MARKETPLACE VEHICLES: GOING MOBILE
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The Cars ask in their song "Drive":
"Who's gonna tell you when it's too late
Who's gonna tell you things aren't so great"?

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CONCLUSION AND OVERVIEW

To the majority of Wall Street marketplace observers, price fluctuations for at least the past few months in many key benchmarks such as the United States government 10 year note, the broad real US trade-weighted dollar, and the S+P 500 generally have seemed relatively peaceful. Many players are rather complacent. However, history reveals that the relative lack of dramatic movement ("volatility") according to such perspectives of course does preclude greater and ongoing violent future swings. Though the outward landscape of the given financial realm may seem calm, powerful intertwined and shifting forces may lurk beneath, perhaps eventually and possibly suddenly causing substantial tremors in one or more economic (and political) domains.

Confidence yardsticks for US consumers and small businesses are high. American unemployment has slipped substantially in recent years. Yet the fierce political conflicts around the globe between assorted camps, including various right and left wing populist crews and diverse establishment (elite) groups, hint at and probably reflect strong, entangled, and contending variables in economic spheres. The long-running accommodative monetary schemes by the key global central banks such as the Federal Reserve Board, European Central Bank, Bank of England, and Bank of Japan reflect not only their devotion to their interpretation of their beloved legislative mandates. Sustained marketplace manipulation programs such as yield repression and money printing (quantitative easing) also aim at sparking and sustaining economic outcomes favorable to (or at least protective of) the economic and political interests of "the establishment". Central banks do not want the establishment's boat to get rocked too much or capsize!

In America and many other regions around the world, sharp cultural divisions involve more than just economic (or "class") quarrels and concerns regarding financial opportunities and mobility. Partisan feuds involve politics, whether Democrats versus Republicans, liberal versus conservative, the quality of the current Presidential leadership, and so on. Yet fervent debates and frequent anger on Main Street regarding issues relating to race/ethnicity, sex/gender, age, religion, geography, the environment, and so on probably reflect economic (political) splits and consequently hint at the potential for marketplaces to become inflamed.

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In any case, the US Treasury 10 year note and the broad real trade-weighted dollar ("TWD") are two important marketplace vehicles currently near critical levels. The key US 10 government note height is around 2.65 percent, that in the TWD around 96.2 to 96.6. A sustained rise in the UST above that level or a decisive TWD breakdown under 96.0 (and especially if both events occurred) might reflect and probably would increase price volatility in those fields. Such significant moves in rates and the dollar probably also would spark a substantial reversal of the current bull trend in the S+P 500 (and related advanced and emerging marketplace stock arenas). Commodities "in general" in this scenario likely would decline as well.

The enthusiastic "buy the dips" chorus for US equities likely will not remain forever fashionable or successful. What happens if the American Congress does not enact tax "reform" in the near future? Suppose observers focus more closely on the long run US federal budget deficit and debt issues (and debt problems in China, Japan, and elsewhere)? What if US corporate earnings do not sustain notable growth? Will such events (or a US dollar decline; or higher interest rates or central bank threats of these; or some other phenomenon such as trade wars, the North Korea nuclear issue, or further petroleum price rallies) help to stop the train of the glorious long bull market trend for the S+P 500?

CURRENTLY IN THE SLOW LANE: THE US 10 YEAR GOVERNMENT NOTE

The United States 10 year government note probably ended its major bull move in summer 2016, establishing a major yield bottom on 7/6/16 at 1.32 percent. Recall not merely 6/13/07's 5.32pc yield pinnacle as the Goldilocks Era ended. Remember the heavenly 10 year UST yield on 9/20/81 at 15.84 pc. This mid-year 2016 yield trough has ushered in an extended period of rising rates.

See also the Bank of England, "Staff Working Paper No. 686", "Eight centuries of the risk-free rate: bond market reversals from the Venetians to the 'VaR shock'" (October 2017). The author, Paul Schmelzing, declares: "the global risk-free rate in July 2016 reached its lowest nominal level ever recorded." He designates the sovereign 10 year maturity point as the risk-free rate for modern times. For 1919 until 1961, and from 1981 to the present, he employs the US Treasury 10 year instrument (selecting German 10 year government bonds for 1962-1980).

However, UST yields have remained relatively peaceful for the past year. The US Treasury 10 year note has meandered sideways in a fairly narrow path, with highs around 2.65 percent (2.64pc on 12/15/16; 2.63pc on 3/13/17) and a low bordering two percent (2.01pc on 9/8/17; 2.10pc 6/14/17).

This track record of a narrow range and quiet fluctuations may persist for a while longer. Patrolling central bankers generally continue to offer audiences the fuel of a highly accommodative monetary policy, including yield repression schemes. Benchmark "inflation" measures such as the consumer price index have not jumped decisively over widely-monitored targets of around two percent. The US CPI-U all items index rose 2.0pc year-on-year in October 2017 (Bureau of Labor Statistics, 11/15/17). In October 2017, annual OECD area (advanced nations) consumer price inflation hovered at 2.2pc in October 2017 (12/5/17). Yet as yield repression eases, might "pent-up inflation" built up via the massive money printing festival emerge?

To some extent, extended spans of yield repression (and related forward guidance) probably helped to slash public expectations of higher rates and thus to some extent lowered interest rate levels themselves. Thus shifts in policy yield levels (or hints this will occur) could accelerate interest rate increases. The beloved Federal Reserve, though slow to "normalize" (alter the direction of) its policy, is tightening by raising the Fed Funds level and decreasing its reinvestment of principal payments it receives from holdings of UST (and agency and mortgage-backed securities). Suppose the European Central Bank indicates it will significantly reduce its ravenous consumption of interest rate securities.

In recent years, the extensive quantity of global money printing (aided by yield repression) has helped many nominal asset prices such as stocks (for example, the S+P 500) and real estate to

rocket substantially higher. As central bank accommodation ends and expectations of continued yield repression diminish, perhaps consumer prices, personal consumption expenditure inflation, producer prices, wages, and other signpost inflation measures also will climb to more lofty levels than many expect.

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Economic sages define, measure, evaluate, and forecast "inflation" in various ways. There is no objective (scientific) definition of or arguments and conclusions related to "inflation" (or other economic labels and variables). Marketplace storytellers place inflation in assorted contexts in relation to other marketplace phenomena. No objective "natural" (or equilibrium) interest rate exists. All economic viewpoints are entirely subjective (cultural viewpoints).

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Low interest rates have been an engine for economic growth, plus a means of boosting stock and real estate values (and thereby improving household balance sheets). Especially if government rates offer apparently inadequate yields relative to inflation, Wall Street and Main Street fortune hunters avidly gear up and race to find good (reasonable) returns elsewhere.

Yet though much of their inflation wordplay concentrates on factors such as consumer prices (and personal consumption expenditures) and wages, the Fed and other central bankers currently seem mildly concerned about elevated asset price levels. Given the great importance of central bank rhetoric and action to interest rate levels and trends in recent years, their emerging wariness regarding asset prices underlines the likelihood that a secular rise in government (and related) yields is underway, even if such an ascent has been slow so far.

See the Federal Open Market Committee Minutes (10/31-11/1/17). "The staff continued to judge that the overall vulnerabilities [of the US financial system] were moderate" although "Asset valuation pressures across markets were judged to have increased slightly, on balance, [since July] and to have remained elevated". The FOMC drivers did not specify whether these asset classes include stocks, interest rate arenas (high prices/low yields in government and corporate sectors), real estate, or elsewhere.

Read the Bank for International Settlements' media briefing for its December 2017 Quarterly Review (12/3/17) of the most recent quarter. The head of its Monetary and Economic Department spoke with a trace of humor, surprise, and curiosity regarding the current "Goldilocks economy" in which "The macroeconomic backdrop brightened further."

The BIS crew chief waved caution flags. "The risk-on phase intensified." He mentioned existing "high debt levels, in both domestic and foreign currency" and "frothy valuations" (which are "in turn underpinned by low government bond yields").

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Looking forward, and especially if yields ascend, how easy will it be to finance public, corporate, and consumer debt? Debt challenges in the US, China, and elsewhere arguably have grown despite the international economic recovery following the global economic disaster.

In particular, the US federal budget deficit situation (especially over the long run) remains a substantial problem. The enactment of the current tax "reform" proposals, if that occurs, will worsen the baseline fiscal outlook.

Foreigners own a large percentage of US federal debt. The US federal deficit is forecast to widen over the next several years, and the proposed tax reform will only increase the shortfall. Moreover, the Fed is shrinking its balance sheet. In a period of sustained rising American government interest rates, foreigners may become less willing to be substantial net buyers. A weakening US dollar, especially if it accompanies a trend toward higher government rates, also could discourage overseas ownership of US Treasuries. What will happen to US yields if foreigners become net sellers of US debt securities?

http://ticdata.treasury.gov/Publish/tressect.txt
http://ticdata.treasury.gov/Publish/mfh.txt

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All else equal, and especially for a nation which is a substantial debtor (such as America), substantial and ongoing national political strife with little chance of a "satisfactory" outcome anytime soon reduces confidence in that country. A generally unpopular key leader (such as President Trump) exacerbates this situation. Consequently, all else equal, lending money to the United States government (or American firms), becomes somewhat riskier. Thus interest rates will tend to ascend.

Moreover, suppose lack of faith in the country's overall direction and the quality of its national leadership becomes more widespread and entrenched. All else equal, this can weaken the home currency (such as the US dollar).

Republicans fear Congressional losses in the 2018 midterm elections (hence a motivation for their rush to accomplish something that seems important, such as tax reform). The Cook Political Report summarizes the relationship between Presidential job approval and results (11/21/17). Trump's approval (citing the Gallup poll of November 13-19, 2017) is 38 percent. According to the Cook Report, when the President's popularity sits under 50pc, the average House of Representatives seat loss for the Presidential Party is 40 seats (Senate loss is five seats). The Pew Research Center (survey 11/29-12/4/17) gives Trump's job approval rating at 32 percent (12/7/17).

Suppose the Republicans lose control of the House in 2018. A Democratic House is unlikely to get along with President Trump. And maybe even the Senate will become Democratic (though many more Democratic than Republican seats are up for grabs in 2018). Will impeachment risks become more likely in calendar 2018 and thereafter?

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UST 10 year note travels fairly close to or above 2.65 percent, and especially over 3.05pc (1/2/14's top), probably would provoke increased volatility (agitation) in interest rate territories, and it also probably will trigger bearish responses by the S+P 500 and other stock benchmarks of various advanced nations and emerging marketplace countries. Not only was the 12/15/16 top 2.64pc. Half the 5.32pc major high on 6/13/07 is 2.66pc. Twice 7/6/16's 1.32pc bottom is 2.64pc. Recall a minor top during the 2013 taper tantrum, 2.67pc on 6/24/13. Near January 2014's 3.05 percent height, don't overlook interim troughs around 3.25pc as 2007-09's economic crisis developed (1/23/08 and 3/27/08 at 3.28pc and 9/16/08's 3.24pc).

As the blissful Goldilocks Era motored to its 2007-08 finish line, ascending US government interest rate yields (UST 10 year note yield major pinnacle 5.32 percent 6/13/07) arguably preceded (led) the major peak in American stocks (S+P 500 initial plateau 7/16/07 at 1556, major high 10/11/07 at 1576). History warns that climbing US interest rate yields often precede

(connect with; lead to) pinnacles in the Dow Jones Industrial Average and the S+P 500. See "History on Stage: Marketplace Scenes" (8/9/17).

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The Federal Reserve Bank of New York manufactured an "Underlying Inflation Gauge". Its "full data set" is broader (because it incorporates additional macroeconomic and financial variables) than the "prices-only" (CPI series based) measure. The full data set increased to 2.96 percent (almost three pc) in October 2017. This is the highest August 2006's 3.10pc. The prices-only level was 2.30pc in October 2017. The NY Fed stated: "both UIG measures continue to indicate a firming in trend inflation…and both [are] registering above the actual twelve-month change in the CPI."

Thus based upon the UIG sustaining the October 2017 levels, and assuming that nominal yields eventually should incorporate some real return relative to inflation, current UST 10 year yields appear low. A one percent return over 2.3pc gives 3.3 percent; a one pc addition to October 2017's full data set level of nearly 3.0pc equals four pc.

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Commodity price inflation can help to significantly boost future levels of the overall CPI and similar measures. The broad S+P Goldman Sachs Commodity Index crashed to a low on 1/20/16 at 268. It jumped (substantially assisted by a bull charge in the petroleum complex) 61.2 percent to 11/24/17's 432, flying above 2/13/17's 409 top. Observers should highlight the relatively recent sharp rally from 6/21/17's 351, which speeded up 23.1pc to 432.

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In the US government yield curve nowadays, longer term note and bond yields stand higher than those of those of short term instruments. For example, compare the ten year UST note with the two year UST (or three month Treasury Bill). However, the yield curve spread gradually has been flattening (narrowing) over the past few years. If this flattening pattern ultimately becomes an inversion (short rates greater than long term yields), this relationship (yield curve shape will warn of a recession. See the Financial Times, "Yield curve test faces test of its predictive powers" (11/29/17, p20) and the Federal Reserve Bank of New York (12/4/17) probability of recession graph.
https://www.newyorkfed.org/medialibrary/media/research/capital_markets/Prob_Rec.pdf

TICKET TO RIDE: THE BROAD REAL TRADE-WEIGHTED DOLLAR

In the 1966 movie "Grand Prix" (John Frankenheimer, director), a race car driver comments: "The danger? Well, of course. But you are missing a very important point. I think if any of us imagined- really imagined- what it would be like to go into a tree at 150 miles per hour we would probably never get into the cars at all, none of us. So it has always seemed to me that to do something very dangerous requires a certain absence of imagination."

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The broad real trade-weighted dollar ("TWD"; Federal Reserve, H.10, monthly average; March 1973=100) is a better indicator for the "overall" US dollar trend than individual FX cross relationships.

The broad real trade-weighted US dollar probably established a major high at 103.2 in December 2016/January 2017. Although it pedaled downhill to 95.2 in September (a 7.8 percent decline), it edged up to 96.7 in October, with November staying close by at 96.9.

The peak in the nominal broad TWD (which has daily data, most recent release 12/11/17) was 12/28/16 at 128.9 (1/3/17 at 128.8). The fall to the subsequent low on 9/8/17 at 116.7 was 9.5pc (12/8/17 height 120.1).

Major support (resistance) for the broad real TWD is around 96.2 to 96.6. The major top near the end of the global economic crash was March 2009's 96.6. Also, 96.2 was an interim top in June 1989 and 96.4 was an important interim low in April 2016; a 20 percent rally from the July 2011's major bottom is 96.4.

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Currency patterns and levels intersect with and can offer guidance to American (and other, including emerging marketplace) stock price trends. Some heralds announce that a "weak dollar equals (or tends to generate) strong (US) stocks"/"strong dollar equals weak (US) stocks". However, this relationship is not always or necessarily true in theory or historical practice.

In regard to the current situation, first note the price decline in the broad GSCI and petroleum from "around" the time (GSCI top 2/13/17 at 409) of the peak in the TWD. Thus there was a weaker dollar/weaker commodity relationship until about the time of the GSCI's 6/21/17 low (NYMEX crude low $42.05 on 6/21/17). For the next several weeks, the relationship between the dollar and commodities looks unclear, with the dollar weakening into calendar September as petroleum prices tended to rally.

However, the broad real TWD's September 2017 low (the nominal TWD's 9/8/17 trough at 116.7) links closely to a rally in petroleum prices and the GSCI. Note the advance of NYMEX crude oil from 8/31/17's $45.58 (and Brent/North Sea crude from 8/17/17's $50.00 and 8/31/17's $50.56). Thus this move of "stronger dollar/stronger commodities" during the past two or three months mirrors the "weaker dollar/weaker commodity prices" relationship of around early first quarter 2017 until late June 2017.

Thus suppose the broad real TWD starts to weaken from around current levels (and especially if it ventures decisively under 96.0). That dollar feebleness arguably will associate with (be confirmed by) weakness in commodities "in general" (especially the petroleum complex).

The broad GSCI sometimes has made important price turns (trend changes) around the same time and in the same direction as the S+P 500. Admittedly, this linkage is not always close (and does not always occur).

In any event, underscore the subsequent US stock rally in the S+P 500 from around the time of the nominal TWD's low on 9/8/17. The S+P 500 created a price gap as it spiked upward; the S+P 500's 9/8/17 high was about 2467, 9/11/17's low 2475.

If weakness in the broad real trade-weighted US dollar resumes, the history of the past few months (since around 9/8/17) probably foretells that the US dollar breakdown eventually will connect with S+P 500 weakness. Suppose US tax reform legislation is not enacted, or that corporate earnings growth appears endangered.

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A further upward move in UST 10 year yields from present levels likely "by itself" would pressure emerging marketplace stocks. Emerging stock marketplaces also probably are vulnerable to dollar rallies (even such modest ones as that since 9/8/17, and especially if US rates are inching higher) given the amount of dollar-denominated debt of many emerging developing countries (and corporations). Such emerging marketplace stock weakness could encourage feebleness in the S+P 500.

However, in the globalized economy, prospects for emerging marketplaces such as China closely entwine with those of advanced nations such as America. Suppose the resumption of the weaker dollar pattern that began in December 2016/January 2017, particularly if it were associated with issues such as a failure to enact US tax reform (or declining US corporate earnings prospects) linked to (confirmed, inspired) a decline in the S+P 500. Then such S+P 500 weakness likely would encourage bear trends in many emerging stock marketplaces.

See also "Trend Relationships: US and Chinese Stocks and the Internet Sector" (11/27/17).

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"Drivers and risks of the cryptocurrency boom" headlines the Financial Times (12/1/17, p20), where "Bitcoin's surge past $11,000 reflects an investor mania seen by some as a bubble". And: "The dangers of a digital gold rush", where "Bitcoin is becoming an investment mania made for the times…it has attracted people who mistrust institutions and those who are looking for a way to get rich quick." (Financial Times, 12/2-3/17, p7).

The bitcoin/cryptocurrency frenzy in assorted marketplace circles and the financial media to some extent suggests not only some declining faith in traditional institutions (and traditional forms of money). It also hints that volatility may erupt in interest rate, currency, and stock domains.

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