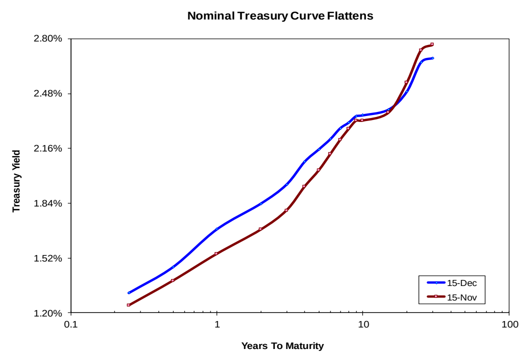
The Macro Environment For Financial Markets

There is a reason we call participants in financial markets "traders" and not "holders;" who wants to sit and do nothing all day? That this has been the winning stratagem over the past year has been very frustrating for many, but the simple question is and must remain, "What has changed?" If the answer is, "Nothing," then the laws of inertia dictate what has been working will continue to work. The causal chain is:

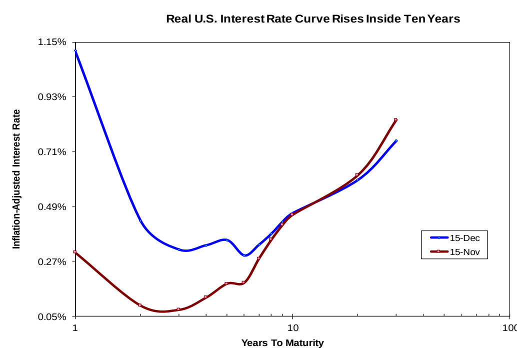
1. The market is following the FOMC lead and is pricing in a March 2018 rate hike;
2. Inflationary expectations are confined to a narrow range;
3. The secular flattening trend in the U.S. yield curve continues;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are inverting bullishly; and
6. CDS costs have resumed their decline.

Key Market Indications

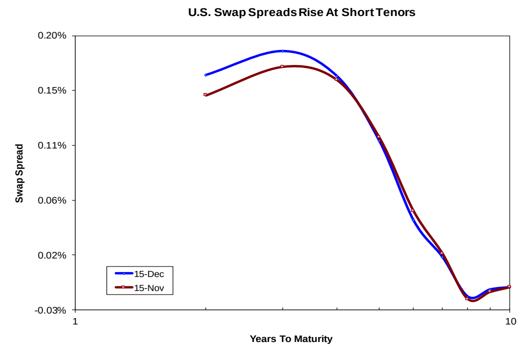
I commented two weeks the UST market is not supposed to be this quiet. It is, and the best thing to do simply is to accept it. The flattening yield curve is not a recessionary sign as it is being produced by very strong holders of long-term debt being unwilling to sell. To repeat, the rise in short-term rates has to be placed into context; ten years ago, a 2-year yield of 1.84% would have been considered freakishly low.



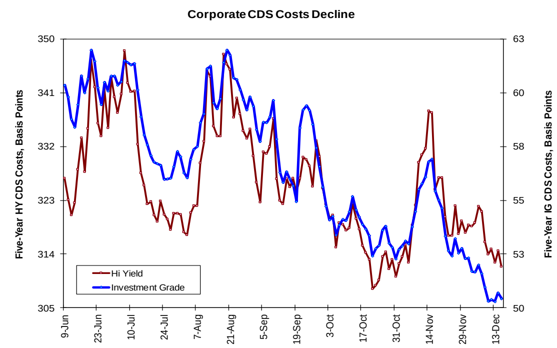
The pseudo-real yield curve shifted higher at the short end of the yield curve and remains stable at the long end of the yield curve. The combination continues to favor risky financial assets over precious metals.



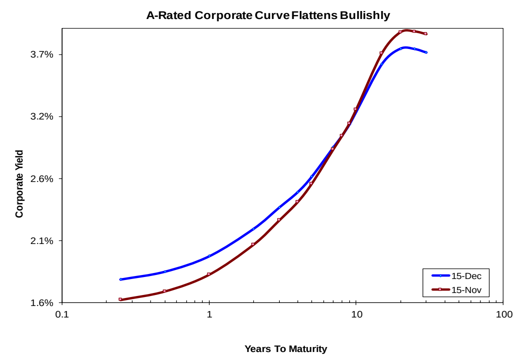
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose at the short end of the yield curve as further short-term rate increases appear likely. This is decreasingly bullish for corporate credit and for equities, but the situation is nowhere close to being bearish.



CDS costs declined once again, with the larger decline coming this week in high-yield bonds. Unless equities decline and produce correlation trades, there is no reason for CDS costs to rise.



The A-rated corporate yield flattened bullishly. This remains a bull market with limited upside potential.



Market Structure

None of the physical commodities are in structural uptrends. Both the EM index and ten-year UST are in structural downtrends within the financials while the EAFE and S&P 500 returned to uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Dec. 18 - 22
BBerg	29	Trending	-0.266	6.8%	-0.12%
BBerg Grain	29	Trending	-0.222	9.9%	-0.07%
BBerg Ind. Metl	29	Trending	0.053	13.1%	
BBerg Pre. Metl	29	Trending	-0.219	8.9%	-0.07%
BBerg Softs	29	Trending	-0.276	13.3%	-0.28%
BBerg Nat. Gas	29	Trending	-0.503	20.3%	-0.11%
BBerg Petroleum	15	Transitional	-0.032	17.5%	
BBerg Livestock	4	Sideways	0.053	12.6%	
Dollar Index	29	Trending	0.036	5.1%	
S&P 500 Index	26	Trending	0.294	7.3%	0.12%
EAFE Index	26	Trending	0.032	7.0%	0.09%
EM Index	26	Trending	-0.084	8.4%	-0.44%
Ten-year UST (price)	27	Trending	0.014	4.0%	-0.06%

Performance Measures

Has the Natural Gas index really lost 38.75% this past year? The Jan. 1991 = 100 index is now a 0.636. Grains are not quite as bad, but the subindex has declined 13.46% over the past year.

Industrial Metals reversed their recent slide, proving once again trading anything based on news out of China is a good way to lose a lot of money quickly.

I might add these declines have occurred in a time of coordinated global growth and ample financial liquidity. This demonstrates once again markets work if you let them; too bad politicians like to impose price controls instead.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.08%	-3.03%	4.00%	-2.65%
Grains Sub-Index	-1.41%	-3.01%	-13.05%	-13.46%
Corn	-1.46%	-0.89%	-16.33%	-14.02%
Soybeans	-2.31%	-2.32%	1.21%	-10.42%
Wheat	-0.15%	-5.60%	-20.88%	-14.61%
Energy Sub-Index	-1.97%	-4.79%	13.27%	-7.87%
Petroleum Sub-Index	-0.99%	-0.62%	29.22%	5.13%
WTI	-0.23%	1.00%	25.08%	0.96%
Brent	-0.58%	0.61%	32.23%	8.92%
ULSD	-1.07%	-2.02%	32.61%	9.21%
Gasoline	-3.26%	-4.73%	26.91%	1.18%
Natural Gas	-5.54%	-17.89%	-24.40%	-38.75%
Precious Metals Sub-Index	0.95%	-4.47%	-1.36%	6.36%
Gold	0.75%	-3.24%	-0.28%	9.65%
Silver	1.54%	-7.97%	-4.43%	-2.30%
Industrial Metals Sub-Index	4.44%	0.21%	19.50%	16.24%
Copper	5.26%	1.51%	20.55%	19.81%
Aluminum	2.68%	-2.03%	9.28%	17.64%
Nickel	5.75%	-0.03%	28.72%	2.15%
Zinc	3.98%	0.62%	28.16%	17.82%
Softs Sub-Index	-0.87%	-4.10%	-2.83%	-19.23%
Coffee	-1.48%	-5.01%	-8.38%	-22.71%
Sugar	-2.75%	-11.04%	-2.87%	-28.03%
Cotton	3.01%	10.40%	9.57%	7.08%
Livestock Sub-Index	1.34%	-1.11%	-5.10%	5.66%
Cattle	2.33%	-2.83%	-6.58%	9.29%
Hogs	-0.45%	2.26%	-2.70%	0.31%

Rally in the Antipodes! Both the AUD and NZD posted gains against the USD, as did the politically unsettled CLP. The majors are trading as December currency markets should, quiet and erratic. This has been a very bad year for currency traders as no one dealt them a royal flush and they had to figure out to play the cards otherwise. They failed to do so.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.20%	-0.36%	5.42%	12.82%
Chinese yuan	0.18%	0.22%	3.00%	5.10%
Japanese yen	0.78%	0.25%	-1.48%	4.96%
British pound	-0.52%	1.13%	4.41%	7.26%
Swiss franc	0.22%	-0.21%	-1.53%	3.99%
Canadian dollar	-0.14%	-0.79%	3.13%	3.65%
Australian dollar	1.82%	0.75%	0.88%	3.91%
Swedish krona	-0.69%	-0.88%	2.88%	10.64%
Norwegian krone	-1.06%	-1.65%	1.46%	3.38%
New Zealand dollar	2.13%	1.69%	-2.98%	-0.64%
Indian rupee	0.64%	1.82%	0.77%	5.92%
Brazilian real	-0.27%	0.39%	-0.82%	1.90%
Mexican peso	-0.99%	0.70%	-5.62%	6.36%
Chilean peso	3.04%	-0.45%	4.63%	4.68%
Colombian peso	0.43%	1.02%	-1.54%	0.14%
Bloomberg-JP Morgan Asian dollar index (spot)	0.18%	0.65%	2.33%	5.18%

Emerging markets managed to pull out of their recent decline, but this index is going to struggle as carry trades of all stripes evaporate. The U.S. remains the market of choice.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.61%	2.70%	9.52%	21.79%
North America	0.88%	4.26%	11.02%	20.34%
Latin America	0.52%	1.56%	8.16%	23.68%
Emerging Market Free	0.71%	0.72%	13.07%	33.67%
EAFE	0.14%	1.83%	8.04%	24.45%
Pacific	0.52%	1.06%	9.81%	22.20%
Eurozone	-0.83%	0.53%	7.57%	29.16%

While CTAs had positive returns on the week, hedge funds continued to lose money and, worse, continue to announce closures. You have to be smart to convince people to fund you instead of simply buying an index fund.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.26%	2.19%	1.69%	0.31%
Newedge Trend	0.43%	1.86%	1.04%	1.84%
Newedge Short-Term	-0.62%	0.40%	-1.50%	-6.93%
HFR Global Hedge Fund	-0.25%	0.53%	2.28%	5.17%
HFR Macro/CTA	-0.55%	-0.12%	0.50%	1.36%
HFR Macro: Sytematic Diversified CTA	-0.28%	1.51%	2.93%	2.61%