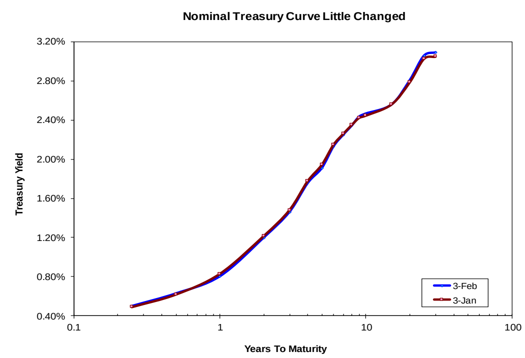
The Macro Environment For Financial Markets

Trading ranges are born either from economic equilibria in various industries or in levels of confusion so high both buyers and sellers move to the sidelines. The latter appears to be the case at present. The good news is the general state of affairs continues to favor slow growth, only modest sovereign rate increases, declining credit risk and none of the sorts of events that force traders and investors to reassess their opinions. There is no intrinsic reason this is unstable even though a rational and experienced person knows it will end one day. The causal chain remains:

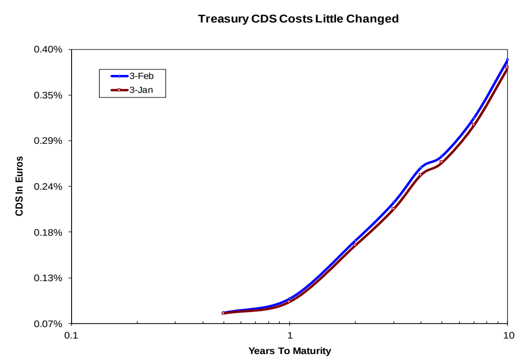
1. The market is nominally pricing in higher short-term rates in 2017, but the conviction levels are weak;
2. Inflationary expectations have resumed rising;
3. The U.S. yield curve has paused in its secular flattening trend;
4. Short-term borrowers have stopped terming out short-term debt into the bond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

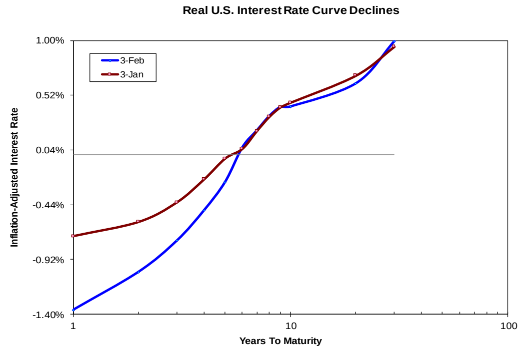
To repeat verbatim from last week, sometimes boring is good. The quiet conditions seen in the UST market since mid-December will end in a burst of volatility once the new administration and Congress start fleshing out the budget. There is little reason to expect any sort of reckless fiscal expansion, but there is no reason to expect a strong fixed-income rally, either.



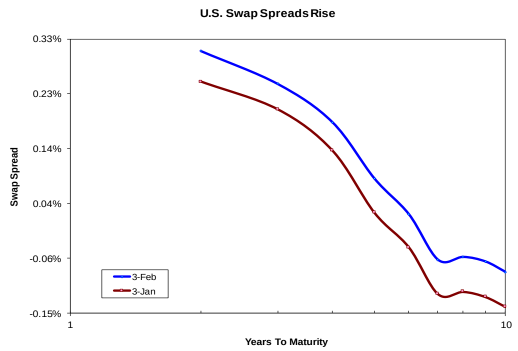
CDS costs on UST remain little changed. This market is likely to remain quite dormant unless Republican party discipline breaks down entirely and the federal deficit expands.



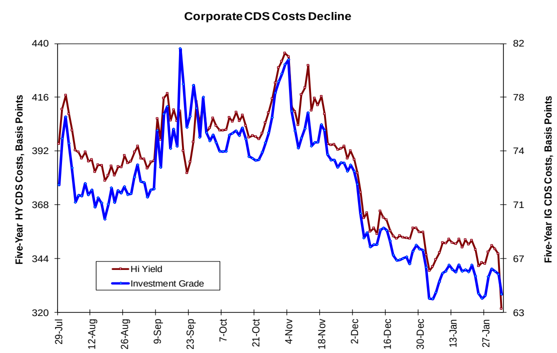
The pseudo-real yield curve declined across maturities over the past month, with most of the decline occurring at the short end of the yield curve. This helped push precious metals higher.



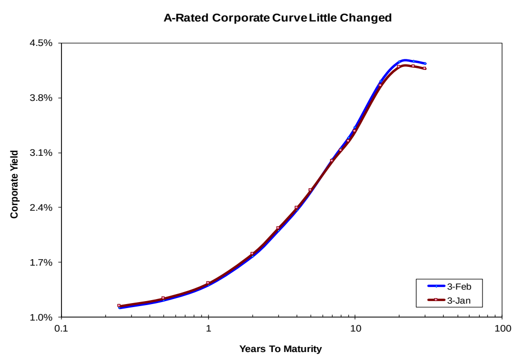
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market is pricing in higher sovereign rates. The swap market was slow to price in higher rates in November and appears to be behind the curve once again. Heavily insured events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



CDS costs declined sharply by the end of the week as prospects for higher short-term interest rates continue to get pushed into the future and as the prospects for lower regulatory burdens improved the outlook across the financial, energy and healthcare sectors.



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 index returned to a structural uptrend, joining the Grains and Industrial Metals amongst the physical markets. The dollar index is the sole financial market in a structural trend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 6 - 10
BBerg	28	Trending	0.075	8.1%	0.10%
BBerg Grain	29	Trending	0.092	12.3%	0.11%
BBerg Ind. Metl	29	Trending	0.123	15.8%	0.50%
BBerg Pre. Metl	9	Sideways	0.097	13.0%	
BBerg Softs	7	Sideways	0.020	14.9%	
BBerg Nat. Gas	18	Transitional	-0.141	30.9%	
BBerg Petroleum	22	Trending	0.029	18.9%	
BBerg Livestock	21	Trending	-0.020	11.6%	
Dollar Index	28	Trending	-0.159	8.9%	-0.13%
S&P 500 Index	19	Transitional	0.128	6.5%	
EAFE Index	5	Sideways	0.040	9.7%	
EM Index	5	Sideways	0.076	7.2%	
Ten-year UST (price)	26	Trending	-0.040	5.6%	

Performance Measures

The sideways action in Petroleum markets has continued, a rarity over the past two years. Natural Gas retreated sharply given forecasts for a milder second half of February. While the main Bloomberg index returned to a structural uptrend, this remains a rather gradual affair, one seemingly unable to gather momentum in the face of slack supply capacity in the Energy and Industrial Metals markets.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.03%	0.70%	5.09%	16.74%
Grains Sub-Index	0.12%	2.44%	2.86%	-3.01%
Corn	0.77%	2.07%	6.72%	-8.13%
Soybeans	-2.11%	3.28%	3.68%	17.05%
Wheat	2.33%	1.69%	-5.40%	-19.33%
Energy Sub-Index	-1.34%	-3.81%	11.16%	26.77%
Petroleum Sub-Index	1.43%	-2.74%	18.03%	35.02%
WTI	1.25%	-1.86%	17.72%	30.34%
Brent	1.97%	-1.71%	18.59%	41.83%
ULSD	1.89%	-2.96%	18.19%	38.75%
Gasoline	0.13%	-6.28%	18.10%	28.28%
Natural Gas	-8.78%	-6.81%	-5.75%	5.10%
Precious Metals Sub-Index	2.37%	4.37%	-10.48%	7.60%
Gold	2.50%	3.82%	-9.48%	4.39%
Silver	2.01%	5.85%	-12.69%	16.44%
Industrial Metals Sub-Index	0.32%	4.06%	14.35%	28.49%
Copper	-2.72%	2.79%	20.53%	22.71%
Aluminum	0.88%	6.79%	10.68%	19.86%
Nickel	7.94%	-0.31%	-5.29%	23.39%
Zinc	1.69%	6.74%	22.37%	64.29%
Softs Sub-Index	0.77%	4.42%	4.10%	33.73%
Coffee	-4.03%	2.42%	-1.92%	10.81%
Sugar	3.85%	1.78%	0.85%	52.69%
Cotton	2.09%	3.31%	-1.10%	26.19%
Livestock Sub-Index	0.09%	2.04%	3.19%	-6.84%
Cattle	-1.44%	1.43%	-1.03%	-4.77%
Hogs	2.87%	3.30%	9.40%	-10.08%

The GBP prevented a complete losing week for the USD. As short-term interest rate expectations continue to soften and as the 2015-2016 pattern of FOMC jawboning exceeding FOMC actions returns, the USD should remain contained in the absence of more overt fiscal stimulus. The likelihood of Congress agreeing to the various border tax adjustment proposals seems slight.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.79%	3.63%	-3.28%	-2.90%
Chinese yuan	0.24%	1.41%	-3.39%	-4.23%
Japanese yen	2.21%	4.56%	-10.10%	4.70%
British pound	-0.57%	2.02%	-6.31%	-14.51%
Swiss franc	0.63%	3.46%	-1.99%	1.14%
Canadian dollar	1.00%	3.10%	0.34%	5.82%
Australian dollar	1.71%	6.39%	1.21%	7.13%
Swedish krona	0.96%	4.53%	-2.49%	-3.81%
Norwegian krone	1.63%	5.49%	3.02%	4.38%
New Zealand dollar	0.77%	5.74%	2.18%	9.72%
Indian rupee	1.07%	1.51%	-0.48%	1.12%
Brazilian real	0.57%	4.55%	3.70%	24.75%
Mexican peso	2.57%	3.67%	-7.25%	-10.77%
Chilean peso	1.91%	5.65%	2.82%	10.66%
Colombian peso	2.82%	4.63%	8.52%	18.34%
Bloomberg-JP Morgan Asian dollar index (spot)	1.21%	2.30%	-2.21%	-0.60%

At what point will the TINA trade assume the defining characteristic of a bubble, that people buy it because it is going up? That has yet to happen, but it will if gains continue to persist in the face of acceptable, but not strong, earning growth and an eventual withdrawal of global monetary stimulus.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.16%	1.34%	6.26%	21.63%
North America	0.22%	2.19%	7.52%	23.73%
Latin America	0.69%	7.94%	10.15%	53.45%
Emerging Market Free	0.33%	5.84%	6.82%	30.85%
EAFE	0.04%	3.93%	6.42%	14.72%
Pacific	-0.11%	1.78%	7.04%	20.09%
Eurozone	0.11%	1.23%	7.97%	14.97%

Both CTAs and hedge funds returned to their losing ways this week. At least the CTAs have an excuse in largely trendless markets, but the losses for the hedge funds during a week of equity gains are surprising.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.02%	-0.80%	-9.14%	-11.42%
Newedge Trend	-0.96%	-0.96%	-8.02%	-8.73%
Newedge Short-Term	-2.05%	-4.58%	-9.28%	-7.91%
HFR Global Hedge Fund	-0.39%	0.65%	2.80%	6.36%
HFR Macro/CTA	-0.75%	-0.76%	-3.41%	-4.82%
HFR Macro: Sytematic Diversified CTA	-0.89%	-1.71%	-6.68%	-6.46%