MARKETFIELD
ASSET MANAGEMENT

The Weekly Speculator

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Another week, another record high, with the SPX reaching 2511.75 on Wednesday afternoon before settling back to close at 2507.04, a whisker below its September 20th record close at 2508.24. The RTY index was somewhat more decisive, bursting out of its long trading range to surge 1.92% on Wednesday and close at 1484.8 and this index has risen 9.50% since August 18th, greatly closing the gap with the large cap benchmark. By contrast neither the NDX index or MXEF index were able to record new highs this week.

The former suffered from another sudden liquidation of mega-cap holdings (the selling was somewhat broader than the FANGs), which spilled over into the emerging market technology sector, while the strong recovery of the USD kept the index under pressure on Wednesday. Even so the emerging market complex has enjoyed an excellent 3 quarters and this week's decline in the MXEF has only taken it back to its rising trend around the 50 day ma. Although a rising USD is always a headwind for the MXEF, we would expect to see far less damage from the USD's advance than we saw in the post-election period (and a much smaller gain for the USD itself), and would expect any further drawdown to attract investment capital.

As far as the overall environment is concerned, yet again we have seen rotational forces at play, but very little in the way of outright liquidation. A simplification of the current environment would be to describe it as combining a slow-moving but dominant passive bid (from both investors and central banks) that concentrates on index product and fast moving active flows that constantly react to perceived drivers of performance across various sectors and geographic regions. Thus we see index level volatility driven down to record lows and a similar phenomenon in fixed income where underlying sovereign yields and credit spreads have been unusually docile, while sector by sector volatility is much closer to normal levels.

Over the last couple of weeks the drivers have been geopolitical (North Korea), political (the new tax cut proposal) and monetary. The first of these forces seems to be losing its sway over the market and provided no marked escalation in actual action takes place the influence on future price action looks likely to be minimal even if language on both sides continues to be aggressive. With the tax proposal it is too early to ascribe the likelihood of

success for these measures actually being crafted into legislation that can be successfully voted into effect, but we are not surprised to see money flow rapidly to names that are expected to benefit. However, within the sphere of monetary policy a palpable shift in the environment looks to have taken place following the FOMC statement last week and Chair Yellen's comments in a speech this Tuesday.

It would seem clear that although the FRB will continue to pay lip service to inflation targeting, and will keep a 2% target for the PCE price index as an explicit policy goal, the Committee is increasingly willing to take other factors into account when setting monetary policy. This is very reminiscent of what took place with QE3, which was originally explicitly matched to a 6.5% Unemployment Rate as a goal of the policy. However, the FOMC greatly overestimated how long it would take for Unemployment to fall to this level, and QE3 was allowed to continue for several quarters longer than it took to reach 6.5%. The only difference is that back in 2013/14 this resulted in an extension of stimulus, whereas the effective severing of inflation as a tether for policy allows the FOMC to accelerate the pace of tightening action.

Thus it seems increasingly likely that a December rate hike will take place, unless a surprising degree of deterioration is reported in economic data that cannot be attributed to the recent massive storm damage. More importantly, the way is clear for a series of rate hikes in 2018. The FOMC's median "dot plot" for the Fed Funds at 2.125% by the end of 2018 no longer looks like a stretch.

We have argued before that central banks tend to build momentum behind the direction of monetary policy and the longer they do something the more likely they are to continue doing so. Ironically this is the opposite of what would occur if policies were straightforwardly effective, but as Chair Yellen admitted, economic data is uncertain and the relationship between various factors such as labor and inflation are complex and incompletely understood. Thus there is an understandable tendency for changes in direction to have considerable inertia, they are very hard to start and equally hard to stop. To our eyes a tightening cycle was entered last December (the December 2015 hike proved to be a "false start"), and the Committee is likely to continue to enact steady hikes in the months ahead to a degree not fully anticipated by the market.

Thus far the only clear sign that the market understands that something has changed is the break out of the 2 year yield to a new cycle high at 1.47%, however, even at this level very little in the way of 2018 tightening is priced into market. We remain open minded as to how influential tightening will be on the long end of the curve, but we would expect the yield curve to flatten considerably if the FOMC were to increase its policy rate 3 or 4 times in the next 12 months.

Overall this is consistent with our view that we have entered the final portion of this long bull market. We would however, avoid the temptation to jump to obvious conclusions as to how markets will behave if policy is indeed tightened. Although the USD would appear to be an obvious beneficiary (and certainly rallied in recent sessions) the degree to which other central banks start to tighten will be important, and there is always more to FX flows than simple interest rate differentials. The same could be said of commodities which can withstand both higher rates and a stronger USD provided the balance of supply and demand is favorable.

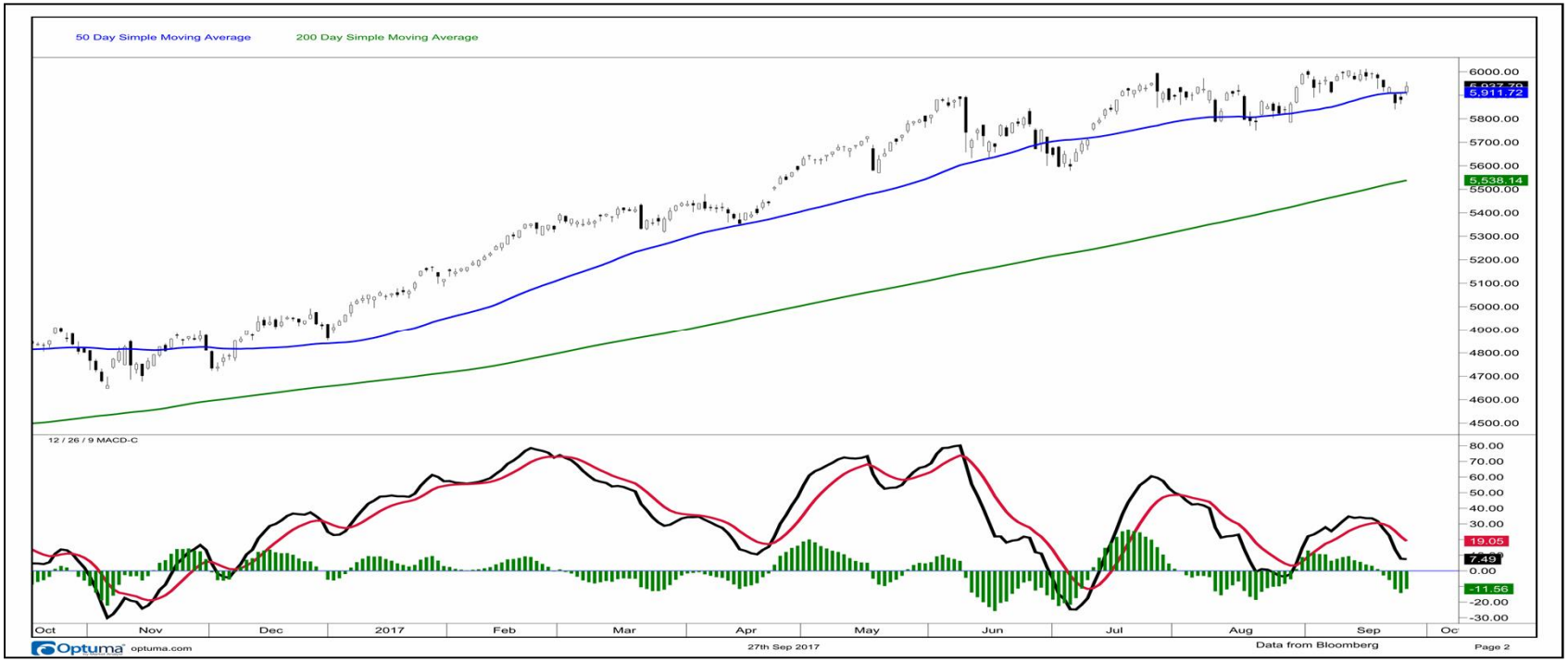
What does seem likely to come under pressure are bond proxies, since the availability of a steady hassle free yield from short term treasuries and money market instruments is something that has been completely absent from the investment landscape over the course of the cycle. Indeed it is notable that both REITs and Utilities have reacted poorly to the recent chain of events, which threaten to reduce their popularity in the months ahead.

Readers should note that due to the timing of the Jewish holidays there will be no publications of the Weekly Speculator on October 5th or 12th.

S&P 500

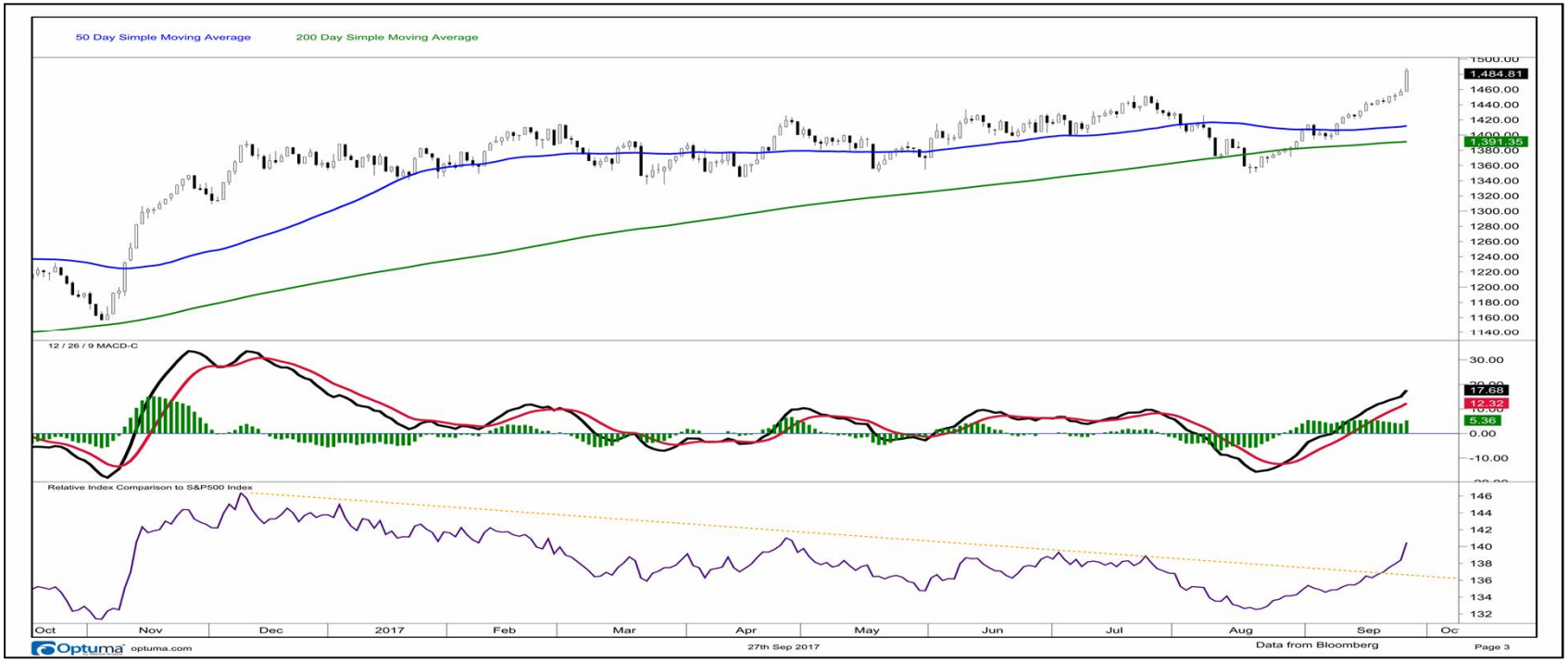
The SPX registered a new intra-day high yesterday at 2511.75 before retreating into the close (2507.04 up +10.20 points or +0.41%). Over the past 10 trading sessions the large cap index has churned sideways to higher at the index level while there has been significant sector rotation. MACD has pulled back slightly in positive territory but has held above its signal line. We find it hard to argue with the technical action in the SPX and suspect that at the very least that the index has a better than even chance to extend its gains into the end of the quarter until a meaningful short term price retracement unfolds. We continue to mark first support at the rising 50-day ma (2,471.66 at last nights close) and second at 2,417 which marks the August lows.

NASDAQ 100



Although the NDX has overtaken the 6,000 level on an intra-day and closing basis several times, that round number resistance level has thwarted a bonafide break out since it first tagged that level in July. That said we would not classify the price action as weak as it tracks higher in the longer term uptrend. MACD rolled over since we last wrote two weeks ago but remains in positive territory and is trying to hook higher. We now mark first support at 5,750 and second at 5,600.

Russell 2000



The RTY marked an impressive breakout during yesterday's trading session. The index rallied +27.95 points or +1.92% to close at a record high of 1,484.81. This fulfilled our 2% breakout rule and decisively broke out of the 9-month sideway trading pattern. MACD continues to accelerate higher in positive territory. Since December the RTY has exhibited continued relative weakness in comparison to the SPX (note lower panel), then the relative strength indicator bottomed in August and last week broke out of the downtrend (yellow dotted line). The index has been powered higher by a turn in both financials and energy which have a heavy weighting in the small cap index. We would also suggest that there likely been an unwinding of market protection in the underlying ETF (IWM) as the market continues to defy the bears. We now mark first support at 1,450 and second at 1,350.

VXO

Despite the fact that there is plenty of internal volatility within the US equity market at the level of the SPX and OEX index (which the VXO follows) the various moves have evened themselves out to a remarkable degree in recent weeks. Thus the ultra-low level of the VXO index at 8.42 is arguably justified by the benign overall environment and until matters change spikes in volatility have generally marked buying opportunities for the underlying market.

We do not of course suggest that this is a permanent state of affairs, but the sometimes queasy equilibrium of the summer months has yet to be challenged by a credible outside force large enough to change the rotational forces in play into widespread liquidation of positions.

Morgan Stanley Emerging Markets

The MXEF marked a new recovery closing high last Monday before the price pullback that has driven the index back to its 50-day ma. As we said in our last note the index had again become a little stretched and a constructive pullback was in order. This marks the fifth time the MXEF has retreated to the shorter term moving average without disturbing the longer term uptrend of higher lows and higher highs. Although MACD has rolled over it remains in positive territory as it has during the entire price advance since the start of this year. We continue to mark first support at the rising 50-day ma and second at the August lows at 1,040.

10 Year Treasury Note

The long end of the yield curve in the US continues to push higher as part of a global repricing of future central bank activity. The 10 year yield closed at 3.13% on Wednesday, up from 2.19% when we wrote two weeks ago and certainly fulfilling our required threshold for a move to be considered more than "noise". Even so the rapid 30 bp advance that has taken place since September 8th only takes the yield back to its level at the end of July, and we would still consider the yield to be range bound below its May high (2.42%), a breach of which would conceivably open the path for a test of the December 2016 high at 2.64%.

Where things seem more decisive is at the short end of the curve with the 2 year yield rising 22 bp since early September to break out to a 9 year high this week at 1.77%. With this in mind a full test of the May high seem likely to occur during the current move higher.

US Dollar

The DXY advanced through its 50-day ma yesterday reaching the best level in a month. As we wrote in our last note this is not the first time we have witnessed an oversold bounce over the past nine months, even one that has been able to trade above its falling shorter term moving average. The DXY remains in the longer term down trend and we continue to mark the 94 level as key resistance and only an advance through that level would suggest that a counter trend move of a larger degree, such as unfolded in February, was developing. We now mark first support at 92.75 and second at the 91.00 level.

Gold

Gold has been unable to withstand the recovery of the USD and wide move higher by global sovereign yields and the metal declined to $1282.80 at Wednesday's close, its lowest since mid-August. This negates the August breakout above $1300 and puts the metal back within the $1200 - $1300 trading range that contained prices for approximately 6 months. We would hope that the metal can find its footing above the midpoint of this range, which would conceivably allow for a retest of resistance at some point during the 4th quarter.

Crude Oil

Oil retook the ground above its 200-day ma and broke out above the 8 month down trend in price the day of our last published note. After 6 sessions of consolidation oil traded higher on Monday and since has been challenging the next key level at $52 which appears to be surmountable. We are inclined to give oil the benefit of the doubt considering its ability to advance as the USD has rallied over the past 2 weeks. MACD suggests the oil has the wind at its back but the real work is ahead as prices enter the upper boundary of the year long $13 sideways trading pattern. The proof of the pudding will be how price reacts between current levels and $55. We now mark first support at $50 and second at the rising 50-day ma ($48.70 as of yesterdays close).

Copper

Copper's very rapid move between $6000 and $7000 left the metal overextended and the result has been an equally rapid pullback to $6437, just below the midpoint of the surge and the 50 day ma. We view this as a healthy pause in the upward move higher and would continue to give the metal the benefit of the doubt for the time being. Support around the current price level and we would expect support at $6,000 to be sufficient to stem any decline through this band of support.

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