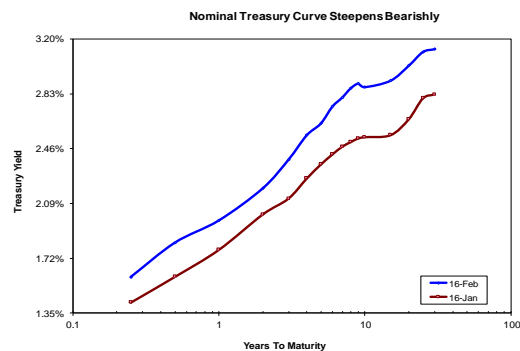


Even though the U.S. inflation data was higher than desired, the worst had been discounted already and this allowed both equity and fixed-income markets to stabilize. The biggest destabilizing fundamental remains herding behavior in financial markets; if market capitalization is greater than GDP, irruptions such as the volatility-unwinding trade of not-so-blessed memory can and will have macroeconomic effects. Bull markets don't die, they are killed, generally by central banks but increasingly likely by traders. The causal chain now is:

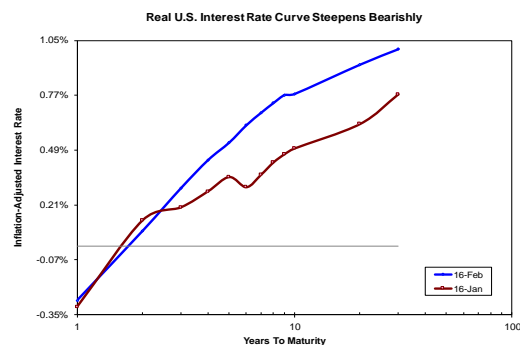
1. The market is pricing in March and June 2018 rate hikes;
2. Inflationary expectations are on pace to reach their next target of 2.26% for the ten-year;
3. The bearish steepening of the yield curve has hit resistance;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are rising; and
6. CDS costs have declined, but more as a reflection of equity markets than of changes in credit conditions.

Key Market Indications

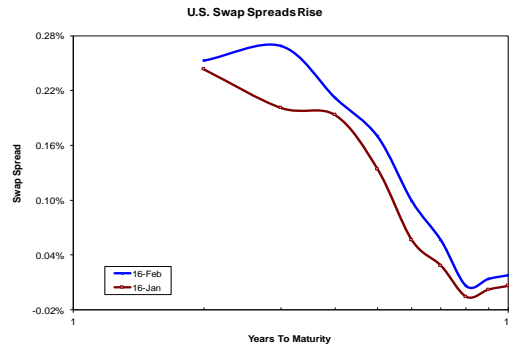
Ten-year UST did not sell off on the combination of higher reported inflation and a return to risk-on trades. Any market that fails to sell off on bad news has found fundamental support. While we will test support at 3.05% on the ten-year at some point, the worst of the selloff is over for now.



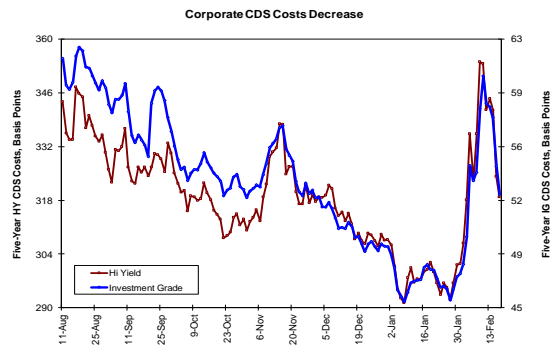
The pseudo-real yield curve shifted higher at the long end of the yield curve. While this did not punish equities, let's just say no one has repealed any financial laws of gravity recently and therefore this is negative news for capital market-horizon assets.



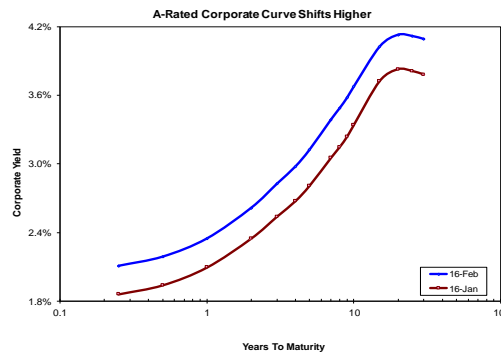
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across the maturity spectrum. The rise at the long end present a danger to the long end of the corporate bond yield curve.



In a mirror image from last week, CDS costs fell as equities rose. As the economic data continue to improve and liquidity remains ample, these spreads reflect equities far more than they do credit conditions.



The A-rated corporate yield curve continues to shift higher. However, the combination of rising UST yields and higher credit spreads have improved the risk/reward of what had been a very overbought market.



Market Structure

Grains and Industrial Metals moved back into structural uptrends. Financials all remain within consolidative structures.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 19 - 23
BBERG	16	Transitional	0.003	10.2%	
BBERG Grain	29	Trending	0.367	9.3%	0.22%
BBERG Ind. Metl	21	Trending	0.120	16.9%	0.11%
BBERG Pre. Metl	15	Transitional	0.093	12.4%	
BBERG Softs	29	Trending	-0.232	15.0%	-0.12%
BBERG Nat. Gas	29	Trending	-0.206	21.3%	-0.05%
BBERG Petroleum	29	Trending	-0.190	18.9%	-0.49%
BBERG Livestock	29	Trending	0.042	10.4%	
Dollar Index	12	Transitional	-0.062	8.2%	
S&P 500 Index	4	Sideways	0.066	14.4%	
EAFE Index	4	Sideways	0.102	14.1%	
EM Index	14	Transitional	0.016	16.0%	
Ten-year UST (price)	6	Sideways	-0.005	5.9%	

Performance Measures

If the world is not going to end, why not buy some copper? He gains in both Industrial Metals and Energy were quite impressive, but the way both complexes have been tracking equities as opposed to their own fundamentals is a trifle disturbing. The post-WASDE move higher in Grains is the first rally in months in this complex.

	Commodity Total Returns			
	Five-Days	One Month	Six Months	One Year
Bloomberg Index	3.02%	-0.27%	6.64%	1.19%
Grains Sub-Index	2.61%	5.86%	1.54%	-10.04%
Corn	1.47%	4.33%	-2.63%	-11.82%
Soybeans	3.96%	4.64%	7.15%	-5.01%
Wheat	2.30%	8.69%	0.29%	-13.26%
Energy Sub-Index	2.59%	-6.47%	10.94%	1.40%
Petroleum Sub-Index	3.54%	-4.54%	23.61%	12.83%
WTI	4.32%	-2.36%	25.82%	10.59%
Brent	3.31%	-4.85%	26.98%	15.32%
ULSD	3.07%	-6.80%	18.75%	14.34%
Gasoline	2.92%	-5.94%	16.88%	9.47%
Natural Gas	-0.05%	-11.60%	-20.94%	-27.41%
Precious Metals Sub-Index	3.21%	0.72%	3.19%	3.96%
Gold	3.11%	1.48%	4.92%	8.60%
Silver	3.58%	-1.79%	-2.13%	-8.47%
Industrial Metals Sub-Index	6.08%	3.02%	12.16%	19.99%
Copper	7.10%	2.01%	9.64%	17.84%
Aluminum	3.95%	-0.64%	5.98%	15.16%
Nickel	7.32%	9.44%	26.14%	24.42%
Zinc	5.70%	4.86%	16.07%	28.37%
Softs Sub-Index	-2.02%	-2.67%	-2.43%	-25.57%
Coffee	-2.75%	-2.23%	-11.88%	-26.50%
Sugar	-2.08%	0.77%	-3.55%	-36.78%
Cotton	-0.61%	-8.65%	13.50%	3.71%
Livestock Sub-Index	1.96%	-0.42%	3.41%	5.98%
Cattle	3.29%	4.13%	8.45%	13.24%
Hogs	-0.99%	-9.63%	-6.60%	-7.05%

Only the CNY stood in the way of the USD declining across the board. This is welcome news for global equities as the dollar carry trade had moved back into prominence in recent months. Markets are bypassing normal interest rate arbitrage and the effects of fiscal stimulus and monetary tightening to focus on declining relative real returns for the USD.

	Currency Returns			
	Five-Days	One Month	Six Months	One Year
Euro	1.26%	1.19%	5.43%	16.23%
Chinese yuan	-1.00%	1.51%	5.20%	8.29%
Japanese yen	2.44%	3.99%	3.75%	6.62%
British pound	1.44%	1.70%	8.80%	12.31%
Swiss franc	1.25%	3.51%	4.19%	7.56%
Canadian dollar	0.18%	-0.98%	0.48%	4.09%
Australian dollar	1.18%	-0.70%	-0.25%	2.74%
Swedish krona	1.40%	0.90%	1.36%	11.18%
Norwegian krone	2.33%	1.21%	1.86%	6.51%
New Zealand dollar	1.81%	1.62%	1.00%	2.44%
Indian rupee	0.28%	-0.27%	-0.10%	4.45%
Brazilian real	2.17%	-0.22%	-2.44%	-4.37%
Mexican peso	0.95%	1.31%	-4.66%	10.02%
Chilean peso	1.75%	2.35%	8.77%	7.65%
Colombian peso	3.64%	0.95%	4.63%	1.37%
Bloomberg-JP Morgan Asian dollar index (spot)	0.40%	1.00%	4.35%	6.61%

In risk-off periods, correlations rise. The same can happen in reverse, apparently. The one thing we can say with impunity about equity markets over the past three weeks is the efficient market hypothesis should be retired in an algorithmic world.

	Equity Total Returns			
	Five-Days	One Month	Six Months	One Year
MSCI World Free	4.32%	-2.99%	11.79%	19.26%
North America	4.35%	-1.56%	11.49%	17.88%
Latin America	5.70%	4.03%	12.42%	20.39%
Emerging Market Free	5.04%	-1.38%	14.09%	30.18%
EAFE	4.28%	-3.10%	8.73%	21.70%
Pacific	3.02%	-3.62%	10.86%	19.22%
Eurozone	4.76%	-3.60%	7.54%	27.99%

While both CTAs and hedge funds gained this week, neither outperformed equities after they lost during the equity selloff. There are cheaper ways to trade closet index funds.

	CTA/Hedge Fund Returns			
	Five-Days	One Month	Six Months	One Year
Newedge CTA	2.29%	-7.13%	6.45%	-2.93%
Newedge Trend	1.75%	-5.66%	4.11%	-1.35%
Newedge Short-Term	0.87%	-1.54%	2.82%	-0.64%
HFR Global Hedge Fund	1.35%	-0.73%	4.26%	5.38%
HFR Macro/CTA	1.69%	-2.03%	4.06%	2.94%
HFR Macro:	2.57%	-4.95%	6.83%	2.79%
Systematic Diversified CTA				