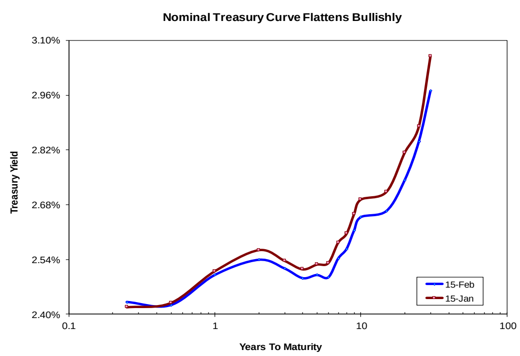
The Macro Environment For Financial Markets

If anyone ever had a question of how financial markets regarded the misguided protectionist policies threatened globally, this week should have put those doubts to bed. Higher trade barriers are recessionary; end of story. If we combine an end to the madness – a big if – with other fiscal stimulus and a pause in monetary contraction, we could continue to see a rally in risky assets. However, that would be an open invitation to the Federal Reserve to resume its misguided tightening policies of 2018. Such is life. The causal chain now is:

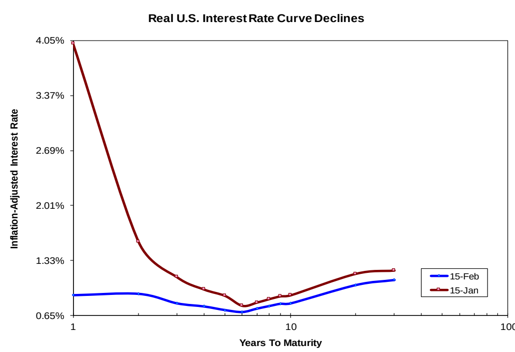
1. The market has priced out a 2019 rate hike;
2. The yield curve is holding its weak positive slope;
3. Inflationary expectations are poised to rise, but have yet to break out to the upside;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are declining; and
6. CDS costs are declining as the equity rally has resumed.

Key Market Indications

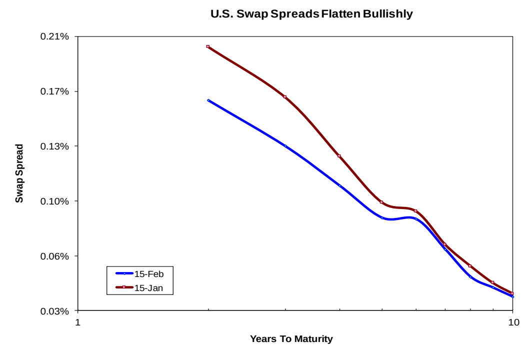
The rally in UST continues to be led from the mid-curve. The news of an expanding deficit was greeted with a yawn as were both a continued rally in equities and the USD and some weaker economic news, especially declining retail sales. In interest rate theory parlance, it appears as if everyone is in their preferred habitat and has no reason to leave it. The path of least resistance for yields remains lower.



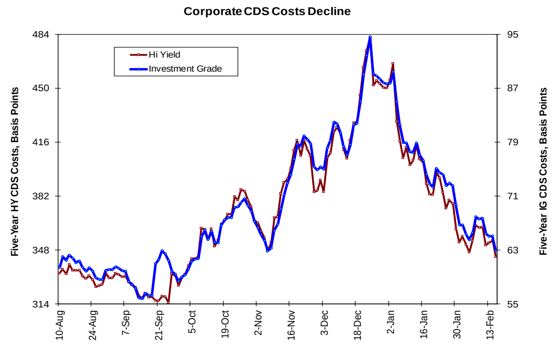
The pseudo-real yield curve is declining across the maturity spectrum, especially at the short end of the yield curve, as expectations for tighter monetary policy dissipate.



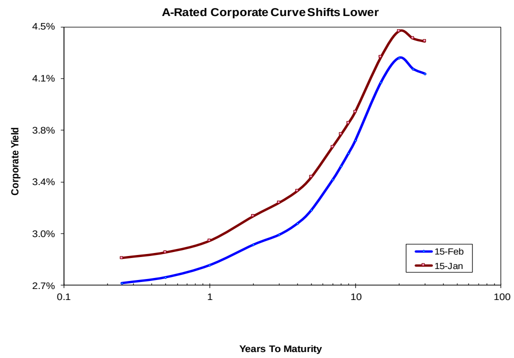
Swap spreads, which rise when floating-rate borrowers want to fix their payments, have declined slightly at the long end of the yield curve and more substantially at shorter tenors. The market has become complacent about higher credit spreads and interest rate shifts.



CDS costs remain linked to the equity markets. This week's rally has led to a small decline in credit risk.



Corporate bonds continue to rally as recession risk is being priced out of the market and the Federal Reserve appears content to remain on the sidelines.



Market Structure

Grains and Softs have turned negative and helped shift the main Bloomberg index into a sideways structure. Petroleum and Industrial Metals remain in structural uptrends. Ten-year UST and the dollar index joined the S&P 500 and the EAFE index in structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 18 - 22
BBerg	10	Sideways	0.096	8.0%	
BBerg Grain	29	Trending	-0.144	10.2%	-0.12%
BBerg Ind. Metl	29	Trending	0.138	11.5%	0.36%
BBerg Pre. Metl	8	Sideways	0.068	7.0%	
BBerg Softs	29	Trending	-0.116	13.4%	-0.41%
BBerg Nat. Gas	27	Trending	-0.090	22.2%	-0.15%
BBerg Petroleum	29	Trending	0.246	24.6%	0.96%
BBerg Livestock	29	Trending	0.037	8.9%	0.12%
Dollar Index	29	Trending	0.176	4.6%	0.12%
S&P 500 Index	29	Trending	0.351	11.3%	0.27%
EAFE Index	29	Trending	0.207	8.9%	0.20%
EM Index	8	Sideways	-0.113	7.6%	
Ten-year UST (price)	22	Trending	0.081	3.7%	0.03%

Performance Measures

The entire Energy complex reversed last week's decline. Grains, Softs and economically sensitive Industrial Metals all declined. Precious Metals advanced on declining short-dated implied real rates.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.16%	-0.33%	-1.73%	-6.27%
Grains Sub-Index	-0.91%	-1.78%	-6.43%	-10.66%
Corn	0.19%	-1.63%	-2.87%	-8.84%
Soybeans	-0.74%	-0.84%	-0.21%	-15.63%
Wheat	-2.40%	-2.41%	-13.73%	-3.35%
Energy Sub-Index	5.12%	-1.66%	-7.66%	2.41%
Petroleum Sub-Index	6.17%	4.98%	-10.20%	-0.33%
WTI	5.54%	3.11%	-13.75%	-5.19%
Brent	6.80%	5.85%	-7.22%	6.61%
ULSD	6.01%	6.15%	-2.18%	9.21%
Gasoline	6.49%	5.11%	-17.21%	-12.88%
Natural Gas	1.82%	-18.69%	-6.61%	3.17%
Precious Metals Sub-Index	0.15%	2.68%	10.75%	-3.99%
Gold	0.32%	2.77%	11.82%	-3.21%
Silver	-0.38%	2.42%	7.23%	-6.56%
Industrial Metals Sub-Index	-1.04%	2.29%	0.80%	-15.11%
Copper	-0.44%	3.06%	6.23%	-14.83%
Aluminum	-1.26%	-1.12%	-8.37%	-13.93%
Nickel	-1.37%	4.83%	-8.10%	-11.09%
Zinc	-1.80%	2.86%	15.43%	-21.32%
Softs Sub-Index	-0.42%	-1.34%	1.97%	-14.84%
Coffee	-3.85%	-5.86%	-7.72%	-24.06%
Sugar	3.37%	0.94%	22.00%	-8.20%
Cotton	-2.65%	-4.27%	-14.14%	-6.26%
Livestock Sub-Index	0.18%	-3.17%	1.46%	-2.52%
Cattle	-0.54%	0.03%	7.51%	1.13%
Hogs	1.93%	-10.02%	-11.05%	-10.14%

Even though the USD gained against most majors, commodity-linked currencies such as the CAD, AUD, BRL and NZD all gained. The decline in other Latin currencies indicates the associated equity rally is about to end; who, after all, can be enamored of the political landscape in Latin America?

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.24%	-1.03%	-0.43%	-9.68%
Chinese yuan	-0.41%	-0.18%	2.39%	-6.37%
Japanese yen	-0.67%	-1.62%	0.24%	-3.93%
British pound	-0.42%	0.22%	1.51%	-8.58%
Swiss franc	-0.47%	-1.73%	-1.15%	-8.28%
Canadian dollar	0.26%	0.17%	-0.78%	-5.76%
Australian dollar	0.75%	-0.83%	-1.35%	-10.12%
Swedish krona	-0.09%	-3.40%	-0.84%	-14.53%
Norwegian krone	0.03%	-1.08%	-2.09%	-10.07%
New Zealand dollar	1.90%	0.75%	4.62%	-7.28%
Indian rupee	0.11%	-0.26%	-1.87%	-10.27%
Brazilian real	0.83%	0.50%	5.49%	-12.70%
Mexican peso	-0.91%	-1.30%	-0.59%	-3.90%
Chilean peso	-0.76%	1.64%	0.08%	-10.63%
Colombian peso	-0.81%	0.01%	-2.85%	-9.19%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.05%	0.13%	1.77%	-5.37%

The stronger USD continues to pressure the EM index, but both the U.S. and the EAFE index posted strong gains.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.35%	3.46%	-2.36%	-0.90%
North America	2.51%	4.19%	-1.72%	3.44%
Latin America	1.13%	2.04%	16.01%	-4.19%
Emerging Market Free	-0.49%	1.30%	1.70%	-11.67%
EAFE	2.04%	2.08%	-3.59%	-8.37%
Pacific	1.25%	1.09%	-3.95%	-7.63%
Eurozone	2.81%	2.47%	-4.78%	-12.02%

While CTAs posted small gains on the week, likely in energy and currency markets, macro-oriented hedge funds continued to retreat. Global hedge funds gained as equity markets remained strong.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
SocGen CTA	0.36%	0.58%	-6.98%	-7.37%
SocGen Trend	0.40%	0.62%	-3.29%	-4.36%
SocGen Short-Term	-0.09%	-1.68%	-2.75%	-3.66%
HFR Global Hedge Fund	0.13%	1.00%	-3.35%	-5.37%
HFR Macro/CTA	-0.30%	0.46%	-4.43%	-5.66%
HFR Macro: Sytematic Diversified CTA	-0.83%	0.01%	-5.75%	-6.23%