THE CURTAIN RISES: 2016 MARKETPLACE THEATERS

 January 4, 2016

Shakespeare proclaims in "As You Like It" (Act II, Scene VII):
"All the world's a stage,
And all the men and women merely players".

THE 2016 WORLDWIDE ECONOMIC STAGE

As the 2016 international economic (and political) drama commences, the worldwide economy not only is sluggish, but also feebler than most forecasters assert. International real GDP, as well as that in the United States, has a notable chance of slowing down further than many expect (the International Monetary Fund predicts real global output will increase 3.6 percent in calendar 2016; "World Economic Outlook", Chapter 1, Table 1.1).

The ability of the Federal Reserve Board, European Central Bank, Bank of England, Bank of Japan, China's central bank, and their friends to engineer their versions of desirable outcomes via highly accommodative policies has diminished. Beloved schemes such as quantitative easing (money printing) and yield repression and related rhetoric are becoming less influential. Ongoing significant political divisions and conflicts (America's troubling carnival represents only one example) likely will make it challenging for political leaders to significantly promote substantial (adequate) growth.

The failure of longer term US government yields such as the UST 10 year note to rise substantially despite the Fed's recent modest boost in the Federal Funds rate represents a noteworthy warning sign regarding American and global financial prospects. Note also very low sovereign yields in much of the Eurozone (picture Germany); Japanese government rates remain near the ground floor. However, yields of less creditworthy debt instruments, whether sovereign or corporate, probably will continue to climb in 2016, another ominous indication.

For the near term at least, the broad real trade-weighted US dollar probably will remain strong. Emerging marketplace equities and commodities "in general" likely will persist in bear trends. What does the rally of the dollar above its late August/September 2015 heights signal? What does the collapse of benchmark commodity indices such as the broad GSCI beneath their late August 2015 lows portend? These warn not only of worldwide economic weakness, but also of further declines in the S+P 500. Note that emerging marketplace stocks hover fairly closely to their 2015 depths. The S+P 500 probably will remain in a sideways to bearish trend.

OPENING ACT

Financial marketplaces intertwine in various fashions. These links and relationships, including convergence/divergence and lead/lag ones, of course can change. Marketplace history is not marketplace destiny.

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As the wonderful Goldilocks Era ended, stocks peaked before commodities. The S+P 500's major pinnacle was 10/11/07's 1576, with that in emerging marketplace stocks in general ("MXEF"; MSCI emerging stock markets index, from Morgan Stanley) accompanying it on 11/1/07 at 1345.

The broad Goldman Sachs Commodity Index ("GSCI") established its major peak on 7/3/08 at 894 (the Bloomberg Commodity Index ("BCI") top likewise was 7/3/08, at 238.5). However, these commodity summits were close in time to the S+P 500's final peak at 1440 on 5/19/08 (and the MXEF's final top at 1253 on 5/19/08), and not long after the broad real trade-weighted dollar's ("TWD") key April 2008 low near 84.2 (Fed H.10; monthly average). The GSCI's 2/19/09 major bottom at 306 (BCI trough 2/26/99 at 74.2) occurred near the S+P 500's 3/6/09 major low at 667, attained alongside the TWD's March 2009 major top at 96.9. The MXEF's major trough occurred 10/28/08 at 446, its final low 3/3/09 at 471.

During the worldwide economic recovery that walked on scene around 2009, neither commodities in general nor the MXEF surpassed their 2008 plateau.

Although commodities in general and the MXEF failed to break over their spring 2011 highs, whereas the S+P 500 amidst widespread applause paraded to record heights, the S+P 500 often made important turns around the same time as these two marketplaces. For example, recall the S+P 500's interim top on 5/2/11 at 1371. It tumbled 21.6 percent to 1075 on 10/4/11. The nominal TWD established a daily low on 5/2/11 near 93.9, only slightly broken by 7/26/11's 93.7.

ACT TWO

The following table portrays the major relationship between the commodity universe (see the broad GSCI and the Bloomberg Commodity Index), emerging marketplace stocks in general (MXEF), and the broad real trade-weighted dollar since spring 2011. The price fluctuations of the various marketplace realms of course were not precisely the same. However, as the TWD major bull move commenced and accelerated, so did bear performances in emerging marketplace stocks and commodities, crashing from interim tops built in mid-year 2014.

The major peak in commodities in general and the MXEF (spring 2011) and their important 2014 interim tops occurred before the S+P 500's 5/20/15 summit at 2135. This pattern differs from the 2007-08 one. However, in late spring 2015, the S+P 500 (and China's Shanghai Composite stock index) nevertheless joined (encouraged) the slump in the MXEF and commodities alongside an acceleration of US dollar strength. Thereafter, as in the speeding up of the tragic global economic disaster after around mid-2008, the S+P 500, MXEF, and broad GSCI retreated together in conjunction with TWD appreciation.

In late August 2015, commodities and stocks made lows at the same time. The subsequent decisive fall by commodities under their August 2015 floor is a bearish warning sign to stock marketplaces, including the S+P 500, especially as it occurred alongside a renewed rally in the US dollar.

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	Broad GSCI	**Bloomberg Comm. Index**	**Emerging Market Stocks MXEF**	**US Dollar ("TWD")**
Peak 2011	762 (4/11 and 5/2/11)	175.7 (4/25/11)	1212 (4/27/11)	Major low 80.5 July 2011

Recent High	673 (6/23/14)	138.7 (4/29/14)	1104 (9/4/14)	86.6 in Sept 2014 walked over 86.2, June 2012's interim ceiling
Recent Low	304 (12/21/15)	76.2 (12/17/15)	763 (8/24/15)	98.5 (November 2015)
Percent Fall From 2014 High	**54.8**	**45.1**	**30.9**	**TWD rally 22.4pc since July 2011 bottom**

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The MXEF touched lows at 770 on 9/29/15 and (around the same time as those in the GSCI) at 766 on 12/14/15. Thus as calendar 2015 exited, its August 2015 low was still intact. However, widespread commodity weakness, the strong broad real TWD, and renewed slides in the S+P 500 probably will inspire a significant attack on and break under the MXEF's August 2015 support. The MXEF high since the August 2015 depth is 11/4/15's 873.

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The February 2009 GSCI trough, 2/19/09's 306, is part of a double bottom. Note an earlier adjacent low at 308 on 12/24/08. The GSCI's 12/21/15 low thus not only edges under 2/19/09's major bottom, but coincides with the calendar timing of the first low (calendar December) of the 2008-09 double bottom. Therefore a further and sustained downtrend beneath that key worldwide economic crisis support would be a bearish signal for emerging marketplace and advanced nation stocks.

In regard to this important commodity price and time issue, place the oil domain in the limelight. Petroleum is a major part of the broad GSCI. The recent low in NYMEX crude oil (nearest futures continuation) at $33.98 occurred in calendar December on 12/21/15. Historians should recall prior major bottoms during calendar December for NYMEX crude oil: 12/19/08 at $32.40, 12/21/98 at $10.35, and 12/20/93 at $13.75. (Also, in the current oil environment, monitor actual contract months along the price curve, not only nearest futures continuation.)

Oil and natural gas obviously have different supply/demand characteristics. Yet note that NYMEX natural gas (nearest futures continuation) achieved a bottom on 12/18/15 at 1.684, around the time of those in crude oil. Natural gas (nearest futures) thereafter rallied sharply. This December 2015 natural gas low also represents a ten year long diagonal bear move from its record pinnacle achieved 12/13/05 at 15.78.

The GSCI high following its 8/24/15 low at 334 was 386 on 10/9/15.

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What about the roles of other individual commodities? Many reached new lows in their bear trend during December (or late November) 2015. In the petroleum complex, in addition to that in NYMEX crude oil (nearest futures continuation) at $33.98 on 12/21/15, see also ICE Brent/North Sea crude oil (nearest futures) at $35.98 on 12/22/15 and the OPEC daily basket at $30.74 on 12/21/15. In this picture, don't overlook US Gulf Coast regular gasoline's 12/22/15 trough at 108.6 and USGC diesel's low at 99.5 on 12/17/15. USGC 3.0pc residual fuel reached around $20.13 on 12/30/15.

For base metals (in general) see the London Metal Exchange's LMEX index. In recent weeks, the LMEX broke beneath its minor low of 2276 on 8/26/15. The new low is 11/23/15's 2097, preceding the recent depths in the petroleum complex. As of end December 2015, it stood slightly over 2200.

Iron ore (delivered to China) crashed to 38.3 on 12/11/15, an eighty percent collapse versus 7/17/11's 191.7 apex.

Silver fell beneath its minor low at $13.98 on 8/26/15; the new low is 12/14/15's $13.65.

Gold's weakness since its 9/6/11 record at $1921 interrelates with the TWD's long run bull move since July 2011 and the related bear move in commodities in general. An initial minor low in gold, 7/24/15's $1072, occurred before the late August ones in petroleum and base metals. Yet the new gold low at $1045 on 12/3/15 thrust beneath the July 2015 one. December 2015's low neighbors 3/17/08's $1034 major high during the worldwide economic crisis.

Fears of international financial meltdown nevertheless can spark rushes into gold. The 8/24/15 minor high at $1169 occurred alongside the S+P 500, MXEF, and GSCI lows.

As for the agriculture complex "in general", the S+P Goldman Sachs Agriculture Index's recent low remains 9/4/15's 273.2. However, 12/29/15's 281.3 neighbors September's elevation. Its major peak was 3/4/11 (at 570.5)/4/8/11 (566.5), with an important interim high 5/1/14 at 424.6.

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Will commodities "in general" hold their late December 2015 lows (and LMEX base metals their November one)? Much depends on the petroleum complex.

The December 2015 lows in the broad GSCI will be attacked and probably broken. Worldwide economic weakness is notable. The broad real trade-weighted dollar will remain strong and emerging marketplace stocks will stay weak. The S+P 500 probably will continue to venture lower relative to its May 2015 summit. Rising United States corporate bond yields (and some evidence of increasing downgrades, delinquencies, and defaults for weaker corporate and sovereign credits around the globe) underline the economic weakness.

Moreover, the worldwide petroleum arena is significantly oversupplied and likely to remain so for the next few months (and perhaps most of calendar 2016).

Is OPEC's new policy of reducing high-cost (non-OPEC) production succeeding? Some, but not a great deal so far.

For 1996-2014, end year OECD oil inventory (relative to forward quarter average daily petroleum product demand) averaged about 54.2 days of consumption (see the IEA's "Annual Statistical Supplement" and monthly "Oil Market Report").

According to the International Energy Agency's "Oil Market Report", end 3Q15 OECD industry stocks were 64.0 days of forward demand (12/11/15, Table 5). Thus 3Q15 petroleum inventories leap about 9.8 days beyond the 1996-2014 end year average. OPEC crude oil output probably was 31.7mmbd in 4Q15. Because the EIA estimates the call on OPEC crude for 4Q15was 30.3mmbd, the oversupply situation persisted after 3Q15.

Perhaps the desired industry stock holding level shifted upward in recent years. The 2008-2013 span averaged was about 57.0 days coverage, with 4Q14 at 59.0 days. Thus current and anticipated OECD inventories look high regardless of the recent historical time horizon selected. Admittedly the OECD region is not the whole world.

What about calendar 2016? The IEA predicts global oil consumption will hop up 1.3 percent in calendar 2016 to 95.8mmbd (Table 1). This guide heralds that total non-OPEC supply will decline modestly from calendar 2015's 58.3mmbd to 2016's 57.7mmbd. Yet for full year 2016, the implied call on OPEC crude oil is about 31.3mmbd, slightly below recent OPEC crude oil output levels around 31.7mmbd. These statistics indicate the massive OECD industry stock overhang probably will not be reduced substantially in the near term (the 1Q16 call on OPEC crude is 30.5mmbd, 2Q16 30.8mmbd).

In addition, suppose that in the aftermath of Iran's nuclear deal and the removal of sanctions against it, its crude oil production climbs a few hundred thousand barrels a day. Other OPEC producers are unlikely to cut back to accommodate this output. Libyan output remains depressed, but suppose its political situation improves.

Will Saudi Arabia and its allies curtail production with prices of Brent/North Sea under $40-$45? Probably not anytime soon, as their current production levels and the 12/4/15 OPEC meeting indicate, unless non-OPEC members significantly cut production, or Russia or Mexico or other key non-OPEC members agree to a production restriction regime in conjunction with OPEC. Also, the Saudis and other OPEC allies surely are not pleased by the late year US decision to lift the nearly complete ban on American oil exports. In any event, the Saudis have sufficient financial reserves to wait for at least a couple more years to achieve its goals.

The growing hostility between Saudi Arabia and Iran may cause petroleum price rallies, but these probably will be sustained only if those nations suffer output interruptions. At present, and despite heated rhetoric, significant interruptions are unlikely. Given this strife, Saudi Arabia is unlikely to cut back its production to accommodate Iranian output increases following the ending of nuclear sanctions.

For the current arena, the 2008-09 GSCI pattern suggests the possibility of a low in late winter 2016 (recall February 2009's major and final trough). However, one should not be dogmatic about calendar timing. Alternatively, monitor for signs of a double bottom in the GSCI (as in 2008/09), particularly if the December 2015 low is not breached by much (though a second low may not occur around calendar February 2016).

ACT TWO (CONTINUED): STOCK (AND FX) THEATERS

The Band sings in "Stage Fright":
"See the man with the stage fright
Just standin' up there to give it all his might
And he got caught with the spotlight…"

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The interim low in the broad nominal trade-weighted dollar (which has daily data, unlike the broad real TWD) occurred 5/15/05 at 112.8, shortly before the S+P 500's May 2015 summit.

	S+P 500	**China Shanghai Composite**
Recent High	2135 (5/20/15)	5178 (6/12/15)
Recent Low	1867 (8/24/15)	2851 (8/26/15)
Percent Fall	**12.6**	**44.9**

Broad real TWD's initial advance beyond October 2008's important 93.8 level in March 2015 (94.9); decisively over with July 2015's 95.7

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The nominal TWD did not stop rising with its 8/26/15 height at 120.2. The nominal TWD reached 121.8 on 9/23/15, shortly before the second low in the S+P 500. It slipped slightly to about 118.0 on 10/15/15 (around the time of the GSCI's 10/9/15 minor high), and thus a couple of weeks before the 11/3/15 minor top in the S+P 500 at 2116 (compare the timing with the MXEF's 11/4/15 minor top). However, the nominal TWD then resumed its rally, reaching a new high 123.5 on 12/17/15. Note the day of the nominal TWD high in the context of the December 2015 lows in commodities in general.

The broad real TWD marched upwards, reaching a new high in its long-running bull move with November 2015's 98.5 (over September 2015's 98.0 and October 2015's 97.2). The Fed soon will unveil statistics for the broad real TWD for calendar December 2015. Available data for the nominal broad TWD through 12/24/15 suggests the real TWD ascended about one percent relative to November.

The bearish pattern in numerous "commodity currencies" (Australia, Brazil, Canada, Russia, South Africa, and others) alongside TWD strength (and emerging stock marketplace downtrends) does not merely confirm the TWD bull trend. It also emphasizes the likelihood of further slowing of global real GDP.

Efforts by China in recent weeks to depreciate the renminbi underline the slowdown in that nation and elsewhere. The rally in the Shanghai Composite since late August 2015, though remarkable (high since 8/26/15 is 3685 on 12/23/15, not long after minor tops in early December in the S+P 500 and SXXP), probably will continue to fade as other stock marketplace tumble lower and China's GDP expansion rate ebbs.

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The MXEF attained a second low near its late August 2015 one, 9/29/15's 769.7. So did the S+P 500, at 1872 on 9/29/15 (the VIX volatility index high was 8/24/15 at 53.3).

Trends in the SXXP (Stoxx 600 European stock index) generally have been attached to those in the S+P 500. The SXXP touched its 332.0 low on 8/24/15, with a nearby second one 9/29/15 at 335.4. The SXXP high since then is 12/3/15's 387.4. The S+P 500's high since its 9/29/15 low is 11/3/15's 2116 (paralleling MXEF's 11/4/15 one), then a lower high at 12/2/15 at 2104 (compare that in the SXXP).

What about Japan? The Nikkei high since its 16,901 low on 9/29/15 is 12/2/15's 20,012; compare the timing with the minor low and high in the S+P 500. The Japanese Yen's rally in the past few weeks reflects worldwide economic weakness (recall the Yen's rally during the worldwide economic crisis of 2007-09). Though players should focus on the Yen's real effective exchange rate, note the modest rally in the Yen versus US dollar cross rate since the Yen's low at Y125.9

on 6/5/15. As massive Yen depreciation alongside quantitative and qualitative easing (QQE) helped to propel the Nikkei (and thereby other stock marketplaces such as the S+P 500 and SXXP higher), growing Yen strength (all else equal) tends to push the Nikkei and other stock realms lower.

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The Fed and its allies do not want the S+P 500 to collapse twenty percent or more (and maybe not even much more than ten percent) from its May 2015 summit.

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Falls in US corporate earnings will tend to weaken the S+P 500. US after tax corporate profits (without inventory valuation and capital consumption adjustments) in 3Q15 inched up 1.3 percent versus the prior year quarter. However, 3Q15's profits retreated 3.3pc beneath 2Q15's (Bureau of Economic Analysis, 12/22/11, Table 11).

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Increasing fears of terrorism afflict the world economy and political arena, probably damaging growth prospects.

THE CURRENT STAGE: GLANCING AT US INTEREST RATES

Major resistance for the 10 year US Treasury note looms around 3.05 percent (1/2/14 high). Above that stands 2/9/11's 3.77pc plateau and several earlier summits around four percent. However, the late spring interim elevation in the 10 year note on 6/11/15 at 2.50pc (roughly a 50pc leap in the yield level from 1/30/15's 1.64pc take-off point) remains a noteworthy initial barrier.

The UST 10 year high since the 1.90pc levels on 8/24/15 and 10/2/15 is 11/9/15's 2.38 percent. Failure of longer term yields to surpass that November height, especially given the Fed's boost to the Federal Funds rate after its 12/15-16/15 meeting, warns of economic weakness. Underscore that the 11/9/15 yield occurred rather close in time to the S+P 500's 11/3/15 minor top at 2116. Note also low yields for the German Bund and Japanese JGB in recent months.

Important UST 10 year support exists around 2.04pc (12/18/08 major low) to 1.90pc. The August and October 2015 UST yield depths happened around the times of notable S+P 500's troughs, 8/24/15's 1867 and 9/29/15's 1872. Major support for the 10 year exists at 7/25/12's 1.38pc major bottom. Watch for "flights to quality" in the UST.

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Review Moody's Baa index of corporate bonds (this signpost includes all industries, not just the industrial sector; average maturity 30 years, minimum maturity 20 years; Federal Reserve, H.15). The Fed's longstanding yield repression has not prevented the modest yet steady climb in medium-grade US corporate debt yields. In addition, the yield spread between that corporate debt index and the 30 year US Treasury bond has widened. Although these rate moves have not shifted as dramatically as they did during the worldwide financial crisis, they likewise warn of (confirm) US (and global) economic weakness.

From January 2015's 4.45pc low (monthly average), the Baa index walked up to 5.20pc in July 2015 (5.19pc August 2015) and about 5.46pc in November 2015 (December monthly statistic not yet released). On a daily price basis, the high yield is 12/29/15's 5.54pc.

Significantly, the move to higher Baa corporate yields since around June 2015 occurred as US Treasury 30 year (and 10 year) yields were falling slightly. Because the S+P 500 was beginning to slide around that time (peak 5/20/15 at 2135, with tops 6/22/15 at 2130 and 7/20/15 at 2133; note also the stumble in emerging marketplace equities), the modest rally in 10 year UST note prices since 6/11/15's 2.50pc high probably in part represents a flight to quality, and thus fears about economic recovery (and deflation/too low inflation).

For the Moody's Baa index less US Treasury 30 year spread (using weekly data, at Friday), underline several lows in May and June 2014 around 1.37 percent (137 basis points). These spread lows occurred near in time to the broad GSCI's 6/23/14 high at 673. The initial spread widening period following that trough occurred not far from the MXEF's 9/14/14 top. The Baa/UST 30 year spread widened to 203 basis points by 1/23/15. It did not step above that level until 7/3/15's 207 basis points. Note the spread's decisive advance over 2.00pc in July 2015 alongside the broad TWD appreciation. By late December 2015, the Baa versus UST 30 year spread widened to just over 250 basis points.

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The 6/12/15 pinnacle at 5178 in China's Shanghai Composite not only occurred close in time to the S+P 500's 5/20/15 pinnacle and its following 6/22/15 top, but also alongside the 10 year UST note's interim high yield on 6/11/15 at 2.50pc. This coincidence is a further warning that the Chinese and worldwide economic growth will continue to weaken.

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See "America: a House Divided" (12/7/15), "Two-Stepping: US Government Securities" (12/1/15), "Treacherous Days: Waiting on Central Banks" (11/10/15), "Commodities: Captivating Audiences" (10/12/15), "Déjà Vu (Encore): US Marketplace History" (10/4/15), "Marketplace Twists and Shouts: As the World Turns" (9/10/15), "Wall Street Marketplace Violence" (9/1/15) and earlier marketplace essays for additional analysis.

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