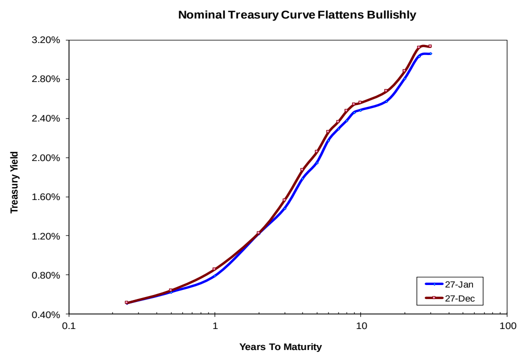
# The Macro Environment For Financial Markets

Common advice for traders in the old days was to step away from the screen to clear the head. That advice might be reborn as turning off all news sources, fake or otherwise, and following absolutely no one on Twitter. Come back in a few months when silly and unworkable proposals have disappeared and you will have some idea of where the world is headed. The usual worrywarts aside, the answer probably is "to a better place." The causal chain now is:

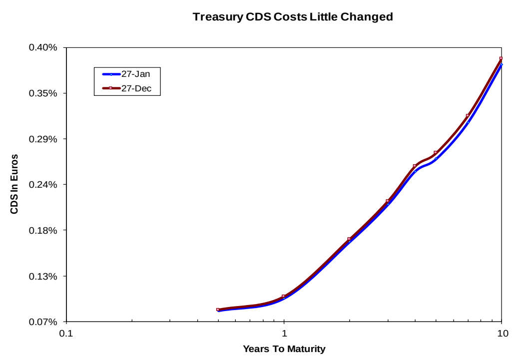
1. The market is nominally pricing in higher short-term rates in 2017, but the conviction levels are weak;
2. Inflationary expectations have resumed rising;
3. The U.S. yield curve has paused in its secular flattening trend;
4. Short-term borrowers have stopped terming out short-term debt into the bond 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**

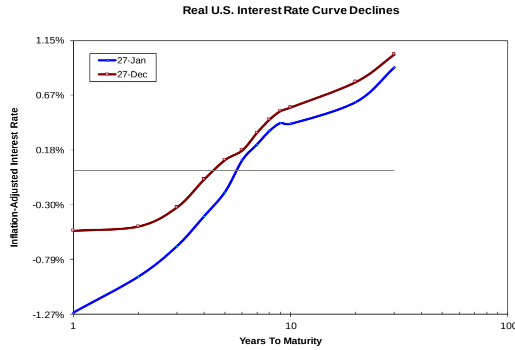
Sometimes boring is good. The quiet conditions seen in the UST market since mid-December will end in a burst of volatility once the new administration and Congress start fleshing out the budget. There is little reason to expect any sort of reckless fiscal expansion, but there is no reason to expect a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



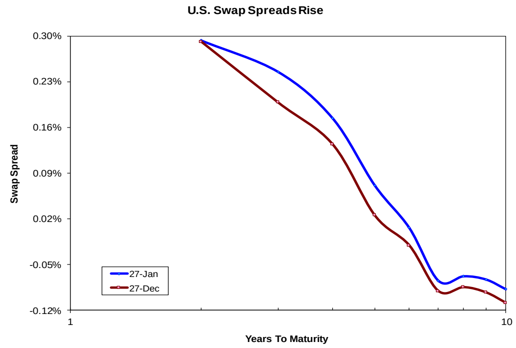

CDS costs on UST remain little changed. This market is likely to remain quite dormant unless Republican party discipline breaks down entirely and the federal deficit expands.



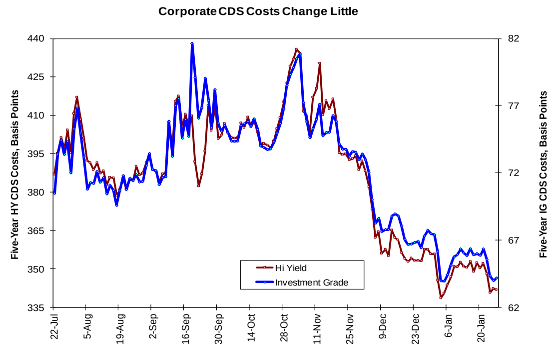
The pseudo-real yield curve declined across maturities over the past month. This did not help precious metals, primarily due to a preference for risky assets. The decline in implied real rates at the long end of the yield curve is supportive for risky financial assets.



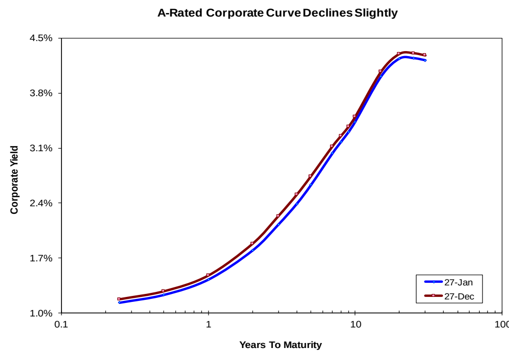

Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market is pricing in higher sovereign rates. The swap market was slow to price in higher rates in November and appears to be behind the curve once again. Heavily insured events have a way of not materializing.




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

The main Bloomberg index moved out of a trending structure. This was the only development in the physical markets. The S&P 500 re-entered a structural uptrend with the financial markets.

| | N-Day Speed | Market Structure | Trend Oscillator | HLC Volatility | Daily Trend Rate Jan.30 - Feb. 3 |
|---|---|---|---|---|---|
| BBerg | 6 | Sideways | -0.062 | 7.5% | |
| BBerg Grain | 29 | Trending | 0.111 | 12.1% | 0.11% |
| BBerg Ind. Metl | 29 | Trending | 0.113 | 17.5% | 0.50% |
| BBerg Pre. Metl | 26 | Trending | 0.134 | 11.7% | 0.22% |
| BBerg Softs | 4 | Sideways | 0.003 | 13.6% | |
| BBerg Nat. Gas | 18 | Transitional | 0.078 | 36.6% | |
| BBerg Petroleum | 17 | Transitional | -0.057 | 19.4% | |
| BBerg Livestock | 18 | Transitional | -0.019 | 12.6% | |
| Dollar Index | 26 | Trending | -0.138 | 8.9% | -0.13% |
| S&P 500 Index | 20 | Trending | 0.158 | 6.4% | 0.07% |
| EAFE Index | 8 | Sideways | 0.087 | 8.7% | |
| EM Index | 29 | Trending | 0.545 | 7.6% | 0.07% |
| Ten-year UST (price) | 24 | Trending | -0.059 | 5.4% | |

## Performance Measures

The sideways action in Petroleum markets has continued, a rarity over the past two years. This, along with a pullback in the grains markets following better weather news, contributed to the main Bloomberg index moving into a consolidation.

**Commodity Total Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| **Bloomberg Index** | -0.44% | 0.57% | 4.60% | 14.32% |
| **Grains Sub-Index** | -1.84% | 3.53% | 0.76% | -5.05% |
| Corn | -1.95% | 3.02% | 2.66% | -10.35% |
| Soybeans | -1.70% | 4.55% | 2.91% | 17.58% |
| Wheat | -1.80% | 3.11% | -5.67% | -23.22% |
| **Energy Sub-Index** | 0.44% | -5.51% | 12.71% | 18.53% |
| Petroleum Sub-Index | -1.02% | -4.26% | 18.05% | 24.03% |
| WTI | -0.08% | -2.69% | 16.83% | 18.28% |
| Brent | -0.79% | -3.12% | 17.97% | 31.32% |
| ULSD | -1.70% | -5.93% | 16.84% | 33.70% |
| Gasoline | -2.64% | -7.94% | 23.04% | 12.33% |
| Natural Gas | 4.59% | -8.81% | -0.41% | 3.44% |
| **Precious Metals Sub-Index** | -0.83% | 4.30% | -13.83% | 9.02% |
| Gold | -1.36% | 3.20% | -12.54% | 5.61% |
| Silver | 0.62% | 7.22% | -16.64% | 18.44% |
| **Industrial Metals Sub-Index** | 0.15% | 5.38% | 12.84% | 28.15% |
| Copper | 2.47% | 7.39% | 20.15% | 28.35% |
| Aluminum | -1.81% | 7.06% | 9.50% | 16.84% |
| Nickel | -2.39% | -5.59% | -11.60% | 8.15% |
| Zinc | -0.69% | 6.71% | 21.48% | 66.64% |
| **Softs Sub-Index** | 0.65% | 10.68% | 3.17% | 31.16% |
| Coffee | -0.51% | 11.25% | -0.39% | 19.49% |
| Sugar | 0.75% | 4.25% | 3.75% | 48.49% |
| Cotton | 2.49% | 5.99% | 0.41% | 21.26% |
| **Livestock Sub-Index** | -0.98% | -0.09% | 4.66% | -6.96% |
| Cattle | -1.38% | 1.83% | 3.84% | -3.09% |
| Hogs | -0.25% | -2.87% | 5.01% | -13.08% |

The CNY really needs to decline, but it cannot for now for obvious political reasons. The JPY finally is falling under the weight of declining implied real interest rates. But the biggest trade of all remains the erosion of the USD under the realization the Federal Reserve is terrified of getting blamed for a rising USD pinching U.S. exporters and raising risks for non-U.S. commercial banks.

**Currency Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| Euro | -0.04% | 2.31% | -3.25% | -1.78% |
| Chinese yuan | -0.17% | 0.94% | -3.08% | -4.38% |
| Japanese yen | -0.42% | 2.02% | -8.43% | 3.11% |
| British pound | 1.45% | 2.31% | -5.05% | -11.80% |
| Swiss franc | 0.23% | 2.87% | -1.34% | 1.58% |
| Canadian dollar | 1.27% | 3.21% | 0.27% | 7.17% |
| Australian dollar | -0.05% | 5.09% | 0.80% | 7.46% |
| Swedish krona | 0.35% | 4.27% | -2.49% | -3.82% |
| Norwegian krone | 0.84% | 4.39% | 2.37% | 3.86% |
| New Zealand dollar | 1.24% | 5.34% | 2.59% | 12.86% |
| Indian rupee | 0.21% | 0.03% | -1.31% | 0.02% |
| Brazilian real | 1.06% | 4.22% | 3.85% | 30.85% |
| Mexican peso | 3.36% | -0.61% | -9.86% | -11.56% |
| Chilean peso | 0.92% | 3.68% | 2.47% | 9.81% |
| Colombian peso | -0.40% | 2.22% | 5.20% | 14.40% |
| Bloomberg-JP Morgan Asian dollar index (spot) | -0.16% | 1.03% | -2.91% | -1.29% |

I noted last week the TINA trade should prevail until some event occurs. That event has been a belief U.S. fiscal policies will lead to accelerated economic growth. Perhaps. But the money has to go somewhere.

**Equity Total Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| **MSCI World Free** | 1.17% | 3.06% | 5.84% | 18.52% |
| North America | 1.10% | 1.61% | 7.28% | 25.47% |
| Latin America | 3.84% | 11.96% | 9.66% | 59.04% |
| Emerging Market Free | 2.55% | 8.73% | 5.80% | 31.48% |
| EAFE | 1.30% | 4.24% | 5.97% | 13.63% |
| Pacific | 1.28% | 4.45% | 5.27% | 19.12% |
| Eurozone | 0.63% | 2.40% | 6.38% | 12.16% |

It is nice to see a week of gains across the board for professional traders, but this is too little and too late. The decision by Harvard Management to stop confusing brains with trading success is one more nail in the coffin. What will those in-house ETF managers do all day?

**CTA/Hedge Fund Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| Newedge CTA | 0.78% | -0.83% | -7.71% | -9.60% |
| Newedge Trend | 0.63% | -0.82% | -6.70% | -7.03% |
| Newedge Short-Term | 0.59% | -3.24% | -7.41% | -6.08% |
| HFR Global Hedge Fund | 0.68% | 0.95% | 3.13% | 6.63% |
| HFR Macro/CTA | 0.88% | -0.58% | -2.74% | -3.96% |
| HFR Macro: Sytematic Diversified CTA | 0.71% | -1.84% | -5.24% | -5.43% |