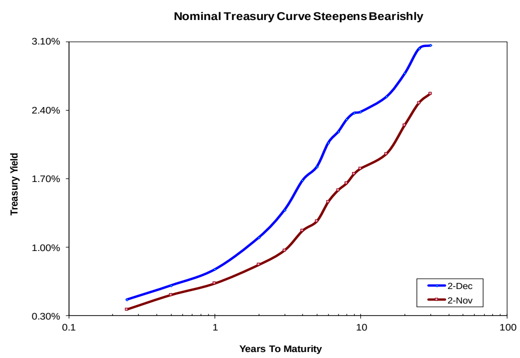
The Macro Environment For Financial Markets

We can cry for Argentina so long as we do not emulate it. The notion of a U.S. President jawboning a company to make sub-economic decisions under duress simply replaces the egregious crony capitalism of one party with something more akin to the Peronist model. These policies will be popular amongst the defined beneficiaries but will come at a cost of greater economic stagnation to the rest of the population. No amount of regulatory relief, always a short-term state in a lawyer-infested society, can offset this and produce higher growth. The causal chain now is:

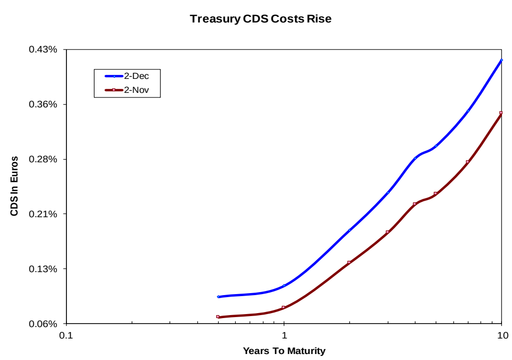
1. The market has priced in a December increase in U.S. short-term rates;
2. Inflationary expectations are rising globally, albeit excessively;
3. The U.S. yield curve is in a short-term bearish steepening;
4. Short-term borrowers have stopped terming out short-term debt into the bond market;
5. Swap spreads remain complacent about future rate increases; and
6. CDS costs remain controlled in the absence of an economic shock.

Key Market Indications

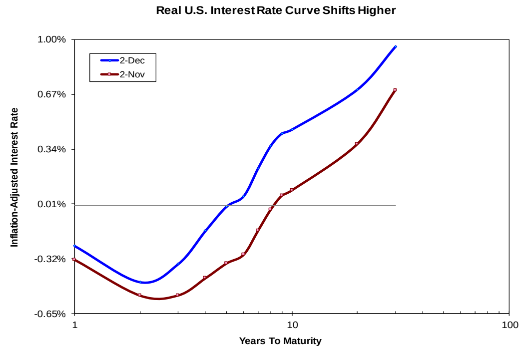
We have moved through key support at the long end of the yield curve and have to recognize this as a bear market, duration to be determined. The market is convinced the combination of lower monetary accommodation and greater fiscal stimulus will propel yields higher. As neither effect is likely to be as large as feared, the betting here is this bear market will be a short-lived affair.



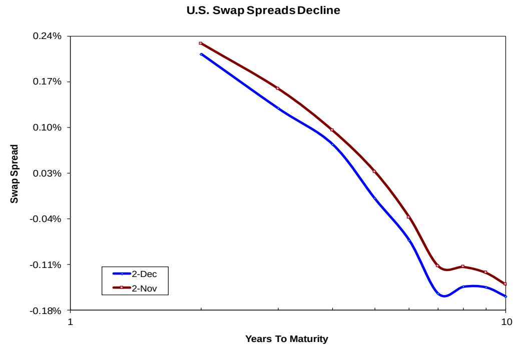
CDS costs on UST shifted higher over the past month. It is doubtful the incoming administration will jeopardize the U.S.' credit rating, but it may be given a very short leash by foreign creditors.



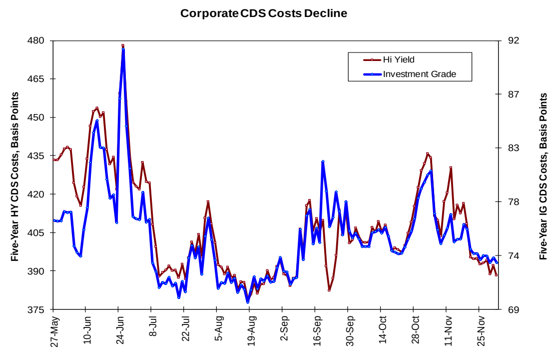
The pseudo-real yield curve rose at the short end of the yield curve over the past month. The increase in these measures in both the U.S. and elsewhere put pressure on the precious metals. The rise in long-term implied real rates is a negative for risky financial assets even though this effect has yet to manifest itself in U.S. equities.



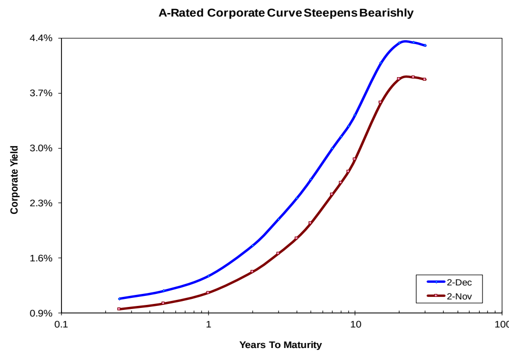
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower across tenors. The swap market is acting as if the rise in sovereign rates is a singular adjustment to the rally ending in July. As noted previously, those closest to the commercial trade in any industry are always the last ones to grasp the secular turn.



CDS costs resumed declining, which is completely consistent with expectations for stronger economic growth and still accommodative monetary policy. We would need to see a sharp downturn in equities to trigger correlation trades at this point to see rising CDS levels.



The A-rated corporate yield curve continues to shift higher at the long end of the yield curve. This reflects movements in the Treasury market far more than it does credit spreads.



Market Structure

Both Natural Gas and Petroleum moved into structural uptrends and pulled the main Bloomberg index higher with them. The S&P 500 remains in a structural uptrend within the financials, while the EM index remains in a downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Dec. 5 - 9
BBerg	28	Trending	0.207	12.1%	0.30%
BBerg Grain	26	Trending	-0.073	15.1%	
BBerg Ind. Metl	4	Sideways	-0.006	25.0%	
BBerg Pre. Metl	28	Trending	-0.276	17.7%	-0.20%
BBerg Softs	29	Trending	-0.489	17.5%	-0.17%
BBerg Nat. Gas	29	Trending	0.203	31.5%	1.03%
BBerg Petroleum	29	Trending	0.301	28.1%	0.74%
BBerg Livestock	29	Trending	0.040	12.5%	0.15%
Dollar Index	5	Sideways	-0.043	8.0%	
S&P 500 Index	29	Trending	0.162	8.7%	0.08%
EAFE Index	5	Sideways	0.002	10.9%	
EM Index	29	Trending	-0.199	12.5%	-0.41%
Ten-year UST (price)	7	Sideways	-0.026	7.0%	

Performance Measures

The double-digit percentage gains in the Petroleum markets are doubly impressive when you consider their origin in a cartel's supply restriction agreement. The buyers may be wrong, but they ran over anyone in their way. Grains, Softs, Industrial Metals and Livestock all had substantial losses. The main Bloomberg index, now at 201.4, can rise to 227.2 and still be in a long-term bear market.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	2.37%	3.80%	0.56%	8.64%
Grains Sub-Index	-2.77%	-0.94%	-18.05%	-7.72%
Corn	-3.06%	-2.16%	-21.55%	-13.75%
Soybeans	-1.76%	4.20%	-9.18%	14.62%
Wheat	-3.63%	-7.23%	-25.52%	-24.32%
Energy Sub-Index	10.93%	13.07%	3.29%	3.01%
Petroleum Sub-Index	12.36%	12.21%	0.06%	0.86%
WTI	12.21%	12.56%	-2.57%	-6.89%
Brent	12.50%	12.95%	0.59%	4.67%
ULSD	11.58%	11.65%	3.00%	8.96%
Gasoline	13.31%	10.34%	1.83%	-2.07%
Natural Gas	7.32%	15.42%	15.40%	5.43%
Precious Metals Sub-Index	0.30%	-10.27%	-1.53%	12.98%
Gold	-0.26%	-10.18%	-3.51%	10.84%
Silver	1.69%	-10.49%	3.62%	18.23%
Industrial Metals Sub-Index	-2.72%	10.06%	23.96%	29.48%
Copper	-2.10%	17.23%	25.53%	27.32%
Aluminum	-2.51%	-0.95%	10.19%	12.23%
Nickel	-0.94%	10.89%	34.19%	25.58%
Zinc	-5.51%	9.70%	33.38%	69.27%
Softs Sub-Index	-3.81%	-9.68%	6.66%	14.83%
Coffee	-6.17%	-12.40%	11.63%	10.38%
Sugar	-3.62%	-11.86%	2.39%	19.58%
Cotton	-0.29%	2.69%	11.81%	10.75%
Livestock Sub-Index	-3.68%	0.50%	-17.67%	-13.91%
Cattle	-2.95%	2.27%	-8.88%	-9.75%
Hogs	-4.79%	-2.12%	-28.76%	-19.87%

Markets do not move in straight lines, and this most definitely includes the USD; only the JPY and BRL declined against it this week. The December rate hike is priced into the markets and everyone understands the Federal Reserve is not going to get too far ahead of its sister central banks, certainly not given the protectionist tendencies of the incoming administration.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.71%	-3.91%	-4.37%	0.46%
Chinese yuan	0.56%	-1.79%	-4.30%	-7.00%
Japanese yen	-0.26%	-8.99%	-4.09%	8.57%
British pound	2.02%	3.45%	-11.75%	-14.86%
Swiss franc	0.30%	-3.75%	-2.05%	0.71%
Canadian dollar	1.71%	0.76%	-1.47%	0.38%
Australian dollar	0.19%	-2.66%	3.15%	2.02%
Swedish krona	0.38%	-3.18%	-9.62%	-5.82%
Norwegian krone	1.88%	-2.76%	-1.03%	2.75%
New Zealand dollar	1.39%	-2.02%	4.86%	7.55%
Indian rupee	0.36%	-2.21%	-1.37%	-2.37%
Brazilian real	-1.81%	-7.05%	3.35%	10.37%
Mexican peso	0.12%	-6.11%	-9.46%	-19.70%
Chilean peso	1.29%	-3.22%	2.78%	4.84%
Colombian peso	2.74%	-0.55%	-0.08%	2.42%
Bloomberg-JP Morgan Asian dollar index (spot)	0.31%	-2.02%	-2.18%	-3.17%

Can interest rates and inflation expectations rise and not affect equities negatively at some point? No, and if we throw in the likelihood no amount of fiscal stimulus will be proffered in a quantity to offset the loss of monetary stimulus, we have an environment of very constrained gains ahead of us.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.65%	2.40%	3.23%	3.46%
North America	-0.88%	4.62%	5.28%	7.80%
Latin America	-2.03%	-10.05%	10.16%	19.95%
Emerging Market Free	-0.29%	-4.10%	7.16%	6.65%
EAFE	-0.22%	-1.34%	-0.22%	-3.50%
Pacific	-0.03%	-0.84%	7.65%	3.84%
Eurozone	-0.44%	-3.12%	-3.81%	-7.14%

CTAs lost again this week, suggesting they stayed too long in the long equity trade and missed the jump in crude oil. Hedge funds had small gains, which seldom is the case when equities decline.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.56%	-0.51%	-4.06%	-9.08%
Newedge Trend	-0.52%	-1.35%	-3.48%	-5.01%
Newedge Short-Term	0.23%	1.05%	-5.10%	-3.80%
HFR Global Hedge Fund	0.16%	1.12%	2.58%	0.03%
HFR Macro/CTA	0.06%	-0.28%	-2.10%	-4.96%
HFR Macro: Sytematic Diversified CTA	0.02%	0.45%	-0.96%	-3.48%