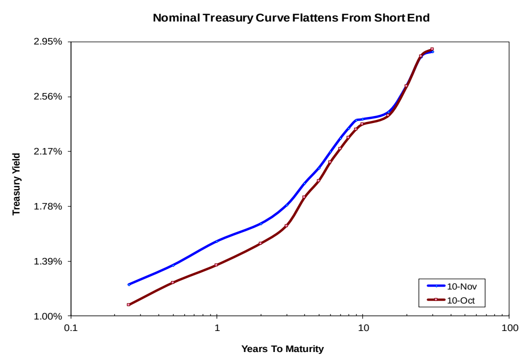
The Macro Environment For Financial Markets

Sometimes we are best not to mince words. In normal times, single-party control and a perceived need to achieve results focuses the mind, but this is not the case in Washington, D.C. The lack of consensus on tax policy is remarkable and the resulting product will be the proverbial camel generated by multiple committees trying to construct a horse. Throw in the poor election results for Republicans and we might have global investors looking at a three-year lame-duck period in the U.S. It will take a great deal of earnings growth and a non-hostile monetary policy to produce a bullish outcome for risky assets from current valuation levels. The causal chain now is:

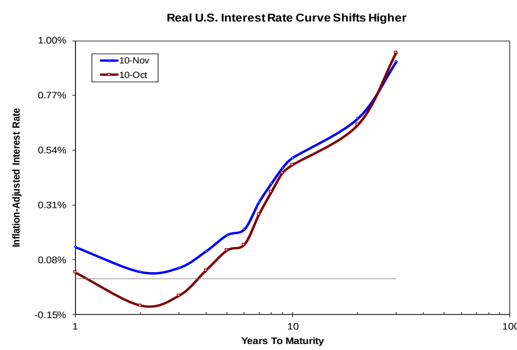
1. The market has priced in a December rate hike but is uncertain for 2018;
2. Inflationary expectations are rising slowly;
3. The secular flattening trend in the U.S. continues;
4. Short-term borrowers are starting to accept rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are inverting bullishly; and
6. CDS costs failed at resistance and jumped higher.

Key Market Indications

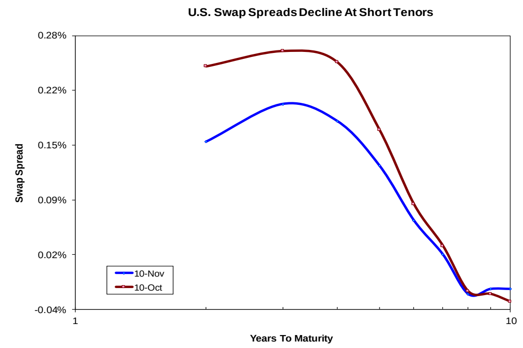
The ten-year UST moved right back to its key support level but once again held there. Lenders realize existing holders are not going to liquidate their portfolios. Such is not the case at the short end of the yield curve, however. Short-term rates continue to move to levels not seen since 2008. As a result, the secular flattening trend in the yield curve remains intact.



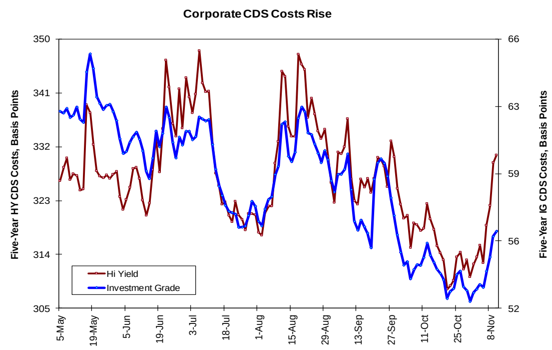
The pseudo-real yield curve shifted higher for maturities ten years and less and is negative over the 2-3 year segment.



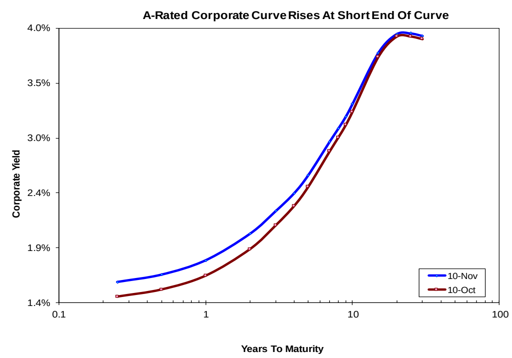
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose slightly at the long end of the yield curve but declined at the short end. This remains bullish for corporate credit and for equities.



CDS costs jumped significantly, especially for the high-yield index. On one level this is little more than the restoration of a more normal risk premium, but on another level it is a tribute to how illiquid markets have become in all but the most plain-vanilla securities.



The A-rated corporate yield rose slightly at the short end of the yield curve over the past month. This remains a bull market with limited upside potential.



Market Structure

The main Bloomberg index along with Natural Gas, Petroleum and Livestock are in structural uptrends, while Grains and Precious Metals are in downtrends. The dollar index remains in an uptrend while ten-year UST shifted into a downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 13 - 17
BBerg	29	Trending	0.263	6.6%	0.13%
BBerg Grain	28	Trending	-0.060	10.7%	-0.07%
BBerg Ind. Metl	29	Trending	-0.046	14.8%	
BBerg Pre. Metl	20	Trending	-0.054	8.8%	-0.09%
BBerg Softs	17	Transitional	0.142	14.9%	
BBerg Nat. Gas	29	Trending	0.151	19.0%	0.89%
BBerg Petroleum	29	Trending	0.409	17.0%	0.65%
BBerg Livestock	29	Trending	0.200	9.8%	0.19%
Dollar Index	29	Trending	0.080	5.2%	0.09%
S&P 500 Index	13	Transitional	0.016	6.2%	
EAFE Index	14	Transitional	-0.023	5.9%	
EM Index	15	Transitional	0.067	7.6%	
Ten-year UST (price)	21	Trending	-0.089	3.6%	-0.01%

Performance Measures

The purge in Saudi Arabia and the shocking realization it gets cold in the Northern Hemisphere at this time of year pushed the Energy index higher. However, the economically sensitive Industrial Metals index declined, as did the increasingly volatile and increasing unimportant Livestock index. The pattern of decreased correlations of returns between commodity subindices is continuing, and this is for the better.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.49%	1.70%	5.10%	6.85%
Grains Sub-Index	-0.15%	-2.13%	-7.22%	-8.51%
Corn	-1.31%	-2.51%	-12.10%	-9.93%
Soybeans	0.05%	-2.22%	1.25%	-3.99%
Wheat	1.44%	-1.67%	-8.40%	-10.99%
Energy Sub-Index	3.40%	8.21%	10.51%	17.72%
Petroleum Sub-Index	2.35%	10.73%	22.63%	26.90%
WTI	2.03%	9.80%	15.64%	18.18%
Brent	2.52%	11.80%	24.13%	31.46%
ULSD	2.61%	8.13%	27.94%	31.08%
Gasoline	2.31%	13.05%	27.44%	30.51%
Natural Gas	6.78%	1.16%	-17.31%	-5.69%
Precious Metals Sub-Index	0.37%	-2.45%	3.17%	1.17%
Gold	0.42%	-2.24%	3.44%	3.27%
Silver	0.24%	-3.02%	2.42%	-4.35%
Industrial Metals Sub-Index	-2.33%	-0.77%	19.81%	19.58%
Copper	-1.30%	-1.74%	21.12%	20.35%
Aluminum	-3.93%	-1.78%	9.76%	18.06%
Nickel	-4.88%	3.65%	29.09%	6.45%
Zinc	0.03%	-0.15%	27.27%	30.63%
Softs Sub-Index	2.76%	1.30%	-8.93%	-25.45%
Coffee	2.85%	0.89%	-9.00%	-26.90%
Sugar	4.06%	3.91%	-7.86%	-33.87%
Cotton	0.33%	0.54%	-12.18%	1.16%
Livestock Sub-Index	-4.36%	2.72%	-2.56%	23.70%
Cattle	-5.04%	3.28%	-5.14%	24.04%
Hogs	-3.01%	1.58%	1.51%	22.40%

The INR and CNY prevented a clean sweep against the USD. Markets once again are taking a much more dovish view of U.S. interest rates than are FOMC members. More important, the prospects for strong fiscal stimulus in the U.S. have eroded.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.49%	-1.21%	7.33%	7.09%
Chinese yuan	-0.03%	-1.00%	3.95%	2.48%
Japanese yen	0.48%	-0.95%	0.66%	-5.90%
British pound	0.91%	-0.05%	1.99%	5.11%
Swiss franc	0.46%	-2.10%	1.29%	-0.93%
Canadian dollar	0.65%	-1.32%	7.68%	6.21%
Australian dollar	0.14%	-1.50%	3.99%	0.63%
Swedish krona	0.96%	-3.35%	6.82%	8.22%
Norwegian krone	0.52%	-2.23%	6.01%	2.84%
New Zealand dollar	0.43%	-1.88%	-0.04%	-3.83%
Indian rupee	-0.95%	0.18%	-0.83%	2.24%
Brazilian real	0.92%	-3.15%	-3.54%	3.33%
Mexican peso	0.53%	-1.43%	-0.45%	7.72%
Chilean peso	0.57%	-0.27%	6.53%	4.10%
Colombian peso	1.01%	-1.75%	-2.11%	3.65%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.11%	-0.19%	2.20%	2.69%

The key reversal lower in Japan ended a strong run for the EAFE index, but the EM index benefited from Asian emerging markets. The decline in the U.S. was trivial but somehow felt like the start of a larger pullback.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.20%	0.72%	8.99%	23.19%
North America	-0.08%	1.34%	8.89%	21.48%
Latin America	-0.57%	-6.95%	3.94%	21.89%
Emerging Market Free	0.22%	1.48%	15.30%	32.26%
EAFE	-0.40%	0.58%	8.89%	25.30%
Pacific	1.35%	3.31%	12.94%	23.26%
Eurozone	-1.82%	-1.40%	7.70%	32.34%

The pullback in equities and the end of a strong uptrend in the USD weighed on both CTA and especially on hedge fund performance.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.06%	5.49%	2.64%	1.62%
Newedge Trend	-0.01%	4.69%	2.14%	2.09%
Newedge Short-Term	-1.03%	1.62%	0.14%	-2.92%
HFR Global Hedge Fund	-0.34%	0.09%	2.45%	6.73%
HFR Macro/CTA	0.24%	2.69%	3.47%	2.60%
HFR Macro: Sytematic Diversified CTA	0.15%	5.17%	5.21%	3.23%