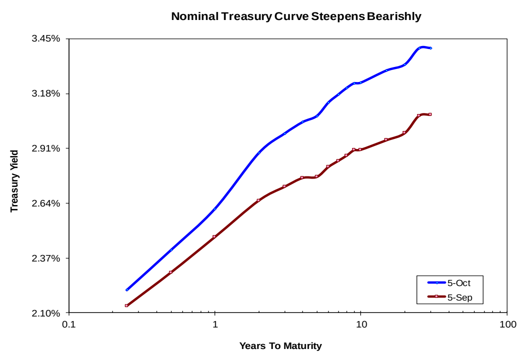
The Macro Environment For Financial Markets

The combination of a more aggressive Federal Reserve, trade tensions in the technology sector, a stronger dollar and rising wage pressure as evidenced by Amazon's action is bearish in the short-term for equities. The next major risk factor will be the U.S. midterm elections; anyone claiming special insight there should be ignored. October will be a difficult month. The causal chain now is:

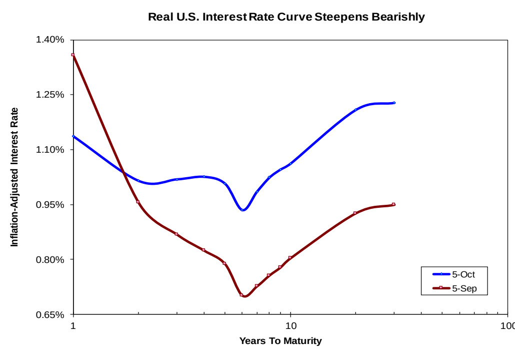
1. The market is pricing in December 2018 and March 2019 rate hikes;
2. Inflationary expectations are consolidating recent increases;
3. The yield curve is entering a steepening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to invert bullishly; and
6. CDS costs are starting to rise.

Key Market Indications

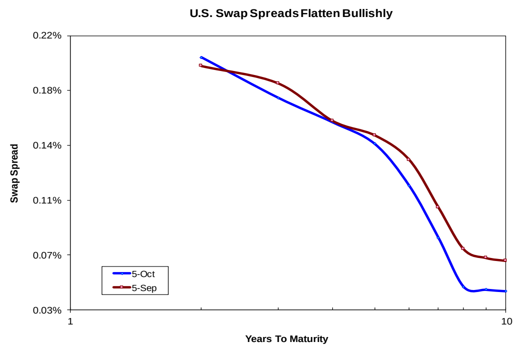
The "unusually slow" pace of yield increases noted here for several weeks broke as the Federal Reserve signaled its intention to keep raising short-term rates and as increasingly negative currency basis swaps made U.S. debt unattractive to both Eurozone and Japanese lenders. The strong holders of UST will remain, but we are in a bear market for bonds now.



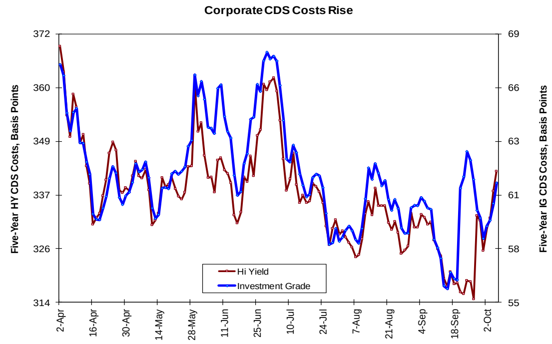
The pseudo-real yield curve steepened bearishly. The rise at the long yield of this yield curve is sufficient to threaten returns for risky assets.



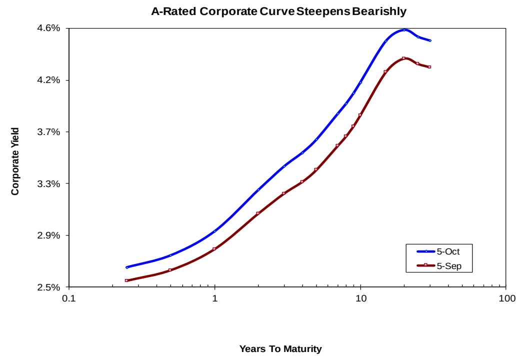
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to flatten bullishly. The swap market remains complacent about the prospect for higher long-term yields.



CDS costs rose with the reemergence of Italian debt problems, trade-related issues in the technology sector and the threat of higher interest rates.



The A-rated corporate yield curve steepened bearishly in parallel to the Treasury curve. Corporate bond yields have been so low for so long ten-year A-rated yields can rise another 50 basis points and still not be in a bear market.



Market Structure

Softs joined the main Bloomberg index, Industrial Metals and both Petroleum and Natural Gas in structural uptrends within physical markets. The dollar index returned to an uptrend while ten-year UST entered an oversold zone.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 8 - 12
BBerg	29	Trending	0.356	7.8%	0.11%
BBerg Grain	15	Transitional	0.130	14.1%	
BBerg Ind. Metl	29	Trending	0.097	18.6%	0.28%
BBerg Pre. Metl	17	Transitional	0.059	11.0%	
BBerg Softs	24	Trending	0.245	19.5%	0.29%
BBerg Nat. Gas	29	Trending	0.160	15.5%	0.21%
BBerg Petroleum	29	Trending	0.309	17.3%	0.07%
BBerg Livestock	11	Transitional	0.044	9.2%	
Dollar Index	29	Trending	0.134	5.7%	0.09%
S&P 500 Index	8	Sideways	-0.094	9.7%	
EAFE Index	19	Transitional	-0.204	8.4%	
EM Index	18	Transitional	-0.306	9.9%	
Ten-year UST (price)	29	Trending	-0.527	3.4%	-0.09%

Performance Measures

This week's eye-popping move was the 12.8% return in Sugar. The gains in Energy, both Precious and Industrial Metals and Grains joined Softs in the move higher, pushing the main Bloomberg index to a gain over a six-month period. This could be a particularly fragile move given physical commodities' normal reaction to equity downturns and trade tensions.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	2.04%	5.40%	0.95%	5.32%
Grains Sub-Index	2.92%	1.80%	-11.00%	-7.41%
Corn	3.41%	0.51%	-11.87%	-7.01%
Soybeans	2.82%	3.13%	-17.75%	-14.82%
Wheat	2.40%	2.08%	0.58%	0.90%
Energy Sub-Index	2.25%	10.27%	21.76%	35.82%
Petroleum Sub-Index	1.49%	9.43%	24.79%	51.42%
WTI	1.53%	10.23%	24.17%	57.06%
Brent	1.93%	10.43%	29.87%	61.60%
ULSD	1.91%	7.93%	23.39%	40.91%
Gasoline	0.06%	7.15%	17.44%	33.01%
Natural Gas	4.54%	12.84%	13.39%	-3.26%
Precious Metals Sub-Index	0.56%	1.24%	-10.30%	-7.97%
Gold	0.83%	0.60%	-10.11%	-6.20%
Silver	-0.39%	3.55%	-10.95%	-13.53%
Industrial Metals Sub-Index	0.57%	5.18%	-6.04%	-4.02%
Copper	-1.46%	5.53%	-10.53%	-10.18%
Aluminum	3.48%	3.78%	7.59%	1.26%
Nickel	0.22%	2.15%	-5.00%	18.70%
Zinc	1.06%	10.62%	-15.58%	-14.52%
Softs Sub-Index	7.59%	3.72%	-7.79%	-13.15%
Coffee	6.39%	6.52%	-12.12%	-23.43%
Sugar	12.81%	7.45%	-6.00%	-16.07%
Cotton	-0.31%	-7.03%	-4.52%	13.41%
Livestock Sub-Index	-0.56%	3.53%	9.78%	-1.23%
Cattle	-0.55%	3.50%	11.94%	-0.47%
Hogs	-0.61%	3.64%	6.01%	-3.85%

Political news helped propel the GBP and BRL higher, but this week belonged to the USD as the Federal Reserve made its hawkish stand known. While other central banks are moving toward tightening, no one is ahead of the U.S. in this regard.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.69%	-0.91%	-5.85%	-1.60%
Chinese yuan	-0.17%	-0.96%	-8.31%	-3.03%
Japanese yen	-0.02%	-1.93%	-5.57%	-0.79%
British pound	0.68%	1.67%	-6.31%	0.01%
Swiss franc	-1.04%	-2.05%	-2.87%	-1.38%
Canadian dollar	-0.24%	1.85%	-1.46%	-2.89%
Australian dollar	-2.38%	-1.96%	-8.22%	-9.53%
Swedish krona	-1.95%	-0.13%	-7.15%	-10.21%
Norwegian krone	-1.27%	1.66%	-5.18%	-3.07%
New Zealand dollar	-2.66%	-2.29%	-11.46%	-9.47%
Indian rupee	-1.73%	-2.73%	-11.94%	-11.69%
Brazilian real	5.48%	7.97%	-12.87%	-17.86%
Mexican peso	-0.56%	2.75%	-3.30%	-1.74%
Chilean peso	-3.03%	1.56%	-10.91%	-7.20%
Colombian peso	-2.16%	2.13%	-7.94%	-3.46%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.90%	-0.97%	-7.01%	-3.09%

The persistent threat of higher short-term interest rates and a stronger USD combined to push the main equity indices lower. This could be a persistent correction for the rest of the month.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-1.47%	0.83%	6.21%	9.42%
North America	-1.01%	-0.03%	9.00%	14.34%
Latin America	2.21%	10.78%	-12.98%	-9.36%
Emerging Market Free	-4.48%	-1.81%	-12.52%	-6.74%
EAFE	-2.34%	0.51%	-2.36%	0.83%
Pacific	-1.97%	3.29%	-0.61%	5.78%
Eurozone	-2.47%	0.54%	-6.10%	-4.35%

Both CTAs and macro hedge funds gained on the week, a rare development in a declining global equity environment. This suggests they were short bonds, long the USD and long the energy markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	1.42%	-0.38%	2.28%	4.43%
SocGen Trend	1.36%	0.20%	0.76%	2.23%
SocGen Short-Term	0.75%	0.48%	1.23%	1.71%
HFR Global Hedge Fund	-0.19%	-0.74%	-0.42%	-0.39%
HFR Macro/CTA	0.53%	-0.47%	1.28%	1.36%
HFR Macro: Sytematic Diversified CTA	0.61%	-0.81%	1.60%	4.50%