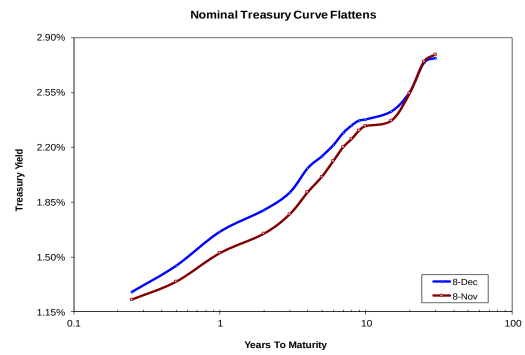
The Macro Environment For Financial Markets

As noted previously, those complaining about low volatility will miss it badly one day. The presumption is traders do well in volatile markets. No; this is a zero-sum game except in equities, which are a positive-sum game. Most players in zero-sum games lose. So long as we have convergent policies and convergent growth rates around the world and a lack of speculative excess, the always-entertaining Bitcoin excepted, there is no reason why the bull market in risky assets cannot continue. I might add I have been making this same argument for five years now, and that should tell you something. The causal chain remains:

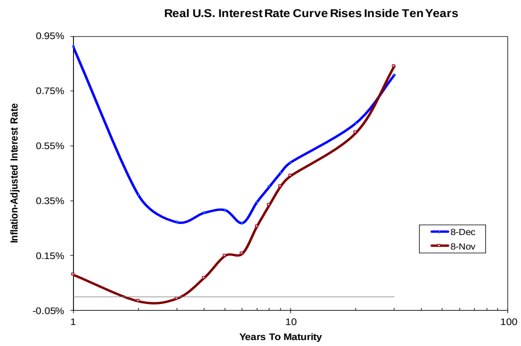
1. The market has priced in a December rate hike but is divided over the March 2018 meeting;
2. Inflationary expectations are confined to a narrow range;
3. The secular flattening trend in the U.S. yield curve continues;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads are inverting bullishly; and
6. CDS costs have resumed their decline, especially for the investment-grade index.

Key Market Indications

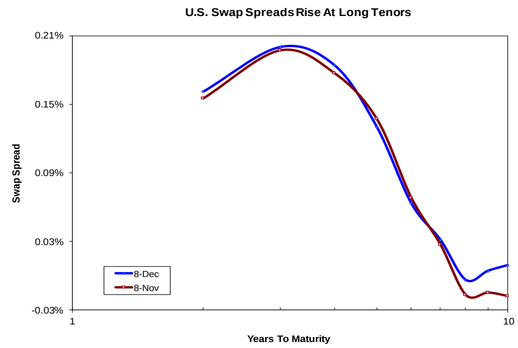
I commented last week the UST market is not supposed to be this quiet. It is, and the best thing to do simply is to accept it. The flattening yield curve is not a recessionary sign as it is being produced by very strong holders of long-term debt being unwilling to sell. The rise in short-term rates has to be placed into context; ten years ago, a 2-year yield of 1.79% would have been considered freakishly low.



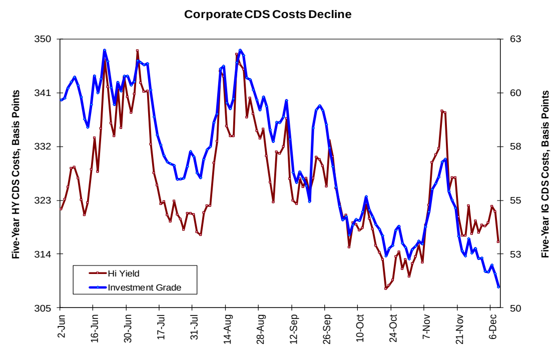
The pseudo-real yield curve shifted higher at the short end of the yield curve and remains stable at the long end of the yield curve. The combination continues to favor risky financial assets over precious metals.



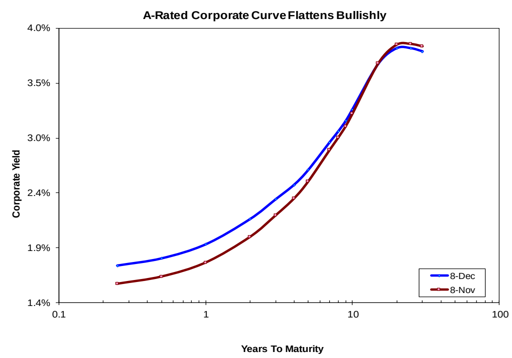
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose slightly at the long end of the yield curve. This is decreasingly bullish for corporate credit and for equities, but the situation is nowhere close to being bearish.



CDS costs declined, with the move once again being stronger for investment-grade 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.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Dec. 11 - 15
BBerg	29	Trending	-0.321	6.9%	-0.12%
BBerg Grain	26	Trending	-0.128	9.9%	-0.07%
BBerg Ind. Metl	29	Trending	-0.321	13.9%	-0.18%
BBerg Pre. Metl	27	Trending	-0.383	9.2%	-0.07%
BBerg Softs	29	Trending	-0.223	13.9%	-0.28%
BBerg Nat. Gas	25	Trending	-0.361	18.0%	-0.11%
BBerg Petroleum	13	Transitional	0.022	14.5%	
BBerg Livestock	12	Transitional	-0.209	11.0%	
Dollar Index	27	Trending	0.005	5.1%	
S&P 500 Index	5	Sideways	0.075	7.1%	
EAFE Index	16	Transitional	0.007	6.8%	
EM Index	29	Trending	-0.181	8.6%	-0.44%
Ten-year UST (price)	26	Trending	-0.045	3.9%	-0.06%

Performance Measures

Only cotton stood in the way of uniform losses by physical commodities. Once again, the lack of liquidity even in large markets such as Natural Gas and Sugar is allowing for some outsized moves. The economically important Industrial Metals had a bad week on Chinese demand news and Precious Metals declined on higher implied short-term real rates. The world's producers of physical commodities continue to overwhelm buyers.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-2.83%	-3.65%	2.49%	-3.83%
Grains Sub-Index	-1.97%	-2.08%	-11.02%	-12.82%
Corn	-1.65%	-1.00%	-16.83%	-13.47%
Soybeans	-0.44%	0.37%	3.81%	-8.47%
Wheat	-4.42%	-6.66%	-17.06%	-15.90%
Energy Sub-Index	-3.03%	-4.44%	13.90%	-6.78%
Petroleum Sub-Index	-1.09%	-0.64%	28.03%	8.08%
WTI	-1.68%	0.78%	22.40%	2.33%
Brent	-0.65%	-0.24%	30.56%	11.07%
ULSD	-0.63%	-0.37%	33.47%	13.15%
Gasoline	-1.42%	-4.34%	27.77%	8.25%
Natural Gas	-9.44%	-16.09%	-20.10%	-39.85%
Precious Metals Sub-Index	-2.82%	-3.39%	-3.97%	2.42%
Gold	-2.62%	-2.26%	-2.17%	6.55%
Silver	-3.42%	-6.64%	-9.01%	-8.04%
Industrial Metals Sub-Index	-3.68%	-4.86%	12.07%	9.07%
Copper	-3.66%	-3.71%	11.06%	10.26%
Aluminum	-3.13%	-4.46%	4.12%	12.44%
Nickel	-3.03%	-9.68%	21.13%	-5.92%
Zinc	-5.17%	-4.40%	22.96%	14.09%
Softs Sub-Index	-4.27%	-2.28%	-5.72%	-20.29%
Coffee	-5.34%	-6.22%	-9.06%	-19.80%
Sugar	-6.18%	-5.99%	-5.95%	-29.91%
Cotton	0.63%	6.74%	1.67%	5.24%
Livestock Sub-Index	-2.86%	-4.95%	-10.14%	9.15%
Cattle	-2.99%	-6.52%	-12.88%	11.47%
Hogs	-2.63%	-1.96%	-5.38%	5.92%

Only a tiny gain in the INR prevented a clean sweep by the USD. Even though the Federal Reserve is not overtly hawkish and U.S. fiscal policy is not strongly stimulative, the argument for a rising USD is stronger than it is for other currencies. The January-August slide in the USD feels like a distant memory.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.03%	1.54%	4.98%	10.91%
Chinese yuan	-0.07%	0.11%	2.71%	4.08%
Japanese yen	-1.15%	0.34%	-3.05%	0.49%
British pound	-0.65%	2.09%	3.35%	6.39%
Swiss franc	-1.66%	0.75%	-2.57%	2.38%
Canadian dollar	-1.27%	-0.93%	5.12%	2.67%
Australian dollar	-1.37%	-2.20%	-0.50%	0.62%
Swedish krona	-1.09%	-0.76%	3.14%	8.08%
Norwegian krone	-0.11%	-1.55%	2.41%	1.68%
New Zealand dollar	-0.64%	-1.71%	-5.10%	-4.56%
Indian rupee	0.01%	0.78%	-0.38%	4.50%
Brazilian real	-1.08%	-1.31%	-0.97%	2.48%
Mexican peso	-1.56%	0.83%	-3.86%	7.33%
Chilean peso	-1.27%	-3.52%	1.60%	-0.11%
Colombian peso	-0.41%	0.27%	-3.04%	-0.23%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.24%	0.68%	1.89%	4.18%

We are continuing to see the global equity rally devolve into a U.S. equity rally, something a little unusual at a time when a rising USD should start to make non-U.S. markets increasingly attractive.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.23%	1.81%	8.94%	20.72%
North America	0.30%	2.26%	10.02%	19.94%
Latin America	-0.99%	-4.01%	7.25%	19.47%
Emerging Market Free	-0.45%	-2.05%	10.65%	29.63%
EAFE	0.10%	-0.20%	6.93%	23.47%
Pacific	-0.62%	-0.66%	9.83%	19.48%
Eurozone	1.03%	1.17%	6.64%	30.68%

Both CTAs and hedge funds lost money again, as has been typical whenever equities stall or decline. They managed to sidestep strong gains in the USD and declines in physical commodities. Latching on to those trends is their job.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.42%	-1.23%	1.33%	1.54%
Newedge Trend	-0.70%	-2.00%	-0.26%	1.92%
Newedge Short-Term	-0.03%	-1.56%	-0.71%	-4.99%
HFR Global Hedge Fund	-0.30%	-0.56%	2.17%	5.24%
HFR Macro/CTA	-0.28%	-1.49%	0.47%	2.15%
HFR Macro: Sytematic Diversified CTA	-0.38%	-0.60%	2.71%	3.67%