The Macro Environment For Financial Markets

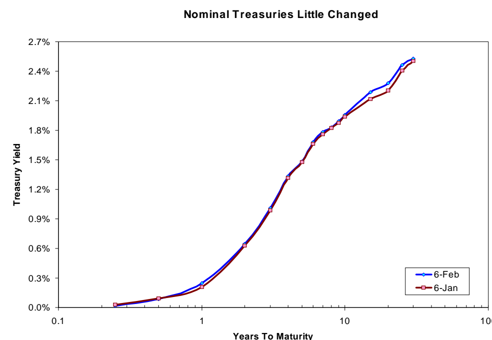
We have heard twice since 2000, usually in self-exculpation, you cannot identify a bubble while it is happening, only in hindsight. An unspoken presumption was "bubbles" were greed-driven affairs wherein investors would push prices higher and receive immediate positive feedback for doing so. We have been in a fear-driven bubble wherein investors received immediate gratification for the absurdity of paying governments to lend to them. Self-flagellation best is left to religious fringes; it has no place in capital markets. However, we do know how to live with the suppression of market signals and the gross misallocation of resources ongoing for the past six years; we have no idea whether we can live with the inevitable period of detoxification resulting from any end to those policies. If you have enjoyed recent volatility, great; there will be plenty more from whence it came.

The causal chain now is:

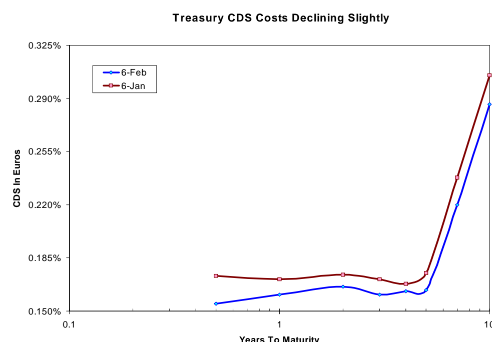
1. Short-term interest rates will remain artificially low globally;
2. Disinflationary pressures will remain so long as the global banking system remains unable to expand credit;
3. Inflation expectations as measured by the TIPS market will remain subdued;
4. Sovereign debt yields will retrace toward levels seen in 2014:Q4 as the supply of risk-averse lenders appears to have been exhausted;
5. The U.S. yield will retain a bias toward flattening, but via higher short-term rates;
6. Short-term borrowers will continue to accept rollover risk;
7. Swap spreads will continue their move higher as floating-rate payors move to fix their payments; and
8. Credit spreads will remain range-bound barring an external shock.

Key Market Indications

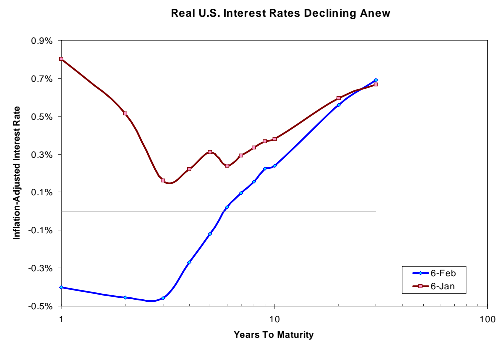
While the yield curve flattened, it did so via higher two-year rates, a situation similar to that of 2014:Q4. Ten-year yields ranged between 2.09% and 2.37% over this period, which makes any approach toward the 2.09% level critical for the continuation of the bull marker in Treasuries. The global consensus investors would be willing to accept increasingly negative implied real rates indefinitely as a form of insurance could be challenged violently if proven wrong.



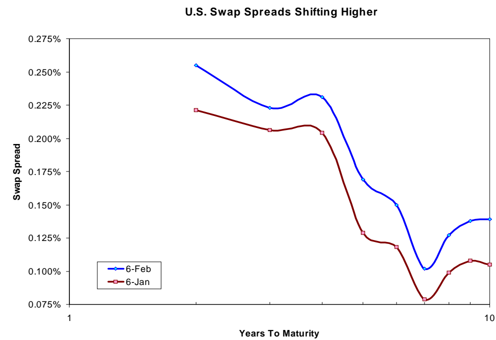
CDS costs retreated on the realization the budgetary disagreements between the Administration and Congress will be resolved the way they always are, in favor of higher spending and taxes imposed by the governing class upon the much-admired and much-abused "middle class," a category representing approximately 105% of the American population at last count.



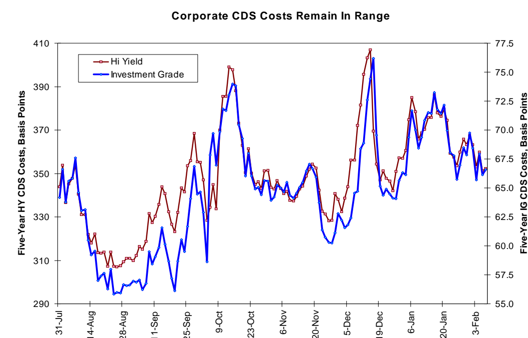
Implied real rates have shifted sharply lower over the past month but increased over the past week as nominal interest rates rose. The shift is not yet a threat to risky financial assets, but as it was not produced by higher inflation expectations, it is a negative for precious metals.



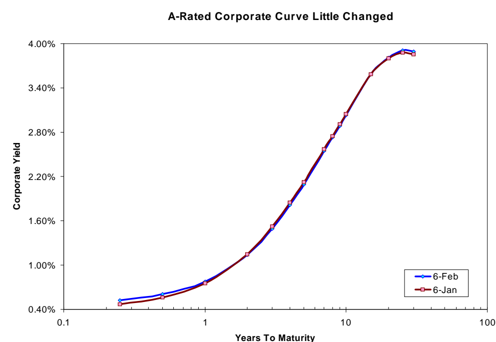
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue their small move higher, but the term structure remains strongly inverted. These long-term swap spreads do not constitute an impediment to either corporate bonds or, by extension, to equities. However, these rising swap spreads eventually will lead to higher credit spreads for corporate bonds.



Both the IG and HY CDS indices remain range-bound. The rise in interest rates and swap spreads is insufficient to push them higher, but the impending end of excessive monetary accommodation removes most of the downward impetus.



The A-rated yield curve continues to mimic the UST yield curve. If the UST yield curve steepens bearishly – a statement and not a forecast – the A-rated yield curve is unlikely to steepen as rapidly as it was not suppressed as much.



Market Structure

Only the Grains index has any manner of directional certainty amongst physical markets at present, and even that is wavering. The EAFE and EM indices are entering uptrends amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 9 - 13
BBerg	11	Transitional	0.085	15.4%	
BBerg Grain	29	Trending	-0.134	18.2%	-0.62%
BBerg Ind. Metl	10	Sideways	0.062	21.2%	
BBerg Pre. Metl	29	Trending	-0.066	18.5%	
BBerg Softs	23	Trending	-0.131	18.6%	
BBerg Nat. Gas	17	Transitional	-0.157	42.4%	
BBerg Petroleum	15	Transitional	0.206	40.4%	
BBerg Livestock	8	Sideways	0.002	18.4%	
Dollar Index	9	Sideways	0.045	10.0%	
S&P 500 Index	29	Trending	0.061	13.6%	
EAFE Index	20	Trending	0.133	14.0%	0.20%
EM Index	29	Trending	0.146	9.4%	0.26%
Ten-year UST (price)	11	Transitional	-0.181	8.0%	

Performance Measures

The short-term bottoming attempts for the economically important Petroleum and Industrial Metals markets noted last week continued this week, with the Petroleum move being especially violent. The cure for low prices is low prices as these invite lower investment and the prospective reduction of oversupply; these are called cyclical businesses for a reason. These will not be hard reversals as much as longer-term price bottoms defining the reservation price for disinvestment. The modest rebound in the Precious Metals index turned lower even as real short-term rates in the Eurozone remain strongly negative.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.79%	-1.38%	-19.93%	-19.83%
Grains Sub-Index	3.38%	-7.41%	-7.25%	-16.17%
Corn	4.26%	-4.75%	-0.48%	-19.75%
Soybeans	1.30%	-7.79%	-11.17%	-12.35%
Wheat	4.82%	-10.94%	-11.08%	-15.67%
Energy Sub-Index	4.40%	3.29%	-40.96%	-43.09%
Petroleum Sub-Index	7.46%	8.87%	-43.48%	-42.57%
WTI	7.15%	6.67%	-45.56%	-43.46%
ULSD	8.13%	8.54%	-35.20%	-36.82%
Gasoline	5.43%	12.47%	-39.97%	-39.37%
Natural Gas	-4.16%	-11.80%	-38.42%	-47.53%
Precious Metals Sub-Index	-3.36%	0.96%	-8.69%	-6.06%
Gold	-3.49%	1.18%	-5.75%	-2.06%
Silver	-2.99%	0.34%	-17.17%	-17.22%
Industrial Metals Sub-Index	1.96%	-1.65%	-14.88%	-6.21%
Copper	3.65%	-6.56%	-18.58%	-19.68%
Aluminum	0.34%	4.71%	-9.49%	3.80%
Nickel	0.44%	-0.27%	-19.37%	7.23%
Zinc	1.71%	-0.61%	-9.21%	5.58%
Softs Sub-Index	0.57%	-1.86%	-17.00%	-13.21%
Coffee	3.06%	-4.60%	-16.48%	12.53%
Sugar	-1.89%	-2.42%	-23.23%	-28.50%
Cotton	3.76%	2.31%	-2.14%	-21.00%
Livestock Sub-Index	-2.03%	-10.40%	-13.25%	-3.35%
Cattle	-0.82%	-8.24%	-4.67%	10.32%
Hogs	-4.12%	-13.45%	-27.60%	-22.99%

While the USD firmed with Friday's employment data, it was down on the week against all but an interesting mix including the low-rate CHF and JPY, two carry trade-funding currencies, and especially the BRL, where official corruption is threatening to trigger investment outflows. Even as the peripatetic expectations for higher short-term rates in the U.S. rose, at least for this week, it is clear a great deal of hesitancy about the greenback remains.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.22%	-4.83%	-15.45%	-16.73%
Chinese yuan	0.10%	-0.50%	-1.30%	-2.92%
Japanese yen	-1.37%	-0.61%	-14.29%	-14.28%
British pound	1.22%	0.61%	-9.55%	-6.61%
Swiss franc	-0.71%	9.00%	-2.07%	-2.78%
Canadian dollar	1.64%	-5.52%	-12.86%	-11.63%
Australian dollar	0.44%	-3.56%	-16.66%	-12.98%
Swedish krona	-1.32%	-5.70%	-17.89%	-22.54%
Norwegian krone	1.29%	1.52%	-17.88%	-18.54%
New Zealand dollar	1.40%	-5.12%	-13.16%	-10.73%
Indian rupee	0.27%	3.03%	-0.32%	1.11%
Brazilian real	-3.56%	-2.92%	-18.29%	-14.38%
Mexican peso	0.87%	0.31%	-10.86%	-10.60%
Chilean peso	1.25%	-1.64%	-7.91%	-11.90%
Colombian peso	2.47%	2.89%	-20.81%	-14.21%
Bloomberg-JP Morgan Asian dollar index (spot)	0.36%	0.01%	-3.18%	-2.63%

The TINA (there is no alternative) argument has been a powerful one for equities during the ZIRP era; it reasserts itself like a band of brigands in a bad Western. Even the smallest hint of the Greek situation moving away from critical levels and another round of Chinese credit-ease were sufficient to trigger a global rally; after all, how much to you want to put into negative-yield bonds?

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.62%	4.14%	2.64%	10.74%
North America	3.23%	2.85%	6.68%	16.92%
Latin America	2.50%	1.13%	-22.70%	-7.57%
Emerging Market Free	1.80%	4.76%	-6.52%	8.26%
EAFE	1.66%	6.29%	-3.30%	1.97%
Pacific	0.41%	4.29%	-3.27%	6.89%
Eurozone	1.97%	7.85%	-3.32%	-2.13%

The poor performance of CTAs should come as no surprise given the violence in energy, currency, precious metal and at week's end, U.S. Treasury markets. While the relative calm in equity markets may seem out of place, these markets have turned into the least-exposed of all to the vagaries of price suppression. I am taking the Plunge Protection Team off my speed-dial.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.71%	2.23%	27.04%	33.93%
Newedge Trend	-1.39%	1.97%	19.74%	24.18%
Newedge Short-Term	-0.84%	1.13%	9.93%	8.91%
HFR Global Hedge Fund	0.60%	0.82%	-0.62%	0.71%
HFR Macro/CTA	-0.03%	1.04%	8.36%	8.50%
HFR Macro: Sytematic Diversified CTA	-0.41%	1.24%	10.07%	7.63%