The Macro Environment For Financial Markets

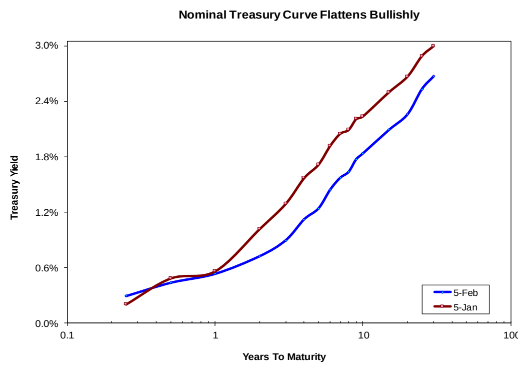
Let's not mince words: The central banks have lost credibility and, worse, they have yet to recognize it. Let's take the case of our beloved Federal Reserve: Even after an employment situation report that was mixed at-best, they seem to be looking for excuses to justify a course of action set upon by a committee last year. The Eurodollar market, the UST yield curve and the short-term swap market all are laughing in their face. I would mention the federal funds futures market, but as only GSE's trade federal funds anymore and the OIS spreads have become unstable, I will not mention federal funds at all. Central banks are held hostage by currency markets, and currency markets have taken away their ability to engage in competitive devaluation. The best thing for any and all of them to do is stop sowing additional confusion. Take a vacation. And stop pretending you have the situation under control.

The causal chain remains:

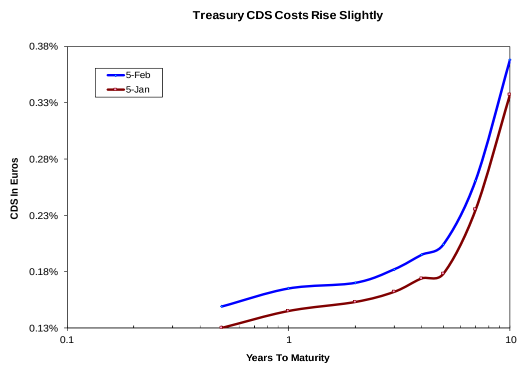
1. The market is pricing out higher short-term interest rates in the U.S. as policy rates are being driven lower globally;
2. Disinflationary pressures will persist;
3. Inflation expectations as measured by TIPS and inflation swaps will remain contained;
4. The U.S. yield curve retains its long-term bias toward flattening even though short-term rates are declining anew;
5. Short-term borrowers will stop terming-out their borrowing to reduce rollover risk;
6. Swap spreads will remain low; and
7. Credit spreads will remain biased toward increasing.

Key Market Indications

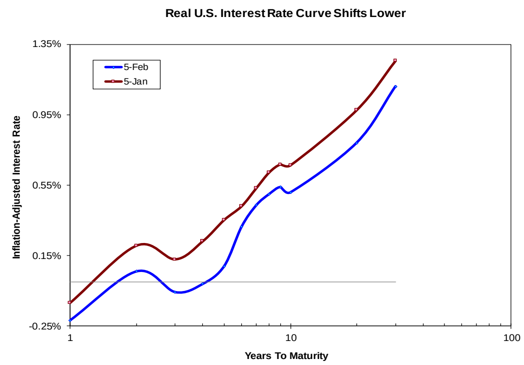
The bullish flattening of the UST yield curve continues; once again the biggest question is why long-term rates have not fallen even further and faster. If large holders of USD reserves, China in particular, are liquidating them and yields are falling, then we know intrinsic demand in what is still a bull market remains quite high.



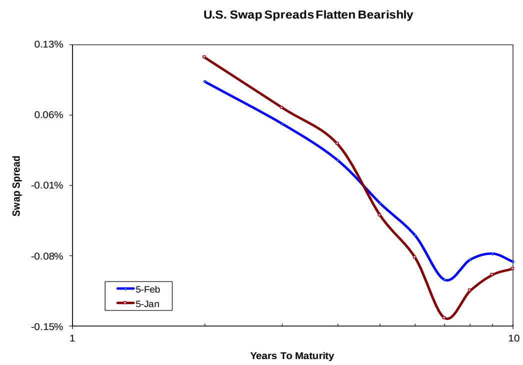
The CDS market for Treasuries has shifted higher, but not significantly so, as nothing yet is signaling a worsening of the federal fiscal outlook.



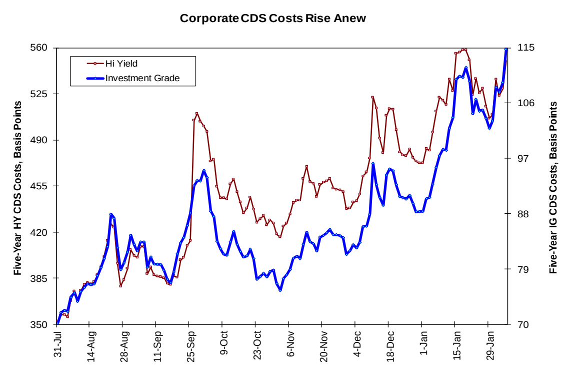
The pseudo-real rate curve shifted lower over the past month and is not significantly over zero until five years. The ongoing decline in implied real yields at the short end is supportive for gold, but only until such time as massive risk-aversion dissipates.



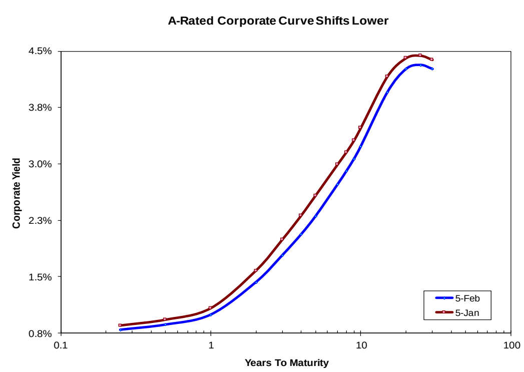
Swap spreads, which rise when floating-rate borrowers want to fix their payments, flattened bearishly over the past month as spreads for four years' tenor and less fell and longer-tenor spreads rose. Before we alarm ourselves, let's remember those spreads for five years' tenor and longer remain negative. This is not a market worried about a surge higher in financing costs.



CDS costs resumed their move higher for both the investment-grade and high-yield indices. On some levels, this is odd considering the economy is not collapsing, the bad news has been known, balance sheets remain flush and short-term rates remain very low. However, when a market rises for non-obvious reasons, it must be respected.



The A-rated yield curve continues to shift lower. The inability of longer-term investment-grade rates to rise remains one of the few pieces of good news for risky financial assets so far in 2016.



Market Structure

Natural Gas and Grains have re-entered structural downtrends, while both Precious and Industrial Metals are in uptrends as is Livestock. The dollar index switched to a structural downtrend and ten-year UST remain in an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 8 - 12
BBerg	5	Sideways	-0.009	13.9%	
BBerg Grain	29	Trending	-0.031	12.6%	-0.08%
BBerg Ind. Metl	29	Trending	0.088	17.0%	0.39%
BBerg Pre. Metl	29	Trending	0.399	12.0%	0.49%
BBerg Softs	4	Sideways	0.000	17.0%	
BBerg Nat. Gas	29	Trending	-0.158	31.1%	-0.41%
BBerg Petroleum	5	Sideways	-0.007	39.2%	
BBerg Livestock	21	Trending	0.091	10.8%	0.13%
Dollar Index	29	Trending	-0.209	8.0%	-0.03%
S&P 500 Index	11	Transitional	-0.077	17.2%	
EAFE Index	10	Sideways	-0.059	14.1%	
EM Index	4	Sideways	0.057	17.3%	
Ten-year UST (price)	29	Trending	0.292	6.4%	0.16%

Performance Measures

Negative carrying costs would increase the value of a pet rock in much the same way they have increased the nominal price of gold. The upcoming week will see downward pressure from the lack of Chinese buying activity during their Tet holiday. Both Grains and Industrial Metals are likely to see downward pressure as a result. The emerging two-way trade in the Petroleum index suggests we are much closer to the bottom than we were, but any base after a pronounced downturn such as we have seen will be very slow and gradual at first.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-2.10%	-1.45%	-16.39%	-26.29%
Grains Sub-Index	-1.99%	0.39%	-9.17%	-14.09%
Corn	-1.67%	2.47%	-6.79%	-15.22%
Soybeans	-1.67%	0.28%	-10.66%	-9.88%
Wheat	-2.60%	-2.44%	-9.97%	-13.53%
Energy Sub-Index	-7.76%	-9.54%	-37.50%	-46.32%
Petroleum Sub-Index	-6.83%	-6.69%	-36.50%	-48.40%
WTI	-8.11%	-9.98%	-38.59%	-53.20%
Brent	-5.59%	-3.06%	-38.32%	-51.36%
ULSD	-1.82%	-1.34%	-37.68%	-47.93%
Gasoline	-12.32%	-14.20%	-30.94%	-35.55%
Natural Gas	-10.23%	-16.50%	-41.21%	-41.11%
Precious Metals Sub-Index	3.72%	5.63%	4.03%	-8.20%
Gold	3.71%	5.44%	5.78%	-6.60%
Silver	3.76%	6.20%	-0.85%	-12.67%
Industrial Metals Sub-Index	0.06%	2.70%	-11.59%	-25.23%
Copper	1.75%	4.03%	-10.44%	-19.39%
Aluminum	-1.66%	-0.06%	-8.32%	-24.43%
Nickel	-5.39%	-4.85%	-24.96%	-47.24%
Zinc	3.15%	11.07%	-11.21%	-24.48%
Softs Sub-Index	1.18%	-5.42%	4.09%	-18.02%
Coffee	3.49%	1.20%	-10.59%	-35.02%
Sugar	1.00%	-8.21%	15.30%	-16.94%
Cotton	-1.89%	-2.31%	-3.13%	-4.49%
Livestock Sub-Index	-0.05%	3.19%	-6.69%	-8.26%
Cattle	0.30%	0.45%	-12.65%	-10.23%
Hogs	-0.56%	7.76%	4.41%	-4.83%

Consider the currency trader's dilemma: You are trying to choose amongst short-term loans issued by debtors bent on destroying their own credit-worthiness. Both the ECB and BOJ have threatened further moves into negative-rate territory only to see their currencies strengthen this past week on the notion the Federal Reserve will have to back away from raising USD rates just a little.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	3.02%	3.81%	2.31%	-2.78%
Chinese yuan	0.03%	-0.89%	-5.55%	-4.89%
Japanese yen	3.65%	1.87%	6.85%	0.56%
British pound	1.82%	-1.17%	-7.05%	-5.38%
Swiss franc	3.24%	1.79%	-1.20%	-7.04%
Canadian dollar	0.42%	0.57%	-5.32%	-10.66%
Australian dollar	-0.24%	-1.31%	-3.93%	-9.37%
Swedish krona	1.48%	1.70%	2.89%	-2.45%
Norwegian krone	1.39%	4.08%	-3.55%	-12.22%
New Zealand dollar	2.24%	-1.13%	1.81%	-10.33%
Indian rupee	0.21%	-1.56%	-5.76%	-8.74%
Brazilian real	2.44%	2.66%	-10.72%	-29.68%
Mexican peso	-1.81%	-5.98%	-11.20%	-19.80%
Chilean peso	0.97%	1.31%	-3.16%	-11.44%
Colombian peso	-1.45%	-3.65%	-11.48%	-28.68%
Bloomberg-JP Morgan Asian dollar index (spot)	0.28%	-0.08%	-3.83%	-6.07%

One wonders how badly equities would be performing if only there well compelling alternatives. Of course, they never would have risen to last year's highs had such alternatives existed then. Nothing suggests we are in anything other than a grinding bear market.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-2.40%	-6.42%	-12.61%	-9.57%
North America	-2.94%	-6.73%	-10.60%	-8.48%
Latin America	0.49%	-1.26%	-20.67%	-31.91%
Emerging Market Free	-0.34%	-3.70%	-16.23%	-22.57%
EAFE	-1.51%	-5.91%	-15.74%	-11.34%
Pacific	-0.91%	-7.07%	-13.37%	-8.40%
Eurozone	-2.34%	-5.10%	-17.73%	-13.39%

The ability of CTAs to gain in 2016 after years of underperformance recalls the late Harry Caray's lament about some late-inning home run in a game already out-of-hand: "Too bad there weren't eleven men on base."

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.64%	3.95%	2.24%	0.33%
Newedge Trend	0.79%	4.47%	3.67%	1.31%
Newedge Short-Term	0.56%	4.22%	2.29%	-2.81%
HFR Global Hedge Fund	-0.03%	-2.76%	-7.92%	-6.81%
HFR Macro/CTA	-0.05%	0.62%	-2.71%	-3.13%
HFR Macro: Sytematic Diversified CTA	0.86%	3.17%	1.03%	-0.40%