The Macro Environment For Financial Markets

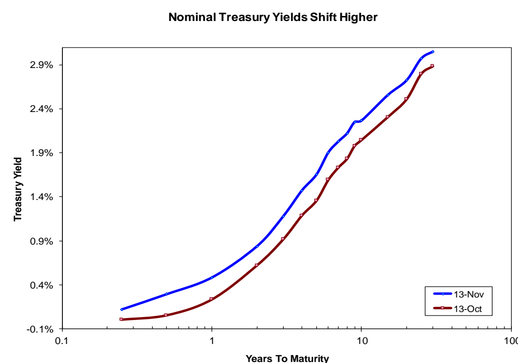
While American businesses routinely are chastised for short-term investing horizons, as if planning for the year 2030 would work in a world where 2:30 PM is unknowable is desirable, policymakers never are chastised for repeating the same mistake inside of three months. To wit: Raising short-term rates and driving the USD higher in the face of declining global growth, strong disinflationary pressures and unsettled financial markets would involve withdrawing liquidity from the banking system and creating a self-fulfilling contractionary cycle. The self-proclaimed geniuses on Constitution Avenue must believe pockets of tightness in the labor market not addressable by higher short-term rates require them to "do something." Trading out of boredom is one of the better ways to become a former trader; the same applies to monetary policy with its long and variable lags.

The causal chain now is:

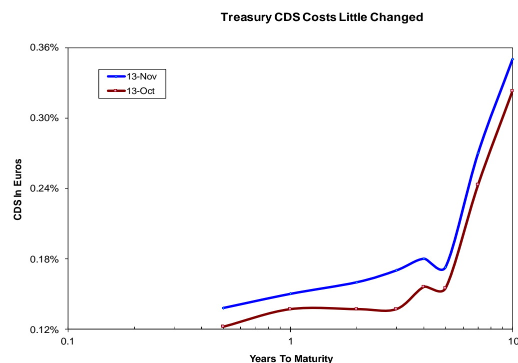
1. Higher short-term interest rates are being priced in still starting in December 2015;
2. Disinflationary pressures are dominating inflationary pressures;
3. Inflation expectations as measured by the TIPS market have seen their lows for the immediate duration;
4. The U.S. yield curve retains its bias toward flattening;
5. Short-term borrowers are terming-out their borrowing to reduce rollover risk;
6. Swap spreads will remain tame; and
7. Credit spreads will retain their upward bias.

Key Market Indications

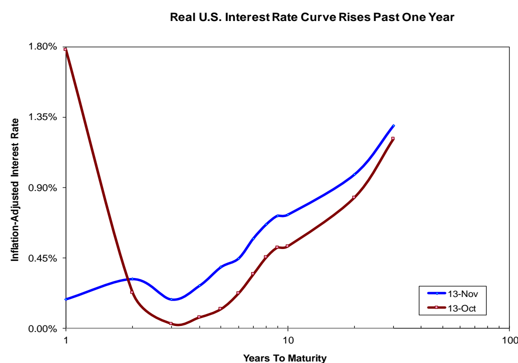
Perhaps the most interesting aspect of the Treasury market this past week was how little of the previous week's selloff was recovered during the equity decline. The prospect of higher short-term interest rates is leading to a flight into the very shortest instruments and not toward notes and bonds. That allowed the yield curve to steepen slightly via lower short-term rates.



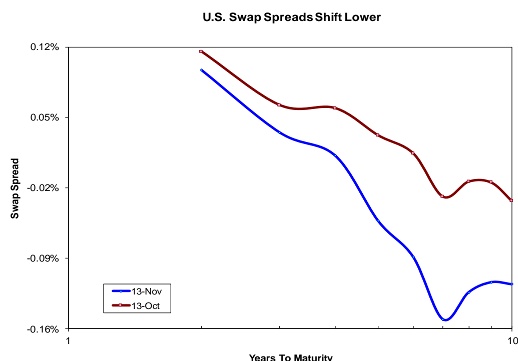
The CDS market for Treasuries is returning to a boring state, which should be welcome news for one and all. The next longer-term concern here should be what happens if Treasury borrowing costs rise at a time of slowing growth.



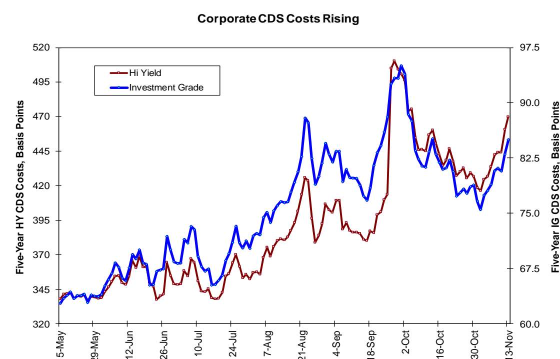
Pseudo-real rates remain lower at the short end of the yield curve over the past month. However, nominal yields at longer maturities have pulled implied real rates higher. While these have not reached the level where they will threaten financial asset returns, they are moving in that direction.



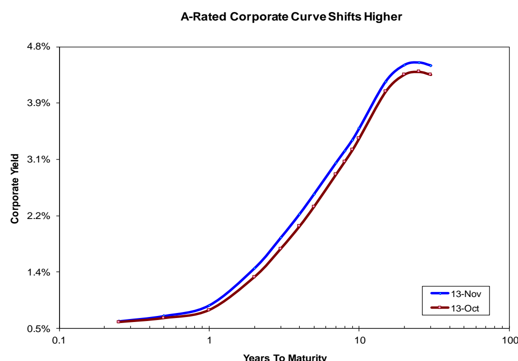
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to decline for tenors longer than one year. Spreads of five years' tenor and longer are negative, a decisively complacent stance on interest rates.



CDS costs for both the investment-grade and high-yield indices turned higher as renewed stresses in sectors such as energy and basic materials combined with increasingly negative macro news outside of the U.S. increased risk aversion. Higher short-term rates will only exacerbate this deteriorating credit-quality situation, and that is anything but supportive for risky financial assets.



The A-rated yield curve has shifted higher. If this curve starts steepening bearishly, it will be a negative for risky financial assets.



Market Structure

The physical markets with the exception of Softs and Natural Gas are in structural downtrends while the equity indices and ten-year UST are in downtrends amongst the financials. Only the dollar index is in a structural uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 16 - 20
BBerg	29	Trending	-0.509	11.2%	-0.30%
BBerg Grain	29	Trending	-0.340	13.4%	-0.31%
BBerg Ind. Metl	29	Trending	-0.314	18.4%	-0.30%
BBerg Pre. Metl	29	Trending	-0.521	12.4%	-0.81%
BBerg Softs	16	Transitional	0.007	19.4%	
BBerg Nat. Gas	5	Sideways	0.068	24.5%	
BBerg Petroleum	29	Trending	-0.343	25.9%	-0.15%
BBerg Livestock	29	Trending	-0.429	16.2%	-0.47%
Dollar Index	29	Trending	0.346	7.0%	0.03%
S&P 500 Index	29	Trending	-0.162	8.8%	-0.04%
EAFE Index	29	Trending	-0.215	10.6%	-0.09%
EM Index	29	Trending	-0.377	10.4%	-0.23%
Ten-year UST (price)	29	Trending	-0.237	4.4%	-0.04%

Performance Measures

The Bloomberg total return index is at a level first reached in March 1997, and that is in current dollars. So much for "commodities for the long run." The story remains drearily the same: Declining import demand in China, slack production capacity, producers trying to cover fixed costs and declining production costs in countries whose currencies are depreciating against the USD. Barring some catastrophic disruption of production, something that cannot be ruled out in today's world, it will take years of non-investment intersecting with growing demand for physical commodities to return to secular uptrends. The last secular bear market lasted more than 20 years and ended with the Chinese demand boom. The present bear market is less than five years old.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-3.28%	-8.18%	-21.73%	-29.45%
Grains Sub-Index	-3.67%	-4.07%	-7.80%	-16.86%
Corn	-4.23%	-5.18%	-6.89%	-17.15%
Soybeans	-1.38%	-5.18%	-8.13%	-15.66%
Wheat	-5.47%	0.49%	-5.30%	-13.69%
Energy Sub-Index	-5.69%	-11.30%	-33.83%	-49.29%
Petroleum Sub-Index	-7.69%	-11.89%	-34.35%	-48.67%
WTI	-7.63%	-13.40%	-35.69%	-53.57%
Brent	-7.41%	-12.74%	-37.39%	-52.07%
ULSD	-6.95%	-9.89%	-34.50%	-43.26%
Gasoline	-9.01%	-8.98%	-26.78%	-37.51%
Natural Gas	-0.23%	-9.74%	-32.01%	-52.41%
Precious Metals Sub-Index	-1.37%	-9.52%	-14.13%	-10.58%
Gold	-0.64%	-8.65%	-12.03%	-9.28%
Silver	-3.43%	-11.96%	-19.69%	-14.25%
Industrial Metals Sub-Index	-2.70%	-8.63%	-26.51%	-30.76%
Copper	-3.37%	-9.86%	-26.26%	-29.06%
Aluminum	-1.99%	-4.95%	-22.32%	-30.53%
Nickel	-2.17%	-11.11%	-33.02%	-40.46%
Zinc	-2.32%	-10.25%	-30.36%	-29.96%
Softs Sub-Index	1.33%	-0.03%	-4.20%	-21.16%
Coffee	-4.47%	-10.61%	-21.85%	-46.92%
Sugar	4.01%	5.40%	4.82%	-14.14%
Cotton	0.28%	-3.16%	-8.52%	1.92%
Livestock Sub-Index	-2.19%	-9.95%	-16.73%	-27.34%
Cattle	-3.21%	-6.33%	-16.33%	-20.66%
Hogs	-0.19%	-16.28%	-16.77%	-38.29%

I commented last week the apparent no-brainer trade of being long the USD would encounter some resistance as the case for raising short-term rates in the U.S. would come into question soon. This materialized very quickly with a large number of European majors and both the NZD and AUD. If financial turmoil rises, look for a repetition of the August-September scenario where the Federal Reserve had to pause.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.30%	-5.33%	-5.12%	-13.66%
Chinese yuan	-0.32%	-0.51%	-2.65%	-3.88%
Japanese yen	0.42%	-2.33%	-2.82%	-5.58%
British pound	1.22%	-0.07%	-3.23%	-3.02%
Swiss franc	-0.07%	-4.80%	-8.89%	-4.23%
Canadian dollar	-0.13%	-2.13%	-10.25%	-14.68%
Australian dollar	1.19%	-1.63%	-12.15%	-18.30%
Swedish krona	0.61%	-6.11%	-4.97%	-14.31%
Norwegian krone	-0.05%	-5.97%	-14.86%	-21.70%
New Zealand dollar	0.25%	-1.54%	-12.61%	-17.02%
Indian rupee	-0.51%	-1.38%	-3.16%	-6.86%
Brazilian real	-2.09%	1.14%	-21.04%	-32.75%
Mexican peso	0.74%	-0.16%	-8.50%	-18.46%
Chilean peso	-0.66%	-2.99%	-14.56%	-15.65%
Colombian peso	-5.98%	-5.31%	-22.31%	-30.20%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.38%	-1.01%	-4.67%	-6.23%

Equity markets can rise in a declining earnings environment only if the real interest rate declines further and faster. As firms can lose money faster than interest rates can go negative, the bias in 2015 has been negative outside of the U.S. and sideways at best in the U.S.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-2.87%	-0.22%	-6.50%	-1.22%
North America	-3.57%	0.58%	-3.94%	-0.30%
Latin America	-2.11%	-3.07%	-25.99%	-30.98%
Emerging Market Free	-3.66%	-3.81%	-19.09%	-14.97%
EAFE	-1.72%	-1.50%	-10.41%	-2.71%
Pacific	0.50%	1.08%	-9.02%	-1.26%
Eurozone	-3.02%	-1.68%	-9.42%	-1.05%

CTAs managed gains in this past week's strong bear trends for physical commodities. While macro-oriented hedge funds gained in response to strong signals of slowing growth, the more equity-oriented global hedge funds retreated.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.85%	2.06%	-1.37%	7.63%
Newedge Trend	0.60%	1.71%	-1.67%	5.69%
Newedge Short-Term	0.26%	1.34%	-3.57%	-1.77%
HFR Global Hedge Fund	-0.82%	-0.19%	-4.40%	-2.70%
HFR Macro/CTA	0.79%	2.26%	-1.19%	0.01%
HFR Macro: Sytematic Diversified CTA	0.86%	1.77%	-0.76%	1.64%