The Macro Environment For Financial Markets

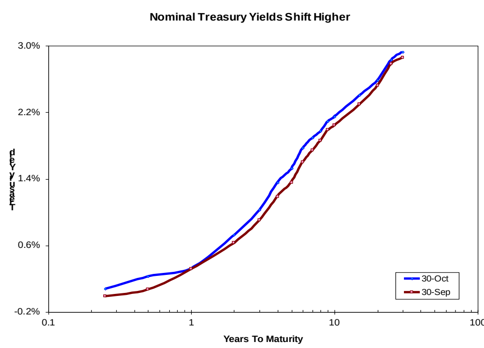
If this were a bad Cold War spy movie, we would be injecting sodium pentothal into policymakers worldwide to hear their confessed truth about how they really want to destroy public debt by creating inflation. The U.S. will not raise rates until some arbitrary target is hit, the Eurozone is facing disinflationary pressures, Japan is there already, etc. Their present efforts to achieve this by negative interest rates have created a slow-growth and increasingly leveraged economy that cannot afford higher debt service costs and therefore demands more of the same free-money medicine that has produced the problem. Today we are hopeless winos; tomorrow we shall be sober. This will all be so much better once we have free college tuition and a $15/hour minimum wage. Did I say that? Yes, I did.

The causal chain remains:

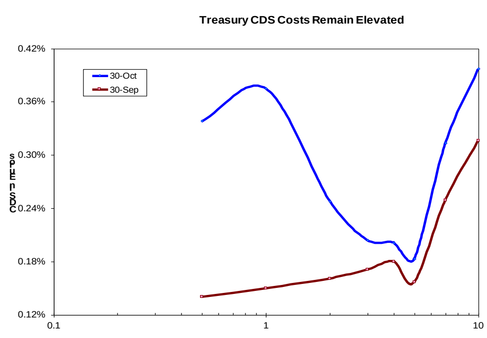
1. Short-term interest rates will rise at some point in the U.S., but probably not in 2015;
2. Disinflationary pressures are dominating inflationary pressures;
3. Inflation expectations as measured by the TIPS market will remain low;
4. The U.S. yield curve retains its long-term trend toward a bullish 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

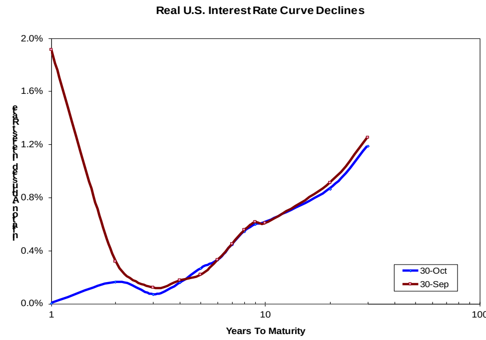
Nothing is more certain than death and taxes than a continuing debate about the course of U.S. short-term rates. The latest chapter in this saga has a December 2015 rate hike in play if conditions are met. Noted. This had the effect of flattening the yield curve via higher short-term rates and raising TIPS breakevens via relatively higher nominal rates. In homage to Ronald Reagan's joke about the boy and the pony, there has to be a signal in this pile of noise.



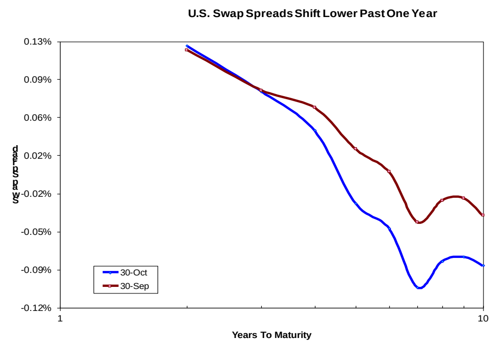
Even though Congress reached an apparent agreement on the debt ceiling, CDS costs on UST remain elevated. Markets regard this as cheap insurance against someone doing something stupid.



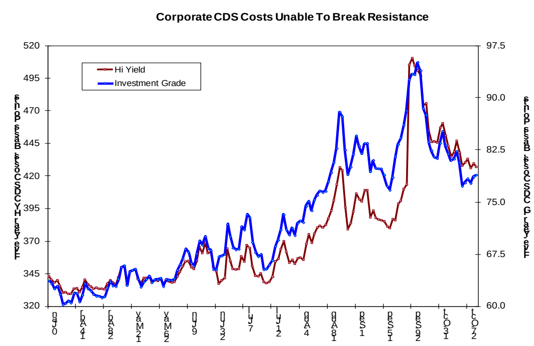
Pseudo-real rates have shifted strongly lower at the short end of the yield curve over the past month. This should support precious metals more than it has; it may take a return to negative pseudo-real rates to achieve that. A further decline at the long end of this yield curve will support risky financial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



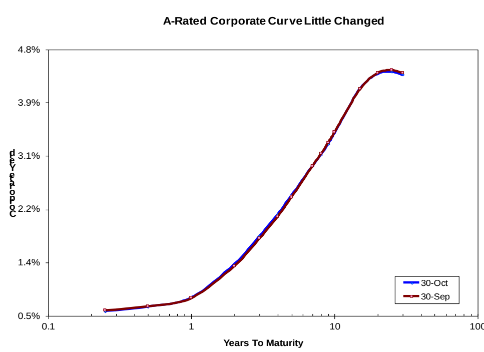
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to decline for tenors longer than one year. Spreads of five years' tenor and longer are negative, a decisively complacent stance on interest rates.



CDS costs for both the investment-grade and high-yield indices remain 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. To repeat verbatim from last week, 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

The Petroleum subindex switched into a structural uptrend; the remainder of the physical commodities remain lower. Ten-year UST moved into a structural downtrend while the S&P 500, the dollar index and the EM index remain in uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 2 - 6
BBerg	27	Trending	-0.090	11.2%	-0.30%
BBerg Grain	29	Trending	-0.002	13.5%	-0.31%
BBerg Ind. Metl	23	Trending	-0.140	20.0%	-0.30%
BBerg Pre. Metl	29	Trending	-0.051	13.9%	
BBerg Softs	10	Sideways	0.037	15.8%	
BBerg Nat. Gas	27	Trending	-0.368	26.9%	-1.54%
BBerg Petroleum	27	Trending	0.034	26.5%	0.05%
BBerg Livestock	19	Transitional	-0.118	12.9%	
Dollar Index	29	Trending	0.160	7.3%	0.03%
S&P 500 Index	29	Trending	0.309	12.5%	0.11%
EAFE Index	9	Sideways	0.028	10.3%	
EM Index	29	Trending	0.117	12.2%	0.50%
Ten-year UST (price)	28	Trending	-0.110	5.4%	-0.04%

Performance Measures

The crude oil market really wants to rally at any sign of declining production and, while we are at it, of further distress to producers everywhere. Saudi Arabia was downgraded, and if that is not a lagging indicator, what is? Still, once prices rise, the fracklog will be revisited and new supplies will come into the market. Rome was not destroyed in a day, either. Slow economic growth globally is continuing to pressure the industrial metals and low inflation expectations are pressuring the precious metals. Weather giveth and weather taketh away: The El Niño drought is supporting various soft commodities while prospects for a warm North American winter are killing natural gas prices.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.02%	-0.53%	-15.43%	-25.72%
Grains Sub-Index	1.33%	-0.34%	-0.89%	-11.56%
Corn	0.66%	-1.80%	0.32%	-10.28%
Soybeans	-1.14%	0.80%	-5.99%	-14.88%
Wheat	6.42%	1.71%	7.74%	-5.00%
Energy Sub-Index	1.30%	-2.34%	-26.86%	-46.66%
Petroleum Sub-Index	3.88%	1.01%	-26.25%	-46.02%
WTI	4.40%	1.61%	-27.10%	-50.52%
Brent	3.37%	1.70%	-29.90%	-50.27%
ULSD	2.47%	-2.29%	-27.32%	-40.71%
Gasoline	5.11%	1.67%	-17.79%	-34.43%
Natural Gas	-5.39%	-10.93%	-27.32%	-51.08%
Precious Metals Sub-Index	-1.79%	0.83%	-3.35%	-3.47%
Gold	-1.84%	0.42%	-3.08%	-3.05%
Silver	-1.64%	1.99%	-4.09%	-4.72%
Industrial Metals Sub-Index	-1.84%	-1.69%	-24.32%	-28.40%
Copper	-1.38%	-0.34%	-21.25%	-24.19%
Aluminum	-1.22%	-5.74%	-25.95%	-32.02%
Nickel	-4.35%	0.27%	-27.29%	-37.20%
Zinc	-2.72%	0.97%	-28.31%	-27.80%
Softs Sub-Index	1.60%	7.82%	-6.02%	-22.24%
Coffee	2.11%	-2.69%	-13.43%	-41.76%
Sugar	1.68%	7.32%	1.04%	-17.83%
Cotton	0.89%	5.29%	-5.99%	-1.27%
Livestock Sub-Index	-3.19%	1.34%	-7.43%	-18.71%
Cattle	-1.17%	7.88%	-7.30%	-11.96%
Hogs	-6.92%	-9.44%	-7.03%	-29.75%

Why would China engage in monetary stimulus last week and then intervene to drive the CNY higher this week? While we are in the inquiring mode, why did the USD rally strongly on the vague suggestion the Federal Reserve might, if the spirits moved them, raise short-term rates either in December or whenever hell froze over, whichever comes first? Finally, will the ECB just give up on QE and decide, in a reverse-Argentine move, simply to add a zero to the EUR?

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.11%	-1.53%	-1.94%	-12.74%
Chinese yuan	0.53%	0.61%	-1.81%	-3.20%
Japanese yen	0.70%	-0.61%	-1.03%	-9.46%
British pound	0.74%	1.98%	0.50%	-3.59%
Swiss franc	-0.94%	-1.48%	-5.62%	-3.23%
Canadian dollar	0.66%	1.78%	-7.67%	-14.50%
Australian dollar	-1.08%	1.71%	-9.70%	-19.21%
Swedish krona	-0.38%	-1.96%	-2.39%	-13.98%
Norwegian krone	-1.17%	0.35%	-11.23%	-21.00%
New Zealand dollar	0.37%	5.92%	-11.01%	-13.60%
Indian rupee	-0.67%	0.50%	-2.82%	-5.84%
Brazilian real	0.53%	2.38%	-21.82%	-37.69%
Mexican peso	0.54%	2.52%	-6.98%	-18.54%
Chilean peso	-0.67%	0.72%	-11.50%	-16.54%
Colombian peso	0.66%	6.59%	-17.74%	-29.22%
Bloomberg-JP Morgan Asian dollar index (spot)	0.03%	1.34%	-3.95%	-5.97%

The boosts to equities from QE are short-lived as they produce one-off decreases in discount rates but they do not produce continuing increases in top-line earnings. Last week's boosts from the Chinese and ECB moves started dissipating already.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.02%	7.95%	-2.89%	3.48%
North America	0.15%	8.04%	-0.70%	4.74%
Latin America	-2.12%	6.11%	-24.51%	-33.77%
Emerging Market Free	-2.38%	7.14%	-17.55%	-13.49%
EAFE	-0.30%	7.82%	-6.25%	1.47%
Pacific	-0.22%	9.13%	-7.50%	1.43%
Eurozone	0.03%	8.99%	-4.66%	3.07%

CTAs managed a sideways week, which must count as some sort of moral victory this year. Hedge funds also managed small gains even though global equity markets did not post strong gains and sovereign bonds retreated.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.03%	-2.14%	-4.78%	12.44%
Newedge Trend	0.00%	-0.72%	-3.88%	8.95%
Newedge Short-Term	0.16%	-0.44%	-5.36%	-0.41%
HFR Global Hedge Fund	0.91%	1.99%	-4.02%	-1.47%
HFR Macro/CTA	0.39%	-0.74%	-3.64%	0.90%
HFR Macro: Sytematic Diversified CTA	-0.06%	-2.36%	-3.49%	3.09%