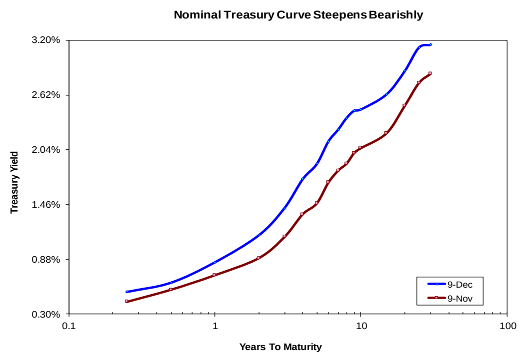
The Macro Environment For Financial Markets

A macroeconomic forecasting colleague initiated a presentation in November 1984 by saying, “I look out there and see nothing but good news.” The economic growth burst of the 1980s, replete with rising financial markets and falling inflation, followed. The skies are not that sunny; after all, both inflation and interest rates are on the rise, fiscal stimulus is more of a pipe dream than realized commonly and the labor market’s structural upheavals continue, but Mr. Trump has picked the best time to be an incoming U.S. President since Bill Clinton in 1993. The causal chain now is:

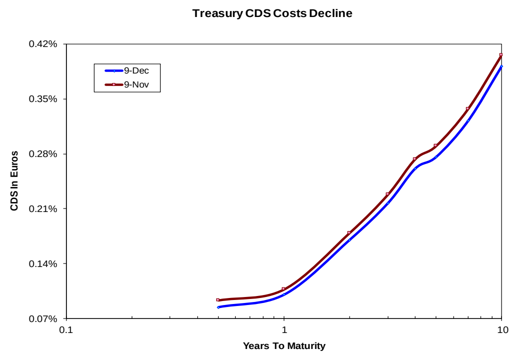
1. The market has priced in a December increase in U.S. short-term rates, but does not appear to be in a hurry to price in another one just yet;
2. Inflationary expectations are rising globally, albeit excessively;
3. The U.S. yield curve is in a short-term bearish steepening;
4. Short-term borrowers have stopped terming out short-term debt into the bond market;
5. Swap spreads remain complacent about future rate increases; and
6. CDS costs have broken through resistance.

Key Market Indications

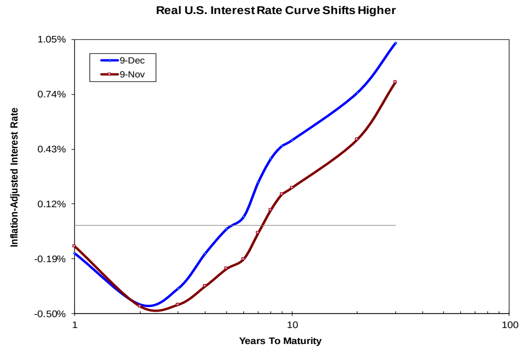
To repeat from last week, we have moved through key support at the long end of the yield curve and have to recognize this as a bear market, duration to be determined. The market is convinced the combination of lower monetary accommodation and greater fiscal stimulus will propel yields higher. As neither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



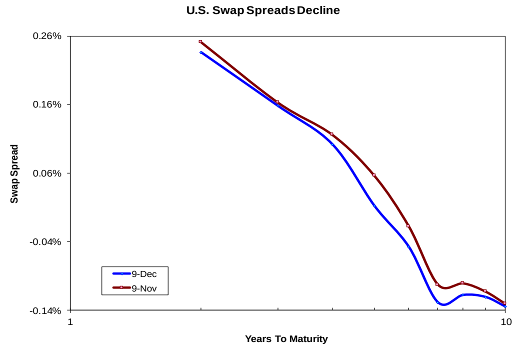
CDS costs on UST declined slightly, which is just as well considering how an impending one-party government is unlikely to default on U.S. debt.



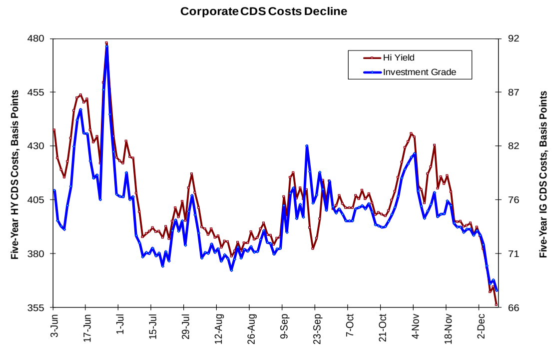
The pseudo-real yield curve declined slightly at the short end of the yield curve over the past month. Increases in these implied real rates in the Eurozone put further downward pressure on gold. The rise in long-term implied real rates is a negative for risky financial assets even though this effect has yet to manifest itself in U.S. equities.



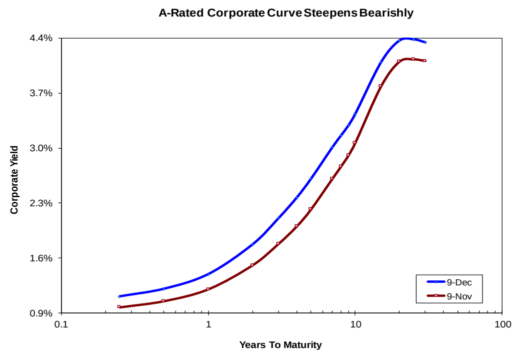
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower across tenors again. The swap market is acting as if the rise in sovereign rates is a singular adjustment to the rally ending in July. As noted previously, those closest to the commercial trade in any industry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



CDS costs not only resumed declining, they took out resistance levels decisively as correlation trades against equities stopped. Even with rising short-term rates in the U.S., global monetary policy remains loose and growth is accelerating, not decelerating. The downside is risk is becoming overpriced again.



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

Natural Gas, Petroleum and the main Bloomberg index remain in structural uptrends and are joined by Grains. The EAFE and EM indices joined the S&P 500 in structural uptrends, while ten-year UST moved into a bearish consolidation.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Dec. 12 - 16
BBerg	29	Trending	0.240	11.9%	0.30%
BBerg Grain	27	Trending	0.078	15.2%	0.11%
BBerg Ind. Metl	7	Sideways	0.013	19.0%	
BBerg Pre. Metl	6	Sideways	-0.057	11.9%	
BBerg Softs	4	Sideways	-0.045	21.7%	
BBerg Nat. Gas	29	Trending	0.315	29.6%	1.03%
BBerg Petroleum	29	Trending	0.265	27.7%	0.74%
BBerg Livestock	29	Trending	0.299	13.0%	0.15%
Dollar Index	10	Sideways	0.062	10.8%	
S&P 500 Index	29	Trending	0.422	8.6%	0.08%
EAFE Index	21	Trending	0.198	12.2%	0.15%
EM Index	29	Trending	0.101	12.5%	0.26%
Ten-year UST (price)	6	Sideways	-0.097	5.8%	

Performance Measures

Hogs took this week's crown for excessive volatility, advancing almost 14%, followed closely by Natural Gas and its 9.09% gain. The Petroleum markets fought off several hard downturns to close only slightly lower on the week, which is remarkable considering the depth of the contango in WTI.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.28%	5.09%	-1.76%	11.58%
Grains Sub-Index	2.35%	2.37%	-18.81%	-6.40%
Corn	3.54%	2.88%	-20.99%	-11.54%
Soybeans	1.00%	4.75%	-10.85%	17.82%
Wheat	2.98%	-1.96%	-27.07%	-25.65%
Energy Sub-Index	1.79%	17.50%	1.20%	11.24%
Petroleum Sub-Index	-0.96%	12.63%	-3.43%	6.35%
WTI	-0.60%	11.85%	-5.91%	-0.55%
Brent	-0.14%	14.02%	-3.31%	11.66%
ULSD	-1.36%	12.01%	-1.24%	13.02%
Gasoline	-3.30%	11.71%	-0.55%	-0.43%
Natural Gas	9.09%	31.14%	16.16%	20.84%
Precious Metals Sub-Index	-0.71%	-8.75%	-7.54%	10.05%
Gold	-1.34%	-8.98%	-9.30%	7.04%
Silver	0.81%	-8.22%	-3.07%	17.68%
Industrial Metals Sub-Index	1.20%	4.43%	23.60%	30.76%
Copper	0.87%	7.26%	28.55%	26.36%
Aluminum	2.15%	-0.21%	9.90%	14.72%
Nickel	0.08%	-1.05%	27.34%	30.07%
Zinc	1.58%	8.65%	29.92%	74.02%
Softs Sub-Index	-1.05%	-12.63%	-2.33%	12.91%
Coffee	-4.41%	-19.83%	-2.01%	0.22%
Sugar	0.64%	-12.95%	-5.57%	22.33%
Cotton	-0.33%	2.84%	7.68%	8.15%
Livestock Sub-Index	6.39%	9.16%	-13.71%	-4.98%
Cattle	1.53%	5.78%	-8.43%	-2.86%
Hogs	13.94%	14.19%	-20.45%	-8.86%

The gains for EM currencies are a strong signal the market does not expect the divergence between U.S. and other interest rates to expand much. The Federal Reserve must pay attention to the dollar. However, the majors, the CAD and SEK excepted, resumed their decline against the USD.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.97%	-3.20%	-6.67%	-4.21%
Chinese yuan	-0.41%	-1.69%	-5.00%	-6.95%
Japanese yen	-1.57%	-8.37%	-7.13%	5.31%
British pound	-1.23%	1.34%	-13.04%	-17.19%
Swiss franc	-0.59%	-3.21%	-5.16%	-3.33%
Canadian dollar	0.86%	1.86%	-3.45%	3.04%
Australian dollar	-0.11%	-2.44%	0.24%	3.04%
Swedish krona	0.28%	-1.37%	-11.02%	-8.48%
Norwegian krone	-0.96%	-1.87%	-4.08%	1.95%
New Zealand dollar	-0.07%	-1.96%	0.44%	6.19%
Indian rupee	1.20%	-1.46%	-1.03%	-0.86%
Brazilian real	2.86%	-4.58%	0.59%	11.01%
Mexican peso	1.17%	-2.67%	-10.50%	-16.30%
Chilean peso	2.99%	-0.28%	4.27%	8.01%
Colombian peso	2.73%	-0.18%	-2.23%	9.26%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.10%	-1.54%	-3.12%	-2.82%

While the combination of rising interest rates and inflation expectations will constrain equity returns at some point, there's nothing quite like a year-end window-dressing rally. If you are waiting for all of those who predicted a hard selloff in the event of a Trump win to apologize, bring something to read while you wait.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	3.03%	3.96%	5.37%	8.61%
North America	3.09%	4.66%	7.83%	13.15%
Latin America	4.34%	-5.77%	8.52%	24.50%
Emerging Market Free	2.92%	-0.20%	6.53%	13.41%
EAFE	2.91%	2.73%	1.25%	1.31%
Pacific	1.90%	6.03%	6.77%	8.36%
Eurozone	4.60%	0.61%	0.45%	-1.19%

Trend-following CTAs lost this week, which is surprising given some identifiable trends, but hedge funds managed to gain on the back of the global equity rally. Just like an index fund, only more expensive.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.58%	-0.27%	-6.05%	-7.37%
Newedge Trend	-0.50%	-1.92%	-5.30%	-4.14%
Newedge Short-Term	0.60%	1.71%	-6.35%	-1.61%
HFR Global Hedge Fund	0.72%	2.00%	2.49%	1.86%
HFR Macro/CTA	0.03%	-0.22%	-3.44%	-4.10%
HFR Macro: Sytematic Diversified CTA	0.50%	1.09%	-3.14%	-2.02%