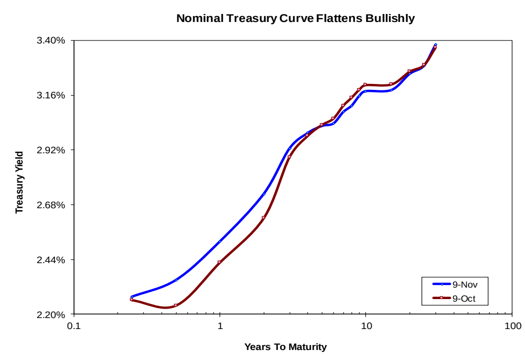
The Macro Environment For Financial Markets

Logic would dictate the Federal Reserve should pause in its self-fulfilling prophecy of higher short-term rates. The mid-term elections guarantee no further fiscal stimulus will be forthcoming, the world's commercial banks are facing higher dollar funding costs, commodity prices are declining and both housing and autos are feeling the effects of higher short-term rates already. But, no; they will continue tightening until something breaks. The causal chain now is:

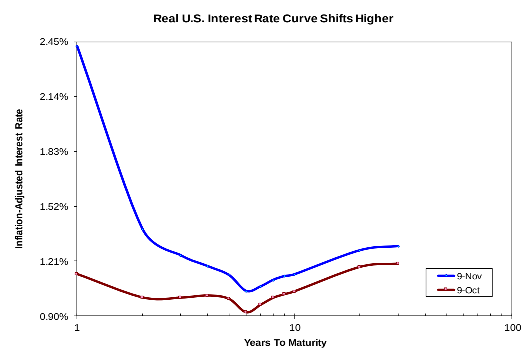
1. The market is pricing in December 2018 and March 2019 rate hikes;
2. Inflationary expectations remain under downward pressure;
3. The yield curve is starting to flatten once again;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads remain inverted; and
6. CDS costs are rising despite the rebound in equities.

Key Market Indications

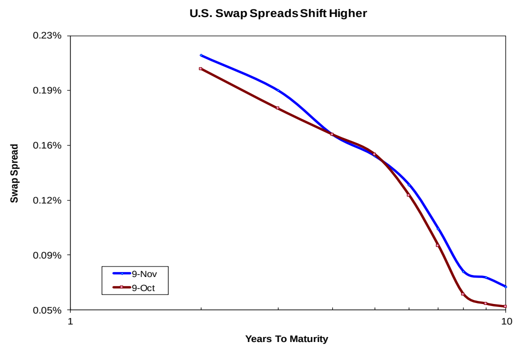
The long end of the UST market remains exceptionally resilient in the face of numerous reasons to sell off. This is prima facie evidence of increased economic headwind from a stronger USD and from higher short-term rates.



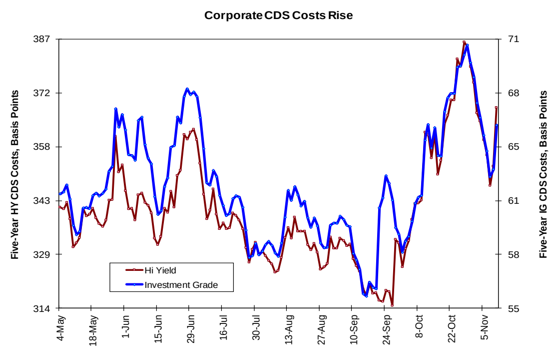
The pseudo-real yield curve shifted higher, especially at the short end. As noted last week, this proved to be a negative for precious metals. The continued rise at the long end of the curve remains a negative for risky financial assets.



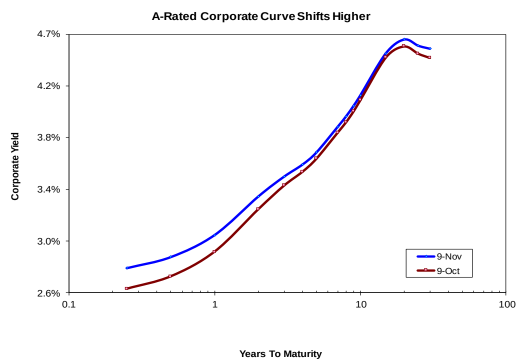
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted higher. In a divergence from recent behavior, spreads rose at the long end of the curve as well as at the short end.



CDS costs rose as equities rose, a most unusual divergence over the past year. The declines in the energy and basic materials sectors are starting to raise concerns about the ability of these firms to service their debt.



The A-rated corporate yield curve flattened 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

None of the physical markets are in structural uptrends. The dollar index remains in a structural uptrend while ten-year UST moved into a downtrend. All of the stock indices are in unstable transitional structures.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 12 - 16
BBerg	29	Trending	-0.442	8.4%	-0.20%
BBerg Grain	29	Trending	-0.047	13.5%	-0.10%
BBerg Ind. Metl	29	Trending	-0.212	17.4%	-0.04%
BBerg Pre. Metl	29	Trending	-0.138	9.5%	
BBerg Softs	7	Sideways	-0.104	18.3%	
BBerg Nat. Gas	17	Transitional	0.184	22.9%	
BBerg Petroleum	27	Trending	-0.462	22.3%	-0.81%
BBerg Livestock	24	Trending	-0.267	10.8%	-0.06%
Dollar Index	29	Trending	0.169	5.5%	0.09%
S&P 500 Index	12	Transitional	0.091	20.2%	
EAFE Index	11	Transitional	0.084	12.0%	
EM Index	13	Transitional	0.050	15.8%	
Ten-year UST (price)	20	Trending	-0.029	4.1%	-0.09%

Performance Measures

The Petroleum markets tumbled yet again, but Natural Gas moved sharply higher on an early cold snap. All other complex declined on the week on the residual effects of over-investment during the previous decade and the prospects of slowing Chinese demand. While the linkages between physical commodities and inflation are far weaker than realized commonly, these declines do make you question whether we are in a rising inflation environment.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.14%	-3.70%	-6.97%	-3.28%
Grains Sub-Index	-0.76%	-1.37%	-11.06%	-7.32%
Corn	-0.36%	-0.90%	-11.36%	-4.79%
Soybeans	-0.07%	0.75%	-13.96%	-14.70%
Wheat	-1.42%	-2.91%	-5.21%	-0.17%
Energy Sub-Index	1.13%	-5.92%	0.20%	10.88%
Petroleum Sub-Index	-3.58%	-12.92%	-9.36%	10.04%
WTI	-4.57%	-14.93%	-11.51%	12.06%
Brent	-3.53%	-12.14%	-6.03%	18.00%
ULSD	-0.13%	-6.76%	-2.13%	14.44%
Gasoline	-5.39%	-16.82%	-18.84%	-11.88%
Natural Gas	12.47%	12.75%	28.47%	5.99%
Precious Metals Sub-Index	-2.44%	-1.42%	-10.36%	-8.48%
Gold	-1.96%	-0.92%	-8.79%	-5.81%
Silver	-4.13%	-3.21%	-15.65%	-16.83%
Industrial Metals Sub-Index	-2.84%	-5.00%	-14.70%	-10.90%
Copper	-4.31%	-3.96%	-13.99%	-13.96%
Aluminum	-1.02%	-4.17%	-13.25%	-4.61%
Nickel	-3.87%	-9.36%	-18.48%	-5.51%
Zinc	-0.89%	-4.06%	-14.53%	-17.62%
Softs Sub-Index	-4.26%	-0.10%	-2.49%	-11.92%
Coffee	-5.11%	-2.13%	-8.08%	-18.29%
Sugar	-5.24%	-2.43%	4.77%	-20.86%
Cotton	-0.73%	-0.07%	-4.73%	16.49%
Livestock Sub-Index	-2.92%	-0.72%	2.18%	-7.61%
Cattle	-2.14%	-1.25%	4.04%	-6.56%
Hogs	-4.91%	0.63%	-1.34%	-10.81%

While the GBP, AUD, NZD and both the CLP and COP gained, the USD continued its rally on the reasonable expectation U.S. short-term rates will continue moving higher relative to the rest of the world. The USD has gained on the entire matrix over the past six months.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.46%	-1.35%	-4.35%	-2.63%
Chinese yuan	-0.95%	-0.49%	-8.54%	-4.55%
Japanese yen	-0.55%	-0.76%	-3.59%	-0.32%
British pound	0.02%	-1.30%	-4.24%	-1.32%
Swiss franc	-0.21%	-1.33%	-0.06%	-1.15%
Canadian dollar	-0.77%	-2.01%	-2.71%	-4.00%
Australian dollar	0.46%	1.73%	-3.18%	-5.91%
Swedish krona	-0.21%	0.28%	-4.14%	-7.73%
Norwegian krone	-0.80%	-1.98%	-4.24%	-3.59%
New Zealand dollar	1.14%	4.06%	-3.58%	-3.04%
Indian rupee	-0.08%	2.61%	-7.20%	-10.42%
Brazilian real	-0.75%	-0.42%	-3.68%	-12.85%
Mexican peso	-0.61%	-5.46%	-2.82%	-5.42%
Chilean peso	0.19%	-0.36%	-7.51%	-7.88%
Colombian peso	0.12%	-3.76%	-9.93%	-5.29%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.42%	0.10%	-5.39%	-3.49%

The EM index was pulled down by Latin America as both Mexico and Brazil were pulled lower by their respective new presidents. Markets elsewhere gained, but this has a very fragile feel to it.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.36%	0.10%	-2.14%	3.60%
North America	1.96%	-3.51%	3.25%	8.61%
Latin America	-3.60%	-4.57%	-5.66%	-2.70%
Emerging Market Free	-2.04%	-1.71%	-13.03%	-11.48%
EAFE	0.24%	-0.47%	-9.42%	-4.94%
Pacific	0.13%	-1.67%	-8.56%	-4.97%
Eurozone	0.07%	-0.59%	-12.96%	-8.59%

While trend-following CTAs lost on the week, the main SocGen index gained as did hedge funds. There is a high probability of this being too little, too late for many hedge funds to avoid large-scale redemptions at the end of the year.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	0.19%	-7.24%	-6.66%	-9.42%
SocGen Trend	-0.24%	-5.20%	-5.36%	-8.11%
SocGen Short-Term	-0.63%	-2.13%	-1.93%	-3.12%
HFR Global Hedge Fund	0.07%	-1.89%	-3.17%	-3.12%
HFR Macro/CTA	0.10%	-4.22%	-4.10%	-5.25%
HFR Macro: Sytematic Diversified CTA	0.28%	-5.37%	-5.12%	-5.96%