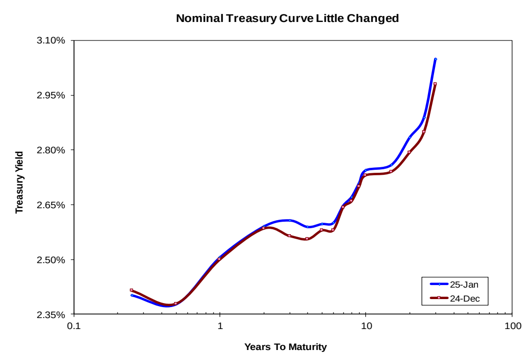
The Macro Environment For Financial Markets

Have financial markets discounted the increasing probability of a round of leftish electoral victories in OECD nations, something astonishing given the failures of socialism in places like Venezuela? Not at all. The four decades of positive returns on capital since the dawn of the Reagan/Thatcher, et al, eras were not an accident. However, at the risk of delving into politics, the electorate has tired of divisions produced by more rightist/centrist politics and may be willing to embrace the devil it does not remember. The causal chain now is:

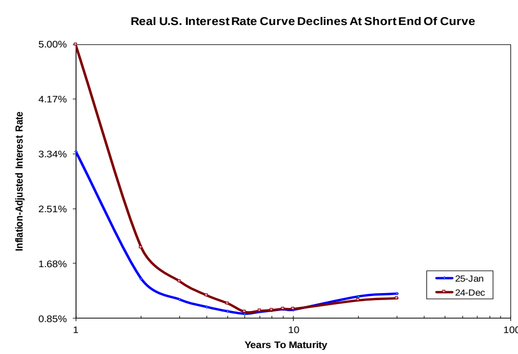
1. The market has priced out a 2019 rate hike;
2. The yield curve is flattening once again;
3. Inflationary expectations have resumed declining;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are flattening bearishly; and
6. CDS costs are declining from their December highs.

Key Market Indications

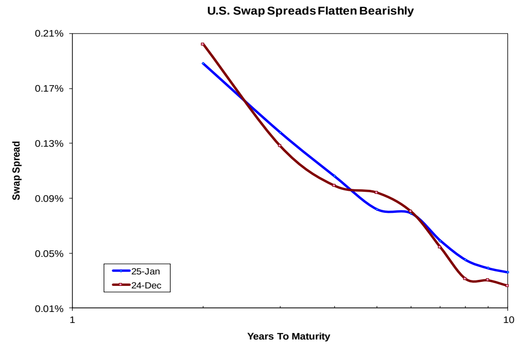
The haven bid in UST has disappeared, and a move back over 2.80% on the ten-year places yields back in an uptrend. However, the break higher is not imminent: The yield curve is starting to flatten once again and inflation expectations are declining.



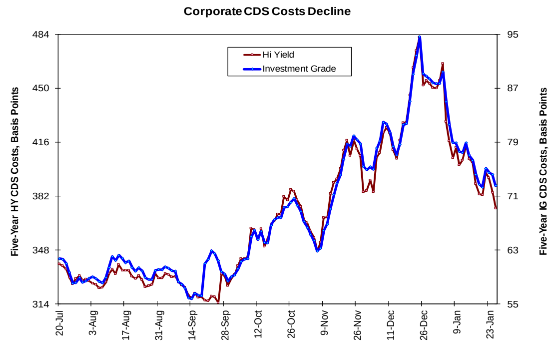
The pseudo-real yield curve remains elevated at the shortest maturities, but is starting to decline. Implied real rates have remained steady at the long end of the yield curve.



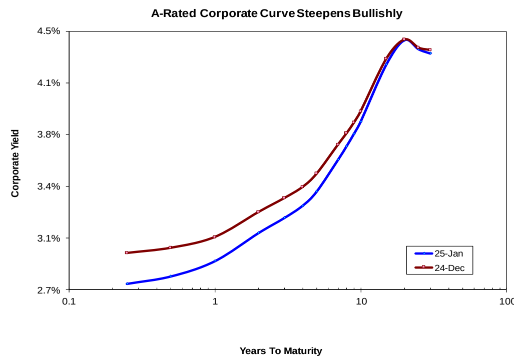
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose at the long end of the yield curve and declined at the short end of the yield curve. However, these changes are minor and do not reflect a large shift in sentiment.



CDS costs have relinked to the equity market as correlation trades fade. We remain unlikely to revisit the lows from early autumn anytime soon.



The A-rated corporate yield curve continues to steepen bullishly as some immediate threats to corporate credit quality, such as higher short-term rates, plunging crude oil prices and declining equities, have ceased for now.



Market Structure

Only Livestock is in a structural downtrend amongst physical commodity markets. The remainder of the complex retains a bear-market rally pose. The S&P 500 moved into a bullish consolidation, while both the EAFE and EM indices remain in structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Jan. 28 - Feb. 1
BBerg	28	Trending	0.283	9.4%	0.16%
BBerg Grain	29	Trending	0.109	10.5%	0.29%
BBerg Ind. Metl	29	Trending	0.309	11.5%	0.36%
BBerg Pre. Metl	11	Transitional	0.120	7.1%	
BBerg Softs	26	Trending	0.111	14.9%	0.17%
BBerg Nat. Gas	28	Trending	0.146	23.6%	0.40%
BBerg Petroleum	4	Sideways	0.022	25.0%	
BBerg Livestock	25	Trending	-0.184	8.2%	-0.15%
Dollar Index	29	Trending	-0.103	5.6%	-0.13%
S&P 500 Index	4	Sideways	0.054	14.1%	
EAFE Index	29	Trending	0.289	11.5%	0.20%
EM Index	29	Trending	0.489	9.9%	0.41%
Ten-year UST (price)	14	Transitional	-0.056	4.2%	

Performance Measures

The ability of the Petroleum complex to advance in the face of weaker gasoline prices remains highly suspect. Economically sensitive Industrial Metals gained on the prospects of another round of fiscal stimulus in China, which may be trading by hope. Declines in implied real short-term rates are supporting Precious Metals.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.82%	4.68%	-3.35%	-8.88%
Grains Sub-Index	0.95%	2.36%	-2.02%	-5.10%
Corn	0.12%	1.46%	-0.68%	-4.75%
Soybeans	1.98%	3.52%	2.60%	-10.88%
Wheat	0.49%	1.85%	-6.44%	3.66%
Energy Sub-Index	-0.16%	8.85%	-9.70%	-9.29%
Petroleum Sub-Index	1.02%	14.94%	-18.93%	-13.70%
WTI	2.60%	17.96%	-20.03%	-14.60%
Brent	0.71%	15.46%	-16.90%	-8.18%
ULSD	0.53%	14.50%	-11.28%	-8.47%
Gasoline	-2.61%	7.47%	-28.66%	-27.66%
Natural Gas	-3.16%	-2.23%	15.58%	-1.45%
Precious Metals Sub-Index	0.63%	1.44%	4.79%	-6.07%
Gold	0.48%	1.33%	5.94%	-4.64%
Silver	1.10%	1.90%	0.96%	-10.76%
Industrial Metals Sub-Index	3.09%	5.54%	-4.36%	-14.84%
Copper	1.88%	1.96%	-2.82%	-15.67%
Aluminum	3.37%	4.38%	-6.81%	-12.74%
Nickel	3.23%	11.51%	-13.76%	-12.52%
Zinc	5.34%	10.29%	7.84%	-18.23%
Softs Sub-Index	0.05%	2.39%	-4.89%	-14.55%
Coffee	4.35%	5.99%	-7.94%	-22.22%
Sugar	-3.14%	0.59%	8.14%	-13.21%
Cotton	-0.27%	2.88%	-16.96%	-6.96%
Livestock Sub-Index	-1.19%	-0.31%	7.05%	-2.30%
Cattle	0.01%	1.43%	7.60%	3.27%
Hogs	-3.82%	-3.69%	6.91%	-13.44%

The USD gained only against the SEK, BRL and COP as prospects for higher short-term rates in the U.S. continue to fade. However, the main rivals to the USD, such as the EUR, are unlikely to provide higher short-term returns anytime soon.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.38%	0.12%	-2.75%	-7.99%
Chinese yuan	0.44%	2.06%	0.32%	-6.25%
Japanese yen	0.21%	0.69%	1.31%	-0.13%
British pound	2.52%	4.11%	0.05%	-6.69%
Swiss franc	0.15%	-0.67%	-0.20%	-5.35%
Canadian dollar	0.32%	2.84%	-1.30%	-6.36%
Australian dollar	0.15%	2.03%	-3.70%	-10.55%
Swedish krona	-0.23%	0.15%	-3.22%	-12.45%
Norwegian krone	0.57%	2.91%	-4.44%	-9.05%
New Zealand dollar	1.42%	1.66%	0.03%	-6.63%
Indian rupee	0.02%	-1.45%	-3.36%	-10.72%
Brazilian real	-0.20%	3.47%	-1.90%	-16.73%
Mexican peso	0.58%	4.89%	-1.69%	-2.02%
Chilean peso	0.32%	3.23%	-2.68%	-10.25%
Colombian peso	-0.85%	4.61%	-8.56%	-11.45%
Bloomberg-JP Morgan Asian dollar index (spot)	0.55%	1.43%	0.11%	-4.95%

While the U.S. struggled, the international indices in general and the EM index in particular continued their January rallies. However, when Latin America is a beacon of strength, something is wrong.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.07%	7.11%	-6.18%	-8.74%
North America	-0.15%	7.72%	-4.70%	-5.58%
Latin America	0.35%	15.16%	7.10%	-7.09%
Emerging Market Free	1.42%	7.29%	-4.51%	-16.57%
EAFE	0.48%	5.99%	-8.85%	-14.18%
Pacific	0.56%	6.09%	-7.22%	-12.59%
Eurozone	1.37%	6.29%	-11.41%	-17.47%

Returns for both CTAs and hedge funds were generally positive on the week as traders have started to accept, albeit slowly, increased risk-acceptance. Performance over the past year has been poor, however, and has failed to offset declines in conventional financial assets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	0.31%	-3.10%	-6.01%	-17.68%
SocGen Trend	0.45%	-2.01%	-2.92%	-12.85%
SocGen Short-Term	-0.09%	0.42%	-1.50%	-6.97%
HFR Global Hedge Fund	-0.09%	2.76%	-4.63%	-7.81%
HFR Macro/CTA	0.83%	-2.42%	-3.61%	-9.71%
HFR Macro: Sytematic Diversified CTA	1.57%	-3.65%	-4.52%	-13.63%