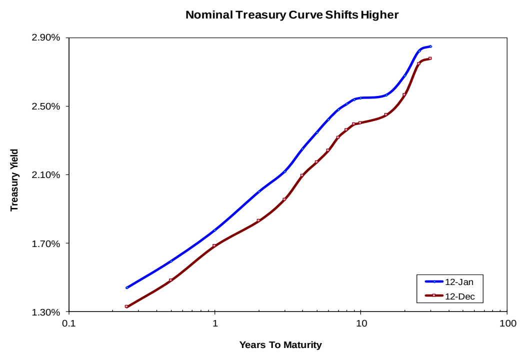
The Macro Environment For Financial Markets

Silence is golden, especially if practiced by attention-seeking bond fund managers. The trillion-dollar question of whether the secular bull market in bonds is over remains unresolved. Let's just say the 2016 lows are unlikely to be revisited in the foreseeable future. The risk-on response to this ignores the powerful tailwind the bull market in bonds has provided to equities, real estate and the fiscal solvency of governments and those with fiscal claims thereon. This reality will make itself known by the end of 2018. The causal chain remains:

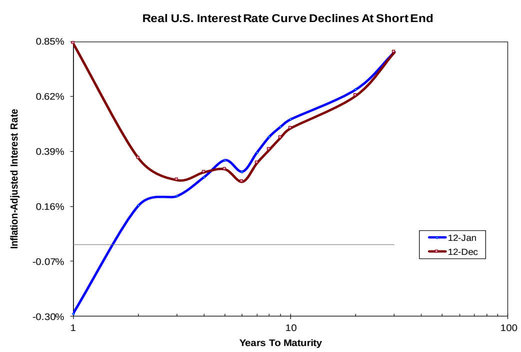
1. The market is pricing in March and June 2018 rate hikes;
2. Inflationary expectations have hit resistance at 2.04%, but their next target of 2.26% is not reachable in the short-term;
3. The secular flattening trend in the U.S. yield curve continues;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are inverting bullishly; and
6. CDS costs remain in their secular downtrend.

Key Market Indications

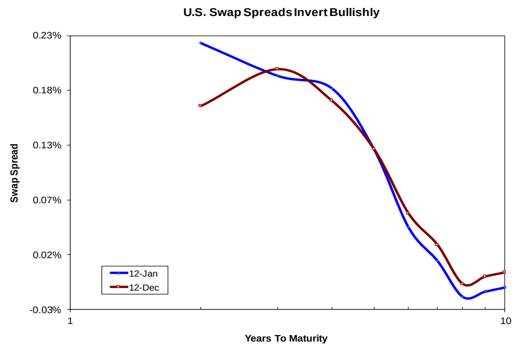
I commented last week: "Over? It will not be over until foreign central banks say it is over!" Rumor had it the Peoples' Bank of China was ready to say it was pulling back on UST purchases, but that would mean China would face a declining current account surplus with the U.S. and would be selling against its existing reserves. Strong auctions at the end of the week indicated must-hold long-term investors have not exited the market, nor can they.



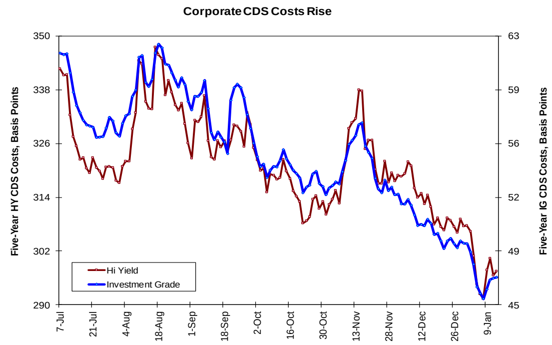
The pseudo-real yield curve shifted lower at the short end of the yield curve as nominal inflation breakevens rose faster than did nominal rates.



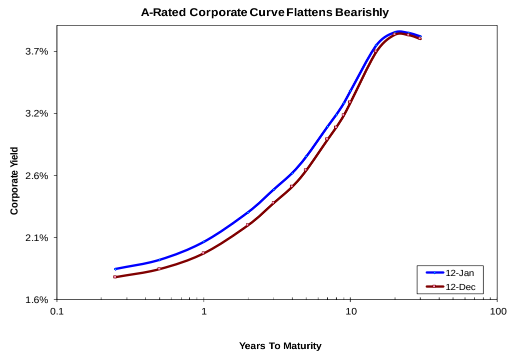
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose at the short end of the yield curve but declined at five-year tenors and longer. These declining spreads are still supportive for both corporate bonds and for equities.



CDS costs rose slightly over their recent lows, but remain well within their downtrends. Unless equities decline and produce correlation trades, there is no reason for CDS costs to rise.



The A-rated corporate yield flattened via higher short-term rates. As UST yields are rising and credit spreads already are just over post-crisis lows, the risk/reward for these markets remains poor.



Market Structure
The overbought Petroleum index and Soft remain in structural uptrends while the Livestock index remains in a structural downtrend within the physical commodities. The S&P 500 moved into a bullish consolidation while the dollar index turned oversold. The EM and EAFE indices remain in uptrends while ten-year UST remain in a downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Jan. 16 - 19
BBerg	6	Sideways	0.078	5.8%	
BBerg Grain	16	Transitional	-0.131	7.1%	
BBerg Ind. Metl	8	Sideways	0.015	12.6%	
BBerg Pre. Metl	5	Sideways	0.101	8.5%	
BBerg Softs	29	Trending	0.046	14.1%	0.30%
BBerg Nat. Gas	7	Sideways	0.071	29.9%	
BBerg Petroleum	29	Trending	0.429	14.3%	0.52%
BBerg Livestock	20	Trending	-0.057	10.1%	-0.10%
Dollar Index	28	Trending	-0.443	4.9%	-0.06%
S&P 500 Index	4	Sideways	0.167	4.9%	
EAFE Index	29	Trending	0.600	6.4%	0.09%
EM Index	29	Trending	0.698	7.1%	0.26%
Ten-year UST (price)	29	Trending	-0.224	4.0%	-0.06%

Performance Measures

The lackluster performance of the main Bloomberg index stands in stark contrast to the sharp ascent in the various energy markets, Natural Gas in particular. Grains, Softs and Livestock all are suffering from overproduction and neither the Precious nor Industrial Metals were able to react to lower implied short-term real rates or to continued solid global growth, respectively. This is not encouraging for commodity bulls.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.99%	5.71%	7.95%	1.23%
Grains Sub-Index	-1.54%	-0.39%	-14.67%	-14.95%
Corn	-1.40%	-0.25%	-14.12%	-14.75%
Soybeans	-1.03%	-1.68%	-5.68%	-11.92%
Wheat	-2.35%	0.65%	-24.98%	-17.47%
Energy Sub-Index	4.77%	12.19%	24.32%	4.23%
Petroleum Sub-Index	3.44%	11.26%	38.21%	17.83%
WTI	4.62%	12.33%	35.74%	14.90%
Brent	3.34%	11.62%	43.74%	22.57%
ULSD	1.72%	9.49%	37.84%	22.30%
Gasoline	3.23%	10.22%	31.57%	8.96%
Natural Gas	9.07%	14.81%	-11.05%	-28.88%
Precious Metals Sub-Index	0.54%	6.42%	8.07%	8.12%
Gold	0.98%	6.27%	8.40%	10.77%
Silver	-0.81%	6.83%	7.05%	0.90%
Industrial Metals Sub-Index	0.34%	5.36%	19.63%	19.08%
Copper	-0.31%	2.79%	18.66%	17.36%
Aluminum	0.44%	7.07%	13.49%	19.64%
Nickel	1.56%	9.83%	32.11%	20.06%
Zinc	0.85%	5.83%	22.97%	22.08%
Softs Sub-Index	-3.17%	5.16%	2.14%	-22.33%
Coffee	-4.80%	1.35%	-12.59%	-25.29%
Sugar	-5.94%	3.92%	-3.87%	-33.61%
Cotton	4.73%	7.70%	23.03%	14.33%
Livestock Sub-Index	-1.00%	-0.41%	-6.08%	2.91%
Cattle	-1.42%	-2.79%	-9.40%	3.17%
Hogs	-0.39%	3.91%	0.23%	2.96%

The USD fell significantly against everything but the CAD and INR. Moves by the Bank of Japan and speculation China may pull back on Treasury purchases combined with the idea the Federal Reserve would not accelerate its quantitative tightening campaign. If you are listening for an apology from those who said the repatriation of dollars held overseas would push the greenback higher, keep listening.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.44%	3.92%	6.92%	14.97%
Chinese yuan	0.30%	2.36%	4.93%	6.57%
Japanese yen	1.79%	2.24%	1.90%	3.30%
British pound	1.16%	3.08%	6.54%	12.88%
Swiss franc	0.77%	2.51%	-0.20%	4.51%
Canadian dollar	-0.38%	3.27%	2.34%	5.51%
Australian dollar	0.67%	4.75%	3.11%	5.79%
Swedish krona	1.35%	4.61%	4.57%	11.21%
Norwegian krone	1.65%	5.38%	4.59%	7.67%
New Zealand dollar	0.96%	4.44%	-0.32%	2.07%
Indian rupee	-0.42%	1.20%	1.41%	6.98%
Brazilian real	0.75%	3.55%	0.09%	-0.58%
Mexican peso	0.75%	0.79%	-6.63%	14.41%
Chilean peso	0.43%	8.41%	9.95%	9.69%
Colombian peso	1.60%	5.93%	6.65%	2.25%
Bloomberg-JP Morgan Asian dollar index (spot)	0.13%	2.00%	4.03%	6.36%

In the absence of negative news, money continues to shift into global equities. The U.S. continues to outpace the rest of the world as the U.S. has a head start on rate hikes and the reduction of central bank balance sheets.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.36%	4.90%	13.29%	25.21%
North America	1.45%	4.73%	14.93%	24.52%
Latin America	0.62%	10.45%	13.56%	25.63%
Emerging Market Free	0.61%	8.92%	18.54%	38.18%
EAFE	1.20%	5.54%	12.94%	27.33%
Pacific	1.07%	5.88%	15.29%	25.05%
Eurozone	1.32%	5.66%	10.44%	30.85%

Both CTAs and hedge funds continued their strong start to 2018, indicating they 1) embraced the risk-on environment and 2) are crowding the trade on each other.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.46%	3.09%	12.43%	4.99%
Newedge Trend	0.38%	2.01%	9.32%	4.55%
Newedge Short-Term	1.01%	1.51%	2.20%	-3.30%
HFR Global Hedge Fund	0.47%	2.32%	4.82%	7.16%
HFR Macro/CTA	0.45%	2.83%	5.50%	5.22%
HFR Macro: Sytematic Diversified CTA	0.45%	3.59%	10.96%	8.14%