MARKETFIELD
ASSET MANAGEMENT

The Weekly Speculator

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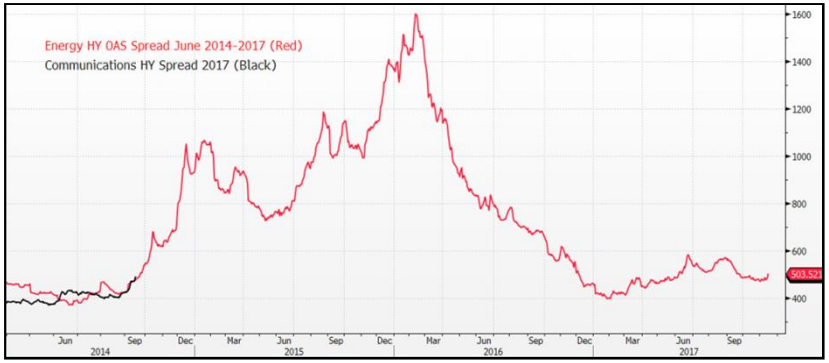
Michael Shaoul,Ph.D.
mshaoul@marketfield.com

Timothy Brackett,MSTA.
tbrackett@marketfield.com

The grinding drift higher by the SPX index that had been in place since the mid-August decline finally gave way this week, with the SPX index falling in 4 of the last 5 sessions. Overall damage at the time of writing remains quite limited with the SPX index closing at 2564.62, only 33 points (-1.3%) below the recent all-time high, and thus far the decline is significantly smaller than the roughly 73 points lost to the index in mid-August when the SPX declined to from 2490 to 2417. Of course that episode did nothing to change the upward trend that has been in place since last November and the SPX index rapidly recovered August's lost ground and added on over 100 points (4%) of "blue sky gains" for good measure. In other words we see little to get excited about in the recent decline, other than it is terminating one of the least interesting but profitable two month periods in the history of the SPX index.

Specific causes for the current decline are somewhat nebulous, although as we explained last week there has been a modest deterioration within high yield markets in recent sessions, driven primarily by ETF redemptions but also some weakness in specific credit issues. These have mostly been within the Communication sector, and very much company specific rather than systemic (although every dislocation tends to start with a concentrated group of weakening credits).



Thus far all we can say is that high yield spreads in the Communication sector have risen by over 100 bps since the summer to reach 493 bp. This compares closely with the performance of the Energy sector in the August/September 2014 period just before the sector and the price of oil fell apart taking the entire equity market sharply lower in mid-October. However, despite the large size of Communication within the high yield market weakness this time around is issuer specific rather than a consequence of an entire sector reaching critical over-supply and driving

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its concentrated revenue source (crude oil and natural gas prices) sharply lower. Nor are global economic or liquidity conditions comparable to 3 years ago. As such while we would accept the deterioration of high yield as a headwind, it is not yet one that looks to be powerful enough one to derail the equity market.

We will of course stay alert and would take a different view if liquidation became more apparent, or weakness spread to a much larger number of issues trading well below par (spread widening above par is less interesting).

The other force that has attracted some negative attention is the flattening of the US yield curve. This has obviously been if force for several months but it is only in recent weeks that commentary has started to focus on the issue. We of course have written about the phenomenon several times, but since it has accelerated somewhat in recent sessions we will summarize our thoughts once more. The first thing we would point out is that a flattening curve is perfectly consistent with an improving economy and rising equity market, particularly one which plays out against a backdrop of modest inflation.

In an environment in which central banks continue to purchase long term securities of one another, private investor flows increasingly favor passive index allocations that have themselves considerable duration and active managers are forced to either follow suit or risk unacceptable underperformance, the economic sensitivity of long term yields is likely to be considerably diminished. Indeed, even in the UK which has recently experienced a genuine breakout of inflation (CPI is above 3.0% and RPI 4.2%) long term yields have hardly budged over the course of 2017 with the 10 year yield at 1.31%, over 160 bp below CPI.

At the risk of seeming cynical we would state that fixed income investors are just as likely to chase prior performance towards the end of the year as their equity brethren, and we should not be too surprised to see appetite for long duration remain strong towards the end of the year.

Meanwhile at the short end of the curve the slow but steady increase in the FDTR has pushed the short end of the curve higher, although the market still prices in rather less tightening in 2018 than the Yellen-led FOMC currently expects to enact. We accept that a Powell-led FOMC may act differently, but with a December rate hike still extremely likely, he will take charge with an FDTR at 1.50%, which hardly makes the 2 year note's yield at 1.68% a stretch.

All of this suggests that the US yield curve will continue to flatten in the months ahead, and may conceivably be completely flat between the 2-10 year portion of the curve by next summer. This does not in itself predict that anything terrible will happen as an immediate consequence, but it would be consistent with the US bull market being in the last few quarters of its powerful run higher.

As far as the yield curve is concerned the most dangerous outcomes are arguably a sharp steepening from here. Although a 10 year yield as high as 2.75 or 3% could conceivably be accommodated a move much higher than that would probably start to set nerves jangling. More serious than a break higher by long term yields would be a sudden turn down by shorter term yields, which would be in response to the market anticipating imminent rate cuts. It was this phenomenon in mid-2000 and 2007 that indicated the death of the last 2 bull markets, while both managed to coexist with a flat or even inverted curve for several months (enough time in both cases for investors to dismiss the condition as irrelevant).

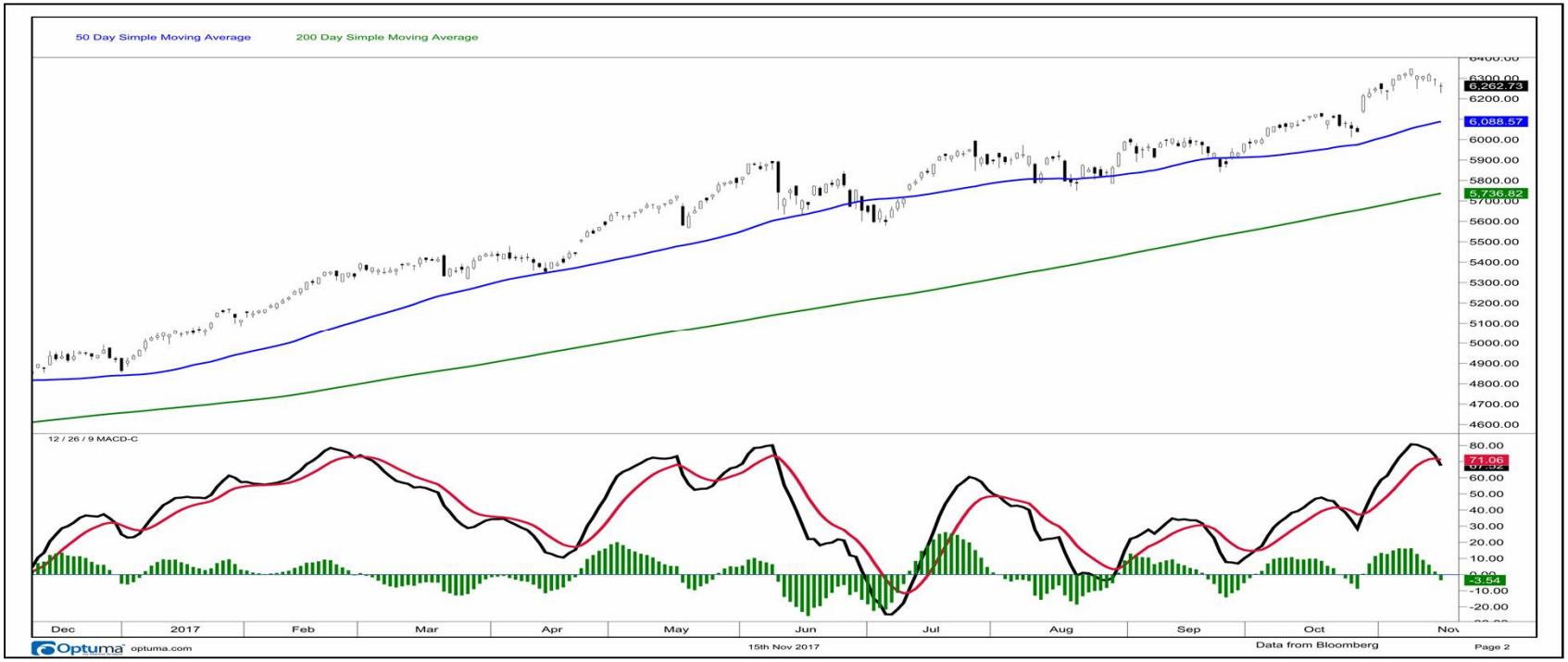
Regarding the shorter term we would note that Asian markets are experiencing their first test since their powerful move higher in the second half of 2017. This

is particularly true of Japan's NKY index which reached a 26 year high at 23382 last Wednesday night before tumbling back down to 22028. Even so the index is slightly higher for November and far above its early September launch point at 19274, and could accommodate deeper decline without brining into question the validity of its breakout. Other key markets such as Korea and Taiwan have suffered much more modest losses, and despite this week's setback the region still looks well positioned going into the last few weeks of 2017.

S&P 500

The SPX traded down at the onset of trading during yesterday's session and although it recovered a portion of its losses it closed down -14.25 points or -0.55% to 2,564.62. We would not classify the one day draw down as a nasty sell off but it is noteworthy because it was the worst day registered since September the 5th pullback of -18.70 points or -0.76%. Saying that, we see little to get excited about in the recent decline, other than it is terminating one of the least interesting but profitable two month periods in the history of the SPX index. MACD failed to find its way above its signal line and has rolled over again. That said, we note that the momentum indicator has tracked into negative territory twice in past year without disturbing the uptrend in price marked by a series of higher lows and higher highs so the turn in the oscillator is not technically concerning. We continue to mark first support at the rising 50-day ma although a minor violation of it would not technically concern us. We continue to mark second support at 2,500.

NASDAQ 100



The NDX is down -1.38% over the past five trading days vs. a -1.15% decline in the SPX. This short term relative weakness is a result of the recent rotation into defensive sectors of the market that have a higher weighting in the SPX, enabling it to hold up relatively better over the very short term. MACD has rolled over after confirming the new highs in price registered last week. Like the SPX the 50-day ma has been an indication of trend and during the shallow price pullback in just weeks ago the index turned higher before tagging it. We now mark first support at 6,130 and second at 6,000.

Despite a touch of relative weakness the NDX still retains its mantle of leadership and when the current corrective phase has run its course we expect the NDX to continue to lead the market higher. We mark first resistance at last Wednesday's closing high at 6,345.81.

Russell 2000

The RTY began correcting weeks ahead of the other equity indexes we track in these pages. Since the start of October the small cap index has been retracing the 7 week/+12.3% rally that began on August 18th. During yesterday' sell off in the equity markets the RTY was down -17.09 points in the first half hour of the session and after nearly touching our first support at 1,450 the small cap index recovered more than half its losses closing down -7.16 points or -0.49% at 1,464.10. MACD has continued to track lower and has just entered negative territory. We continue to mark first support at 1,450 which was the previous breakout level and stress that it is technically important that the RTY not trade back into the eleven month long trading range that it left behind in early October. Such a move could bog down the index in the old range bound price structure further delaying a return to new highs.

VXO

With the SPX index registering modest losses in 4 out of the last 5 sessions there has been a corresponding build in the price of protection. The VXO index reached 12.38 at the start of Wednesday's session, its highest intraday level since August 24th, with its close at 11.36 being the highest since August 18th, despite the recent fall by the equity market being significantly smaller at this point in time (33 SPX points vs. 70 points last August). In other words investors have been willing to pay a higher price for protection in response to a shallower pullback, no doubt partly due to the wish to protect performance records this late in the year.

We are yet to see the VXO fully test or break the 14 level (which marks the beginning of a "corrective" range), but we suspect it would take a full test of the 50 day ma by the SPX to cause this to occur.

Morgan Stanley Emerging Markets

After establishing a new closing high last Wednesday at 1,134.68 the MXEF has pulled back over the past five sessions in a test of first support at its rising 50-day ma. Thus far the shallow price retracement has, for all intents and purposes, left the series of higher lows and higher highs that has been in place for months intact. We are inclined to give the MXEF the benefit of the doubt even if there is a minor violation of the 50-day before a resumption of the uptrend. With that leeway in mind we now mark first support at 1,100 and second support at 1,070.

10 Year Treasury Note

As we have stated before the current trend towards a flattening yield curve seems to be the dominant force at play in the US treasury market, with the short end of the curve moving steadily higher in response to rises in the policy rate and the long end of the curve remaining range-bound. Despite a brief reversal in this trend in late October and last week the yield curve has continued to flatten and the 10 year note has been unable to break though 2.40% with any conviction. Yesterday's session saw the 10 year yield move back down to 2.322%, and it is now pushing against the triple support of the 50 and 200 day ma and 2.30% level, below which it would be targeting 2.20%. We note that the 30 year bond yield has already overcome equivalent support and that the spread between the 10 and 30 year yield is starting to narrow quite quickly, reaching an 8 year low at 44 bp on Wednesday.

US Dollar

Although the break of the short term uptrend in the DXY from the September lows suggests that the counter trend rally in the DXY may have run its course the index was able to hold key support at its 50-day ma yesterday and close up on the day. That short term technical accomplishment solidifies the shorter term moving average as key first support (closing yesterday at 93.42) and a close below that level would likely lead to a quick test of secondary support at the 92 level. We now mark first resistance at 95 which halted the rally for nearly two weeks prior the recent pullback to support.

Gold

Gold remains becalmed between its 50 and 200 day in what we view as a healthy consolidation. We are certainly open to the possibility that some of the wilder participants within the gold and silver market have been diverted to the infinitely more entertaining Bitcoin circus, leaving gold more inert. However, it is also true that most key drivers (interest rates and currencies) have been similarly docile in recent weeks, with any significant daily move negated by its range-bound nature.

Whatever the cause until the metal breaks above $1300 or below $1250 there is little to note. Our money is on the former, but we would view as a good store of value going forwards rather than a sure bet for short term appreciation.

Crude Oil

After the break out in oil through resistance at the $52.50 the follow through rally got ahead of itself and it is not a surprise that we have witnessed the retracement in price that unfolded over the past seven days. MACD has rolled over after reaching the best level since June of last year but the momentum indicator remains firmly in positive territory. We now mark first support at $54 and second at $52.50. A break above last Monday's closing high of $57.35 would open the door to a run at key resistance at the May 15, 2015 high at $62.50.

Copper

Copper remains in a violent consolidation of its late summer gains, declining -$82 (-1.2%) over the course of the week to close just above its 50 day ma at $6,773. If the 50 day does give way then we would look for support around the $6,500 to halt the decline. Significant resistance exists between $7,000 and the October high at $7,177, but provided copper can keep touch with current prices a retest of resistance by the end of the year looks to be achievable.

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