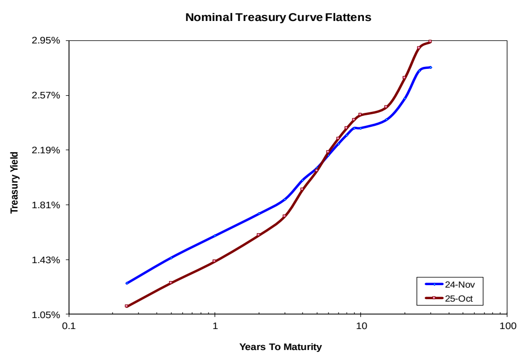
The Macro Environment For Financial Markets

My little contribution to behavioral finance is most traders and investors are more comfortable with losses than with gains; they know they are playing a dangerous game and sort of expect to lose but do not feel as if they are entitled to win. This is applying to conventional markets at present; we are collectively uneasy with the non-stop gains and feel like something bad must happen. Eventually something bad will happen, but not within the time parameters we face on a daily basis. Enjoy the good times. The causal chain now is:

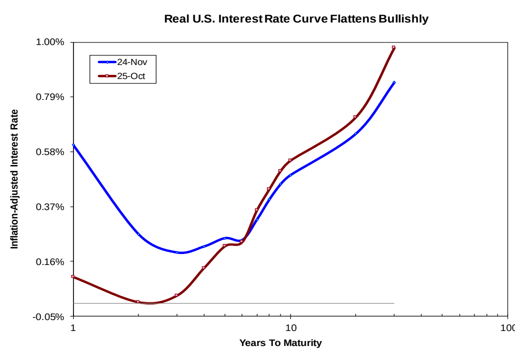
1. The market has priced in a December rate hike but is divided over the March 2018 meeting;
2. Inflationary expectations are confined to a narrow range;
3. The secular flattening trend in the U.S. yield curve continues;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are inverting bullishly; and
6. CDS costs have resumed their decline, especially for the investment-grade index.

Key Market Indications

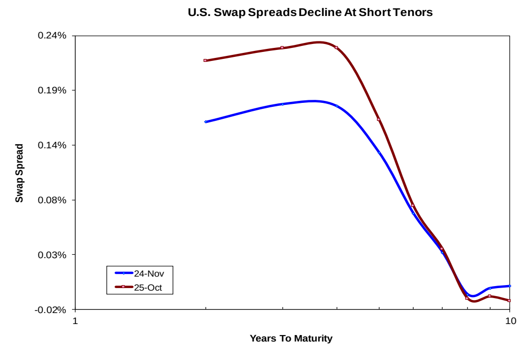
To repeat verbatim from last week: The ten-year UST is continuing to hold support. Lenders realize existing holders are not going to liquidate their portfolios. Such is not the case at the short end of the yield curve, however. Short-term rates continue to move to levels not seen since 2008. As a result, the secular flattening trend in the yield curve remains intact.



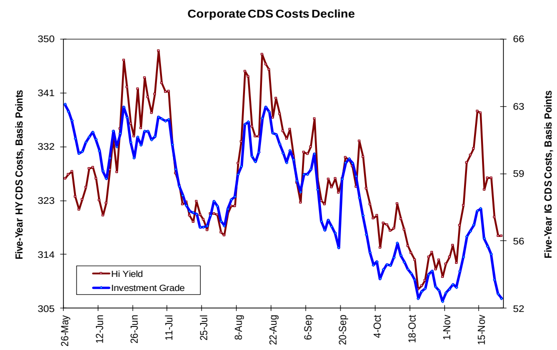
The pseudo-real yield curve shifted higher at the short end of the yield curve, but is starting to decline at the long end of the yield curve. The combination favors risky financial assets over precious metals.



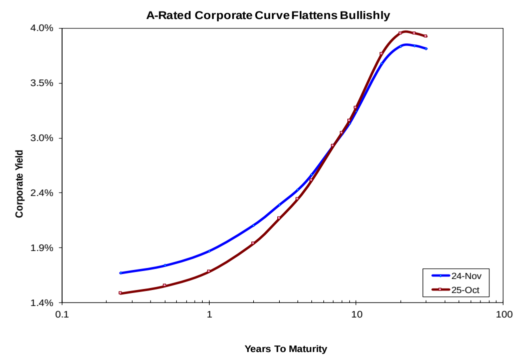
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined shorter tenors and barely rose at the long end of the yield curve. This remains bullish for corporate credit and for equities.



CDS costs declined, but are differentiating along a credit dimension with investment-grade costs nearing their lows for the year while high-yield costs have yet to retrace their recent selloff. Unless equities decline and produce correlation trades, there is no reason for CDS costs to rise.



The A-rated corporate yield flattened bullishly. This remains a bull market with limited upside potential.



Market Structure

Softs and both Precious and Industrial Metals are in structural uptrends while Grains and Natural Gas are in downtrends. Within the financials, the dollar index entered a downtrend while the EM index entered an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 27 - Dec. 1
BBerg	11	Transitional	0.103	6.0%	
BBerg Grain	29	Trending	-0.089	9.4%	-0.07%
BBerg Ind. Metl	20	Trending	0.074	14.2%	0.52%
BBerg Pre. Metl	24	Trending	0.063	8.6%	0.07%
BBerg Softs	24	Trending	0.163	14.1%	0.29%
BBerg Nat. Gas	28	Trending	-0.137	17.8%	-0.18%
BBerg Petroleum	9	Sideways	0.124	14.3%	
BBerg Livestock	29	Trending	0.005	9.9%	
Dollar Index	29	Trending	-0.280	5.1%	-0.11%
S&P 500 Index	11	Transitional	0.106	6.2%	
EAFE Index	15	Transitional	0.179	6.9%	
EM Index	26	Trending	0.311	7.7%	0.12%
Ten-year UST (price)	19	Transitional	0.026	3.3%	

Performance Measures

There is nothing like a 60° in Chicago over the Thanksgiving weekend to help push Natural Gas subindex 7.5% lower on the week. Similarly, take a few supportive economic reports out of China and you push the Industrial Metals subindex higher by 3.4%. The big factor for all physical commodities remains the developing bull market in petroleum; these products have the highest weights in the broad indices.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.59%	1.42%	4.12%	3.21%
Grains Sub-Index	1.26%	-1.07%	-7.48%	-12.15%
Corn	1.75%	-1.84%	-13.26%	-12.64%
Soybeans	2.21%	0.78%	5.92%	-8.90%
Wheat	-0.71%	-2.13%	-12.48%	-13.45%
Energy Sub-Index	1.45%	3.51%	7.28%	7.87%
Petroleum Sub-Index	4.33%	6.56%	19.80%	22.37%
WTI	6.53%	9.09%	15.74%	17.23%
Brent	3.38%	5.79%	20.38%	25.02%
ULSD	2.66%	4.92%	23.55%	26.21%
Gasoline	4.07%	5.31%	22.34%	23.01%
Natural Gas	-7.49%	-5.92%	-22.91%	-25.95%
Precious Metals Sub-Index	0.45%	1.38%	0.29%	6.65%
Gold	0.75%	1.32%	1.22%	8.43%
Silver	-0.41%	1.56%	-2.28%	1.78%
Industrial Metals Sub-Index	3.39%	1.30%	19.75%	14.83%
Copper	3.94%	2.26%	22.81%	16.61%
Aluminum	1.45%	-1.83%	8.01%	18.95%
Nickel	6.04%	3.80%	31.64%	2.58%
Zinc	2.89%	1.93%	23.71%	15.12%
Softs Sub-Index	0.72%	4.45%	-5.59%	#VALUE!
Coffee	-1.97%	-1.78%	-8.75%	-25.20%
Sugar	1.27%	5.70%	-1.92%	-25.28%
Cotton	4.00%	5.26%	-2.58%	2.01%
Livestock Sub-Index	1.16%	-2.09%	-4.18%	15.93%
Cattle	-0.41%	-1.54%	-4.49%	15.60%
Hogs	4.27%	-3.21%	-3.80%	15.76%

The USD lost everywhere except against the CLP, where an election has thrown Chilean markets into a bit of turmoil. Markets have concluded U.S. fiscal policy will not be overtly stimulative and monetary policy will not be overtly contractionary. However, these outlooks have shifted often over the past year.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.21%	1.46%	6.36%	13.07%
Chinese yuan	0.38%	0.52%	4.37%	4.85%
Japanese yen	0.51%	2.13%	-0.04%	1.61%
British pound	0.92%	1.55%	2.81%	7.12%
Swiss franc	0.98%	1.18%	-0.66%	3.76%
Canadian dollar	0.40%	-0.29%	5.47%	6.14%
Australian dollar	0.70%	-2.04%	1.52%	2.82%
Swedish krona	1.81%	-0.69%	4.72%	11.73%
Norwegian krone	1.35%	-1.53%	2.47%	5.76%
New Zealand dollar	0.98%	-0.48%	-2.41%	-1.80%
Indian rupee	0.48%	0.56%	0.05%	6.25%
Brazilian real	0.84%	0.47%	1.40%	5.09%
Mexican peso	1.94%	3.64%	-0.62%	11.78%
Chilean peso	-1.16%	-0.31%	6.02%	7.10%
Colombian peso	0.63%	-0.24%	-2.51%	6.42%
Bloomberg-JP Morgan Asian dollar index (spot)	0.55%	1.28%	2.70%	5.21%

Equity markets are not only punishing bears, they seem to be punishing anyone who has heard a discouraging word. The skies have not been cloudy all year, and that is set to continue.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.32%	1.42%	8.84%	22.64%
North America	0.99%	1.58%	9.53%	20.28%
Latin America	1.56%	-2.03%	11.19%	25.89%
Emerging Market Free	1.57%	3.73%	16.71%	39.02%
EAFE	1.88%	1.61%	8.41%	28.39%
Pacific	1.57%	2.62%	12.56%	22.96%
Eurozone	2.26%	1.44%	8.23%	37.23%

Both CTAs and hedge funds made money, as has been typical whenever equities strengthen. It would be nice if they could beat long-only index funds, which are available at a fraction of the trading cost.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	2.17%	3.23%	5.37%	1.56%
Newedge Trend	1.73%	2.79%	3.49%	2.40%
Newedge Short-Term	1.32%	1.13%	0.49%	-4.73%
HFR Global Hedge Fund	0.50%	0.18%	2.90%	6.40%
HFR Macro/CTA	0.93%	1.03%	3.52%	3.39%
HFR Macro: Sytematic Diversified CTA	1.13%	2.73%	6.01%	4.16%

Futures trading involves the substantial risk of loss and is not suitable for all investors. Each investor must consider whether this is a suitable investment since you may lose all of or more than your initial investment. Past performance is not indicative of future results.