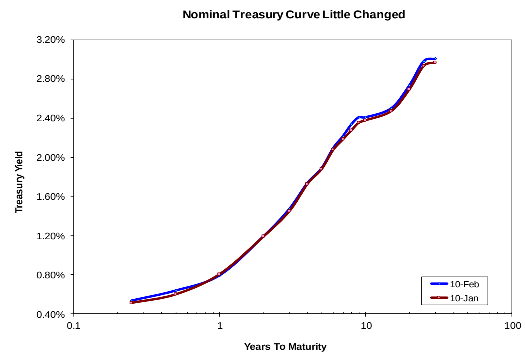
The Macro Environment For Financial Markets

Markets are not perfect, but they usually excel at picking the signal out from the noise. This may be harder than usual given the noise levels we have to endure these days, but the signal is unequivocal: We are in a modest-growth, low-inflation environment with no worrisome imbalances. Human history says this is a bad bet to continue, but unless you have a weekend cabin in Montana, enjoy it. The causal chain remains:

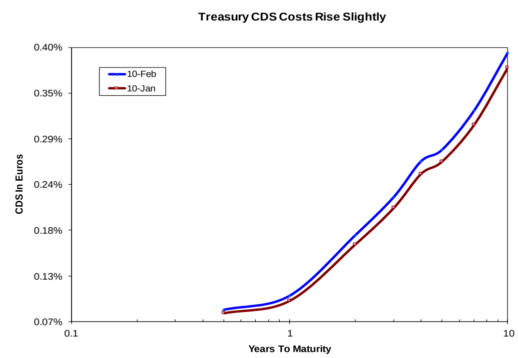
1. The market is nominally pricing in higher short-term rates in 2017, but the conviction levels are weak;
2. Inflationary expectations have resumed rising;
3. The U.S. yield curve has paused in its secular flattening trend;
4. Short-term borrowers have stopped terming out short-term debt into the bond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

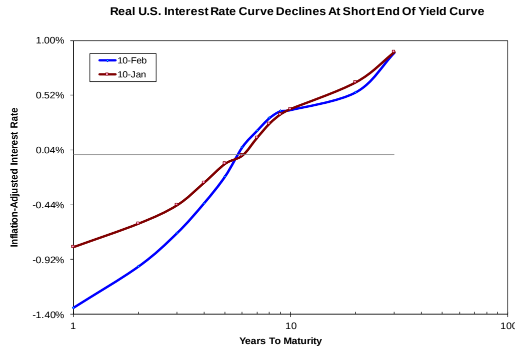
Anyone looking at a chart of ten-year UST yields would have to conclude the post-election rise is going to be retraced. However, we are no closer now than we were then to knowing what the administration's fiscal plans are. It is telling equities rallied on a vapor of tax reform, nowhere defined, while UST yields barely changed.



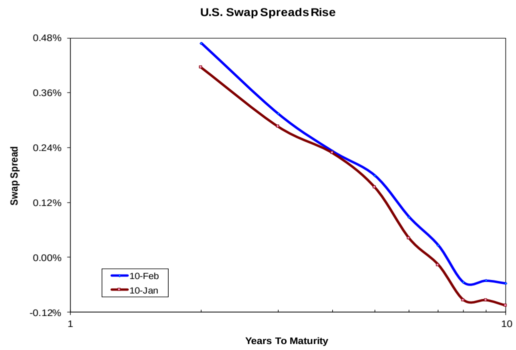
CDS costs on UST have increased very slightly over the past month. This has not risen to a vote of no-confidence yet, but no market has infinite patience.



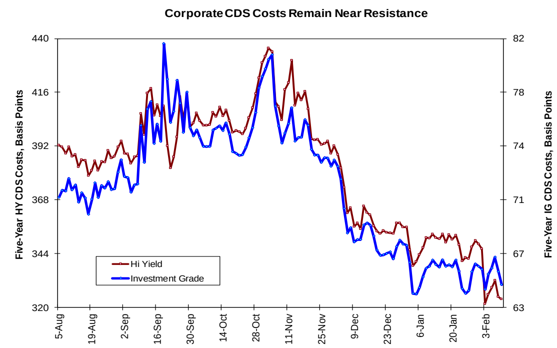
The pseudo-real yield curve declined at both the short and long ends of the yield curve over the past month, with most of the decline occurring at the short end of the yield curve. This helped push precious metals higher.



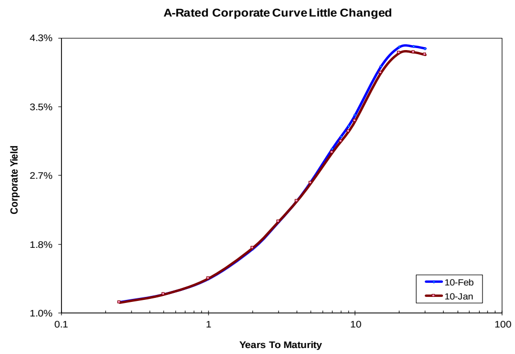
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market is pricing in higher sovereign rates. The swap market was slow to price in higher rates in November and appears to be behind the curve once again. Heavily insured events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



CDS costs were not able to break recent resistance, but neither did they give any sign the recent rally is being rejected. This is a bull market.



The A-rated corporate yield curve has remained near-constant over the past month as modest decreases in credit spreads have been offset by modest increases in UST yields.



Market Structure

The main Bloomberg and Industrial Metals remained in structural uptrends amongst the physical markets and were joined by Precious Metals. The S&P 500 moved back into a structural uptrend while the dollar index barely remained in its structural downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 13 - 17
BBerg	28	Trending	0.232	8.2%	0.10%
BBerg Grain	14	Transitional	0.198	12.5%	
BBerg Ind. Metl	29	Trending	0.315	15.6%	0.50%
BBerg Pre. Metl	29	Trending	0.256	12.4%	0.25%
BBerg Softs	10	Sideways	-0.028	13.4%	
BBerg Nat. Gas	21	Trending	-0.079	28.6%	
BBerg Petroleum	25	Trending	0.050	18.3%	
BBerg Livestock	16	Transitional	-0.029	10.3%	
Dollar Index	29	Trending	-0.010	9.0%	-0.13%
S&P 500 Index	21	Trending	0.216	6.3%	0.08%
EAFE Index	10	Sideways	0.045	8.5%	
EM Index	9	Sideways	0.161	7.1%	
Ten-year UST (price)	29	Trending	0.024	5.6%	

Performance Measures

The sideways action in Petroleum markets has continued, a rarity over the past two years. Both Precious and especially Industrial Metals rallied strongly, the former on a decline in implied real short-term interest rates and the latter on wishful thinking about fiscal stimulus.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.62%	0.96%	6.53%	18.87%
Grains Sub-Index	3.25%	3.49%	5.87%	1.28%
Corn	2.50%	4.46%	9.87%	-3.97%
Soybeans	3.14%	1.27%	6.14%	20.05%
Wheat	4.66%	5.74%	-1.72%	-14.01%
Energy Sub-Index	0.06%	-2.54%	9.13%	29.54%
Petroleum Sub-Index	0.19%	0.27%	12.39%	37.15%
WTI	-0.07%	1.24%	10.97%	35.01%
Brent	-0.15%	1.25%	11.77%	44.82%
ULSD	0.08%	0.29%	11.31%	38.39%
Gasoline	1.49%	-3.66%	19.10%	26.56%
Natural Gas	-0.29%	-10.04%	0.58%	9.40%
Precious Metals Sub-Index	1.62%	4.15%	-8.83%	2.18%
Gold	1.25%	3.11%	-8.28%	-1.29%
Silver	2.60%	7.00%	-9.93%	11.81%
Industrial Metals Sub-Index	4.40%	3.17%	20.50%	36.67%
Copper	5.81%	2.93%	28.36%	34.59%
Aluminum	2.10%	3.28%	12.32%	22.40%
Nickel	4.22%	1.89%	2.68%	34.27%
Zinc	4.64%	4.83%	29.73%	69.07%
Softs Sub-Index	-1.70%	0.27%	1.77%	32.94%
Coffee	-0.35%	-2.36%	1.79%	15.17%
Sugar	-3.12%	-0.30%	0.87%	48.78%
Cotton	-0.64%	5.09%	6.74%	29.36%
Livestock Sub-Index	-0.92%	-1.83%	1.60%	-5.53%
Cattle	-2.13%	-4.01%	-2.30%	-3.00%
Hogs	1.18%	2.12%	7.56%	-9.12%

An ill-defined rising expectation for fiscal stimulus in the U.S. pulled the USD higher against all majors save the GBP. Major EM currencies such as the INR and BRL continued to advance on the back of asset flows, however.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.30%	0.84%	-4.77%	-5.75%
Chinese yuan	-0.16%	0.63%	-3.53%	-4.42%
Japanese yen	-0.54%	2.25%	-10.54%	0.11%
British pound	0.06%	2.58%	-3.99%	-13.99%
Swiss franc	-0.94%	1.46%	-2.73%	-2.86%
Canadian dollar	-0.46%	1.14%	-0.19%	6.44%
Australian dollar	-0.08%	4.15%	-0.38%	8.16%
Swedish krona	-1.73%	1.83%	-5.10%	-6.08%
Norwegian krone	-1.90%	2.87%	-1.13%	1.77%
New Zealand dollar	-1.71%	2.86%	-0.22%	7.54%
Indian rupee	0.65%	1.94%	-0.25%	1.45%
Brazilian real	0.25%	2.54%	0.39%	26.14%
Mexican peso	0.08%	7.18%	-9.49%	-6.92%
Chilean peso	-0.16%	4.74%	1.44%	11.40%
Colombian peso	-0.07%	3.52%	3.09%	18.84%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.41%	1.40%	-3.07%	-1.63%

The ongoing rally of EM equities essentially is a retracement of the Trump trade, which is whatever you want it to mean on a given day. Interestingly, the EAFE and its major Eurozone component were unable to join the global rally. This reflects the high level of political risk in these markets.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.55%	1.59%	5.56%	25.29%
North America	0.88%	2.36%	7.72%	29.09%
Latin America	1.35%	8.67%	7.01%	55.78%
Emerging Market Free	1.25%	5.06%	3.93%	30.83%
EAFE	-0.02%	1.62%	3.47%	19.09%
Pacific	1.07%	1.69%	4.52%	31.20%
Eurozone	-1.64%	-1.05%	2.67%	17.35%

Both CTAs and hedge funds managed small gains this week. With equities being the strongest trend, the implications are both classes of traders remain an inefficient way of jumping on a bull market.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.24%	-0.17%	-10.16%	-12.71%
Newedge Trend	0.36%	-0.43%	-8.28%	-9.95%
Newedge Short-Term	-0.47%	-4.34%	-10.08%	-10.69%
HFR Global Hedge Fund	0.08%	0.69%	2.64%	8.42%
HFR Macro/CTA	0.29%	0.22%	-3.87%	-4.23%
HFR Macro: Sytematic Diversified CTA	0.27%	-0.38%	-7.16%	-7.53%