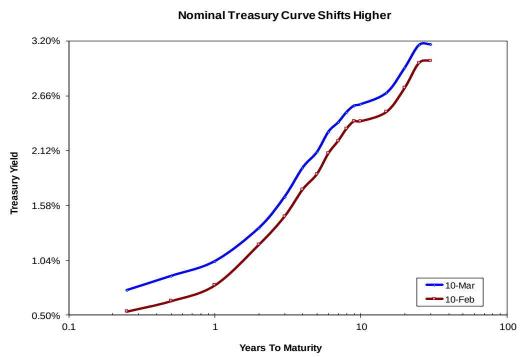
The Macro Environment For Financial Markets

Just when the world agrees QE has failed and short-term interest rates in the U.S. will rise, economic research is joining the conclusion offered here for years: There are no deterministic outcomes to monetary policy. If you think a 25-bp rate hike will slow nascent inflation or accomplish the dubious goal of slowing employment growth, the ball is in your court. And that does not even begin to address the failures of market-derived measures such as TIPS to forecast anything but themselves. Nice to be driving a car with no brakes, steering wheel or clear windshield, no? The causal chain now is:

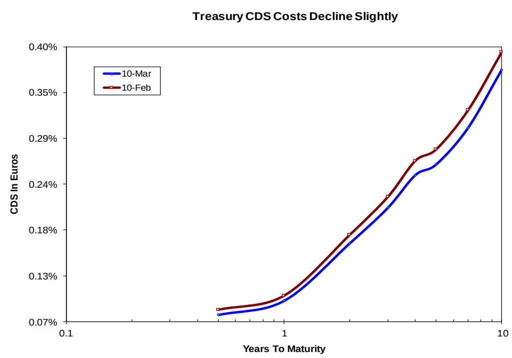
1. The market is pricing in higher short-term rates in 2017;
2. Inflationary expectations have stopped declining;
3. The U.S. yield curve continues in its secular flattening trend;
4. Short-term borrowers have stopped terming out short-term debt into the bond market;
5. Swap spreads are pricing in higher future rates; and
6. CDS costs remain consistent with a bull market in risky assets.

Key Market Indications

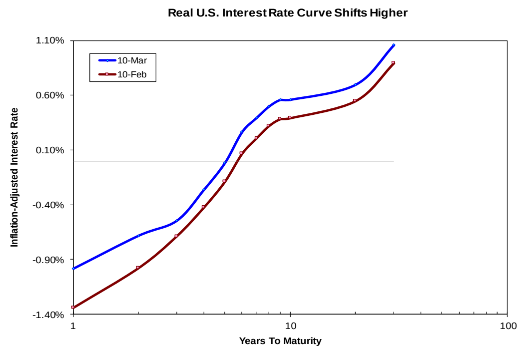
The flattening of the yield curve via relatively higher short-term rates continues. The threat of a UST selloff in the face of excessive fiscal stimulus will prevent the federal government from going overboard on that stimulus. Uncle Sam cannot service the current debt level without a massive inflow of foreign capital at this juncture. Foreign creditors are this generation's bond market vigilantes.



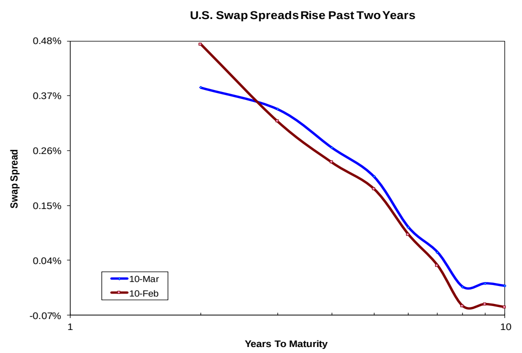
CDS costs on UST have decreased very slightly over the past month. This market is going to remain very quiet until actual budget proposals go before Congress.



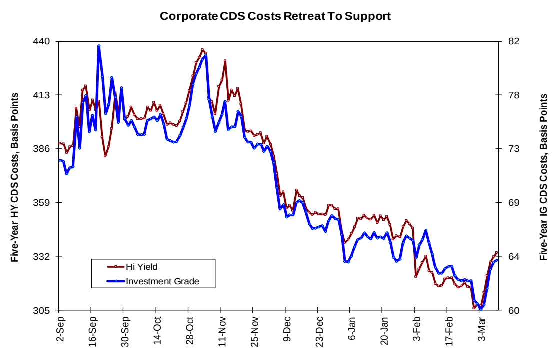
The pseudo-real yield curve rose across the maturity spectrum, contributing not only to the losses in precious metals but to the selloff in fixed-income and equity markets. Unless we have repealed some financial law of gravity, higher real rates are never bullish.



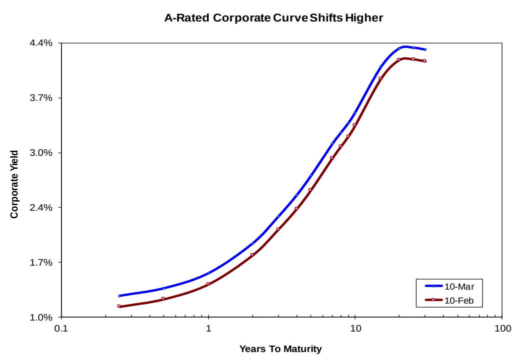
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market is pricing in higher sovereign rates. This market has been overly cautious all year, but it finally appears to be on the right side of things.



CDS costs pulled back to their support levels. If short-term rates start to rise and equity gains consolidate, the lows in credit spreads for 2017 may be in place already.



The A-rated corporate yield curve sold off across the maturity spectrum in response to higher UST yields and higher credit spreads. This is a pause in a bull market, for now, but the risk/reward simply does not favor strong gains while the yield curve is flattening bearishly.



Market Structure

The near-certainty of higher short-term rates combined with a strong selloff in Petroleum and Precious Metals to push nearly all of the physical markets into structural downtrends. The dollar index remains in an uptrend. Ten-year UST entered a downtrend and all of the equity indices are out of structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Mar. 13 - 17
BBerg	29	Trending	-0.485	7.7%	-0.27%
BBerg Grain	19	Transitional	-0.182	15.0%	
BBerg Ind. Metl	22	Trending	-0.229	15.4%	-0.75%
BBerg Pre. Metl	25	Trending	-0.345	9.8%	-0.78%
BBerg Softs	26	Trending	-0.312	14.0%	-0.12%
BBerg Nat. Gas	29	Trending	0.028	27.0%	
BBerg Petroleum	29	Trending	-0.452	18.6%	-0.10%
BBerg Livestock	29	Trending	0.031	9.1%	
Dollar Index	26	Trending	0.031	6.3%	0.09%
S&P 500 Index	7	Sideways	-0.001	5.4%	
EAFE Index	11	Transitional	0.064	8.5%	
EM Index	11	Transitional	-0.109	8.4%	
Ten-year UST (price)	29	Trending	-0.216	4.7%	-0.13%

Performance Measures

To repeat from last week, you cannot have a bull market in physical commodities without a bull market in petroleum markets, and you cannot have a bull market in petroleum unless OPEC is willing to cut production and support non-OPEC investment. Why the selling should spread to all other physical markets save Livestock is something of a mystery, but the weight of correlated positions in illiquid markets is a sight to behold.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-3.34%	-4.89%	1.73%	5.80%
Grains Sub-Index	-3.55%	-5.21%	4.42%	-5.55%
Corn	-4.32%	-4.80%	5.74%	-8.78%
Soybeans	-2.98%	-5.52%	3.84%	10.51%
Wheat	-2.85%	-5.64%	2.58%	-20.47%
Energy Sub-Index	-4.32%	-6.68%	-2.09%	7.21%
Petroleum Sub-Index	-7.20%	-8.57%	0.65%	5.19%
WTI	-8.82%	-8.93%	0.22%	2.04%
Brent	-8.05%	-8.13%	0.95%	9.54%
ULSD	-5.80%	-8.29%	0.22%	10.30%
Gasoline	-3.83%	-9.04%	1.86%	-1.39%
Natural Gas	4.61%	-1.06%	-9.11%	15.30%
Precious Metals Sub-Index	-2.74%	-2.90%	-10.10%	-2.36%
Gold	-2.04%	-1.96%	-9.52%	-5.56%
Silver	-4.59%	-5.36%	-11.52%	6.54%
Industrial Metals Sub-Index	-3.69%	-5.32%	18.06%	19.90%
Copper	-3.75%	-7.19%	22.60%	13.83%
Aluminum	-0.79%	0.36%	19.42%	17.74%
Nickel	-10.03%	-7.90%	-0.41%	10.28%
Zinc	-2.59%	-7.32%	20.21%	47.98%
Softs Sub-Index	-3.63%	-6.40%	-6.79%	17.38%
Coffee	-1.35%	-3.51%	-8.13%	2.67%
Sugar	-6.65%	-8.82%	-12.84%	15.10%
Cotton	-0.89%	-1.14%	12.94%	33.00%
Livestock Sub-Index	1.45%	1.86%	10.67%	-9.76%
Cattle	1.29%	4.43%	10.95%	-6.59%
Hogs	1.88%	-2.41%	9.72%	-14.86%

Mario Draghi managed to convince the currency markets he is going to end QE at some point, and this was enough to pull the EUR higher while all other currencies save the INR lost ground against the USD. The next step will be for the Federal Reserve to raise rates while proclaiming their caution so as not to drive the greenback higher. These folks get paid well to do this.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.48%	0.28%	-5.00%	-4.51%
Chinese yuan	-0.14%	-0.45%	-3.32%	-5.80%
Japanese yen	-0.65%	-1.37%	-11.27%	-1.39%
British pound	-1.01%	-2.59%	-8.77%	-14.80%
Swiss franc	-0.30%	-0.84%	-3.86%	-2.56%
Canadian dollar	-0.68%	-2.88%	-3.20%	-0.93%
Australian dollar	-0.71%	-1.72%	-0.32%	1.18%
Swedish krona	-0.32%	-0.99%	-5.90%	-6.98%
Norwegian krone	-2.04%	-2.70%	-4.21%	-0.95%
New Zealand dollar	-1.54%	-3.71%	-5.85%	3.82%
Indian rupee	0.30%	0.42%	0.48%	0.69%
Brazilian real	-0.84%	-0.85%	3.36%	15.42%
Mexican peso	-0.50%	3.76%	-4.06%	-9.19%
Chilean peso	-0.93%	-3.64%	0.90%	2.89%
Colombian peso	-0.06%	-4.34%	-1.52%	8.09%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.04%	-0.16%	-2.33%	-2.19%

The firmer EUR managed to support the Eurozone and EAFE markets while the U.S. took a breather from its strong rally. The rise in corporate bond rates is going to put the U.S. rally on hold; gains are going to be tough to come by for a few months.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.13%	1.47%	10.05%	16.45%
North America	-0.43%	2.17%	12.16%	21.93%
Latin America	-2.53%	-1.96%	8.14%	27.25%
Emerging Market Free	-0.50%	-0.32%	2.62%	20.31%
EAFE	0.42%	1.63%	4.40%	13.07%
Pacific	0.58%	0.42%	7.54%	16.15%
Eurozone	1.29%	3.49%	8.82%	10.86%

Both CTAs and hedge funds posted losses across the board, suggesting they were long equities, not short enough on fixed-income and probably long commodities. Hard to make money when you are wrong.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.55%	0.51%	-3.64%	-8.46%
Newedge Trend	-0.88%	0.77%	-3.01%	-6.07%
Newedge Short-Term	-0.35%	-0.79%	-7.74%	-10.82%
HFR Global Hedge Fund	-0.53%	0.37%	2.99%	6.57%
HFR Macro/CTA	-0.45%	-0.12%	-1.84%	-4.02%
HFR Macro: Sytematic Diversified CTA	-1.11%	0.38%	-3.10%	-5.35%