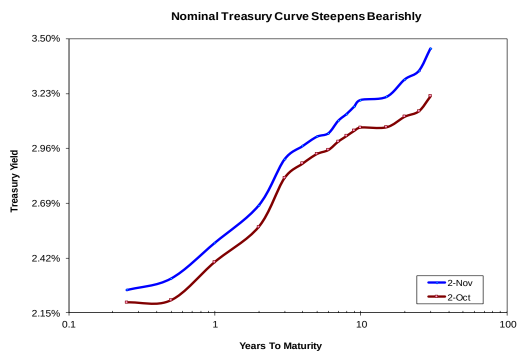
The Macro Environment For Financial Markets

Can risky assets withstand the onslaught of higher short-term rates, a stronger USD, the shrinkage of the Federal Reserve's balance sheet, never-ending noise on trade and the possibility of a fractured federal government? The answer in October was, "Not very well." This week's employment data suggest Main Street is doing much better than Wall Street and likely will for maybe as long as two years. The causal chain now is:

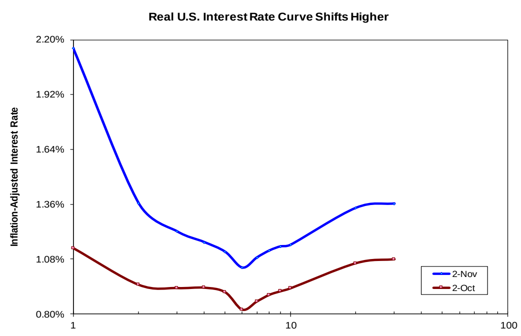
1. The market is pricing in December 2018 and March 2019 rate hikes;
2. Inflationary expectations remain under downward pressure;
3. The yield curve is entering a steepening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads remain inverted; and
6. CDS costs are declining.

Key Market Indications

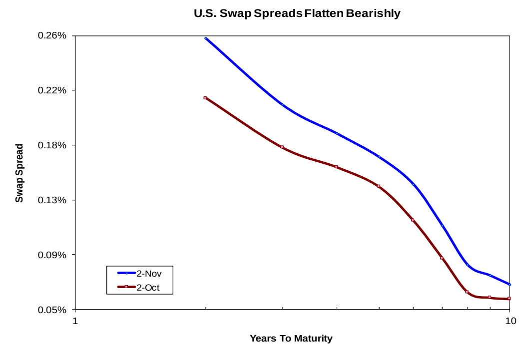
Treasuries did not receive much in the way of a haven bid during the equity selloff, and once the strong employment report hit, yields jumped. This will be a slow-motion bear market, but it will be an enduring one; secular trends in the bond market are generational.



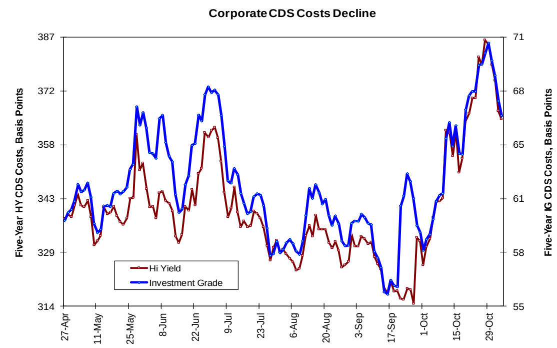
The pseudo-real yield curve shifted higher. The rise at the long yield of this yield curve is sufficient to threaten returns for risky assets. As gold has been trading as a haven asset recently, the rise at the short end of the curve is not a negative for precious metals at present. It will be.



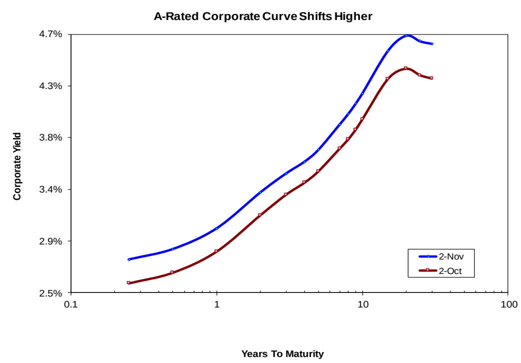
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to flatten bearishly. Markets remain more concerned about rising short-term rates than long-term ones.



CDS costs fell as equities rose. The action of recent weeks flies in the face of those who long have insisted credit markets lead equity markets. Corporations' ability to repay debt remains high even as the embedded call options in equities are repriced lower.



The A-rated corporate yield curve steepened bearishly as short-term corporate rates rose more rapidly than did long-term rates. This remains an asset class with very limited upside and the potential for negative returns if credit spreads expand.



Market Structure

Grains, Softs and Livestock joined Precious Metals in structural uptrends. The EAFE remains in a structural downtrend, while the EM index is poised to move higher.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 5 - 9
BBerg	29	Trending	-0.273	8.3%	-0.20%
BBerg Grain	29	Trending	0.041	13.5%	0.03%
BBerg Ind. Metl	29	Trending	-0.074	18.2%	-0.04%
BBerg Pre. Metl	29	Trending	0.152	9.7%	0.27%
BBerg Softs	29	Trending	0.192	22.6%	0.10%
BBerg Nat. Gas	29	Trending	-0.119	20.7%	-0.57%
BBerg Petroleum	27	Trending	-0.462	21.0%	-0.81%
BBerg Livestock	22	Trending	0.080	10.0%	0.25%
Dollar Index	29	Trending	0.158	5.4%	0.09%
S&P 500 Index	4	Sideways	0.018	17.3%	
EAFE Index	29	Trending	-0.197	11.3%	-0.48%
EM Index	29	Trending	0.053	14.4%	
Ten-year UST (price)	18	Transitional	-0.108	4.4%	

Performance Measures

The Petroleum markets tumbled yet again, this time on the notion the Iran sanctions will not be as restrictive as "feared." Grains caught on bid on the wishful thinking the U.S. and China might come to some sort of trade agreement. Yes; eventually a piece of paper will be signed. What it will contain, when this will occur and how well China will adhere to anything remains to be seen.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.26%	-3.30%	-5.82%	-1.70%
Grains Sub-Index	1.71%	-0.23%	-13.61%	-6.75%
Corn	1.00%	0.99%	-13.14%	-5.70%
Soybeans	3.54%	0.74%	-16.65%	-14.60%
Wheat	0.74%	-2.18%	-8.84%	2.73%
Energy Sub-Index	-4.29%	-9.57%	1.86%	13.38%
Petroleum Sub-Index	-6.20%	-13.67%	-3.44%	16.81%
WTI	-6.56%	-14.42%	-5.78%	19.81%
Brent	-6.18%	-12.93%	0.57%	25.39%
ULSD	-5.80%	-9.39%	1.09%	17.57%
Gasoline	-5.95%	-18.01%	-11.35%	-4.71%
Natural Gas	0.65%	2.20%	17.77%	0.63%
Precious Metals Sub-Index	-0.03%	2.13%	-7.47%	-5.84%
Gold	-0.16%	2.48%	-6.51%	-3.52%
Silver	0.43%	0.91%	-10.74%	-13.04%
Industrial Metals Sub-Index	0.10%	-2.72%	-12.56%	-10.44%
Copper	2.45%	1.77%	-9.32%	-11.26%
Aluminum	-1.22%	-7.40%	-15.32%	-7.42%
Nickel	0.26%	-5.42%	-15.01%	-6.50%
Zinc	-3.72%	-2.51%	-12.94%	-16.85%
Softs Sub-Index	-1.09%	9.87%	-0.90%	-6.55%
Coffee	0.38%	10.38%	-5.63%	-11.43%
Sugar	-2.85%	6.60%	7.81%	-13.10%
Cotton	0.38%	3.72%	-6.51%	17.73%
Livestock Sub-Index	-0.66%	-0.20%	6.81%	-8.98%
Cattle	-1.07%	-0.74%	7.06%	-9.33%
Hogs	0.39%	1.18%	6.74%	-9.03%

AMLO demonstrated there is no point in being a leftist if you cannot act like one; the MXN declined sharply in response. The GBP was bid on the wishful thinking Brexit will have some sort of acceptable outcome for the U.K. Otherwise, this was one more week in the USD's year-to-date bull market.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.13%	-1.39%	-4.71%	-2.32%
Chinese yuan	0.77%	-0.32%	-7.67%	-4.08%
Japanese yen	-1.14%	0.40%	-2.97%	0.78%
British pound	1.11%	-0.07%	-4.46%	-0.68%
Swiss franc	-0.65%	-1.95%	-0.47%	-0.41%
Canadian dollar	-0.03%	-2.19%	-1.72%	-2.30%
Australian dollar	1.45%	0.07%	-4.00%	-6.74%
Swedish krona	0.79%	-0.58%	-1.60%	-7.36%
Norwegian krone	-0.18%	-2.31%	-2.94%	-2.77%
New Zealand dollar	2.16%	1.03%	-4.77%	-3.65%
Indian rupee	1.42%	0.66%	-7.97%	-10.81%
Brazilian real	0.09%	8.58%	-5.28%	-11.77%
Mexican peso	-3.26%	-6.10%	-4.65%	-5.16%
Chilean peso	0.24%	-4.01%	-9.75%	-8.18%
Colombian peso	-0.11%	-5.24%	-11.00%	-4.85%
Bloomberg-JP Morgan Asian dollar index (spot)	0.77%	-0.13%	-5.34%	-3.35%

Even though the markets rallied this week, it had a short-covering feel to it. The simple fact is no one has lived through an unwinding of global QE during a trade war and at the end of a nine-year bull run. The shock of October will last for months.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.79%	-5.24%	-1.37%	2.01%
North America	2.50%	-6.82%	3.70%	6.86%
Latin America	1.41%	3.68%	-4.57%	0.56%
Emerging Market Free	6.09%	-3.45%	-11.77%	-9.11%
EAFE	3.36%	-4.60%	-8.15%	-5.55%
Pacific	3.32%	-5.38%	-7.49%	-3.82%
Eurozone	3.22%	-4.78%	-12.09%	-10.32%

While global hedge funds gained during the equity rally, CTAs and macro funds lost money yet again. The drumbeat of hedge fund closings is not a sign of industry health, is it?

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	-1.38%	-7.04%	-5.60%	-8.07%
SocGen Trend	-0.47%	-4.40%	-4.05%	-6.69%
SocGen Short-Term	-0.86%	-1.51%	-1.56%	-2.71%
HFR Global Hedge Fund	0.83%	-2.83%	-3.02%	-3.36%
HFR Macro/CTA	-1.36%	-4.82%	-3.53%	-5.12%
HFR Macro: Sytematic Diversified CTA	-1.65%	-6.50%	-4.86%	-5.70%