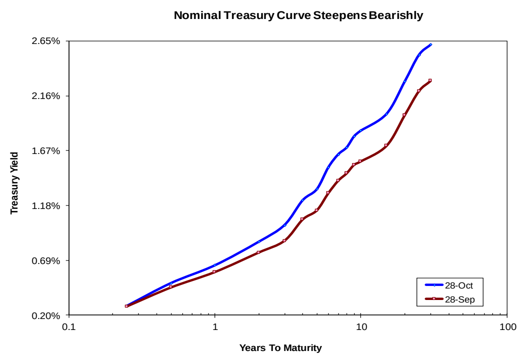
The Macro Environment For Financial Markets

One of the consequences of raising a generation of traders unfamiliar with a bear bond in bonds is they do not understand the asymmetry of career risk across asset classes. Stock traders get fired for missing a rally, but bond traders get fired for being long duration during a selloff. As a large segment of sovereign debt retains negative yields, and as this was one of the biggest greater fool trades of all time, buyers could become scarce. However, a rise in yields will have such consequences for credit demands in a highly leveraged economy, it will become self-defeating shortly after the ten-year UST rises over 1.98%. The causal is:

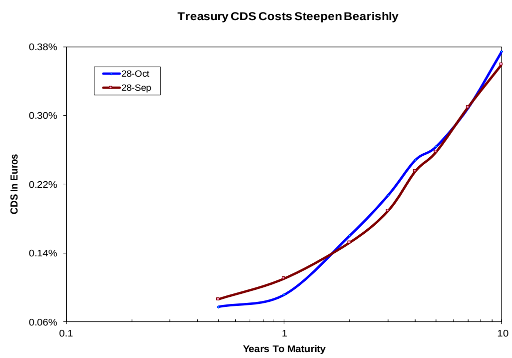
1. The market is pricing in a December increase in U.S. short-term rates;
2. Inflationary expectations are rising globally, even though much of this is a short-term herding trade;
3. The U.S. yield curve retains its long-term bias toward flattening despite a short-term bearish steepening;
4. Short-term borrowers are terming out short-term debt into the bond market;
5. Swap spreads are starting to rise at the long end of the yield curve; and
6. CDS costs are rising to reflect higher short-term interest rates.

Key Market Indications

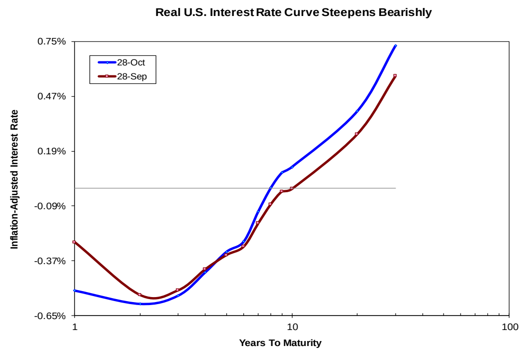
The Federal Reserve made a serious error – imagine that – by musing forever on the virtues of rising inflation. If they want to stanch the bleeding, they will have to continue reducing the size of their balance sheet; that is more important than raising the target federal funds rate by 25 basis points. Such a move would be contractionary unless offset by fiscal stimulus. Let's pray no one contemplates the latter.



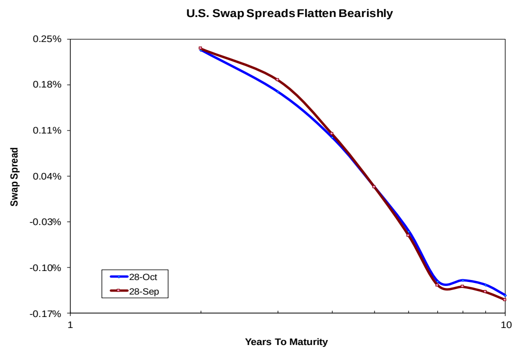
CDS costs on UST continued to decline at the short end of the yield curve even as they rose past two years. This suggests markets are looking at two years or more of a Republican-controlled Congress thwarting the next President, whomever or whatever that may be.



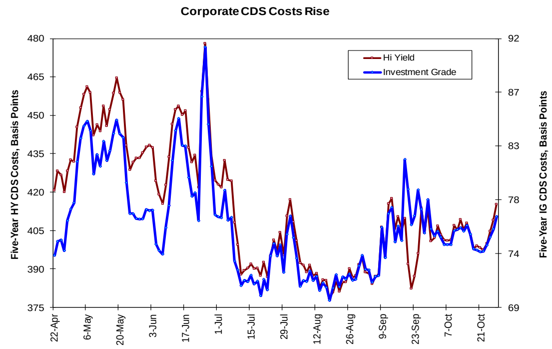
The pseudo-real yield curve declined again at the short end of the yield curve. However, it rose at the long end of the curve, and that is never bullish for risky financial assets.



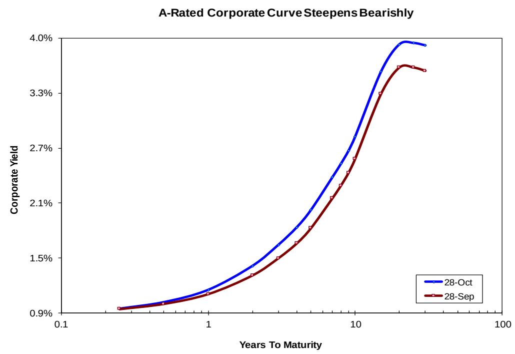
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to shift lower at the short end of the yield curve and remain bullishly inverted. However, swap spreads are starting to rise at the long end of the yield curve.



CDS costs moved higher in the absence of bearish corporate credit news. This reflects anticipation of higher short-term interest rates. Nothing yet can be construed as a bearish move.



The A-rated corporate yield curve finally shifted higher at the long end of the yield curve. This reflects movements in the Treasury market far more than it does credit spreads.



Market Structure

Industrial Metals joined Grains in a structural uptrend amongst physical commodities while Natural Gas entered a structural downtrend. The dollar index remained in an uptrend, the S&P 500 joined the EAFE and ten-year UST in a downtrend amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 31 - Nov. 4
BBerg	7	Sideways	-0.009	9.2%	
BBerg Grain	28	Trending	0.140	16.2%	0.17%
BBerg Ind. Metl	29	Trending	0.186	12.2%	0.07%
BBerg Pre. Metl	10	Sideways	0.087	9.0%	
BBerg Softs	14	Transitional	-0.007	13.6%	
BBerg Nat. Gas	29	Trending	-0.169	24.7%	-1.06%
BBerg Petroleum	10	Sideways	-0.130	18.2%	
BBerg Livestock	15	Transitional	0.291	14.9%	
Dollar Index	29	Trending	0.239	5.7%	0.22%
S&P 500 Index	23	Trending	-0.112	8.4%	-0.16%
EAFE Index	29	Trending	-0.119	10.2%	-0.32%
EM Index	29	Trending	-0.075	8.9%	
Ten-year UST (price)	29	Trending	-0.271	4.2%	-0.77%

Performance Measures

Industrial Metals reversed their previous weakness despite recent concerns about Chinese demand growth and, yes, a stronger USD. The entire energy complex turned sharply lower, with crude oil chasing its tail on the OPEC story and Natural Gas pricing in some warmer weather. These, too, shall pass. The Livestock markets resolved their downtrend as they always do, in a way that ends most unhappily for the cattle and hogs involved.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.22%	0.69%	0.61%	-1.46%
Grains Sub-Index	0.64%	4.37%	-10.90%	-9.93%
Corn	0.72%	5.45%	-12.84%	-14.44%
Soybeans	2.00%	5.28%	-0.62%	13.69%
Wheat	-1.44%	1.64%	-21.96%	-29.04%
Energy Sub-Index	-4.51%	0.53%	2.75%	-15.48%
Petroleum Sub-Index	-3.58%	0.03%	-0.14%	-17.43%
WTI	-4.08%	0.24%	-2.08%	-25.24%
Brent	-3.81%	-0.11%	0.58%	-15.39%
ULSD	-2.21%	0.24%	5.97%	-12.43%
Gasoline	-3.49%	-0.31%	-3.32%	-13.74%
Natural Gas	-6.87%	2.31%	13.49%	-12.97%
Precious Metals Sub-Index	1.01%	-4.32%	-1.42%	11.76%
Gold	0.72%	-3.04%	-1.65%	11.12%
Silver	1.74%	-7.36%	-0.86%	12.83%
Industrial Metals Sub-Index	5.40%	0.30%	3.35%	6.97%
Copper	5.03%	-0.74%	-4.52%	-6.71%
Aluminum	5.84%	2.68%	1.02%	13.52%
Nickel	4.71%	-1.49%	9.53%	2.03%
Zinc	6.07%	0.61%	22.85%	37.76%
Softs Sub-Index	0.81%	-1.05%	30.16%	33.10%
Coffee	6.03%	9.23%	31.10%	23.85%
Sugar	-2.42%	-3.63%	31.45%	46.37%
Cotton	2.54%	4.05%	10.84%	11.37%
Livestock Sub-Index	5.70%	5.05%	-15.98%	-21.40%
Cattle	2.44%	4.25%	-7.04%	-20.10%
Hogs	11.84%	6.45%	-27.01%	-22.98%

The MXN's uptrend ended unceremoniously with yet another U.S. election story. What was more interesting, though was firmness in the EUR and CHF despite a strong USD versus the other major currencies. At some point Mario Draghi will have to stop being the last man on Earth convinced of the success of Eurozone QE.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.93%	-2.07%	-3.23%	0.57%
Chinese yuan	-0.18%	-1.53%	-4.47%	-6.20%
Japanese yen	-0.90%	-3.87%	3.22%	15.61%
British pound	-0.40%	-6.41%	-16.59%	-20.17%
Swiss franc	0.57%	-1.73%	-2.17%	0.62%
Canadian dollar	-0.49%	-2.37%	-6.29%	-1.55%
Australian dollar	-0.12%	-1.21%	-0.34%	6.80%
Swedish krona	-1.06%	-4.96%	-10.45%	-5.16%
Norwegian krone	-0.19%	-2.78%	-1.53%	3.70%
New Zealand dollar	0.03%	-1.66%	2.89%	6.88%
Indian rupee	0.16%	-0.47%	-0.39%	-2.77%
Brazilian real	-1.38%	0.50%	9.01%	22.04%
Mexican peso	-2.05%	2.08%	-9.03%	-12.36%
Chilean peso	2.63%	1.93%	1.76%	5.71%
Colombian peso	-1.85%	-2.57%	-3.77%	-2.33%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.14%	-1.70%	-2.52%	-2.23%

The relative firmness of the equity markets must be tempered with the realization that while rising earnings expectations are an opinion, rising long-term interest rates are a fact. A bull market based on the TINA trade cannot ignore this for long.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.58%	-1.91%	2.55%	1.79%
North America	-0.69%	-1.91%	3.59%	4.01%
Latin America	-0.01%	7.94%	15.11%	31.24%
Emerging Market Free	-0.84%	-0.88%	8.99%	7.89%
EAFE	-0.38%	-1.89%	-0.19%	-3.00%
Pacific	-0.41%	-0.31%	5.27%	5.11%
Eurozone	0.60%	-0.46%	0.38%	-5.29%

Both CTAs and hedge funds managed to lose over the past week as both stocks and bonds declined simultaneously and the energy markets reversed.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.33%	-4.16%	-3.83%	-5.56%
Newedge Trend	-0.71%	-3.12%	-2.40%	-1.40%
Newedge Short-Term	-0.38%	-2.67%	-5.62%	-2.02%
HFR Global Hedge Fund	-0.36%	-0.18%	2.16%	-0.74%
HFR Macro/CTA	-0.40%	-1.15%	-2.54%	-1.90%
HFR Macro: Sytematic Diversified CTA	-0.78%	-3.66%	-2.69%	-1.17%