
Aluminum	0.06%	-1.21%	9.27%	28.96%
Nickel	0.49%	12.54%	24.65%	16.04%
Zinc	-3.97%	3.09%	20.90%	37.19%
Softs Sub-Index	-2.07%	-5.70%	-13.97%	-29.41%
Coffee	-0.93%	-6.76%	-9.21%	-26.61%
Sugar	-2.82%	-4.29%	-19.01%	-40.89%
Cotton	-2.51%	-2.23%	-11.74%	-2.80%
Livestock Sub-Index	1.15%	4.15%	6.05%	29.63%
Cattle	-0.43%	-0.62%	-1.15%	23.49%
Hogs	4.28%	14.62%	19.76%	41.37%

The USD rose across the board except against the INR. We are moving back toward an environment favoring both fiscal stimulus and somewhat tighter monetary conditions in the U.S. Both are bullish for the USD.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.30%	-0.91%	9.96%	7.82%
Chinese yuan	-0.62%	-0.69%	3.95%	1.88%
Japanese yen	-1.50%	-1.15%	-3.70%	-8.43%
British pound	-0.72%	-2.26%	2.94%	7.64%
Swiss franc	-0.99%	-1.46%	1.47%	0.86%
Canadian dollar	-1.26%	-2.41%	6.67%	4.78%
Australian dollar	-0.89%	-2.66%	3.85%	2.49%
Swedish krona	-0.67%	-1.82%	10.10%	8.70%
Norwegian krone	-1.20%	-1.47%	8.04%	2.52%
New Zealand dollar	-3.04%	-5.36%	-0.68%	-3.21%
Indian rupee	0.16%	-1.38%	-0.63%	2.60%
Brazilian real	-1.50%	-1.89%	-1.46%	-1.62%
Mexican peso	-0.45%	-6.46%	-1.09%	-1.98%
Chilean peso	-0.86%	-1.35%	3.27%	6.01%
Colombian peso	-0.09%	-1.56%	-2.91%	-0.25%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.58%	-0.51%	2.05%	1.23%

The U.S. and Japan were able to keep the global index higher despite pullbacks in both the EM index and in the Eurozone. It has been a generation since Japan led anything to the upside.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.39%	2.24%	11.94%	22.64%
North America	0.81%	2.61%	10.34%	22.28%
Latin America	-1.21%	-2.31%	13.75%	16.21%
Emerging Market Free	-0.55%	0.77%	18.89%	25.83%
EAFE	-0.31%	1.08%	13.97%	22.68%
Pacific	0.31%	2.83%	11.27%	17.77%
Eurozone	-0.30%	0.50%	18.85%	31.18%

Both CTAs and hedge funds had a third 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	1.06%	1.34%	1.39%	-4.62%
Newedge Trend	0.89%	0.90%	0.89%	-3.07%
Newedge Short-Term	-0.11%	0.37%	-0.83%	-7.04%
HFR Global Hedge Fund	-0.01%	0.52%	3.28%	6.17%
HFR Macro/CTA	0.50%	0.24%	2.16%	-0.18%
HFR Macro: Sytematic Diversified CTA	0.49%	0.81%	2.36%	-1.05%