The Macro Environment For Financial Markets

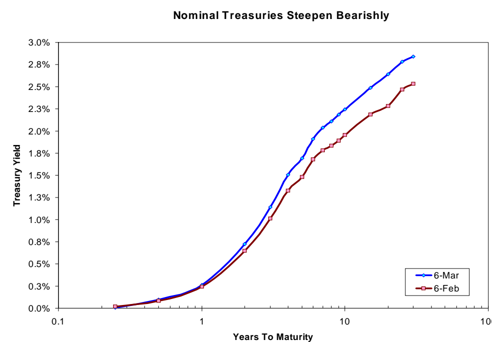
As W.C. Fields noted with his usual insight, "There comes a time in the affairs of man when he must take the bull by the tail and face the situation." Do so and you will find the employment situation report staring back at you in a Cyclopean salute. While cynics might note economic data have provided a parallel to Paul Samuelson's bon mot that the stock market has predicted nine out of the past five recessions in that we have had umpteen head-fakes since rates went to zero in December 2008, this one has the feel of being genuine. Higher short-term rates are a distraction; if your business depends on free overnight money, you have a bad business. The real consideration will come from global policy divergences and the consequences of a significantly stronger USD for all borrowers with USD liabilities.

The causal chain now is:

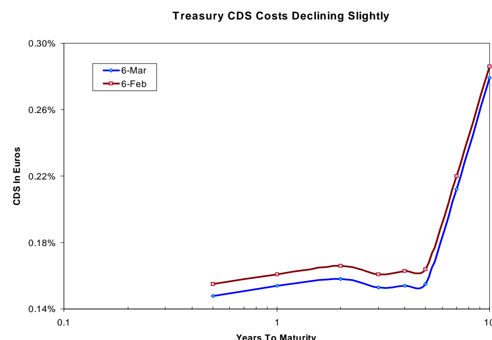
1. Short-term interest rates will remain artificially low globally but will start moving higher in the U.S.;
2. Disinflationary pressures will remain so long as the global banking system remains unable to expand credit;
3. Inflation expectations as measured by the TIPS market will rise more slowly than nominal rates will;
4. Sovereign debt yields have not entered a secular bear market, but the tone has changed over the short-term to selling rallies;
5. The U.S. yield will retain a bias toward flattening, but via higher short-term rates;
6. Short-term borrowers will start to lock in low rates and gradually end their acceptance of rollover risk;
7. Swap spreads will continue their move higher at the short end of the yield curve as floating-rate payors move to fix their payments. This has yet to proceed to the long end of the yield curve; and
8. Credit spreads will move toward their 2014 lows

Key Market Indications

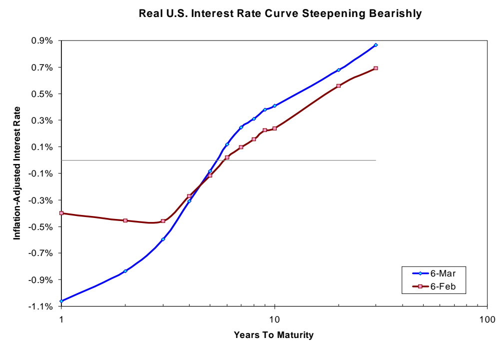
Thirty-year rates hit their post-1977 low on January 30, 2015 and have had two moves outside of a 97.5% confidence bound since then. The long-term meaning of such moves for 21 day-ahead returns has been random for more than 35 years. Moreover, ten-year yields have yet to challenge their 2014:Q4 support level. Still, even if the yield curve does flatten as short-term rates rise and even as the U.S. remains high-yield in comparison to the Eurozone, the tone of the bond market is changing to one of "sell rallies."



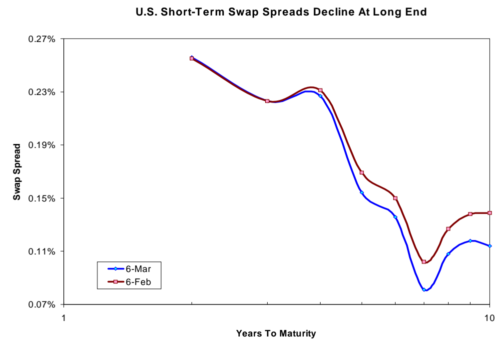
This market continues to remain uninteresting, which is probably a good reason for someone, somewhere with a burning desire to buy an umbrella on a sunny day to take a flyer on it. After all, if U.S. interest rates rise, U.S. debt service costs will rise apace.



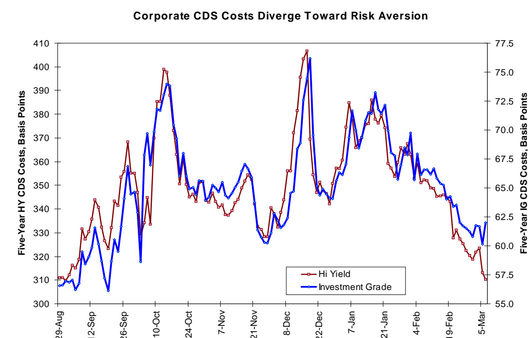
Implied real rates continue in their bearish steepening as short-term breakevens remain elevated. Incredibly, these rates have cushioned what should have been an even stronger selloff in precious metals. The rise in long-term implied real rates should not pose an immediate threat to stocks or to corporate bonds.



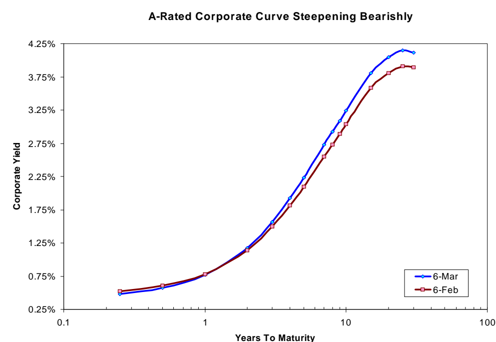
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain strongly inverted as floating-rate payors are willing to stay floating on the long end but are willing to pay to lock in ultralow short-term rates. These declining long-term swap spreads are by themselves positive for corporate bonds and by extension for equities, but their positive impact can be overwhelmed by rising UST rates.



The push lower in HY credit risk is a tribute to the power of yield hogs. It is a tribute as well to an outlook for continued economic stability. IG credit risk took a different course, rising along with Treasury yields; this is consistent with the way the IG market has mimicked UST over the past year. While the HY movement is positive for equities, it can be offset and then some by higher UST yields.



The A-rated yield curve has been far more stable than has the UST yield curve over the past month. The small shift higher in long-term yields will dissipate under declining swap spreads and credit spreads; this will be bullish for equities unless long-term UST yields break support conclusively.



Market Structure

The main Bloomberg index along with Grains, Softs and both Precious and Industrial Metals are in structural downtrends. The S&P 500 and ten-year UST shifted out of uptrends and the EM index entered a downtrend. The dollar index finally entered a structural uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Mar. 9 - 13
BBerg	24	Trending	-0.139	13.2%	-0.44%
BBerg Grain	20	Trending	-0.144	16.2%	-0.86%
BBerg Ind. Metl	23	Trending	-0.093	15.4%	-0.36%
BBerg Pre. Metl	29	Trending	-0.344	16.8%	-0.33%
BBerg Softs	29	Trending	-0.424	16.4%	-0.21%
BBerg Nat. Gas	19	Transitional	0.014	80.2%	
BBerg Petroleum	12	Transitional	-0.042	29.2%	
BBerg Livestock	15	Transitional	0.027	15.6%	
Dollar Index	23	Trending	0.363	8.0%	0.33%
S&P 500 Index	29	Trending	-0.016	9.7%	
EAFE Index	29	Trending	0.071	9.2%	0.20%
EM Index	20	Trending	-0.118	8.5%	-0.38%
Ten-year UST (price)	10	Sideways	-0.200	6.8%	

Performance Measures

The important takeaway from the physical commodity markets is they are moving back into bear markets without a strong downturn in the Petroleum complex. While the relationship between individual currencies, short-term interest rates and individual commodity prices is not the simple one portrayed commonly, this is a business of shooting first and asking questions later. Right now, the initial reaction is to err on the side of bearishness and endure the inevitable short-covering outbursts that dot every commodity bear market.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-2.58%	-2.70%	-18.38%	-25.96%
Grains Sub-Index	-3.54%	-3.52%	-1.45%	-26.22%
Corn	-1.84%	-3.37%	6.21%	-27.81%
Soybeans	-4.53%	0.17%	-2.70%	-20.57%
Wheat	-5.95%	-8.85%	-9.70%	-31.46%
Energy Sub-Index	-1.84%	0.47%	-38.05%	-43.27%
Petroleum Sub-Index	-3.58%	-1.85%	-41.18%	-44.66%
WTI	-1.28%	-6.42%	-45.80%	-48.77%
Brent	-4.70%	-0.46%	-44.20%	-47.70%
ULSD	-4.53%	0.29%	-31.64%	-36.15%
Gasoline	-4.58%	2.24%	-35.98%	-39.72%
Natural Gas	3.65%	7.88%	-33.25%	-42.70%
Precious Metals Sub-Index	-4.16%	-6.60%	-9.43%	-16.41%
Gold	-4.02%	-6.22%	-6.87%	-13.23%
Silver	-4.54%	-7.64%	-16.93%	-25.43%
Industrial Metals Sub-Index	-2.05%	-2.75%	-16.67%	-9.12%
Copper	-3.06%	1.09%	-15.73%	-15.17%
Aluminum	-1.97%	-5.22%	-15.36%	-3.57%
Nickel	1.91%	-5.34%	-24.74%	-7.67%
Zinc	-2.25%	-6.77%	-13.24%	-4.31%
Softs Sub-Index	-2.05%	-8.24%	-21.51%	-34.27%
Coffee	-0.43%	-17.95%	-30.23%	-35.02%
Sugar	-2.40%	-8.94%	-21.73%	-40.42%
Cotton	-3.02%	0.53%	-2.55%	-23.45%
Livestock Sub-Index	0.56%	0.10%	-15.68%	-11.80%
Cattle	1.94%	0.65%	-4.69%	9.67%
Hogs	-2.00%	-0.94%	-33.19%	-38.73%

How can the Federal Reserve raise short-term interest rates while the rest of the world remains in easing mode without the USD jumping? Conversely, how much can the ECB abuse the EUR without seeing it plummet? The answer in both cases is they cannot. If we throw in some localized horror shows in places such as Brazil, we have the makings of the long-awaited monolithic USD rally.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-3.14%	-4.17%	-15.91%	-21.77%
Chinese yuan	0.10%	-0.30%	-1.94%	-2.31%
Japanese yen	-0.99%	-1.42%	-12.25%	-14.70%
British pound	-2.60%	-1.35%	-6.63%	-10.17%
Swiss franc	-3.22%	-6.00%	-5.12%	-10.69%
Canadian dollar	-0.86%	-0.77%	-13.07%	-12.98%
Australian dollar	-1.18%	-1.03%	-16.86%	-15.12%
Swedish krona	-1.49%	-0.79%	-15.94%	-24.46%
Norwegian krone	-3.06%	-3.50%	-19.91%	-24.38%
New Zealand dollar	-2.67%	-0.01%	-11.02%	-13.13%
Indian rupee	-0.67%	-0.70%	-2.84%	-0.67%
Brazilian real	-7.27%	-9.21%	-26.00%	-24.15%
Mexican peso	-3.54%	-4.20%	-15.23%	-15.14%
Chilean peso	-1.59%	-0.11%	-6.50%	-10.99%
Colombian peso	-3.29%	-7.86%	-24.70%	-21.38%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.51%	-0.81%	-4.43%	-3.81%

While the prospect for higher short-term interest rates in the U.S. gets all of the attention from the easily distracted, the real cause for concern is currency volatility. A stronger USD crimps export earnings in the U.S. and raises financing costs for everyone with USD liabilities.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-1.66%	1.49%	0.53%	5.90%
North America	-1.54%	0.97%	2.91%	11.32%
Latin America	-7.13%	-5.56%	-31.56%	-14.79%
Emerging Market Free	-1.87%	-0.61%	-10.70%	2.98%
EAFE	-1.84%	2.34%	-3.08%	-1.78%
Pacific	-0.54%	4.51%	-0.25%	5.71%
Eurozone	-2.42%	2.11%	-5.05%	-5.71%

CTAs are supposed to zig when everyone else zags; that's the theory at least. In practice, they give up gains quickly as markets reverse. The actual surprise this week was hedge funds managing to post gains when equity markets turned lower. They will probably overlook this oversight soon.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.64%	1.08%	18.62%	30.98%
Newedge Trend	-0.42%	0.68%	13.59%	22.63%
Newedge Short-Term	-0.16%	1.53%	9.59%	11.65%
HFR Global Hedge Fund	0.18%	1.35%	-0.97%	-0.34%
HFR Macro/CTA	-0.07%	0.72%	6.06%	9.11%
HFR Macro: Sytematic Diversified CTA	-0.57%	0.32%	7.45%	8.06%