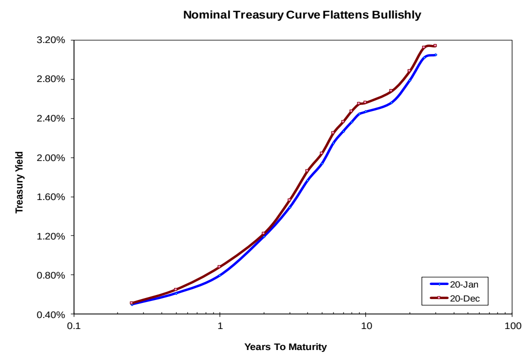
The Macro Environment For Financial Markets

Once the European Central Bank starts to join the U.S. in short-term rate renormalization, the world will be able to close the books on the long-term experiment in monetary stimulus. The debate over its effects will endure for decades. As the world concluded fiscal stimulus was intellectually bankrupt, it will have to conclude the same about monetary stimulus. The real answer is economies are not playthings. Sorry, Davos Man. The causal chain now remains:

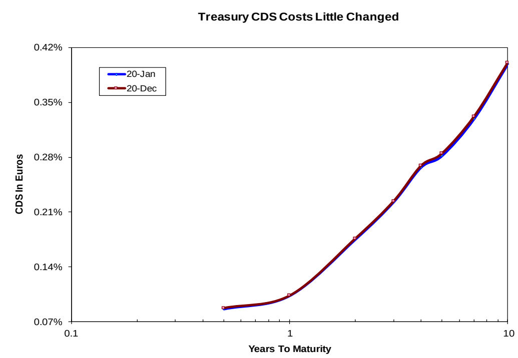
1. The market is nominally pricing in higher short-term rates in 2017, but the conviction levels are weak;
2. Inflationary expectations have stopped rising for the short-term;
3. The U.S. yield curve is re-entering its secular flattening trend;
4. Short-term borrowers have stopped terming out short-term debt into the bond market;
5. Swap spreads are pricing in higher future rates; and
6. CDS costs remain consistent with a bull market in risky assets.

Key Market Indications

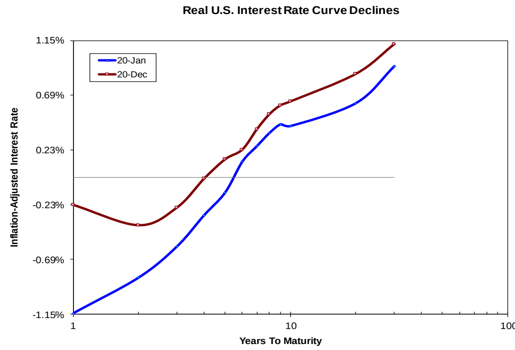
The quiet conditions seen in the UST market since mid-December will end in a burst of volatility once the new administration and Congress start fleshing out the budget. There is little reason to expect any sort of reckless fiscal expansion, but there is no reason to expect a strong fixed-income rally, either.



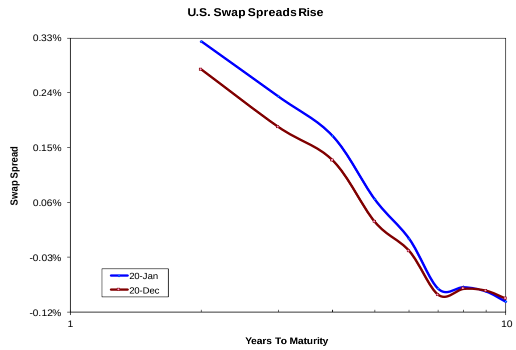
CDS costs on UST continue their small decline. This market is likely to remain quite dormant unless Republican party discipline breaks down entirely and the federal deficit expands.



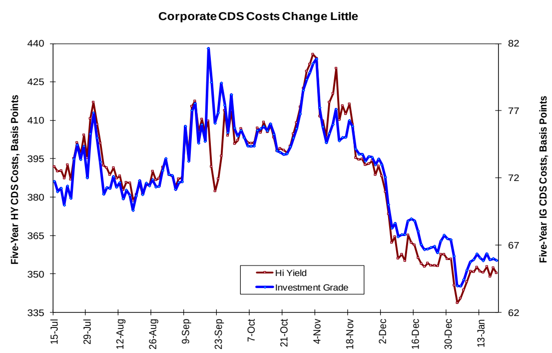
The pseudo-real yield curve declined again at the short end of the yield curve over the past month. This has helped support gold. The rise in long-term implied real rates not only has ended, it is reversing. This is removing one impediment to risky financial assets.



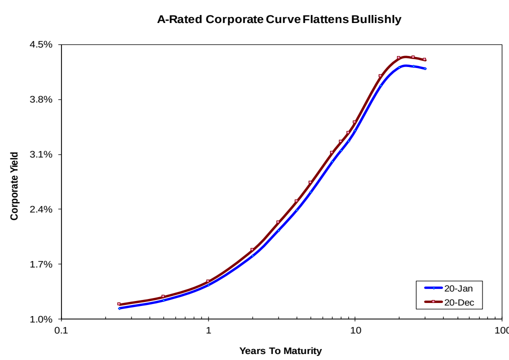
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market is pricing in higher sovereign rates. The swap market was slow to price in higher rates in November and appears to be behind the curve once again.



CDS costs moved sideways but remain within the confines of a bull market. With the pace of future rate hikes in question and with the economic data reflecting strength, the argument for higher CDS costs is absent.



The A-rated corporate yield curve is continuing its slow bullish flattening. The move will be constrained by the UST yield curve. However, even a modest bullish flattening is supportive for equities.



Market Structure

Industrial Metals moved into a structural downtrend amongst the physical markets. The EAFE exited its uptrend amongst the financial markets.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Jan. 23 - 27
BBerg	22	Trending	0.173	8.6%	0.09%
BBerg Grain	29	Trending	0.264	12.7%	0.11%
BBerg Ind. Metl	27	Trending	0.112	17.8%	0.50%
BBerg Pre. Metl	23	Trending	0.263	11.8%	0.22%
BBerg Softs	4	Sideways	0.026	14.3%	
BBerg Nat. Gas	14	Transitional	-0.047	38.3%	
BBerg Petroleum	17	Transitional	-0.032	21.8%	
BBerg Livestock	17	Transitional	0.111	12.8%	
Dollar Index	22	Trending	-0.153	9.2%	-0.13%
S&P 500 Index	6	Sideways	0.009	6.4%	
EAFE Index	6	Sideways	-0.011	10.6%	
EM Index	27	Trending	0.308	8.0%	0.07%
Ten-year UST (price)	22	Trending	-0.022	5.3%	

Performance Measures

The sideways action in Petroleum markets and the selloff in natural gas are masking what has been a grinding uptrend in physical commodities, led by Grains. The lack of volatility so far in 2017 is somewhat striking given the prevalence of very large and sudden moves across a range of markets in the second half of 2016. This may be an artifact of fewer large traders taking bid positions and then trying to unwind them in thin market conditions.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.11%	2.46%	4.63%	17.87%
Grains Sub-Index	2.28%	7.33%	2.30%	-2.71%
Corn	3.22%	6.99%	4.56%	-8.13%
Soybeans	2.63%	7.06%	6.26%	20.41%
Wheat	0.48%	8.88%	-7.89%	-21.19%
Energy Sub-Index	-2.19%	-4.36%	9.33%	25.80%
Petroleum Sub-Index	-1.30%	-1.56%	13.07%	33.25%
WTI	-1.14%	-1.26%	10.08%	23.65%
Brent	-0.82%	-0.74%	12.52%	45.22%
ULSD	-1.25%	-1.74%	12.43%	45.62%
Gasoline	-2.62%	-3.75%	22.47%	17.89%
Natural Gas	-4.62%	-11.55%	-0.15%	6.16%
Precious Metals Sub-Index	0.64%	6.82%	-11.04%	11.81%
Gold	0.41%	6.31%	-9.60%	9.04%
Silver	1.24%	8.12%	-14.38%	19.27%
Industrial Metals Sub-Index	-0.47%	4.72%	13.32%	31.80%
Copper	-1.73%	5.93%	16.53%	29.30%
Aluminum	3.20%	7.31%	13.90%	21.73%
Nickel	-5.64%	-6.93%	-7.54%	9.67%
Zinc	1.52%	7.27%	22.23%	80.49%
Softs Sub-Index	-0.29%	8.73%	1.12%	29.39%
Coffee	2.42%	12.57%	3.16%	20.47%
Sugar	-2.78%	11.23%	0.14%	34.31%
Cotton	0.98%	4.58%	-0.18%	15.82%
Livestock Sub-Index	0.67%	2.73%	4.23%	-4.72%
Cattle	2.05%	3.04%	8.85%	-1.04%
Hogs	-1.64%	1.92%	-2.71%	-10.71%

While other major currencies continued to gain on the USD, the CAD fell sharply on the notion the Bank of Canada will retreat from any move to raise short-term interest rates. The MXN continues to slide under the uncertainty of how U.S.-Mexico relations will develop. Mexican exports to the U.S. are looking increasingly attractive.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.56%	3.03%	-2.83%	-1.72%
Chinese yuan	0.35%	1.11%	-2.89%	-4.34%
Japanese yen	-0.11%	2.83%	-6.74%	2.02%
British pound	1.58%	0.06%	-6.31%	-12.80%
Swiss franc	0.68%	2.72%	-1.43%	0.27%
Canadian dollar	-1.55%	0.36%	-1.97%	8.89%
Australian dollar	0.71%	4.08%	1.03%	9.37%
Swedish krona	0.36%	5.28%	-3.16%	-3.24%
Norwegian krone	1.07%	3.49%	1.04%	5.55%
New Zealand dollar	0.55%	3.67%	2.05%	11.51%
Indian rupee	-0.03%	-0.20%	-1.44%	-0.31%
Brazilian real	1.36%	5.54%	2.70%	29.09%
Mexican peso	-0.52%	-5.23%	-13.47%	-14.18%
Chilean peso	0.32%	2.88%	-0.94%	10.98%
Colombian peso	0.91%	2.56%	0.27%	16.24%
Bloomberg-JP Morgan Asian dollar index (spot)	0.14%	0.91%	-2.56%	-0.90%

Patience is going to be a virtue in equity markets, for the U.S. in particular. With no recession in sight and with fixed-income and credit markets both supportive and unattractive, the TINA trade should prevail until some event occurs.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.29%	1.45%	5.54%	19.11%
North America	-0.19%	0.40%	5.79%	26.09%
Latin America	1.28%	10.21%	3.67%	59.58%
Emerging Market Free	-0.30%	5.28%	3.61%	32.53%
EAFE	-0.47%	3.01%	5.05%	17.20%
Pacific	-0.56%	2.69%	6.82%	20.09%
Eurozone	-0.15%	2.84%	8.68%	12.65%

What has happened over the past week and month to produce such poor performance by professional traders? The end of the Trump trade, thin holiday markets or just the usual combination of bad position selection and risk management? Regardless, they had better perform or the AUM will disappear.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.54%	-1.61%	-8.37%	-11.42%
Newedge Trend	-0.56%	-1.53%	-7.22%	-8.64%
Newedge Short-Term	-1.49%	-3.69%	-8.38%	-6.63%
HFR Global Hedge Fund	-0.26%	0.52%	2.67%	6.03%
HFR Macro/CTA	-0.78%	-1.21%	-3.94%	-5.12%
HFR Macro: Sytematic Diversified CTA	-0.93%	-2.33%	-5.96%	-6.49%