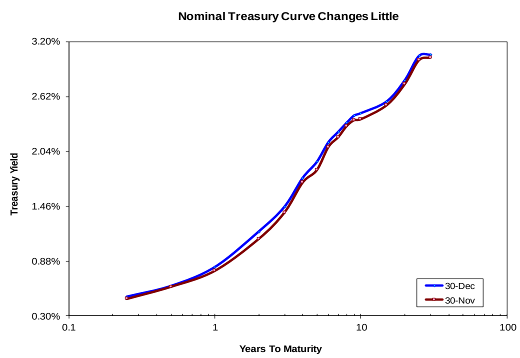
The Macro Environment For Financial Markets

Only a small number of markets changed in a statistically significant manner after the U.S. election. This list included U.S. equities and 7-10 year Treasuries. Both of those changes have started to erode as markets realize the Trump trade will not be as revolutionary as some either thought or hoped. At the end of it, the Federal Reserve will have to exercise caution about raising rates for fear of a soaring USD and the dollar liabilities of commercial banks throughout the world. Fiscal policy has to get through Congress, and that takes time. And patience. The causal chain now remains:

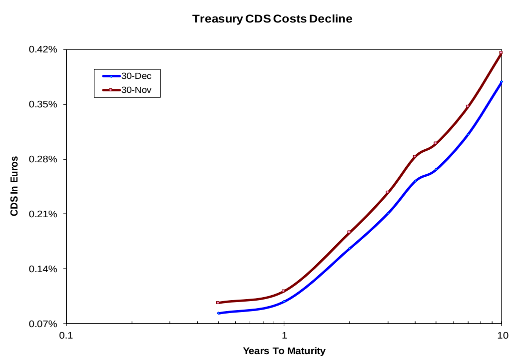
1. The market is pricing in higher short-term rates in 2017;
2. Inflationary expectations have stopped rising for the short-term;
3. The U.S. yield curve is in a short-term bearish steepening;
4. Short-term borrowers have stopped terming out short-term debt into the bond market;
5. Swap spreads are pricing in higher future rates; and
6. CDS costs continue to decline.

Key Market Indications

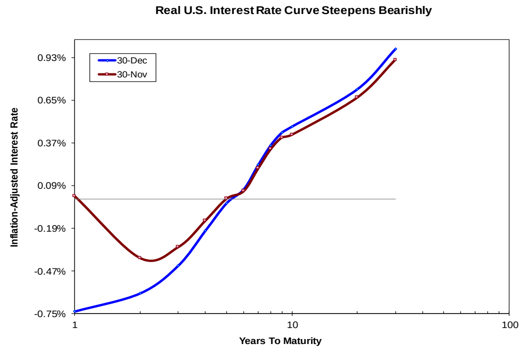
While the overall tenor of the market has to be considered bearish, it will be difficult for the U.S. to sell off significantly when there is such a rate gap with other OECD bond markets. We are in a consolidation period between now and the inauguration.



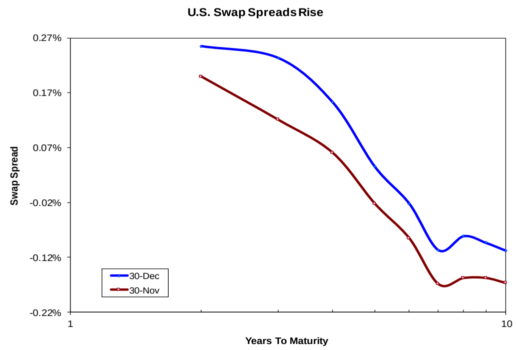
CDS costs on UST declined slightly, which is just as well considering how an impending one-party government is unlikely to default on U.S. debt.



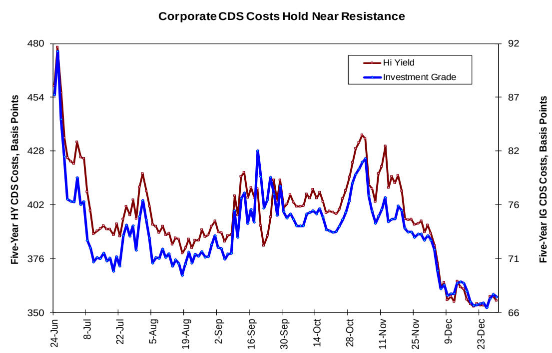
The pseudo-real yield curve declined slightly at the short end of the yield curve over the past month. This helped support gold in the final week of a bad second half of 2016. The rise in long-term implied real rates is a negative for risky financial assets even though this effect has yet to manifest itself in U.S. equities.



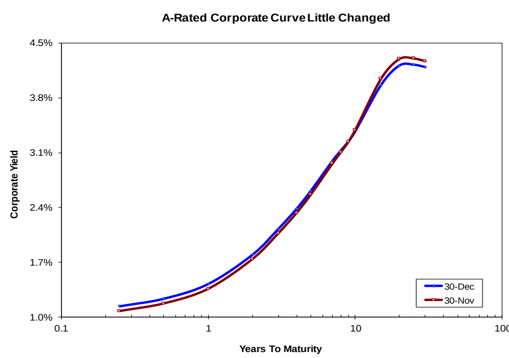
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to rise across tenors as the swap market finally is pricing in higher sovereign rates.



CDS costs remain just below resistance. The economy is not weakening, short-term rate hikes are somewhere in the future and corporate balance sheets are awash with cash. Why should these costs rise?



The A-rated corporate yield curve has changed little over the past month, and actually has flattened bullishly. The ability of the long end of the corporate curve to hold in the face of higher UST yields signals short-term exhaustion in the face of the post-election selloff.



Market Structure

While the main Bloomberg index remains in a structural uptrend, Industrial Metals have joined Grains in a downtrend. All other physical markets are without structure. The EM index remains in a downtrend, with all other financials out of defined structures.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Jan. 3 - 6
BBerg	29	Trending	0.080	9.9%	0.30%
BBerg Grain	28	Trending	-0.118	12.9%	-0.82%
BBerg Ind. Metl	22	Trending	-0.191	19.6%	-0.32%
BBerg Pre. Metl	17	Transitional	-0.045	13.1%	
BBerg Softs	11	Transitional	0.113	18.5%	
BBerg Nat. Gas	13	Transitional	0.110	28.8%	
BBerg Petroleum	12	Transitional	0.099	18.0%	
BBerg Livestock	7	Sideways	0.014	14.1%	
Dollar Index	19	Transitional	0.012	9.9%	
S&P 500 Index	9	Sideways	-0.147	5.7%	
EAFE Index	11	Transitional	0.089	7.5%	
EM Index	23	Trending	0.040	7.9%	-0.24%
Ten-year UST (price)	18	Transitional	0.084	5.4%	

Performance Measures

Concern about Chinese demand growth continues to pressure Industrial Metals. The remaining subindices, including the economically important Energy index, gained. The long-term grinding uptrend for physical commodities remains intact.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.38%	1.80%	-1.31%	12.44%
Grains Sub-Index	1.16%	-0.66%	-12.35%	-6.06%
Corn	1.38%	1.05%	-8.78%	-9.82%
Soybeans	0.01%	-3.72%	-14.37%	14.04%
Wheat	2.78%	1.35%	-16.25%	-24.01%
Energy Sub-Index	2.69%	9.04%	6.53%	19.29%
Petroleum Sub-Index	2.09%	8.18%	6.20%	19.20%
WTI	1.50%	6.63%	1.92%	8.59%
Brent	1.86%	8.21%	5.24%	28.10%
ULSD	2.91%	8.71%	7.70%	34.87%
Gasoline	3.01%	10.94%	17.01%	8.62%
Natural Gas	4.28%	11.24%	7.66%	15.62%
Precious Metals Sub-Index	1.55%	-2.17%	-13.84%	9.45%
Gold	1.87%	-1.85%	-13.35%	7.79%
Silver	0.76%	-2.95%	-15.03%	13.69%
Industrial Metals Sub-Index	-1.65%	-5.04%	10.48%	19.01%
Copper	0.25%	-4.80%	13.23%	15.12%
Aluminum	-1.73%	-2.19%	1.62%	8.23%
Nickel	-6.67%	-11.04%	5.27%	13.39%
Zinc	-2.15%	-4.87%	21.24%	55.10%
Softs Sub-Index	3.50%	-3.68%	-5.13%	13.87%
Coffee	-1.46%	-8.96%	-10.10%	1.09%
Sugar	7.45%	-1.47%	-6.72%	23.57%
Cotton	0.65%	-1.26%	9.34%	9.35%
Livestock Sub-Index	0.56%	10.00%	-4.94%	-5.57%
Cattle	-0.63%	3.71%	-0.46%	-7.36%
Hogs	2.21%	19.83%	-10.85%	-2.90%

While year-end currency markets should not be overanalyzed, it is interesting to note the USD gained only against the INR, MXN and COP. The argument the interest rate divergence between the U.S. and the remainder of the world would increase has come into question, as has the outlook for continued fiscal stimulus.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.58%	-0.68%	-5.30%	-3.81%
Chinese yuan	0.02%	-0.80%	-4.28%	-6.55%
Japanese yen	0.32%	-2.14%	-11.76%	3.04%
British pound	0.47%	-1.33%	-7.29%	-16.71%
Swiss franc	0.74%	-0.17%	-4.22%	-2.96%
Canadian dollar	0.68%	-0.03%	-3.85%	3.27%
Australian dollar	0.45%	-2.40%	-3.26%	-1.08%
Swedish krona	1.08%	1.37%	-7.10%	-7.67%
Norwegian krone	0.70%	-1.34%	-3.21%	1.76%
New Zealand dollar	0.87%	-2.10%	-2.80%	1.36%
Indian rupee	-0.15%	0.68%	-0.59%	-2.26%
Brazilian real	0.46%	4.01%	-1.30%	21.58%
Mexican peso	-0.57%	-0.74%	-11.80%	-16.14%
Chilean peso	0.55%	0.57%	-1.07%	5.64%
Colombian peso	-0.05%	2.39%	-2.72%	5.77%
Bloomberg-JP Morgan Asian dollar index (spot)	0.05%	-0.63%	-3.68%	-3.30%

Did emerging markets gain on intrinsic measures, or is this simply an artifact of rebalancing pressures from those who feel compelled to sell what worked in favor of what did not? I suspect the latter.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.33%	2.43%	7.06%	7.28%
North America	-0.98%	1.86%	7.80%	11.27%
Latin America	3.41%	0.94%	4.60%	32.32%
Emerging Market Free	2.72%	0.29%	4.70%	11.98%
EAFE	0.62%	3.44%	5.78%	0.86%
Pacific	-0.52%	0.48%	7.48%	4.47%
Eurozone	1.28%	6.67%	9.62%	1.24%

Both CTAs and hedge funds continue to perform poorly; unless this changes, the industry will continue to lose AUM to passive managers. You cannot eat diversification, especially when it is eating you.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.36%	1.60%	-6.75%	-4.89%
Newedge Trend	-0.24%	1.17%	-5.89%	-1.99%
Newedge Short-Term	-0.41%	2.24%	-5.29%	0.32%
HFR Global Hedge Fund	-0.11%	1.05%	3.58%	2.32%
HFR Macro/CTA	-0.46%	0.75%	-2.64%	-3.37%
HFR Macro: Sytematic Diversified CTA	-0.31%	1.52%	-3.61%	-1.14%