The Macro Environment For Financial Markets

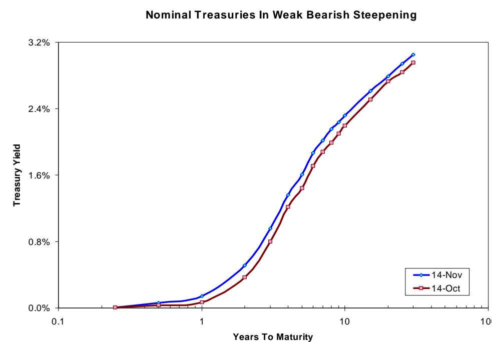
Low short-term interest rates become embedded in economies very quickly. While much has been made of lower gasoline costs leading to higher retail sales, what is lost is the ratio of consumer credit outstanding to GDP has taken out its previous high from January 2009. Unless personal income growth increases, something not indicated despite rising total employment data, this debt level will become an automatic governor on consumer spending if and when interest rates rise. Higher consumer and public sector debt service levels would reduce growth almost immediately and force a redaction of tighter monetary policies. No one thought near-zero interest rates would last in Japan for more than two decades, either. Speaking of Japan, the combination of rising domestic inflation and a weaker yen make this a poor time to be a Japanese consumer. They will discover rising inflation is always and everywhere far more of a curse than the blessing various benighted central bankers hold it to be.

The causal chain is now:

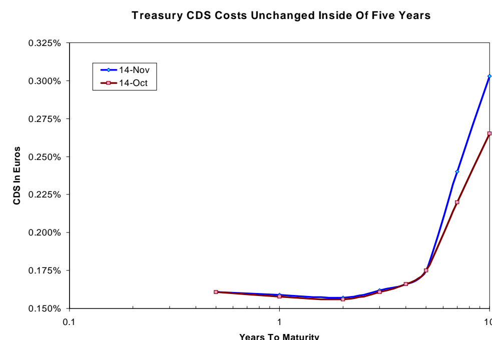
1. Short-term interest rates will remain artificially low globally and will be transmitted into the U.S. via USD appreciation unless the Federal Reserve finds yet one more reason to signal lower rates into 2015;
2. Real rates may rise slightly at the long end of the yield curve, but for the right reason of stronger growth;
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 find further declines difficult to achieve barring a new and unexpected round of monetary stimulus.

Key Market Indications

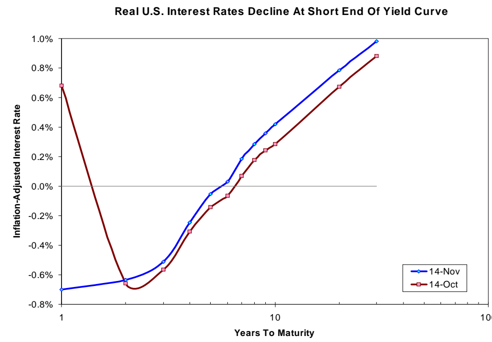
The Treasury market and yield curve have returned to what have been equilibrium levels following a lack of haven bids, rate-hike scares or disruptive news on either the inflation or deflation fronts…yes, you can worry about both and remain socially acceptable. While the action over the past month has described a modest bearish steepening, the longer-term bullish flattening trend remains intact.



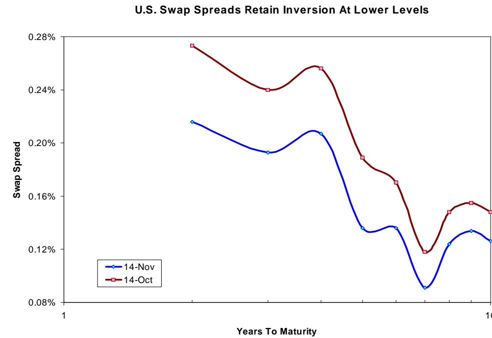
Euro-denominated CDS costs on Treasuries are shifting about within a small range. The U.S. election had almost no effect on this market as the Republican election gains were by centrist candidates who do not wish to see a repeat of the government closure crises of recent years.



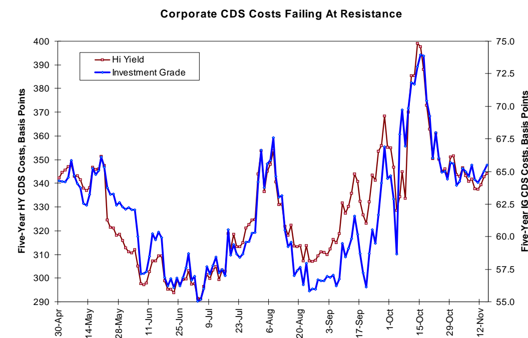
The small rise in implied long-term real rates is not yet at the point where it will encourage a move away from risky assets and back into Treasuries. Higher implied real rates resulting from higher corporate credit demand is the “good” kind of interest rate increase.



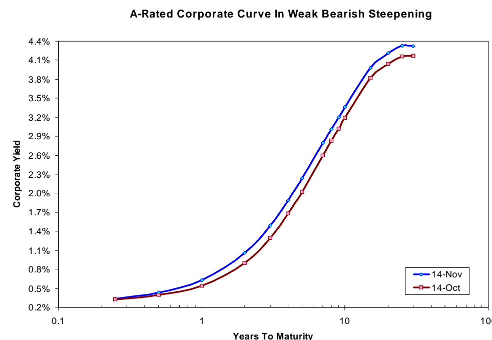
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain inverted and at lower levels. The fixed-income market’s complacency has returned and will encourage moves into risky financial assets.



While both the IG and HY CDS indices have failed to take out their resistance from the past three weeks, they have no impetus to move higher given the slow growth in the overall economy and the high cash levels of American corporations. Their next move higher will come as the October one did, as the result of an equity downturn leading to correlation trades. Reduced risk-seeking will be reflected in apparently lower credit quality, the opposite of what should be.



The A-rated yield curve continues to mimic the UST curve and has moved into a weak bearish steepening. However, as swap spreads and CDS levels are not increasing, there is no reason to question the longer-term bullish flattening of this yield curve, either.



Market Structure

Natural Gas remains in a structural uptrend and both Precious Metals and Softs remain in structural downtrends. The financial indices are surprisingly non-trending. The dollar index has entered a bullish consolidation and the S&P 500's structural uptrend is a slow one. Both reflect investor hesitance in pushing trends too far too fast.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 17 - 21
BBerg	14	Transitional	-0.017	10.3%	
BBerg Grain	9	Sideways	0.083	19.9%	
BBerg Ind. Metl	17	Transitional	-0.009	14.1%	
BBerg Pre. Metl	27	Trending	-0.099	17.4%	-0.15%
BBerg Softs	29	Trending	-0.162	17.1%	-0.58%
BBerg Nat. Gas	29	Trending	0.105	28.5%	2.74%
BBerg Petroleum	16	Transitional	-0.201	21.1%	
BBerg Livestock	26	Trending	0.274	10.7%	0.09%
Dollar Index	4	Sideways	-0.017	7.7%	
S&P 500 Index	29	Trending	0.273	13.0%	0.03%
EAFE Index	7	Sideways	0.027	9.0%	
EM Index	18	Transitional	-0.053	8.8%	
Ten-year UST (price)	19	Transitional	-0.011	5.5%	

Performance Measures

A number of profit-taking reversals in hard downtrends such as those in Petroleum and Gold on Friday underscored once again why bear markets in physical commodities can be so difficult to trade. Grains continue to move higher, and have been joined by the economically unimportant Softs and Livestock markets. There is little to suggest a structural end to the problems of ample supply intersecting with slow demand growth. However, these downtrends are not the result of global recession or of monetary factors; they exist independently of both inflation expectations and currency fluctuations.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.68%	-0.48%	-13.56%	-5.10%
Grains Sub-Index	3.17%	7.57%	-20.98%	-12.56%
Corn	3.75%	9.56%	-22.97%	-15.59%
Soybeans	-1.37%	6.54%	-18.04%	-3.00%
Wheat	7.94%	7.63%	-21.57%	-20.09%
Energy Sub-Index	-5.78%	-3.21%	-20.06%	-9.34%
Petroleum Sub-Index	-4.35%	-6.82%	-23.70%	-18.91%
WTI	-3.54%	-7.10%	-22.04%	-13.79%
ULSD	-4.19%	-4.18%	-20.08%	-18.22%
Gasoline	-4.65%	-6.23%	-24.46%	-19.42%
Natural Gas	-8.38%	4.51%	-12.18%	12.14%
Precious Metals Sub-Index	1.90%	-4.69%	-10.36%	-11.86%
Gold	1.34%	-4.32%	-8.45%	-8.13%
Silver	3.80%	-5.89%	-16.06%	-22.17%
Industrial Metals Sub-Index	-0.21%	1.35%	-0.17%	3.91%
Copper	0.17%	1.34%	-3.63%	-4.21%
Aluminum	-1.58%	2.82%	12.35%	6.18%
Nickel	0.98%	-0.81%	-18.80%	11.04%
Zinc	0.59%	0.38%	8.10%	16.68%
Softs Sub-Index	2.15%	-8.99%	-17.28%	0.16%
Coffee	5.18%	-8.92%	-0.20%	64.78%
Sugar	1.34%	-4.33%	-26.80%	-29.24%
Cotton	-4.69%	-3.24%	-25.24%	-15.58%
Livestock Sub-Index	2.73%	2.77%	5.30%	17.63%
Cattle	1.79%	2.87%	18.68%	27.66%
Hogs	4.67%	2.59%	-12.46%	3.36%

When selected currencies turn lower in today's market, they move violently; this was true for the JPY, GBP, BRL, COP and CLP this past week. Significantly, though, some of the major currencies without deliberate competitive devaluation schemes such as the CAD, AUD and NZD moved higher; this suggests the recent runaway affection for the USD has come to an end for now.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.56%	-1.05%	-8.68%	-6.95%
Chinese yuan	-0.12%	-0.08%	1.61%	-0.61%
Japanese yen	-1.45%	-7.95%	-12.37%	-14.00%
British pound	-1.26%	-1.48%	-6.55%	-2.47%
Swiss franc	0.74%	-0.56%	-7.23%	-4.45%
Canadian dollar	0.37%	0.09%	-3.53%	-7.29%
Australian dollar	1.31%	0.42%	-6.70%	-6.08%
Swedish krona	0.26%	-1.83%	-11.19%	-9.99%
Norwegian krone	0.96%	-2.61%	-12.29%	-8.89%
New Zealand dollar	1.99%	0.84%	-8.77%	-4.42%
Indian rupee	-0.14%	-0.49%	-3.32%	2.27%
Brazilian real	-1.65%	-7.74%	-15.35%	-11.04%
Mexican peso	0.05%	-0.66%	-4.70%	-4.21%
Chilean peso	-1.19%	-1.16%	-7.34%	-12.76%
Colombian peso	-2.73%	-5.04%	-10.91%	-10.79%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.35%	-0.77%	-1.42%	-1.56%

The Latin American index has had an awful month as Mexico, Brazil, Argentina and Venezuela compete to give the region a bad name. The other EM regions did well and the Pacific index has turned higher on the back of the umpteenth rally to nowhere in Japan.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.65%	6.81%	2.46%	9.14%
North America	0.52%	8.63%	8.28%	15.36%
Latin America	-3.49%	-10.61%	-13.23%	-8.33%
Emerging Market Free	0.34%	-0.02%	-2.29%	2.67%
EAFE	0.88%	3.99%	-5.75%	0.39%
Pacific	1.30%	6.11%	2.37%	1.82%
Eurozone	0.58%	1.37%	-11.64%	-3.49%

CTA performance continues strong in reflection of trends in energy, the dollar and grains. The consolidations in both long-term debt and equity markets dampened hedge fund performance, but it managed to remain positive. The beleaguered macro funds have turned in a good week within some choppy markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.41%	4.29%	16.43%	15.90%
Newedge Trend	0.44%	3.15%	10.50%	11.86%
Newedge Short-Term	0.49%	0.86%	8.04%	10.72%
HFR Global Hedge Fund	0.00%	1.14%	-0.70%	0.97%
HFR Macro/CTA	0.31%	2.02%	5.59%	5.24%
HFR Macro: Sytematic Diversified CTA	0.60%	2.15%	4.62%	3.07%