

---

## The Macro Environment For Financial Markets

---

To twist Benjamin Franklin's bon mot on hanging together to avoid hanging separately, the American electorate has a collective genius generally unobservable in its individual members. It would have been easy to have pinned economic angst on the rising concentration of wealth by the beneficiaries of ZIRP and QE and have rewarded redistributionist candidates, but the electorate realized greater rewards would come from curbing those statist excesses. In the meantime, those policies continue to reward financial risk-takers and will continue to do so for a very long time as central bankers realize they cannot remove the proverbial punchbowl without dynamiting the one singular success of the post-crisis era. It took more than a decade of rising inflation in the 1970s to give Paul Volcker the political cover needed to break inflation; Janet Yellen and her counterparts have absolutely no cover whatsoever for ending financial stimulus. In the U.S., the electorate has concurred. In Brazil, the electorate stayed their populist course and the Bovespa index has declined 13.9% in three weeks. Which is preferable?

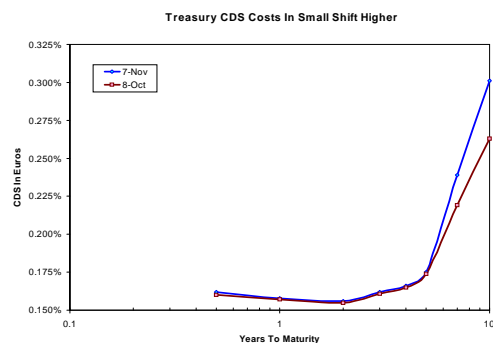
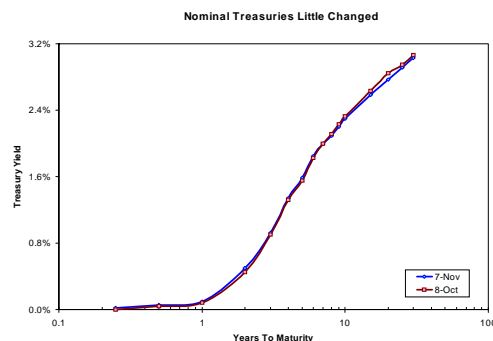
The causal chain is now:

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 will remain elevated at the short end of the yield curve and will struggle to move lower at the long end of the yield curve until LT nominal rates resume their decline;
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 fight through demonstrated liquidity risks and continue their decline.

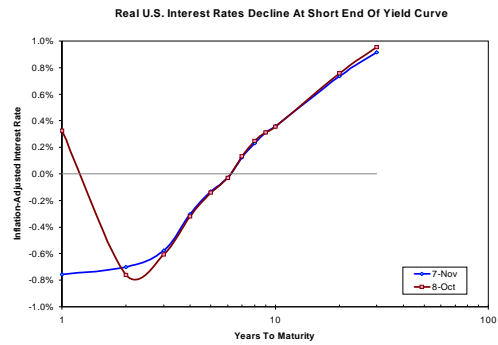
### Key Market Indications

The small rally in the UST market at the end of the week signals the bull market remains intact. The rally at the two-year horizon was stronger, and this improbably led to a small steepening in the yield curve. Carry trades into the USD will support Treasuries, especially if the ECB actually acts and forces Eurozone sovereign debt yields lower.

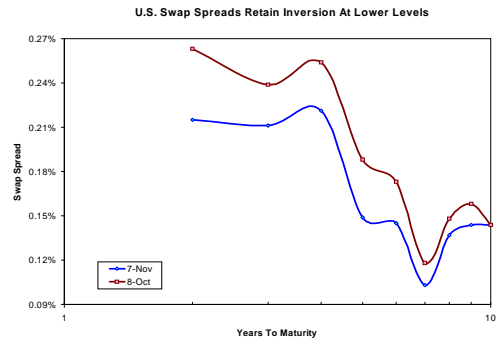
Euro-denominated CDS costs on Treasuries are shifting about within a small range. The U.S. election had almost no effect on this market as the Republican election gains were by centrist candidates who do not wish to see a repeat of the government closure crises of recent years.



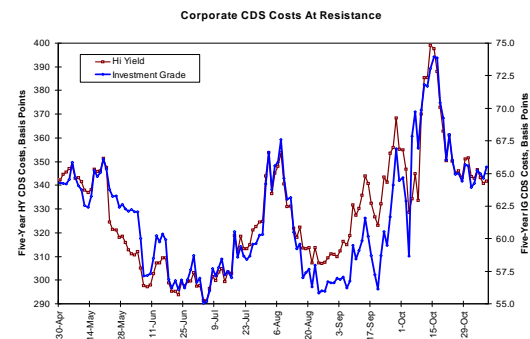
The sharp downward shift in implied short-term real rates is an artifact of a rollover in the TIPS used for its calculation; one-year breakevens really did not move from -0.79% on Nov. 3<sup>rd</sup> to 0.90% on Nov. 4<sup>th</sup>. Of greater importance is the stabilization of longer-term implied real rates: Their inability to decline further constitutes a small impediment to gains in risky financial assets.



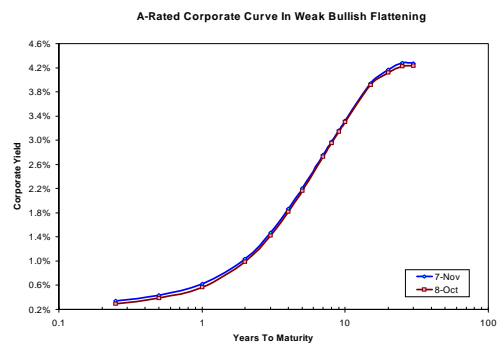
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain inverted. Floating-rate borrowers are less anxious to fix short-dated and mid-curve payments but are willing to remain floating at the long end of the yield curve. This inversion at historically low levels will maintain both the carry trade inflow into U.S. assets and lower LT corporate bond yields.



To repeat verbatim: Both IG and HY CDS levels are at resistance levels and should continue to decline in the face of stable U.S. economic news and carry trade inflows into USD-denominated instruments. The recent demonstration of illiquidity in the corporate bond market is likely to deter a revisit of the July lows, but never underestimate the willingness of a yield hog to take undue risk for little return.



The A-rated yield curve remains in its weak bullish flattening, but it continues to lag the UST curve. As before, the downward trend and inverted term structure of swap spreads and the narrowing of credit spreads will keep performance on par with Treasuries and, critically, will not pose a threat to risky assets.



## Market Structure

Natural Gas reversed into a strong structural uptrend. Only Precious Metals and Softs remain in structural downtrends amongst the physical markets. The financial indices are surprisingly non-trending except for the dollar index. The S&P 500's structural uptrend is a slow one that reflects investor hesitation in pushing it too far too fast.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Oct. 10 - 14
B Berg	12	Transitional	0.015	9.0%	
B Berg Grain	6	Sideways	-0.040	19.0%	
B Berg Ind. Mett	14	Transitional	0.018	14.4%	
B Berg Pre. Mett	24	Trending	-0.288	15.3%	-0.15%
B Berg Softs	29	Trending	-0.313	18.9%	-0.58%
B Berg Nat. Gas	29	Trending	0.337	27.3%	2.74%
B Berg Petroleum	12	Transitional	-0.060	20.2%	
B Berg Livestock	19	Transitional	0.122	11.4%	
Dollar Index	23	Trending	0.226	8.2%	0.27%
S&P 500 Index	29	Trending	0.282	13.7%	0.03%
EAFE Index	4	Sideways	-0.039	9.1%	
EM Index	15	Transitional	-0.068	9.4%	
Ten-year UST (price)	16	Transitional	-0.015	6.1%	

## Performance Measures

Natural Gas approached the heating season with a flat forward curve and low inventories that made it vulnerable to even small changes in demand. A one-week advance of 13.84% is a testament to inelasticity. With the exception of Livestock, the other markets have had negative returns, but no one should expect a hard downturn in the Grains prior to the Southern Hemisphere growing season or a continuation of recent sharp downturns in both Precious Metals and Petroleum: When supply closures begin, downtrends end.

	Five-Days	One Month	Six Months	One Year
<b>Bloomberg Index</b>	-0.05%	-0.45%	-13.31%	-4.49%
<b>Grains Sub-Index</b>	-2.37%	8.16%	-26.68%	-16.38%
Corn	-2.45%	10.03%	-29.26%	-20.06%
Soybeans	-1.19%	11.42%	-18.13%	-2.82%
Wheat	-3.38%	3.21%	-32.20%	-26.67%
<b>Energy Sub-Index</b>	3.10%	-0.65%	-14.55%	-2.00%
Petroleum Sub-Index	-1.97%	-6.35%	-18.50%	-13.96%
WTI	-2.26%	-7.21%	-17.33%	-11.06%
ULSD	-0.72%	-2.90%	-15.24%	-12.72%
Gasoline	-1.19%	-5.21%	-18.64%	-12.42%
Natural Gas	13.84%	11.78%	-6.66%	25.52%
<b>Precious Metals Sub-Index</b>	-0.69%	-5.43%	-11.50%	-13.97%
Gold	-0.15%	-4.25%	-9.25%	-9.16%
Silver	-2.43%	-9.18%	-18.25%	-27.12%
<b>Industrial Metals Sub-Index</b>	-0.68%	0.71%	0.39%	2.39%
Copper	-0.28%	0.12%	-1.80%	-6.75%
Aluminum	0.59%	6.63%	14.54%	6.19%
Nickel	-2.26%	-5.88%	-23.19%	9.23%
Zinc	-2.92%	-3.13%	9.09%	15.48%
<b>Softs Sub-Index</b>	-2.32%	-10.58%	-20.02%	-3.50%
Coffee	-2.98%	-17.24%	-4.52%	59.65%
Sugar	-2.18%	-5.20%	-24.78%	-32.22%
Cotton	-0.76%	-0.22%	-23.72%	-11.22%
<b>Livestock Sub-Index</b>	0.58%	-1.45%	2.52%	13.99%
Cattle	0.45%	0.91%	16.57%	26.15%
Hogs	0.85%	-5.96%	-16.32%	-3.38%

As noted last week, the only impediment to a USD rally would be another FOMC backtrack on raising rates in 2015. Everything else is pointing higher for the greenback, including another yet-to-be consummated promise of QE by the ECB, the continued aftershocks of Japan's monetary expansion and general avoidance of Latin American markets. Markets this out-of-balance often produce strong reversals, but not just yet.

	Five-Days	One Month	Six Months	One Year
<b>Currency Returns</b>				
Euro	-0.56%	-1.69%	-10.46%	-7.18%
Chinese yuan	-0.15%	0.29%	1.85%	-0.50%
Japanese yen	-1.99%	-5.73%	-11.08%	-14.41%
British pound	-0.79%	-1.41%	-6.39%	-1.42%
Swiss franc	-0.37%	-0.97%	-9.30%	-5.22%
Canadian dollar	-0.56%	-1.36%	-3.79%	-7.65%
Australian dollar	-1.83%	-2.04%	-7.40%	-8.65%
Swedish krona	-0.16%	-2.93%	-12.22%	-11.78%
Norwegian krone	-1.00%	-5.28%	-13.34%	-11.34%
New Zealand dollar	-0.45%	-1.01%	-10.47%	-6.84%
Indian rupee	-0.44%	-0.38%	-2.44%	1.26%
Brazilian real	-3.16%	-6.34%	-13.37%	-9.87%
Mexican peso	-0.44%	-0.48%	-4.26%	-2.34%
Chilean peso	-1.67%	1.35%	-3.83%	-12.00%
Colombian peso	-1.97%	-3.39%	-8.98%	-8.12%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.28%	-0.44%	-1.02%	-1.38%

Can the world's equity markets be the U.S. and everything else? The answer can be deceptively simple; between 2001 and 2010 the now-lagging emerging markets outperformed the U.S. handily. Investors in U.S. equities might find their good fortune difficult to accept.

	Five-Days	One Month	Six Months	One Year
<b>Equity Total Returns</b>				
MSCI World Free	0.02%	2.91%	2.61%	10.17%
North America	0.66%	4.72%	8.35%	17.52%
Latin America	-4.08%	-7.91%	-8.70%	-5.41%
Emerging Market Free	-2.79%	-2.20%	0.10%	0.49%
EAFE	-1.01%	0.12%	-5.52%	0.01%
Pacific	-0.50%	0.96%	3.64%	1.11%
Eurozone	-2.24%	-1.51%	-11.75%	-3.16%

CTA performance reflected strong trends in the dollar and in the energy markets. The consolidations in both long-term debt and equity markets dampened hedge fund performance, but it managed to remain positive.

	Five-Days	One Month	Six Months	One Year
<b>CTA/Hedge Fund Returns</b>				
Newedge CTA	3.86%	2.58%	16.63%	14.89%
Newedge Trend	2.80%	1.97%	10.78%	11.25%
Newedge Short-Term	1.22%	2.06%	7.73%	10.38%
HFR Global Hedge Fund	0.20%	-1.12%	-0.59%	1.02%
HFR Macro/CTA	1.11%	1.07%	5.76%	4.72%
HFR Macro:	1.14%	0.77%	4.16%	2.77%
Systematic Diversified CTA				