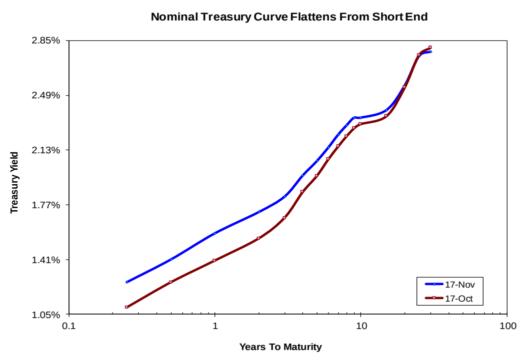
The Macro Environment For Financial Markets

One of the factors separating good traders from mediocrities is the ability to enter the tough trade. The tough trade at present is to accept things are going fairly well globally and while risky assets are expensive, they really are not in a bubble. Moreover, policymakers appear to be resisting their worst instincts, which are to do something when doing nothing is the best course of action. The last time the world was in such an environment was late 1984, and that led to almost three years of strong global growth before the crisis of 1987. The causal chain now is:

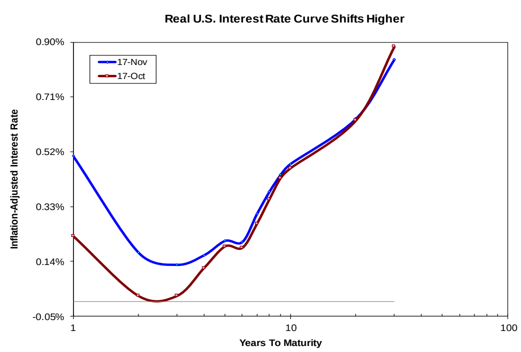
1. The market has priced in a December rate hike but is uncertain for 2018;
2. Inflationary expectations are confined to a narrow range;
3. The secular flattening trend in the U.S. continues;
4. Short-term borrowers are starting to accept rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are inverting bullishly; and
6. CDS ended their selloff.

Key Market Indications

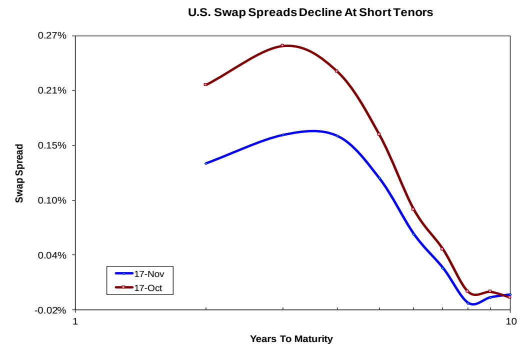
The ten-year UST is continuing to hold support. Lenders realize existing holders are not going to liquidate their portfolios. Such is not the case at the short end of the yield curve, however. Short-term rates continue to move to levels not seen since 2008. As a result, the secular flattening trend in the yield curve remains intact.



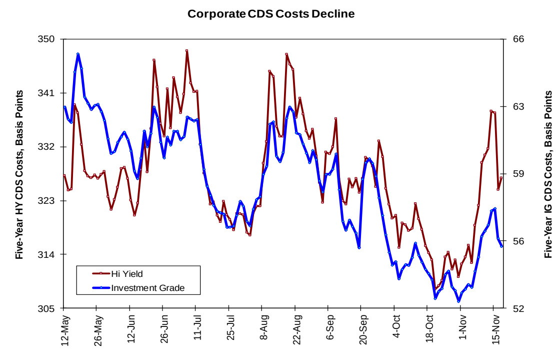
The pseudo-real yield curve shifted higher at the short end of the yield curve and has exited negative implied real rates across the maturity spectrum.



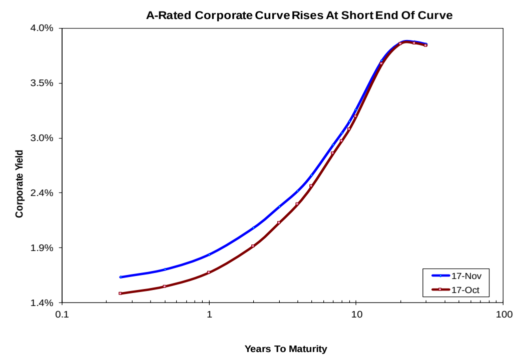
Swap spreads, which rise when floating-rate borrowers want to fix their payments, declined across the maturity spectrum, especially at shorter tenors. This remains bullish for corporate credit and for equities.



CDS costs declined as a few bad stories from last week did not prove to be the start of a broader selloff. Still, the swift selloff was a reminder bond investors are not being compensated adequately for the risks inherent in corporate bonds, especially in an environment dominated by corporate bond ETFs.



The A-rated corporate yield rose slightly at the short end of the yield curve over the past month. This remains a bull market with limited upside potential.



Market Structure

The main Bloomberg index along with Softs, Natural Gas, Petroleum and Precious Metals are in structural uptrends, while Grains and Livestock are in downtrends. Nothing within the Financials is in a structural trend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Nov. 20 - 24
BBerg	29	Trending	0.130	6.6%	0.13%
BBerg Grain	28	Trending	-0.070	10.5%	-0.07%
BBerg Ind. Metl	29	Trending	-0.113	15.2%	
BBerg Pre. Metl	21	Trending	0.190	8.6%	0.07%
BBerg Softs	29	Trending	0.142	14.1%	0.29%
BBerg Nat. Gas	29	Trending	0.099	18.5%	0.89%
BBerg Petroleum	29	Trending	0.255	16.6%	0.65%
BBerg Livestock	29	Trending	-0.112	9.9%	-0.31%
Dollar Index	29	Trending	-0.078	5.2%	
S&P 500 Index	8	Sideways	-0.016	7.0%	
EAFE Index	15	Transitional	-0.096	6.6%	
EM Index	16	Transitional	0.123	8.0%	
Ten-year UST (price)	16	Transitional	0.034	3.3%	

Performance Measures

It has been quite difficult to sustain a bullish trend in the energy markets as higher prices are seen as an invitation to the expansion of production. This is keeping these key markets capped. The weakness in Industrial Metals is one more reaction to higher long-term interest rates in China; this can change at the latest whim of policymakers there. The small rise in Precious Metals is interesting in light of rising short-term interest rates and still-subdued inflation; perhaps asset allocators are rolling into markets that have not worked so they do not have to be burdened with all of those profits in financial assets.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.57%	1.85%	2.96%	5.40%
Grains Sub-Index	-0.47%	-0.17%	-7.61%	-9.86%
Corn	-0.44%	-0.64%	-12.86%	-11.48%
Soybeans	0.38%	0.22%	2.68%	-4.39%
Wheat	-1.28%	0.13%	-10.11%	-12.91%
Energy Sub-Index	-1.61%	5.96%	6.08%	10.95%
Petroleum Sub-Index	-1.01%	8.56%	15.30%	20.43%
WTI	-0.45%	9.07%	9.42%	12.03%
Brent	-1.42%	8.99%	16.22%	23.82%
ULSD	0.59%	8.08%	21.44%	27.26%
Gasoline	-2.87%	7.25%	18.23%	23.43%
Natural Gas	-3.47%	-1.46%	-16.74%	-12.95%
Precious Metals Sub-Index	2.09%	1.47%	3.08%	5.54%
Gold	1.77%	1.34%	3.11%	6.42%
Silver	3.01%	1.82%	3.00%	2.98%
Industrial Metals Sub-Index	-0.85%	-1.54%	16.20%	20.19%
Copper	-0.15%	-2.90%	18.22%	22.20%
Aluminum	0.13%	-1.70%	6.94%	21.60%
Nickel	-4.45%	-1.45%	22.74%	5.13%
Zinc	-1.21%	2.72%	22.59%	25.65%
Softs Sub-Index	0.21%	4.34%	-10.30%	-22.71%
Coffee	-2.74%	-0.96%	-9.59%	-28.47%
Sugar	2.76%	9.88%	-10.36%	-26.82%
Cotton	0.34%	3.48%	-8.87%	-3.12%
Livestock Sub-Index	-2.59%	-1.07%	-5.47%	18.92%
Cattle	-1.56%	2.10%	-6.08%	19.23%
Hogs	-4.56%	-7.03%	-5.03%	17.19%

The USD gained against the odd mix of the Nordics and commodity-linked currencies such as the CAD and AUD. It lost against the other majors and against a wide range of emerging market currencies. If the forthcoming Powell era will be dovish and if the new tax environment in the U.S. is not overly stimulative, the USD will have a hard time gaining against whoever decides to renormalize monetary policy next.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.07%	0.20%	5.65%	10.95%
Chinese yuan	0.21%	-0.05%	3.80%	3.79%
Japanese yen	1.28%	0.09%	-1.13%	-1.77%
British pound	0.14%	0.19%	1.89%	6.43%
Swiss franc	0.71%	-1.08%	-1.03%	1.82%
Canadian dollar	-0.63%	-1.89%	6.57%	5.94%
Australian dollar	-1.27%	-3.59%	1.78%	2.13%
Swedish krona	-0.88%	-3.26%	3.64%	9.68%
Norwegian krone	-1.29%	-3.59%	2.00%	3.65%
New Zealand dollar	-1.85%	-5.05%	-1.92%	-3.07%
Indian rupee	0.23%	0.02%	-1.32%	4.33%
Brazilian real	0.75%	-3.03%	-3.69%	4.96%
Mexican peso	0.97%	-0.68%	-0.71%	7.99%
Chilean peso	0.65%	-0.57%	6.75%	7.71%
Colombian peso	0.21%	-1.80%	-3.44%	5.23%
Bloomberg-JP Morgan Asian dollar index (spot)	0.55%	0.36%	2.17%	4.00%

Despite earnings growth and no overt crises of monetary policy, equities continued to act as if they were exhausted. These markets remain in bull trends, but the risk/reward for overt bullishness appears minor and who wants to end a strong year on a sour note?

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.27%	0.06%	8.46%	22.74%
North America	-0.08%	0.96%	10.69%	20.13%
Latin America	0.80%	-5.11%	3.27%	25.45%
Emerging Market Free	0.72%	1.01%	14.54%	37.66%
EAFE	-0.59%	-0.33%	6.76%	25.48%
Pacific	-1.19%	1.77%	11.70%	22.58%
Eurozone	-0.24%	-1.34%	5.84%	35.68%

Both CTAs and hedge funds lost money, as has been typical whenever equities weaken.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.81%	0.08%	0.73%	0.51%
Newedge Trend	-1.49%	0.29%	0.09%	1.10%
Newedge Short-Term	-1.69%	-0.63%	-1.00%	-5.14%
HFR Global Hedge Fund	-0.25%	-0.28%	2.09%	6.11%
HFR Macro/CTA	-0.74%	0.49%	1.90%	2.44%
HFR Macro: Sytematic Diversified CTA	-0.41%	1.32%	3.39%	2.96%