The Macro Environment For Financial Markets

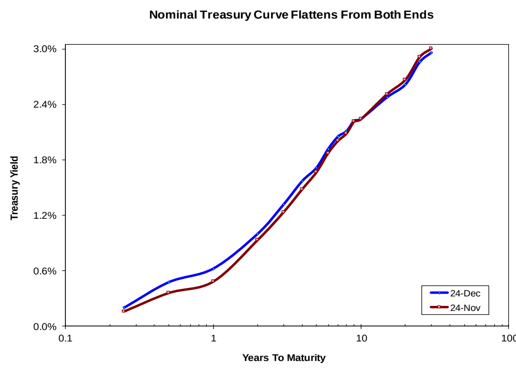
In an homage to the Lord Kitchener/Uncle Sam recruiting posters of a bygone day, everyone wants you to be a consumer. They do not wish to provide you with the means of being one, however, and they really do not wish for you to add to anything in an excess of supply. Did I mention official policies treat the resulting "good deflation" created by rising production efficiencies as something to be combated by still-accommodative monetary policies? Nothing like losing purchasing power to inflation to get the consumer's juices flowing, is there? Societies used to solve this mismatch via a new technology, such as automobile manufacturer or the creation of suburbs, or by destroying production capacity via wars. Nothing is imminent on either front, so we are likely to continue in this slow-growth, low-investment environment for the foreseeable future.

The causal chain remains:

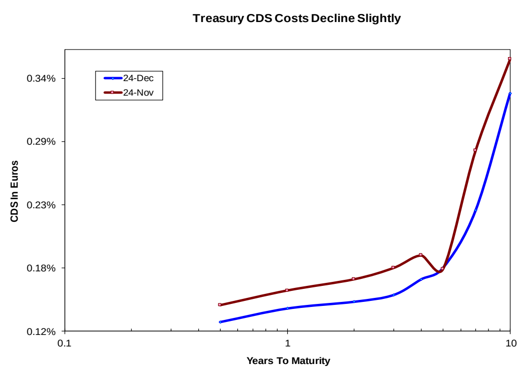
1. Higher short-term interest rates have arrived at last, but there is no rush to push them higher anytime soon;
2. Disinflationary pressures will rise once again with rising risk-aversion;
3. Inflation expectations as measured by the TIPS market have seen their lows for the immediate duration, but are biased lower once again;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are terming-out their borrowing to reduce rollover risk;
6. Swap spreads will remain low even as declining UST rates lead to a small increase; and
7. Credit spreads will retain and most likely expand their upward bias.

Key Market Indications

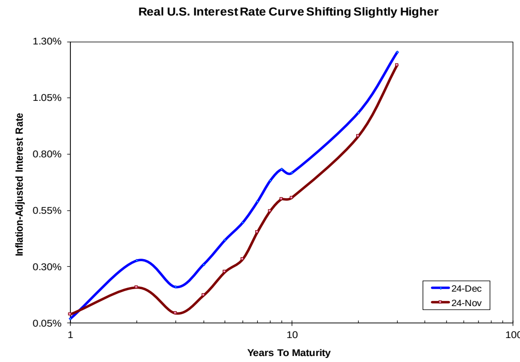
The yield curve continues to flatten via higher short-term rates. This is a market trapped between the artificial demand of capital charges and illiquid corporate bonds and rising short-term rates. While the secular bull market remains intact, the gains for participating in it are quite small indeed.



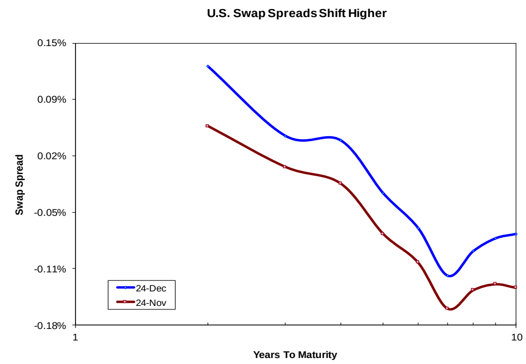
The CDS market for Treasuries declined slightly over the past month, as well it should have given the lack of news emanating from Washington, D.C., over fiscal matters.



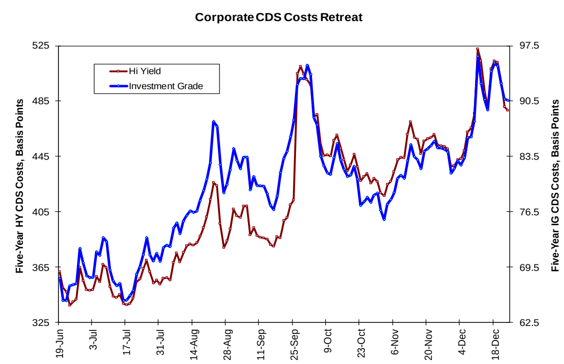
The pseudo-real rate curve rose slightly beyond one year. As movement in the TIPS market reflected a lack of trading activity and the nominal UST market was largely flat, this small shift higher can be ignored for fundamental purposes.



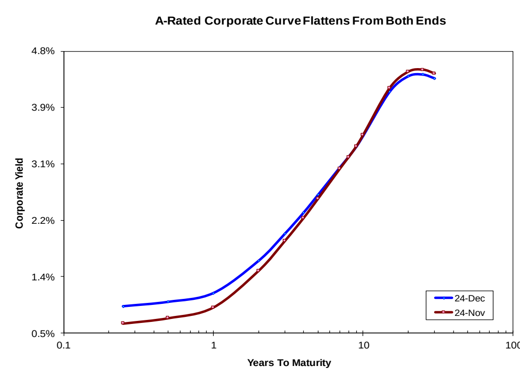
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted higher in response to flattening of the yield curve from the short end. They remain negative for tenors of five years and longer.



CDS costs for both the investment-grade and high-yield indices retreated slightly, but neither measure has reversed the primary uptrend extant over the last half of 2015.



The A-rated yield curve mirrored the UST curve over the past month as it flattened from both ends via a combination of higher short-term rates and lower long-term rates.



Market Structure

Volatile transitional structures and bear market consolidations characterized by sideways structures continue to dominate. The Softs subindex moved into a structural uptrend. In the financial markets, the S&P 500 exited its downtrend and the EAFE moved into a structural uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Dec. 28 - Jan. 1
BBerg	18	Transitional	-0.041	11.2%	
BBerg Grain	19	Transitional	-0.132	15.5%	
BBerg Ind. Metl	14	Transitional	0.101	15.3%	
BBerg Pre. Metl	14	Transitional	0.078	11.2%	
BBerg Softs	29	Trending	0.007	18.9%	0.31%
BBerg Nat. Gas	29	Trending	-0.130	26.2%	-0.55%
BBerg Petroleum	26	Trending	-0.219	28.5%	-0.59%
BBerg Livestock	19	Transitional	0.239	17.4%	
Dollar Index	8	Sideways	-0.055	7.2%	
S&P 500 Index	23	Trending	0.004	11.7%	
EAFE Index	29	Trending	0.013	11.1%	0.11%
EM Index	29	Trending	-0.069	10.1%	-0.49%
Ten-year UST (price)	15	Transitional	-0.019	5.5%	

Performance Measures

Physical commodity markets cannot and do not go to zero. They also are subject to ad valorem inventory taxes, which makes the past week's strong rallies more than a little suspect. As nothing has changed fundamentally, we should expect the primary bearish trends to resume in January.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	2.46%	-4.58%	-22.18%	-26.03%
Grains Sub-Index	-2.11%	-1.97%	-11.74%	-20.64%
Corn	-2.60%	-2.19%	-9.56%	-20.09%
Soybeans	-0.54%	-0.59%	-11.45%	-14.75%
Wheat	-3.40%	-4.08%	-14.46%	-25.38%
Energy Sub-Index	4.00%	-14.94%	-40.80%	-42.60%
Petroleum Sub-Index	2.37%	-16.16%	-40.59%	-40.85%
WTI	4.41%	-15.66%	-43.17%	-45.54%
Brent	2.13%	-19.12%	-44.38%	-47.03%
ULSD	-0.77%	-21.91%	-43.91%	-43.67%
Gasoline	1.59%	-6.92%	-25.18%	-15.36%
Natural Gas	8.67%	-11.45%	-40.64%	-48.72%
Precious Metals Sub-Index	3.13%	0.82%	-8.76%	-9.05%
Gold	2.51%	0.60%	-8.39%	-8.74%
Silver	4.94%	1.46%	-9.77%	-9.73%
Industrial Metals Sub-Index	3.51%	2.44%	-20.06%	-27.62%
Copper	3.94%	3.68%	-19.48%	-26.25%
Aluminum	3.90%	4.62%	-13.63%	-22.01%
Nickel	0.08%	-3.15%	-32.45%	-44.51%
Zinc	3.62%	-2.25%	-25.15%	-29.99%
Softs Sub-Index	1.88%	0.00%	3.62%	-13.14%
Coffee	1.19%	-4.64%	-15.94%	-36.67%
Sugar	2.45%	1.03%	17.49%	-7.36%
Cotton	1.07%	0.62%	-2.84%	1.05%
Livestock Sub-Index	9.23%	2.07%	-8.50%	-18.47%
Cattle	11.84%	2.95%	-12.25%	-12.57%
Hogs	4.53%	0.41%	-1.66%	-28.04%

The currency markets were effectively closed this past week, as they will be for the coming week. The USD weakened against the majority of major currencies, but still managed to firm against the larger Latin currencies. An interesting exception here was the COP, which has been one of the more petroleum-linked currencies since June 2014.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.85%	3.16%	-2.19%	-10.35%
Chinese yuan	0.08%	-1.34%	-4.12%	-4.25%
Japanese yen	0.69%	2.00%	2.74%	-0.19%
British pound	0.12%	-1.43%	-5.30%	-4.15%
Swiss franc	0.40%	3.40%	-5.20%	-0.45%
Canadian dollar	0.96%	-3.86%	-10.82%	-15.91%
Australian dollar	1.45%	0.39%	-5.92%	-10.33%
Swedish krona	1.98%	4.03%	-1.74%	-7.27%
Norwegian krone	0.76%	-0.43%	-10.02%	-14.33%
New Zealand dollar	1.68%	4.00%	-0.98%	-11.59%
Indian rupee	0.78%	0.40%	-3.93%	-4.41%
Brazilian real	-1.67%	-6.21%	-21.45%	-31.65%
Mexican peso	-0.59%	-4.27%	-10.20%	-14.54%
Chilean peso	-0.18%	2.06%	-9.78%	-12.96%
Colombian peso	5.04%	-3.69%	-19.67%	-25.99%
Bloomberg-JP Morgan Asian dollar index (spot)	0.40%	-0.90%	-4.28%	-5.02%

Every now and then a Wall Street cliché becomes operative; such was the case for the "Santa Claus" rally. That is the good news; the bad news is much of the gains globally were concentrated in beaten-up sectors and look to be the result of short-covering.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.45%	-1.31%	-5.08%	-0.63%
North America	2.76%	-1.44%	-2.49%	-0.39%
Latin America	0.06%	-6.96%	-25.36%	-29.59%
Emerging Market Free	1.87%	-3.71%	-17.46%	-13.03%
EAFE	1.95%	-1.12%	-9.09%	-1.01%
Pacific	0.74%	-1.87%	-8.64%	1.56%
Eurozone	2.02%	-1.28%	-9.55%	-2.61%

Trend-following CTAs managed gains again this week, a minor accomplishment in thin markets. The same can be noted for global and macro-oriented hedge funds. However, this has not been a banner year for anything dependent on trading skill, has it?

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.23%	-0.66%	0.96%	2.11%
Newedge Trend	0.37%	-0.11%	1.73%	2.32%
Newedge Short-Term	-0.89%	-2.17%	-2.72%	-4.99%
HFR Global Hedge Fund	0.14%	-1.20%	-6.14%	-3.23%
HFR Macro/CTA	-0.04%	-1.03%	-2.50%	-1.14%
HFR Macro: Sytematic Diversified CTA	0.22%	-0.31%	-0.16%	0.47%