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## The Macro Environment For Financial Markets

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Refugee flow is an incontrovertible measure of political success. Bluntly, you do not see Europeans fleeing into Syria, nor did anyone ever ride an inner tube across the Florida Straits to get to Cuba. Given the relative attractiveness of the Eurozone, what does it say that the ECB feels compelled to push sovereign debt rates further into negative territory: You, too, can pay 31.9 basis points to lend money to Germany for two years. The world may not be a happy place, but the only tool policymakers seem to have is monetary stimulus. It does not and indeed cannot create demand, but it can and does raise the price of financial assets. If you wonder how long this absurdity can continue, ask whether you thought you would see ZIRP turn seven years old, as it will in December.

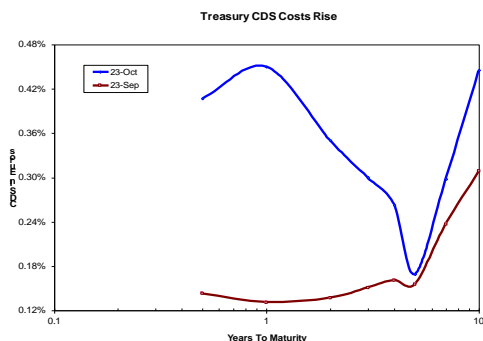
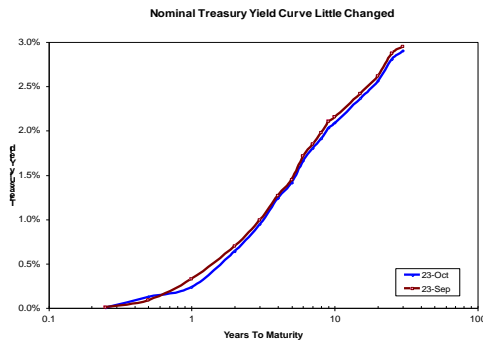
The causal chain remains:

1. Short-term interest rates will rise at some point in the U.S., but probably not in 2015;
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 continue to accept rollover risk;
6. Swap spreads will remain tame; and
7. Credit spreads will remain within their recent elevated range.

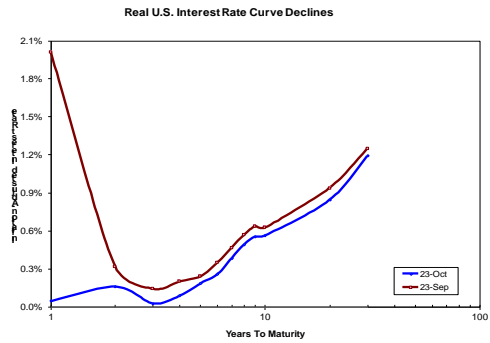
### Key Market Indications

Declining sovereign rates elsewhere are raising the rate advantage of Treasuries to, say, Bunds, but the rising USD is making those Treasuries more expensive and therefore riskier for foreign investors. As piling into UST at these yields is not inviting and going short them has not been a productive exercise for years, the market may be content to sit until the next round of “what’s the Fed going to do?” comes into play.

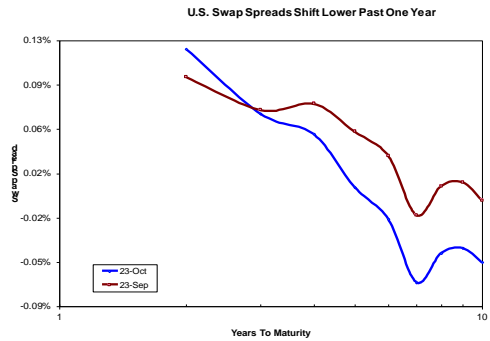
Let’s stipulate Congress will extend the debt ceiling and the U.S. will not default. Let’s also stipulate they will create unnecessary anxiety in the process. The jump in short-dated CDS costs on U.S. debt is noteworthy. Also noteworthy is if you “win” this bet you get paid in euros. Enjoy spending them in the post-apocalyptic wasteland.



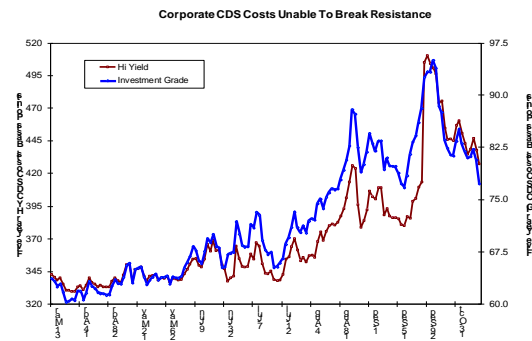
Pseudo-real rates have shifted strongly lower at the short end of the yield curve over the past month. This should support precious metals more than it has; it may take a return to negative pseudo-real rates to achieve that. A further decline at the long end of this yield curve will support risky financial assets.



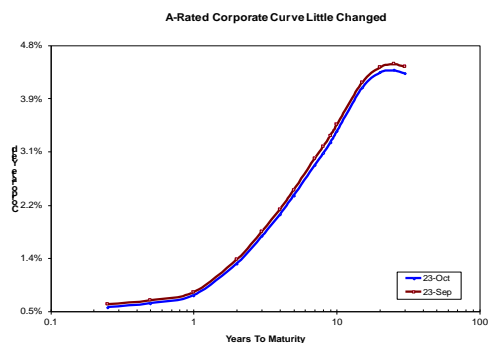
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to decline for tenors longer than one year. Spreads of six years' tenor and longer are negative, a decisively complacent stance on interest rates.



CDS costs for both the investment-grade and high-yield indices have reached but have been unable to decline through resistance. If this is all CDS costs have been able to decline given renewed monetary accommodation, then we should conclude corporate bonds remain highly vulnerable to any outburst of negative macro news.



The A-rated yield curve, like the UST yield curve, has changed little over the past month. Its inability to decline further in the face of global monetary accommodation, declining swap spreads, lower CDS costs and renewed risk-seeking in equities is something of a warning signal: Markets that do not rise on good news are exhausted and vulnerable to pullbacks.



## Market Structure

With the exception of Precious Metals, the physical commodities have either returned to structural downtrends or, in the case of Natural Gas and Softs, are about to do so. The dollar index reversed to an uptrend, joining ten-year UST and both the S&P 500 and the EAFE therein.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 26 - 30
BBerg	28	Trending	-0.095	12.3%	-0.30%
BBerg Grain	29	Trending	-0.089	14.0%	-0.31%
BBerg Ind. Metl	29	Trending	-0.051	20.3%	-0.30%
BBerg Pre. Metl	29	Trending	0.124	14.1%	0.09%
BBerg Softs	7	Sideways	-0.063	18.0%	
BBerg Nat. Gas	13	Transitional	-0.323	19.3%	
BBerg Petroleum	28	Trending	-0.111	28.4%	-0.62%
BBerg Livestock	29	Trending	0.076	14.3%	
Dollar Index	29	Trending	0.220	7.7%	0.03%
S&P 500 Index	27	Trending	0.331	13.6%	0.11%
EAFE Index	5	Sideways	0.084	11.4%	
EM Index	29	Trending	0.356	12.6%	0.50%
Ten-year UST (price)	29	Trending	0.005	5.7%	0.06%

## Performance Measures

I commented last week, "...we are reminded that cash-strapped producers still need to maintain production in a vain hope of covering their fixed costs. That means the secular bear market in physical commodities is very much with us." This has yet to change and will not change until something, somewhere, increases demand. That something will not be monetary excess in China as that will go toward financial speculation as opposed to the construction of ghost cities in Inner Mongolia. Too bad; those absorbed a lot of copper. What is notable once again is the uniformity of declines in physical commodities; only corn, sugar and cattle managed gains over the week.

	Five-Days	One Month	Six Months	One Year
<b>Bloomberg Index</b>	-2.60%	0.30%	-13.93%	-25.39%
<b>Grains Sub-Index</b>	-0.02%	-0.40%	-5.43%	-9.63%
Corn	0.80%	-0.91%	-3.97%	-6.65%
Soybeans	-0.67%	3.20%	-6.38%	-9.66%
Wheat	-0.36%	-3.35%	-4.26%	-9.76%
<b>Energy Sub-Index</b>	-5.18%	-5.09%	-25.23%	-46.96%
Petroleum Sub-Index	-4.87%	-2.21%	-27.32%	-48.52%
WTI	-6.25%	-0.36%	-28.88%	-53.38%
Brent	-4.77%	-1.18%	-30.40%	-52.37%
ULSD	-3.39%	-5.14%	-27.07%	-41.70%
Gasoline	-3.56%	-4.94%	-19.87%	-38.15%
Natural Gas	-5.97%	-12.52%	-17.28%	-46.00%
<b>Precious Metals Sub-Index</b>	-1.73%	3.85%	-2.37%	-6.65%
Gold	-1.72%	2.77%	-2.90%	-5.86%
Silver	-1.78%	7.02%	-0.86%	-9.06%
<b>Industrial Metals Sub-Index</b>	-2.89%	0.81%	-16.93%	-25.68%
Copper	-2.23%	2.37%	-13.42%	-22.95%
Aluminum	-4.89%	-6.16%	-19.33%	-29.25%
Nickel	-0.70%	7.75%	-17.76%	-31.61%
Zinc	-2.61%	5.84%	-22.14%	-24.03%
<b>Softs Sub-Index</b>	-1.68%	13.73%	-6.83%	-23.89%
Coffee	-5.88%	1.94%	-19.59%	-44.53%
Sugar	0.07%	23.64%	-1.55%	-19.79%
Cotton	-1.71%	4.65%	-5.17%	0.04%
<b>Livestock Sub-Index</b>	0.71%	3.22%	-2.92%	-17.27%
Cattle	2.85%	5.64%	-6.11%	-12.53%
Hogs	-3.01%	-0.97%	3.61%	-25.13%

European currencies fell hard with the ECB's stance, and the CAD sold off on the election results. As the Federal Reserve is unlikely to follow the ECB down the road toward greater monetary accommodation, the bias will remain for a stronger USD.

	Five-Days	One Month	Six Months	One Year
<b>Currency Returns</b>				
Euro	-2.91%	-1.50%	1.79%	-12.87%
Chinese yuan	0.05%	0.52%	-2.40%	-3.64%
Japanese yen	-1.67%	-0.98%	-1.56%	-10.87%
British pound	-0.80%	0.45%	1.71%	-4.47%
Swiss franc	-2.54%	0.11%	-2.44%	-2.50%
Canadian dollar	-1.91%	1.17%	-7.76%	-14.70%
Australian dollar	-0.66%	3.04%	-7.23%	-17.64%
Swedish krona	-3.06%	-0.80%	1.54%	-14.65%
Norwegian krone	-3.29%	-1.38%	-6.65%	-21.57%
New Zealand dollar	-0.81%	7.63%	-11.07%	-13.68%
Indian rupee	-0.02%	1.79%	-2.32%	-5.47%
Brazilian real	1.22%	7.79%	-23.36%	-35.51%
Mexican peso	-1.00%	3.17%	-7.46%	-18.26%
Chilean peso	-1.72%	2.49%	-10.20%	-14.96%
Colombian peso	-1.10%	6.91%	-15.34%	-29.48%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.43%	1.69%	-3.88%	-6.00%

If we have learned anything over the past year, and we generally do not, it is QE produces diminishing returns for equities. Of course, diminished returns are not negative returns, and the ECB and PBOC policies have given equities a boost, one that may prove to be short-lived.

	Five-Days	One Month	Six Months	One Year
<b>Equity Total Returns</b>				
MSCI World Free	1.40%	7.09%	-3.56%	5.34%
North America	1.75%	6.72%	-2.16%	6.80%
Latin America	0.23%	9.82%	-22.43%	-29.01%
Emerging Market Free	0.39%	9.83%	-16.00%	-9.03%
EAFE	0.84%	7.71%	-5.75%	3.04%
Pacific	1.07%	7.30%	-8.27%	4.32%
Eurozone	1.54%	9.85%	-3.16%	2.97%

CTAs turned in another poor week, suggesting they had been leaning to the long side of physical markets and the short side of the USD. Macro-oriented hedge funds benefited, as they always seem to do, from the rise in global equity markets.

	Five-Days	One Month	Six Months	One Year
<b>CTA/Hedge Fund Returns</b>				
Newedge CTA	-0.01%	-1.24%	-8.66%	10.33%
Newedge Trend	-0.05%	-0.42%	-6.78%	7.53%
Newedge Short-Term	-0.70%	-0.87%	-7.24%	-2.27%
HFR Global Hedge Fund	-0.27%	-0.62%	-5.20%	-2.07%
HFR Macro/CTA	0.67%	-1.18%	-5.54%	0.40%
HFR Macro: Systematic Diversified CTA	0.50%	-1.68%	-5.49%	2.33%