Bulletin

September 23, 2016

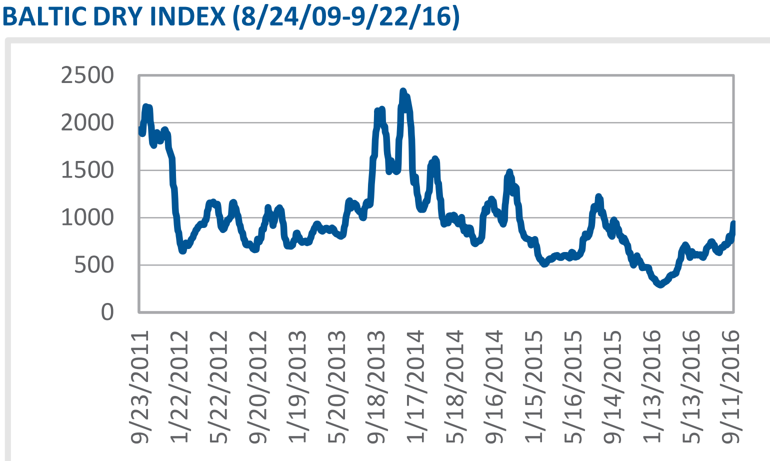
On September 21st, we saw a risk-on reaction to the double-barreled central bank salvo from the Fed and the Bank of Japan (BOJ). It continued during the week, with an interesting wrinkle – FX markets may hold the clue to what happens in trading in the immediate future.

Wednesday's risk-on response was uniform (stocks up, spreads in, commodities up, dollar down), but there were question marks:

- In FX land, when we see commodity and pro-growth currencies move up, it might be reasonable to see risk-off currencies like the Japanese yen under pressure. However, on Monday, while the dollar weakened, as tightening came out of the market, the yen actually moved up. On Thursday, we are saw that curious divergence take a pause. The best performing G-10 currencies are the commodity-linked Norwegian krone and the Canadian dollar, with the Australian dollar not far behind. And the yen? Well, on Thursday it was softer against the dollar, down a little – so far so good.
- The yield curve however remains a question market – US Treasuries are up, but the curve is flattening again. This is worth elevating as a matter of focus. Treasury Inflation Protected Securities (TIPS) however, offer us some consolation that investors are believers that central banks will succeed in their mission to raise inflation, or at least expectations. They continue to do well, a development confirmed by commodity price action and commodity stocks.
- And stocks? It does not take a detective to figure out Wednesday and Thursday were great days.
- Risks? US politics and the unravelling of our civil society and domestic security are genuine – but the markets will not focus on this for now. It's almost quarter-end and there will likely be some meaningful rebalancing by large funds ahead of 9/30. We believe that this will influence risk positioning in the days ahead.

One long forgotten index worth watching is the Baltic Dry Index, which measures the cost of shipping for bulk items. When it goes down, nobody needs shipping and global trade is poor. When it goes up, people need cargo ships to send their goods to customers and global trade is doing better. It is based on an average cost of shipping across over 20 major shipping routes. This index was extraordinarily high pre-financial crisis (when everyone believed China would grow at 10% forever), and then collapsed. The index began breaking out mid-September.

BALTIC DRY INDEX (8/24/09-9/22/16)



Source: Bloomberg. **Past performance is not indicative of future results.**

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