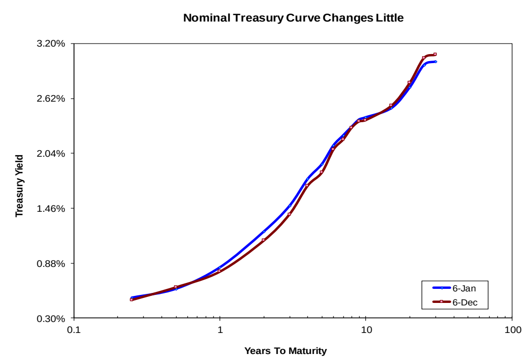
The Macro Environment For Financial Markets

A year ago, markets opened the year by stepping into a hole produced by fear of a weaker CNY, capital outflows from China and poor growth prospects. The first two factors remain, but global growth prospects are at their best levels since the end of the crisis. China attempted to punish yuan shorts, and most certainly did for a few days. However, the weak yuan story will continue. The Federal Reserve will have to take this into account when raising rates as the CNY remains quasi-pegged. The causal chain now is:

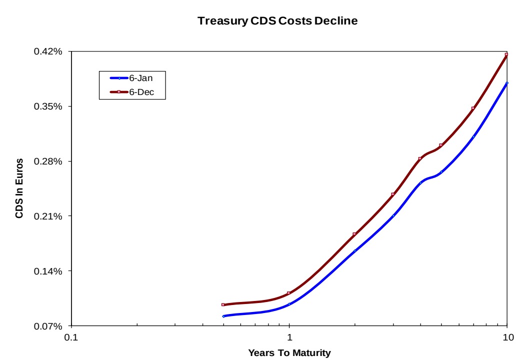
1. The market is nominally pricing in higher short-term rates in 2017, but the conviction levels are weak;
2. Inflationary expectations in the U.S. have stopped rising for the short-term, but are continuing to rise in the Eurozone in reflection of the EUR's decline;
3. The U.S. yield curve re-entering 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 continue to decline.

Key Market Indications

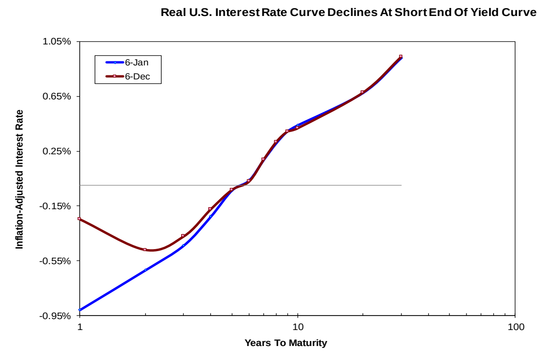
To repeat verbatim from last week, while the overall tenor of the market has to be considered bearish, it will be difficult for the U.S. to sell off significantly when there is such a rate gap with other OECD bond markets. We are in a consolidation period between now and the inauguration.



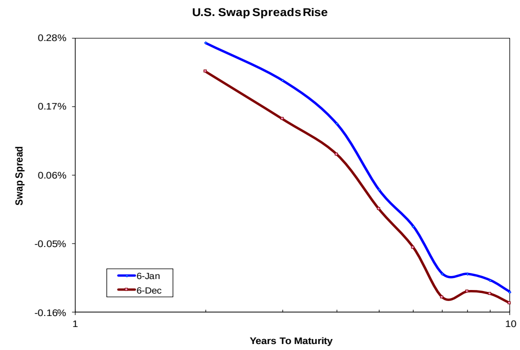
CDS costs on UST declined slightly, which is just as well considering how an impending one-party government is unlikely to default on U.S. debt.



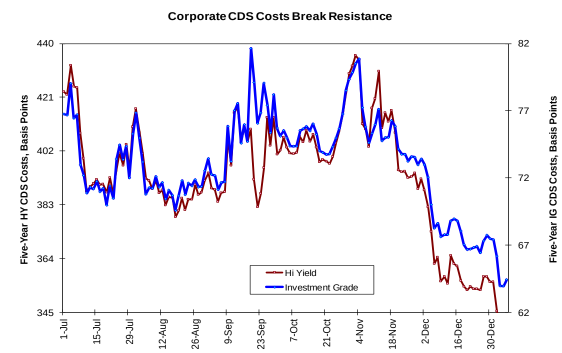
The pseudo-real yield curve declined again at the short end of the yield curve over the past month. This has helped support gold. The rise in long-term implied real rates has ended, removing one impediment to risky financial assets.



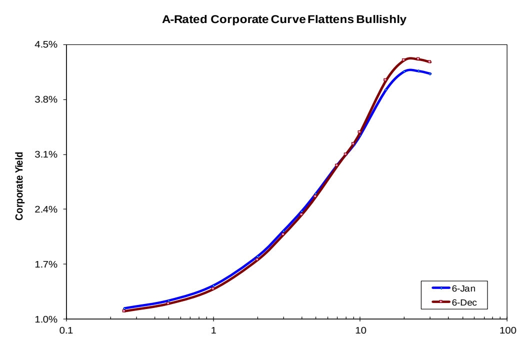
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market is pricing in higher sovereign rates. The swap market was slow to price in higher rates in November and appears to be behind the curve once again.



CDS costs, particularly for investment-grade bonds, broke through resistance. 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 and Grains remain in downtrends amongst the physical markets. The EM and EAFE indices moved into structural uptrends as did the dollar index.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Jan. 9 - 13
BBerg	16	Transitional	0.078	8.7%	
BBerg Grain	29	Trending	-0.006	12.8%	-0.82%
BBerg Ind. Metl	24	Trending	-0.082	18.1%	-0.32%
BBerg Pre. Metl	18	Transitional	0.131	13.5%	
BBerg Softs	15	Transitional	0.294	17.9%	
BBerg Nat. Gas	15	Transitional	-0.109	35.9%	
BBerg Petroleum	5	Sideways	0.025	26.2%	
BBerg Livestock	4	Sideways	0.023	13.5%	
Dollar Index	22	Trending	-0.002	9.4%	0.05%
S&P 500 Index	11	Transitional	0.112	6.3%	
EAFE Index	29	Trending	0.267	9.9%	0.09%
EM Index	24	Trending	0.262	8.2%	0.07%
Ten-year UST (price)	19	Transitional	0.115	5.7%	

Performance Measures

Natural Gas is showing us what happens when everyone's desk meteorologist reads the same data at the same time; you have to love that 12.4% drop over the course of a week. The Petroleum markets are coming to grips with the reality promises of OPEC production cuts and actual production cuts are two different things.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.33%	-0.84%	1.31%	14.25%
Grains Sub-Index	1.31%	-1.52%	-6.88%	-4.96%
Corn	2.37%	-0.38%	-4.48%	-7.76%
Soybeans	-1.77%	-5.11%	-7.49%	13.65%
Wheat	4.58%	1.72%	-11.01%	-22.61%
Energy Sub-Index	-3.63%	-0.41%	9.40%	19.20%
Petroleum Sub-Index	-0.19%	3.97%	12.87%	29.54%
WTI	0.29%	3.03%	8.73%	19.55%
Brent	0.45%	3.75%	12.43%	39.89%
ULSD	-0.79%	3.48%	11.64%	41.07%
Gasoline	-2.06%	7.29%	25.26%	17.43%
Natural Gas	-12.40%	-11.21%	0.57%	-5.83%
Precious Metals Sub-Index	1.49%	-0.05%	-15.51%	8.90%
Gold	1.33%	1.03%	-14.17%	6.01%
Silver	1.87%	-2.60%	-18.66%	16.82%
Industrial Metals Sub-Index	2.38%	-4.30%	12.60%	26.80%
Copper	2.34%	-3.79%	19.22%	24.19%
Aluminum	1.96%	-2.12%	2.01%	12.17%
Nickel	1.21%	-10.76%	2.90%	17.77%
Zinc	3.79%	-3.48%	21.16%	70.96%
Softs Sub-Index	5.92%	4.25%	-0.40%	25.14%
Coffee	5.48%	2.55%	-5.28%	9.49%
Sugar	6.48%	7.89%	3.06%	37.70%
Cotton	4.96%	4.55%	11.66%	19.32%
Livestock Sub-Index	-1.97%	3.95%	-3.21%	-5.78%
Cattle	-2.64%	3.93%	0.77%	-5.69%
Hogs	-1.03%	3.98%	-8.91%	-6.20%

The USD continued to gain against the INR and especially the MXN amongst EM currencies and against the JPY and GBP amongst the G-7 currencies, but it retreated elsewhere in the first trading week of the year. Much of the gain on expected interest rate divergences has been capitalized into rates, and the outlook for reckless U.S. fiscal stimulus is intersecting with the inevitable reality of Congressional resistance.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.14%	-1.74%	-5.12%	-2.31%
Chinese yuan	0.30%	-0.61%	-3.40%	-5.32%
Japanese yen	-0.05%	-2.56%	-13.42%	1.24%
British pound	-0.43%	-3.08%	-4.98%	-16.02%
Swiss franc	0.10%	-0.77%	-4.23%	-1.03%
Canadian dollar	1.54%	0.30%	-2.08%	6.34%
Australian dollar	1.29%	-2.14%	-2.91%	3.24%
Swedish krona	0.54%	0.76%	-5.89%	-5.20%
Norwegian krone	1.20%	-1.56%	-1.24%	4.90%
New Zealand dollar	0.38%	-2.25%	-2.41%	4.84%
Indian rupee	-0.06%	-0.09%	-0.75%	-1.67%
Brazilian real	1.01%	5.82%	3.33%	25.04%
Mexican peso	-2.33%	-3.90%	-11.70%	-17.36%
Chilean peso	0.35%	-1.16%	-0.81%	6.95%
Colombian peso	2.69%	2.72%	2.68%	11.41%
Bloomberg-JP Morgan Asian dollar index (spot)	0.23%	-0.86%	-2.98%	-2.14%

The combination of interest rate stability, improving economic data and poor alternatives elsewhere led to a very strong opening week of 2017 globally. If the USD's gains are muted, the EAFE and EM should outperform the U.S. over the course of the year.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.76%	1.45%	8.40%	17.26%
North America	1.90%	3.14%	9.71%	17.58%
Latin America	1.85%	4.39%	9.97%	39.83%
Emerging Market Free	2.20%	2.64%	8.89%	19.20%
EAFE	1.78%	3.77%	10.05%	7.47%
Pacific	2.40%	0.51%	10.63%	13.61%
Eurozone	2.20%	3.99%	12.59%	10.94%

Both CTAs and hedge funds continue to perform poorly; unless this changes, the industry will continue to lose AUM to passive managers. You cannot eat diversification, especially when it is eating you.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.30%	2.19%	-9.03%	-6.28%
Newedge Trend	-0.16%	1.88%	-7.53%	-3.24%
Newedge Short-Term	-0.90%	1.32%	-6.87%	-0.66%
HFR Global Hedge Fund	0.30%	1.09%	3.63%	3.28%
HFR Macro/CTA	-0.58%	0.38%	-3.64%	-3.75%
HFR Macro: Sytematic Diversified CTA	-1.36%	0.43%	-5.98%	-2.72%