The Macro Environment For Financial Markets

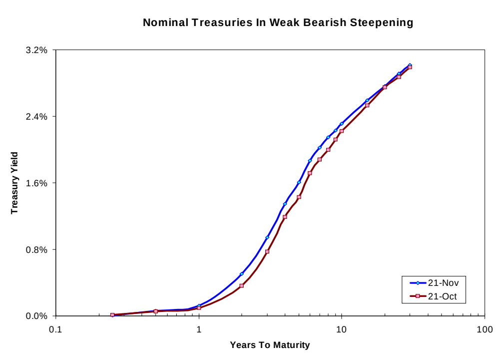
Will China's monetary stimulus be accompanied by another round of public works spending in the workers' paradise? If so, we will see the effects spill over into physical commodity markets and into the equity markets of Asian suppliers. The one piece missing for now is a renewed reliance on the yen carry trade; no one wants to be caught short yen at the next unannounced policy reversal…and make no mistake, Japanese policymaking has turned into Evening At The Improv. At least the Peoples' Bank acts; let's not embarrass them by mentioning them in the same breath as the European Central Bank, which remains one of history's greatest smoke-and-mirror acts. But as long as the euro heads lower and Eurozone bond yields decline, Eurozone governments can join the Japanese government in avoiding the sort of structural reform that might take all of us out of the pink cotton candy world of free money supporting vibrant financial markets while the real economy languishes.

The causal chain is now:

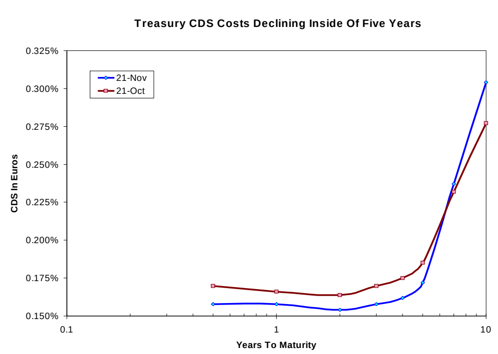
1. Short-term interest rates will remain artificially low globally and will be transmitted into the U.S. via USD appreciation unless the Federal Reserve finds yet one more reason to signal lower rates into 2015;
2. Real rates may rise slightly at the long end of the yield curve, but for the right reason 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

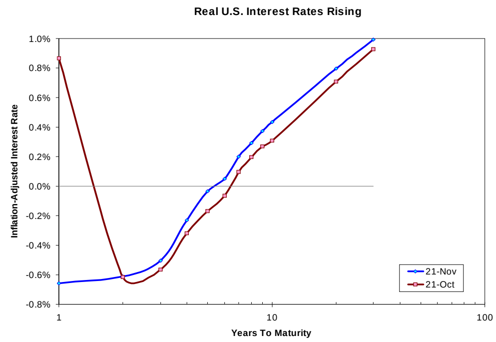
Markets do not owe you a trend, and this has been the case in Treasuries for the past two weeks. While the action over the past month has described a modest bearish steepening, the longer-term bullish flattening trend remains intact.



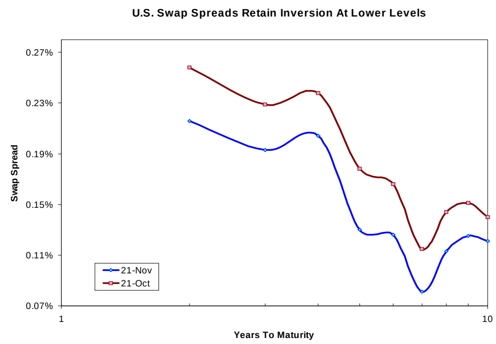
Euro-denominated CDS costs on Treasuries are shifting about within a small range. This may change slightly if the administration provokes Congress into some avoidable budget battle, but that will be a January 2015 story at the earliest.



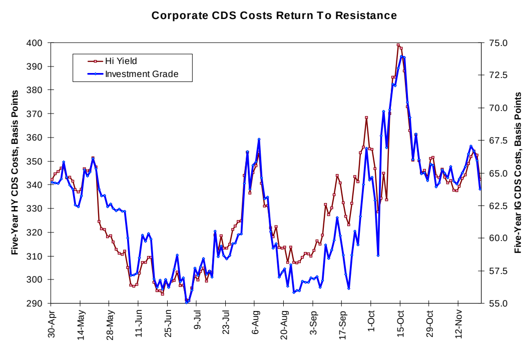
The small rise in implied long-term real rates is not yet at the point where it will encourage a move away from risky assets and back into Treasuries. Higher implied real rates resulting from higher corporate credit demand is the "good" kind of interest rate increase.



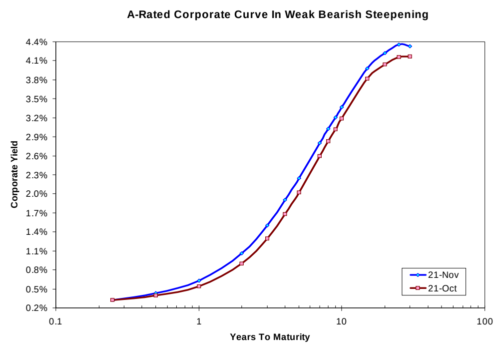
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain inverted and at lower levels. The fixed-income market's complacency has returned and will encourage moves into risky financial assets.



Both the IG and HY CDS indices remain at their resistance levels established a month ago. 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. Deutsche Bank's exit from the single-name CDS business is a warning of future execution vacuums in the synthetic corporate bond market.



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

Only Livestock is in a structural uptrend amongst the physical commodities; both Precious Metals and Softs remain in structural downtrends. While it may seem as if the S&P 500 is in a strong and relentless uptrend, its rate of ascension remains small and it has not been joined by other stock indices.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 24 - 28
BBerg	18	Transitional	0.048	10.0%	
BBerg Grain	11	Transitional	0.024	19.3%	
BBerg Ind. Metl	17	Transitional	0.093	14.6%	
BBerg Pre. Metl	29	Trending	-0.019	17.3%	-0.15%
BBerg Softs	29	Trending	-0.110	16.2%	-0.58%
BBerg Nat. Gas	8	Sideways	-0.037	22.5%	
BBerg Petroleum	4	Sideways	0.074	19.5%	
BBerg Livestock	29	Trending	0.251	10.3%	0.09%
Dollar Index	7	Sideways	0.086	7.3%	
S&P 500 Index	29	Trending	0.302	11.9%	0.03%
EAFE Index	12	Transitional	0.109	9.0%	
EM Index	19	Transitional	0.086	8.4%	
Ten-year UST (price)	22	Trending	0.025	5.0%	

Performance Measures

The large jump in Natural Gas has occurred in the winter 2014-2015 strip and has pushed this segment of the forward curve to a large premium over succeeding months. Call it pre-emptive buying from those who remember last winter's price spike. Declines in other physical markets have slowed for the time being and industrial metals such as nickel and zinc have rebounded on improved supply conditions. Still, there is no reason whatsoever to believe global demand will recover to the point of a resumed secular bull market in physical commodities.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.06%	1.32%	-12.96%	-4.57%
Grains Sub-Index	-0.85%	5.28%	-21.53%	-14.28%
Corn	-2.28%	5.55%	-23.86%	-17.28%
Soybeans	1.61%	5.67%	-19.49%	-4.35%
Wheat	-1.64%	5.50%	-20.29%	-21.70%
Energy Sub-Index	2.90%	1.40%	-18.59%	-8.60%
Petroleum Sub-Index	0.77%	-5.48%	-24.36%	-19.64%
WTI	0.91%	-5.31%	-23.41%	-13.33%
ULSD	-0.16%	-3.58%	-20.37%	-20.99%
Gasoline	1.10%	-4.60%	-24.92%	-20.70%
Natural Gas	6.97%	16.64%	-5.72%	16.72%
Precious Metals Sub-Index	0.92%	-3.19%	-9.55%	-7.74%
Gold	1.02%	-2.78%	-7.39%	-3.94%
Silver	0.58%	-4.52%	-15.96%	-18.27%
Industrial Metals Sub-Index	1.55%	3.02%	-0.22%	5.35%
Copper	-0.31%	-0.22%	-4.55%	-5.59%
Aluminum	1.55%	4.52%	11.31%	8.52%
Nickel	6.65%	10.64%	-15.97%	20.81%
Zinc	1.75%	1.74%	9.09%	17.97%
Softs Sub-Index	-0.75%	-4.18%	-15.49%	-1.80%
Coffee	-2.88%	-2.70%	-1.39%	62.42%
Sugar	1.20%	-1.77%	-23.62%	-27.78%
Cotton	-0.18%	-4.64%	-22.34%	-14.68%
Livestock Sub-Index	-0.48%	1.65%	5.91%	19.02%
Cattle	0.51%	2.25%	20.37%	31.24%
Hogs	-2.48%	0.40%	-13.58%	1.47%

The CAD managed to turn higher on higher reported inflation in Canada; time was when this sort of news was considered bad for a country but not in a world where this takes Canada out of the competitive devaluation game for the time being. The EUR and JPY continue to sink; Japan on actual monetary creation, the Eurozone on Draghi's magic act. The BRL's jump should be dismissed as a one-off burst.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.07%	-2.56%	-9.47%	-8.09%
Chinese yuan	0.08%	-0.03%	1.78%	-0.52%
Japanese yen	-1.27%	-9.16%	-13.94%	-14.12%
British pound	-0.08%	-2.84%	-7.36%	-3.35%
Swiss franc	-1.09%	-2.12%	-7.89%	-5.87%
Canadian dollar	0.48%	-0.11%	-2.86%	-6.37%
Australian dollar	-0.91%	-1.24%	-6.28%	-6.11%
Swedish krona	-1.07%	-3.08%	-12.00%	-11.13%
Norwegian krone	-0.77%	-3.51%	-12.67%	-10.51%
New Zealand dollar	-0.30%	-0.97%	-8.07%	-3.91%
Indian rupee	-0.09%	-0.74%	-4.85%	1.89%
Brazilian real	3.41%	-1.29%	-12.26%	-8.36%
Mexican peso	-0.61%	-0.58%	-5.07%	-4.33%
Chilean peso	0.06%	-1.96%	-7.19%	-12.20%
Colombian peso	0.53%	-4.79%	-11.01%	-10.08%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.17%	-1.30%	-1.64%	-1.66%

The Latin American index managed a rebound on the hope – always a bad word for traders – the Rousseff government can stabilize the BRL. Elsewhere it was the same story of massive monetary stimulus leaking into equities as there are no real alternatives.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.21%	5.44%	4.11%	10.18%
North America	1.32%	6.30%	9.70%	16.58%
Latin America	7.32%	2.77%	-4.37%	-1.39%
Emerging Market Free	1.38%	2.37%	-0.92%	2.77%
EAFE	1.03%	4.09%	-3.85%	1.16%
Pacific	-1.55%	3.84%	3.03%	-0.24%
Eurozone	3.61%	4.45%	-7.78%	0.05%

This was a bad week for both CTAs and hedge funds, suggesting they may have been leaning too hard on downtrends in markets such as crude oil. The toughest thing for many traders is taking a loss, followed closely by staying with long-term trends.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.07%	4.19%	17.00%	15.30%
Newedge Trend	0.08%	3.48%	10.91%	11.69%
Newedge Short-Term	-0.14%	0.19%	7.50%	10.28%
HFR Global Hedge Fund	-0.14%	0.91%	-0.15%	0.83%
HFR Macro/CTA	-0.22%	2.12%	6.37%	4.50%
HFR Macro: Sytematic Diversified CTA	-0.40%	1.58%	4.90%	2.20%