The Macro Environment For Financial Markets

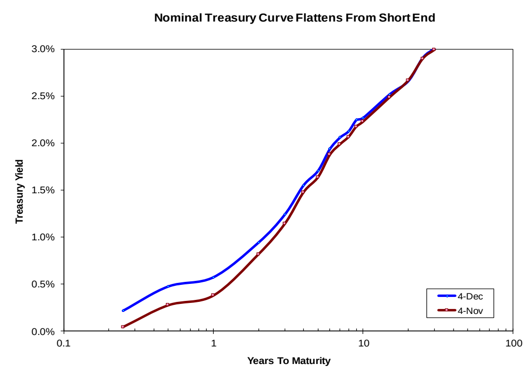
The U.S. surely shall exit the zero interest rate policy era this month, seven years after the "emergency" rate was applied and three QE's ago. Good times. We shall spend far longer dissecting the policies' consequences, but as it was predictable they could have no stimulative effect on output and employment future historians will wonder why we kept going back for more that was not working. Perhaps Mario Draghi was dissuaded from going further into negative interest rate territory by the realization all the ECB was doing was disrupting capital market and not "stimulating" a gosh-darn thing in a world with precious few gosh-darn things (you can look this up). It was mildly amusing, though, to see him and the foreign exchange market reprise the adventures of the Roadrunner and Wile E. Coyote; euro traders should have known that wasn't a real train-tunnel on the side of the cliff.

The causal chain now is:

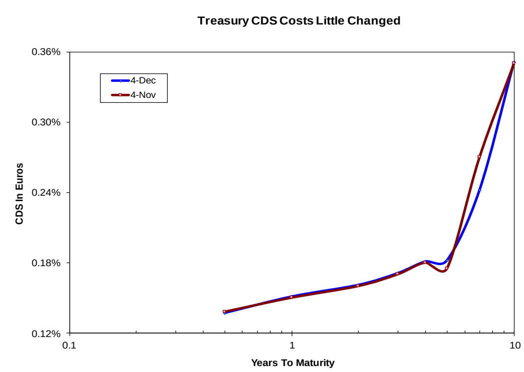
1. Higher short-term interest rates are being priced in still starting in December 2015;
2. Disinflationary pressures are abating;
3. Inflation expectations as measured by the TIPS market have seen their lows for the immediate duration;
4. The U.S. yield curve retains its bias toward flattening, but is poised to steepen around the first rate hike;
5. Short-term borrowers are terming-out their borrowing to reduce rollover risk;
6. Swap spreads will remain tame; and
7. Credit spreads will retain their upward bias.

Key Market Indications

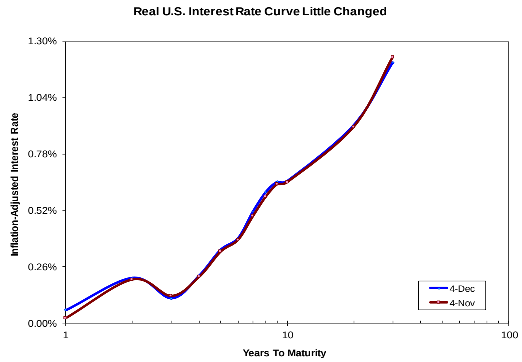
The yield curve continues to flatten via higher short-term rates. We should expect a steepening moving into and immediately after the first rate hike, but until and unless banks can hold anything other than sovereign debt on their books without a significant capital charge, they will be willing to hold UST and maintain the long-term downtrend in long-term yields.



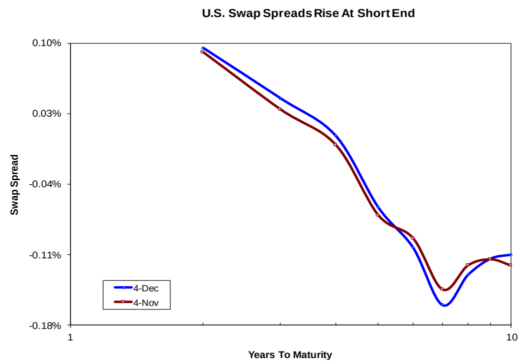
The CDS market for Treasuries has shifted back to its pre-default scare state. Anyone who seek protection in this market during an election cycle must be willing to lose money, and anyone who write protection giving Congressional predilections is not getting paid enough to assume the risk.



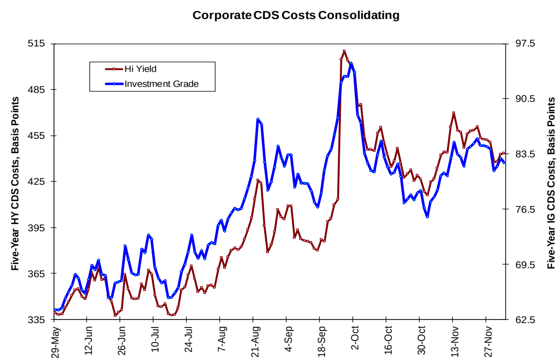
Pseudo-real rates have changed little over the past month. They are not high enough to present a threat to risky asset returns yet. The absence of negative implied short-term real rates had contributed to the significant decline in gold prices until Friday's strong rebound.



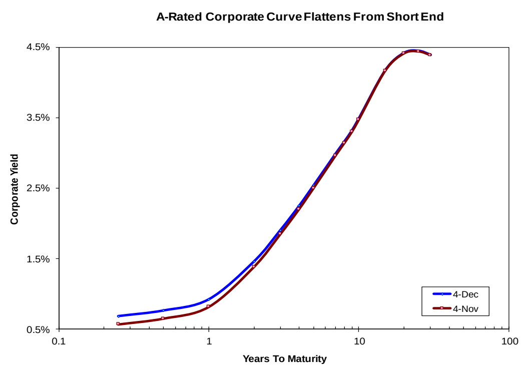
Swap spreads, which rise when floating-rate borrowers want to fix their payments, finally stopped declining at the short end of the yield curve. However, they still remain negative for tenors longer than three years, an unusually complacent state of affairs.



CDS costs for both the investment-grade and high-yield indices have pulled back into consolidations, but it is difficult seeing them decline toward pre-August levels given the still-unsettled state of the energy and basic materials sectors.



The A-rated yield curve mirrored the UST curve over the past month as it flattened via higher short-term rates.



Market Structure

Volatile transitional structures continue to dominate. Only Softs are in a structural uptrend amongst the physical commodities and both the EAFE and ten-year UST are in structural downtrends amongst financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Dec. 7 - 11
BBerg	7	Sideways	0.051	10.2%	
BBerg Grain	29	Trending	0.089	12.7%	
BBerg Ind. Metl	7	Sideways	0.073	19.0%	
BBerg Pre. Metl	10	Sideways	0.131	14.2%	
BBerg Softs	22	Trending	0.151	21.6%	0.33%
BBerg Nat. Gas	18	Transitional	-0.161	24.7%	
BBerg Petroleum	10	Sideways	-0.098	29.9%	
BBerg Livestock	12	Transitional	-0.062	16.7%	
Dollar Index	11	Transitional	-0.118	9.2%	
S&P 500 Index	17	Transitional	0.088	9.6%	
EAFE Index	23	Trending	-0.050	10.4%	-0.07%
EM Index	4	Sideways	-0.095	9.6%	
Ten-year UST (price)	29	Trending	-0.066	4.9%	-0.42%

Performance Measures

The continuing downtrend in the energy markets stood as an exception this week. Really, what should we expect given the combination of warm weather in North America and a complete breakdown of OPEC discipline? The upturns elsewhere reflect a large measure of profit-taking; while these may last until the end of 2015, primary trends remain lower and will continue to remain lower until such time as industrial demand in China starts growing briskly again.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.75%	-5.55%	-18.32%	-27.15%
Grains Sub-Index	3.30%	-2.10%	-4.78%	-14.54%
Corn	3.88%	-2.00%	-2.27%	-12.51%
Soybeans	3.78%	2.50%	-1.98%	-9.59%
Wheat	1.15%	-8.50%	-10.05%	-19.82%
Energy Sub-Index	-3.38%	-12.31%	-32.75%	-46.06%
Petroleum Sub-Index	-4.13%	-12.92%	-32.82%	-43.67%
WTI	-4.17%	-15.33%	-36.11%	-49.85%
Brent	-4.38%	-13.39%	-35.74%	-47.62%
ULSD	-2.59%	-12.16%	-31.84%	-38.93%
Gasoline	-4.97%	-7.83%	-21.98%	-27.38%
Natural Gas	-1.17%	-10.58%	-31.21%	-53.40%
Precious Metals Sub-Index	2.85%	-2.52%	-8.66%	-11.42%
Gold	2.65%	-2.06%	-7.97%	-10.66%
Silver	3.42%	-3.80%	-10.57%	-13.56%
Industrial Metals Sub-Index	1.78%	-7.01%	-22.90%	-32.02%
Copper	1.05%	-10.87%	-23.31%	-29.33%
Aluminum	3.59%	0.61%	-15.96%	-28.33%
Nickel	2.31%	-9.06%	-31.11%	-48.34%
Zinc	-0.14%	-8.15%	-28.80%	-32.56%
Softs Sub-Index	2.77%	4.67%	3.87%	-13.83%
Coffee	2.71%	2.35%	-12.70%	-37.37%
Sugar	3.41%	5.75%	14.75%	-7.61%
Cotton	1.22%	4.21%	-1.97%	5.01%
Livestock Sub-Index	-1.41%	-5.07%	-15.98%	-24.76%
Cattle	-3.45%	-7.28%	-18.83%	-20.72%
Hogs	2.47%	-0.87%	-10.22%	-31.54%

Bear market reversals are vicious. If you combine that with a central banker who pulled off the largest misdirection since the Federal Reserve in September and the Swiss National Bank in January and throw in some very unbalanced positions, you have this week's outsized losses for the USD. The primary trend will reassert itself soon as the interest rate and asset return differentials favor the U.S.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	2.72%	0.14%	-3.18%	-12.10%
Chinese yuan	-0.13%	-1.03%	-3.16%	-3.87%
Japanese yen	-0.25%	-1.25%	1.02%	-2.70%
British pound	0.51%	-1.78%	-1.64%	-3.58%
Swiss franc	3.39%	-0.30%	-6.30%	-2.52%
Canadian dollar	0.07%	-1.59%	-6.44%	-14.80%
Australian dollar	2.03%	2.66%	-4.54%	-12.45%
Swedish krona	2.99%	1.70%	-2.41%	-11.65%
Norwegian krone	2.28%	1.38%	-8.87%	-17.11%
New Zealand dollar	3.28%	2.32%	-5.37%	-13.32%
Indian rupee	0.11%	-1.80%	-4.02%	-7.12%
Brazilian real	2.51%	1.26%	-16.49%	-30.96%
Mexican peso	-0.17%	-0.72%	-6.71%	-15.00%
Chilean peso	1.26%	-1.60%	-10.49%	-13.40%
Colombian peso	-3.00%	-11.45%	-19.13%	-28.81%
Bloomberg-JP Morgan Asian dollar index (spot)	0.15%	-0.88%	-3.78%	-5.30%

Emerging markets are very sensitive to the dollar carry trade and to physical commodity prices. They will continue to underperform, in Latin America especially, until these situations reverse. That will not be at any time soon.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.30%	-0.90%	-3.52%	0.01%
North America	0.02%	-0.53%	-0.56%	1.61%
Latin America	-1.94%	-5.47%	-21.49%	-29.58%
Emerging Market Free	-1.69%	-6.37%	-16.42%	-15.40%
EAFE	-0.82%	-1.50%	-8.08%	-2.55%
Pacific	-0.70%	0.28%	-7.06%	0.30%
Eurozone	-1.62%	-2.35%	-8.47%	-4.22%

We might as well define professional traders as those who lose investors' money during tough markets as this is what they do. The good news is the bad news could have been worse given the end-of-week reversals.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.36%	1.62%	-1.22%	2.89%
Newedge Trend	-1.24%	0.99%	-1.49%	1.23%
Newedge Short-Term	-0.90%	0.84%	-3.71%	-3.36%
HFR Global Hedge Fund	-0.46%	-1.49%	-5.38%	-3.08%
HFR Macro/CTA	-0.93%	0.75%	-2.18%	-0.96%
HFR Macro: Sytematic Diversified CTA	-1.23%	0.83%	-1.41%	0.22%