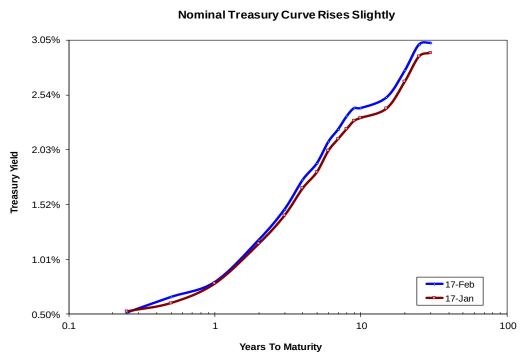
The Macro Environment For Financial Markets

Janet Yellen needs to buy a copy of "Scaring Markets For Dummies." Her threats to raise interest rates were met with a tepid rally in the dollar, almost no change in long-term UST yields and a stock market rally. Did she learn nothing from the Maestro? The ongoing global equity rally is meeting the first condition of an incipient bubble, and that is investors are buying it because it has been going up. The blowoff will follow. The causal chain remains:

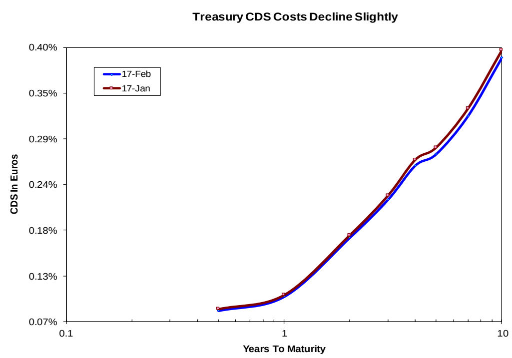
1. The market is nominally pricing in higher short-term rates in 2017, but the conviction levels are weak;
2. Inflationary expectations have resumed rising;
3. The U.S. yield curve has paused in its secular flattening trend;
4. Short-term borrowers have stopped terming out short-term debt into the bond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

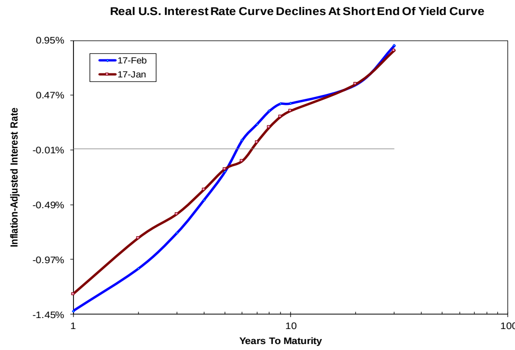
We have expectations for higher inflation, higher short-term rates, greater growth and fiscal stimulus and an end of non-U.S. QE, and ten-year UST yields have barely moved higher since the immediate aftermath of the U.S. election. The demand for seemingly safe assets is far larger than anyone ever imagined.



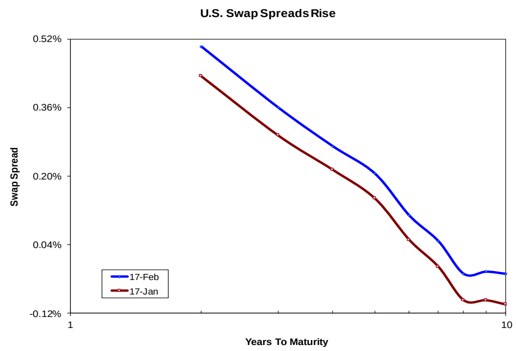
CDS costs on UST have increased very slightly over the past month. This has not risen to a vote of no-confidence yet, but no market has infinite patience.



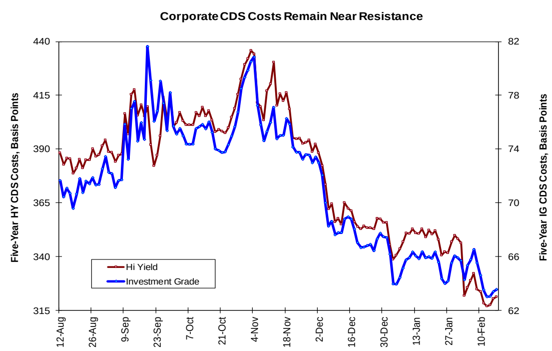
The pseudo-real yield curve declined at the short end of the yield curve over the past month. This helped push precious metals higher. Oddly, for all of the purported increase in inflation expectations, implied long-term real rates have increased only modestly in the 7-10 year range and scarcely at all in the longer maturities.



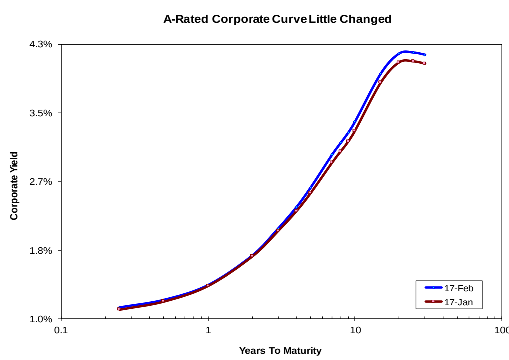
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market is pricing in higher sovereign rates. The swap market was slow to price in higher rates in November and appears to be behind the curve once again. Heavily insured events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

Industrial Metals managed to remain in their structural uptrend in the physical markets, while Natural Gas entered a structural downtrend. Within the financials, the dollar index exited its downtrend and ten-year UST reversed into a weak structural uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 20 - 24
BBerg	18	Transitional	-0.007	7.2%	
BBerg Grain	17	Transitional	0.011	12.7%	
BBerg Ind. Metl	29	Trending	0.150	16.2%	0.50%
BBerg Pre. Metl	5	Sideways	0.048	10.1%	
BBerg Softs	4	Sideways	-0.004	11.4%	
BBerg Nat. Gas	28	Trending	-0.233	28.2%	-0.47%
BBerg Petroleum	27	Trending	-0.038	17.5%	
BBerg Livestock	17	Transitional	0.068	10.3%	
Dollar Index	29	Trending	0.036	8.3%	
S&P 500 Index	29	Trending	0.400	6.2%	0.08%
EAFE Index	15	Transitional	0.107	8.0%	
EM Index	29	Trending	0.389	7.2%	0.22%
Ten-year UST (price)	29	Trending	0.023	5.4%	0.02%

Performance Measures

The Petroleum markets declined on the realization higher OPEC prices support higher non-OPEC production. Who knew? Natural Gas turned lower on freakishly warmer weather in the U.S. Midwest, while Grain prices turned lower on the realization the Southern Hemisphere crops will come in as expected. Two growing seasons mean two rounds of bad trading in grain markets.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.39%	-0.26%	2.39%	17.74%
Grains Sub-Index	-1.88%	-0.44%	1.49%	-1.79%
Corn	-1.68%	-0.43%	4.64%	-7.06%
Soybeans	-2.50%	-3.23%	1.14%	16.48%
Wheat	-1.64%	3.45%	-4.37%	-16.19%
Energy Sub-Index	-2.65%	-3.48%	0.18%	30.46%
Petroleum Sub-Index	-1.74%	-1.16%	1.80%	37.56%
WTI	-1.20%	-0.12%	1.16%	35.22%
Brent	-1.65%	-0.65%	1.48%	43.99%
ULSD	-1.71%	-1.47%	1.58%	39.88%
Gasoline	-2.84%	-3.86%	5.04%	28.45%
Natural Gas	-5.36%	-9.98%	-4.03%	11.52%
Precious Metals Sub-Index	0.36%	3.53%	-8.14%	3.79%
Gold	0.27%	2.64%	-8.24%	-0.33%
Silver	0.59%	5.93%	-7.66%	15.44%
Industrial Metals Sub-Index	-1.00%	3.84%	17.92%	30.56%
Copper	-2.22%	3.13%	24.00%	28.50%
Aluminum	0.33%	1.47%	11.87%	18.59%
Nickel	3.62%	13.78%	5.90%	26.81%
Zinc	-3.93%	1.52%	21.97%	58.76%
Softs Sub-Index	-0.48%	-1.00%	2.63%	33.09%
Coffee	0.97%	-3.94%	1.86%	17.23%
Sugar	-0.80%	0.55%	-0.25%	52.81%
Cotton	-2.10%	1.78%	8.51%	24.72%
Livestock Sub-Index	0.84%	-0.98%	3.40%	-5.99%
Cattle	1.58%	-3.36%	3.09%	-5.02%
Hogs	-0.41%	3.40%	3.78%	-7.56%

If Yellen thought she was signaling the currency markets to expect higher short-term USD rates, the currency markets signaled back, "yes, but not high enough." Moreover, anyone who thought the U.S. was entering a new era of strong fiscal stimulus really did not bring a strong understanding of Congressional procedures to the table.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.25%	-0.91%	-5.96%	-4.60%
Chinese yuan	0.17%	-0.31%	-3.38%	-4.92%
Japanese yen	0.34%	-0.20%	-11.13%	1.12%
British pound	-0.63%	-0.02%	-4.83%	-13.17%
Swiss franc	-0.02%	-0.11%	-4.04%	-1.01%
Canadian dollar	-0.10%	-0.40%	-1.92%	4.40%
Australian dollar	-0.13%	1.28%	0.12%	6.67%
Swedish krona	0.08%	-0.31%	-5.47%	-4.45%
Norwegian krone	0.27%	1.25%	-1.66%	2.41%
New Zealand dollar	-0.11%	-0.46%	-0.97%	8.28%
Indian rupee	-0.20%	1.40%	-0.38%	2.16%
Brazilian real	0.56%	3.67%	3.51%	28.81%
Mexican peso	-0.41%	5.28%	-11.21%	-10.10%
Chilean peso	-0.77%	1.83%	2.07%	8.62%
Colombian peso	-1.30%	0.96%	0.69%	16.23%
Bloomberg-JP Morgan Asian dollar index (spot)	0.08%	0.62%	-2.54%	-0.82%

The EAFE in general and Eurozone equities in particular joined the global rally this week, pushing everything higher. Earning are going to grow faster than interest rates; what else do we need to know?

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.28%	3.19%	7.10%	22.53%
North America	1.52%	3.86%	8.92%	25.51%
Latin America	1.03%	7.70%	6.61%	52.40%
Emerging Market Free	0.97%	4.99%	4.11%	31.15%
EAFE	0.87%	2.05%	4.10%	16.43%
Pacific	0.71%	2.98%	6.31%	23.55%
Eurozone	1.18%	0.26%	4.73%	15.06%

Both CTAs and hedge funds managed small gains again this week. The increase for CTAs is interesting given the general lack of strong trends in anything but the equity indices.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	2.55%	2.02%	-6.33%	-9.51%
Newedge Trend	1.73%	1.28%	-5.40%	-7.69%
Newedge Short-Term	0.76%	-2.80%	-8.99%	-10.04%
HFR Global Hedge Fund	0.40%	0.98%	3.05%	8.76%
HFR Macro/CTA	0.00%	0.45%	-3.08%	-3.86%
HFR Macro: Sytematic Diversified CTA	0.46%	1.04%	-4.89%	-5.98%