The Macro Environment For Financial Markets

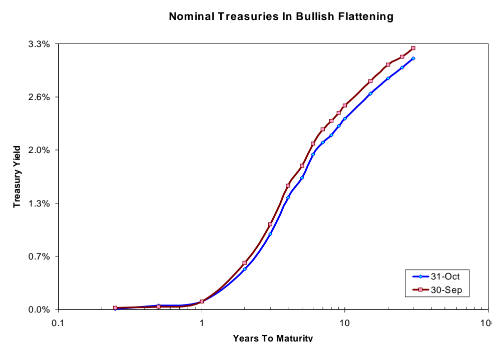
Two statements are true. One, the Nikkei 225 is at a seven-year high. Two, it is trading at 46.2% of its levels from twenty-five years ago this month. However, Japanese monetary expansions, whether in the aftermath of the Kobe earthquake, their adoption of ZIRP in 1999 and QE in 2001 or most recently with their November 2012 and April 2013 assaults on their own currency have proven uniformly bullish for everyone else on the planet with the good sense to take a few cookies when offered. Money for nothing; upticks for free. The USD and CNY, to a lesser extent, were the immediate beneficiaries this week, but those strong currencies soon will be swapped for cheaper assets with higher return potential elsewhere. None of this financial reliquefaction will support the real economy; it will only operate by countering potentially catastrophic asset price collapses. Financial bubbles have few enemies, but economic collapses are a downer for all concerned, so they will be allowed to continue. Investors who take advantage of this largesse should expect the doorbell to ring and find a tax collector suggesting you recycle some of your gains into the common weal. Do not bother trying to hide, they will find you eventually and will be in a sour mood once they do.

The causal chain is now:

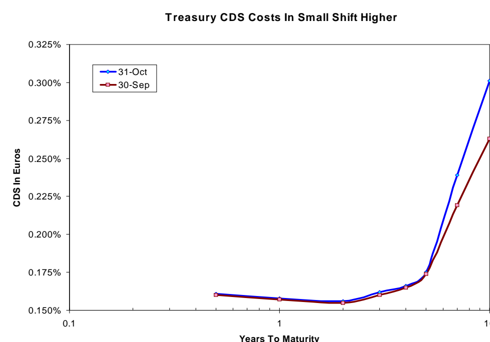
1. Short-term interest rates will remain artificially low globally and will be transmitted into the U.S. via USD appreciation unless the Federal Reserve finds yet one more reason to signal lower rates into 2015;
2. Real rates will remain elevated at the short end of the yield curve and will struggle to move lower at the long end of the yield curve until LT nominal rates resume their decline;
3. Inflation expectations as measured by the TIPS market will remain subdued;
4. Sovereign debt yields will decline globally and continue to cap U.S. long-term yields;
5. The U.S. yield curve should oscillate near its current historically steep levels and will retain a bias toward a bullish flattening;
6. Short-term borrowers will continue to accept rollover risk;
7. Swap spreads are in a stable and inverting configuration, are declining at the short end and do not yet present an impediment to corporate bonds; and
8. Credit spreads will fight through demonstrated liquidity risks and continue their decline.

Key Market Indications

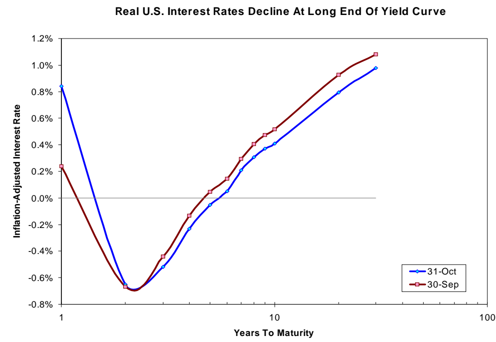
The ten-year UST essentially has completed its retracement to support and cannot go above the 2.46% zone for the bull market to remain intact. The UST market should continue to receive support from carry trade inflows and from the on-again expectation of higher short-term interest rates. This factor has kept the yield curve flat and inflationary expectations capped throughout 2014. As long as higher two-year yield do not lead to domestic carry trade unwinding, the bull market at the long end should continue.



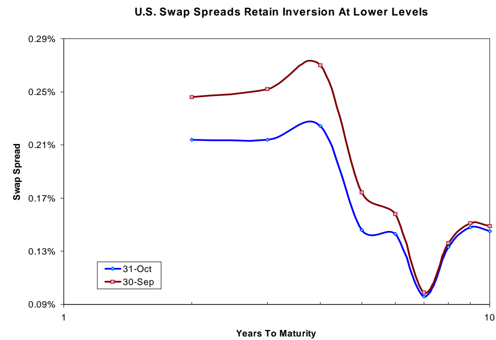
Euro-denominated CDS costs on Treasuries are shifting about within a small range. The U.S. fiscal situation is one of the lowest areas of concern for global markets at present.



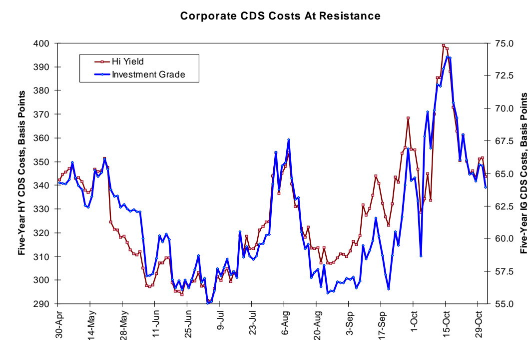
Real rates remain higher at the short end of the yield curve and lower at the long end. The decline at the long end of the yield curve will have to proceed further to maintain the attractiveness of risky financial assets; that will necessitate either a decline in nominal LT rates or an increase in LT inflation expectations or both. The increase in ST implied real rates will remain intact with lower ST inflation expectations and will continue to pressure precious metals.



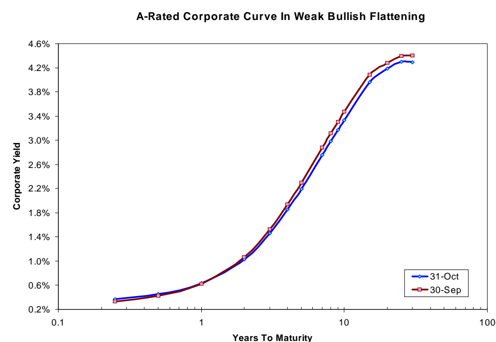
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain inverted. Floating-rate borrowers are less anxious to fix short-dated and mid-curve payments but are willing to remain floating at the long end of the yield curve. This inversion at historically low levels will maintain both the carry trade inflow into U.S. assets and lower LT corporate bond yields.



Both IG and HY CDS levels are at resistance levels and should continue to decline in the face of stable U.S. economic news and carry trade inflows into USD-denominated instruments. The recent demonstration of illiquidity in the corporate bond market is likely to deter a revisit of the July lows, but never underestimate the willingness of a yield hog to take undue risk for little return.



The A-rated yield curve flattened bullishly along with the Treasury curve. This flattening continues to lag that of the UST curve as much of the Treasury rally even as swap spreads remain tame and credit spreads are declining once again. Nothing in this market is an impediment to higher-risk financial assets.



Market Structure

The Grains have moved into a structural uptrend as buyers continue to fix prices; Natural Gas remains in a structural downtrend. The S&P 500 has moved into an uptrend; other financial indices' reversals are keeping them in transitional structures.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For Nov. 3 - 7
BBerg	16	Transitional	0.012	8.9%	
BBerg Grain	21	Trending	0.259	20.8%	0.42%
BBerg Ind. Metl	16	Transitional	0.090	14.7%	
BBerg Pre. Metl	19	Transitional	-0.356	14.6%	
BBerg Softs	28	Trending	-0.200	20.0%	
BBerg Nat. Gas	29	Trending	-0.056	22.9%	-0.27%
BBerg Petroleum	6	Sideways	-0.016	16.9%	
BBerg Livestock	4	Sideways	0.000	10.7%	
Dollar Index	18	Transitional	0.180	8.4%	
S&P 500 Index	29	Trending	0.257	13.9%	0.03%
EAFE Index	11	Transitional	0.174	12.2%	
EM Index	13	Transitional	0.257	10.7%	
Ten-year UST (price)	12	Transitional	-0.082	8.1%	

Performance Measures

The Precious Metals are in a downside breakout likely to continue. While the economically unimportant Softs and Livestock indices declined, other indices including Energy, Industrial Metals and Grains rebounded. Often overlooked in the world of physical commodities is how swift and powerful supply responses to price declines can be, and this discourages wanton selling in these markets. Companies can go bankrupt; corn cannot.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.99%	-0.24%	-13.85%	-4.91%
Grains Sub-Index	5.42%	13.41%	-23.96%	-14.04%
Corn	6.73%	16.55%	-26.32%	-18.12%
Soybeans	6.71%	14.02%	-16.22%	1.85%
Wheat	2.85%	9.63%	-29.19%	-26.13%
Energy Sub-Index	1.44%	-7.28%	-18.25%	-4.89%
Petroleum Sub-Index	0.04%	-7.80%	-17.21%	-12.48%
WTI	-0.47%	-9.15%	-15.18%	-9.01%
ULSD	1.52%	-4.42%	-15.13%	-12.40%
Gasoline	0.15%	-8.37%	-18.81%	-11.36%
Natural Gas	4.54%	-6.22%	-20.87%	11.02%
Precious Metals Sub-Index	-5.21%	-2.38%	-12.16%	-15.30%
Gold	-4.89%	-1.78%	-10.18%	-11.00%
Silver	-6.26%	-4.28%	-18.04%	-27.08%
Industrial Metals Sub-Index	2.36%	2.29%	2.23%	1.04%
Copper	0.20%	1.62%	-1.11%	-7.75%
Aluminum	3.96%	6.83%	12.07%	3.70%
Nickel	5.10%	-4.75%	-14.44%	6.65%
Zinc	2.39%	1.93%	11.86%	16.44%
Softs Sub-Index	-1.56%	-1.65%	-20.06%	-2.44%
Coffee	-1.83%	-8.96%	-10.94%	62.24%
Sugar	-2.08%	-2.43%	-24.21%	-31.35%
Cotton	1.00%	3.17%	-24.73%	-10.27%
Livestock Sub-Index	-1.16%	-1.75%	1.50%	13.36%
Cattle	-0.51%	0.11%	16.18%	25.83%
Hogs	-2.47%	-5.37%	-17.93%	-4.43%

One of the more surprising aspects of the JPY's decline was how it pushed only the USD and, to a far smaller extent, the CNY higher. The Latin currencies outside of the BRL firmed on a sell-the-rumor/buy-the-news response to the Brazilian election; this was the case briefly for the BRL itself until the Rousseff budget was proposed. The only impediment to a USD rally now is yet another FOMC backtrack on raising rates in 2015.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.15%	-0.84%	-9.68%	-7.80%
Chinese yuan	0.06%	0.43%	2.40%	-0.31%
Japanese yen	-3.70%	-2.38%	-8.97%	-12.43%
British pound	-0.59%	-1.34%	-5.20%	-0.28%
Swiss franc	-1.11%	-0.78%	-8.54%	-5.79%
Canadian dollar	-0.31%	-0.60%	-2.70%	-7.41%
Australian dollar	0.06%	0.58%	-5.27%	-6.96%
Swedish krona	-1.91%	-2.43%	-12.05%	-12.32%
Norwegian krone	-2.27%	-4.81%	-11.88%	-11.98%
New Zealand dollar	-0.83%	-0.24%	-9.61%	-5.74%
Indian rupee	-0.14%	0.64%	-1.68%	0.21%
Brazilian real	-0.16%	-1.25%	-9.91%	-9.61%
Mexican peso	0.58%	-0.39%	-2.98%	-3.41%
Chilean peso	1.08%	3.50%	-2.29%	-11.16%
Colombian peso	0.39%	-1.59%	-5.89%	-8.06%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.44%	-0.03%	-0.31%	-1.34%

As central banks have realized lower sovereign debt yields are not stimulative and only risk-averse investors want them, monetary stimulus has taken its next logical step and moved to equities. These will become overpriced in turn, but as Charles Prince of Citigroup notoriety once said, "As long as the music is playing, you've got to get up and dance."

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.43%	0.67%	2.48%	9.25%
North America	2.55%	2.05%	7.49%	16.11%
Latin America	3.90%	-0.11%	-1.66%	-5.40%
Emerging Market Free	3.25%	1.19%	3.96%	0.99%
EAFE	2.24%	-1.45%	-4.63%	-0.17%
Pacific	3.11%	0.92%	3.73%	0.44%
Eurozone	1.76%	-3.49%	-9.98%	-2.77%

CTA performance once again split along position-length lines with the trend-followers gaining and short-term traders losing over the week. Hedge funds demonstrated their dependence on equity markets once again with strong gains for a second week.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.41%	0.99%	13.51%	10.70%
Newedge Trend	0.27%	0.14%	8.00%	8.36%
Newedge Short-Term	-0.72%	1.06%	4.93%	8.04%
HFR Global Hedge Fund	0.25%	-1.65%	-0.86%	0.64%
HFR Macro/CTA	0.66%	0.07%	4.28%	2.48%
HFR Macro: Sytematic Diversified CTA	0.28%	0.24%	2.60%	0.48%