The Macro Environment For Financial Markets

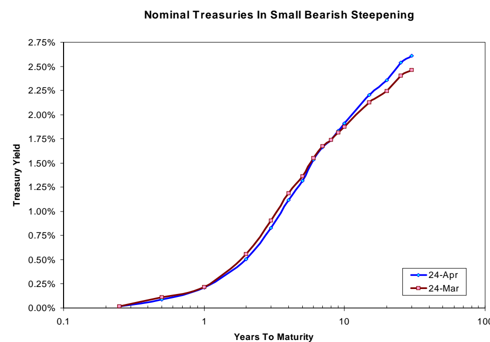
The capacity of the human mind to ignore decades of reality is perplexing. For example, we have had a quarter-century downtrend in core consumer inflation despite vastly different policy regimes and economic environments and yet pretend we can influence it in either direction at will. Or, in the case of financial markets, the most common analytic approach is to presume economic growth drives earnings which driven stock prices and credit spreads in turn. A more robust approach would be to say the policy responses to macroeconomic weakness perpetuate that weakness by preserving overcapacity and discouraging investment in real plant and equipment while making the ongoing return streams from existing capital more valuable vis-à-vis the bupkes-point-five returns available on lower-risk assets. How long can this farce continue? A long time; until cash-flows from existing assets diminish to and below zero or the rates at which they are discounted rise all roads will not lead to Rome but rather to that bilious Charging Bull statue in Bowling Green Park.

The causal chain is now:

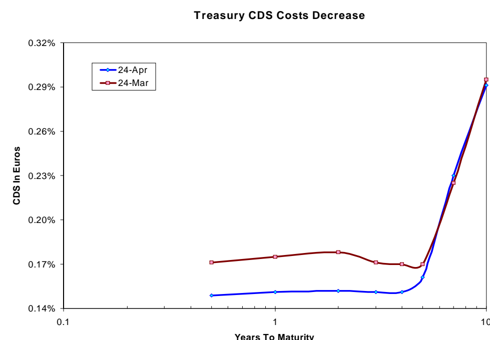
1. Short-term interest rates will remain artificially low globally but will start moving higher in the U.S. at some point;
2. Disinflationary pressures will remain so long as the global banking system remains unable to expand credit;
3. Inflation expectations as measured by the TIPS market have reached their bear market retracement level near 1.95% for ten-year breakevens and may rise up to 2.10%;
4. Sovereign debt yields will remain in their secular bull market;
5. The U.S. yield curve will retain a bias toward flattening;
6. Short-term borrowers will continue to accept rollover risk;
7. Swap spreads will remain tame until monetary policy indications turn more hawkish; and
8. Credit spreads will remain well-confined at historically low levels.

Key Market Indications

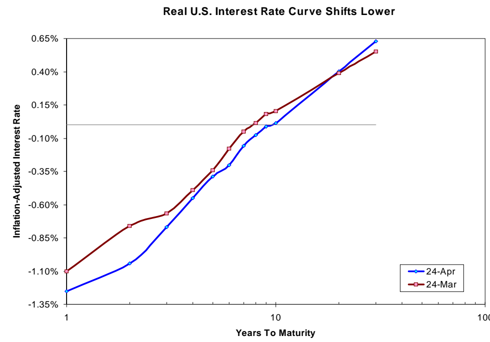
The TINA (There Is No Alternative) argument has been a powerful one for equities; it is just as powerful for Treasuries. The small bearish steepening over the past month will be a short-lived phenomenon as risk-averse investors are unlikely to move into corporate bonds or stocks at this juncture and a small decline in the USD is removing some of the currency risk for non-U.S. investors.



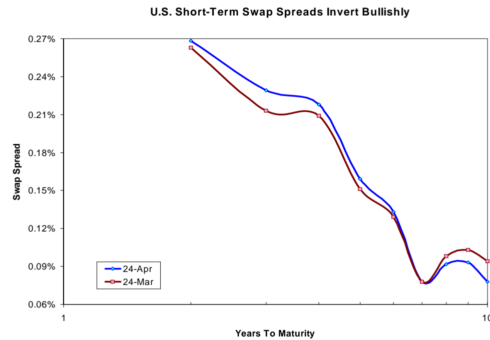
CDS costs shifted lower once again. At this juncture, why should EUR-denominated CDS costs on U.S. debt rise?



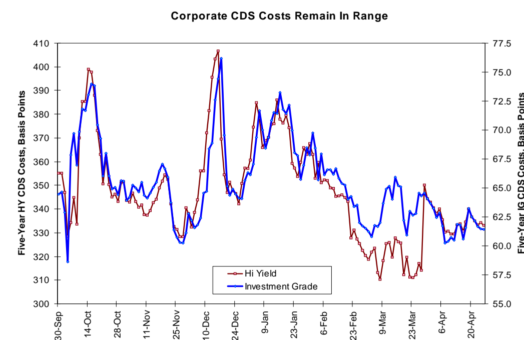
Pseudo-real rates are negative out to nine years. This shift is attributable to rising inflation breakevens being subtracted from stable nominal rates. While this has been supportive for precious metals in the past, the ongoing rally in risky financial assets overwhelms negative carrying costs and makes the precious metals unattractive.



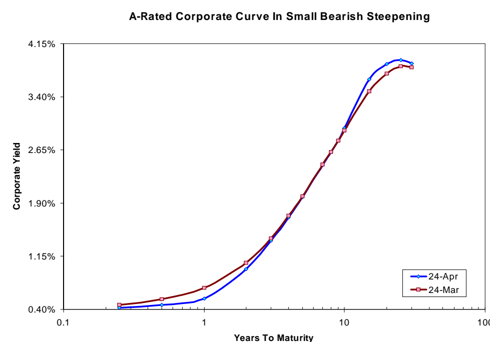
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain strongly inverted as floating-rate payors are willing to stay floating on the long end but are willing to pay to lock in ultralow short-term rates. The small shift higher over the past month at the short end of the yield curve is too minor to constitute a major fundamental shift in this market's assessment of interest rate risks.



Both investment-grade and high-yield CDS costs remain in their downward-sloping trading range. The postponement of a rate hike should maintain this downward drift barring a more serious macro shock.



The A-rated yield curve has steepened bearishly over the past month, but this shift has been quite small. Unless CDS costs and swap spreads increase, this should not present any sort of headwind for equities.



Market Structure

The main Bloomberg index remains in a structural uptrend, but the Grain, Precious Metal and Natural Gas subindices all are in downtrends. The dollar index has moved into a downtrend while both the EM index and ten-year UST have moved into consolidations.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 27 - May 1
BBerg	24	Trending	0.108	10.5%	0.51%
BBerg Grain	25	Trending	-0.256	14.1%	-0.70%
BBerg Ind. Metl	20	Trending	0.114	14.2%	0.17%
BBerg Pre. Metl	25	Trending	-0.229	12.2%	-0.15%
BBerg Softs	16	Transitional	0.089	16.2%	
BBerg Nat. Gas	29	Trending	-0.163	26.7%	-1.02%
BBerg Petroleum	29	Trending	0.264	30.3%	0.36%
BBerg Livestock	28	Trending	0.137	11.5%	0.01%
Dollar Index	21	Trending	-0.105	10.3%	-0.27%
S&P 500 Index	29	Trending	0.149	9.4%	0.28%
EAFE Index	29	Trending	0.207	11.5%	0.16%
EM Index	6	Sideways	0.139	9.3%	
Ten-year UST (price)	9	Sideways	0.001	5.3%	

Performance Measures

While the Precious Metals index turned lower in the face of higher expected inflation, the Petroleum index turned higher in the face of continued inventory builds and the Industrial Metals markets turned higher in the face of slowing Chinese demand and lower U.S. durable goods orders. The economically unimportant Livestock and Softs indices have turned higher as participants in these markets are looking forward to the same sort of potential production cutbacks that have put a floor under petroleum markets. Not only is hope a wonderful thing, it can destroy fundamental analysis in a heartbeat.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.22%	2.24%	-13.04%	-26.39%
Grains Sub-Index	-2.07%	-4.44%	-6.54%	-31.72%
Corn	-4.40%	-7.33%	-5.45%	-34.61%
Soybeans	-0.08%	-0.10%	-5.61%	-24.88%
Wheat	-0.15%	-3.46%	-7.44%	-34.95%
Energy Sub-Index	0.64%	8.61%	-27.98%	-42.84%
Petroleum Sub-Index	2.09%	12.96%	-28.19%	-41.51%
WTI	0.74%	14.18%	-34.00%	-44.38%
Brent	2.69%	13.65%	-30.29%	-45.05%
ULSD	2.31%	11.62%	-19.02%	-33.69%
Gasoline	3.31%	11.13%	-21.32%	-37.87%
Natural Gas	-4.12%	-4.43%	-33.60%	-50.41%
Precious Metals Sub-Index	-2.68%	-3.84%	-5.84%	-12.98%
Gold	-2.34%	-2.14%	-4.63%	-9.98%
Silver	-3.64%	-8.38%	-9.40%	-21.56%
Industrial Metals Sub-Index	0.57%	1.30%	-8.49%	-9.85%
Copper	-0.61%	-0.59%	-10.04%	-11.21%
Aluminum	0.36%	1.89%	-9.74%	-5.73%
Nickel	5.10%	-0.76%	-11.50%	-29.72%
Zinc	1.43%	7.83%	-1.35%	6.84%
Softs Sub-Index	1.28%	4.66%	-17.75%	-34.25%
Coffee	0.53%	0.92%	-29.82%	-37.70%
Sugar	0.08%	9.57%	-16.86%	-38.44%
Cotton	4.82%	4.19%	5.87%	-20.37%
Livestock Sub-Index	2.51%	1.50%	-13.20%	-11.23%
Cattle	1.48%	-1.16%	-4.76%	12.88%
Hogs	4.16%	5.94%	-26.97%	-40.48%

The Federal Reserve is not supposed to target the USD, but then again they are not supposed to target the stock market, either. It is premature to call an end to the longer-term USD rally, but if short-term interest rate hikes in the U.S. are put on hold, as appears likely, you will not hear a peep of protest from U.S. multinationals, labor protectionists or global banks with USD liabilities.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.62%	-0.47%	-14.19%	-21.39%
Chinese yuan	0.05%	0.17%	-1.26%	0.90%
Japanese yen	-0.08%	0.65%	-9.10%	-14.01%
British pound	1.51%	2.27%	-5.61%	-9.61%
Swiss franc	-0.19%	0.45%	-0.21%	-7.58%
Canadian dollar	0.59%	2.62%	-7.75%	-9.47%
Australian dollar	0.54%	-0.67%	-11.02%	-15.54%
Swedish krona	0.07%	-1.58%	-15.95%	-23.82%
Norwegian krone	0.76%	1.07%	-15.13%	-22.81%
New Zealand dollar	-0.99%	-0.67%	-3.21%	-11.26%
Indian rupee	-1.88%	-2.07%	-3.59%	-3.90%
Brazilian real	3.03%	6.38%	-16.18%	-24.98%
Mexican peso	-0.30%	-2.85%	-11.85%	-14.85%
Chilean peso	-0.02%	1.50%	-4.67%	-8.69%
Colombian peso	1.88%	2.36%	-15.81%	-21.02%
Bloomberg-JP Morgan Asian dollar index (spot)	0.10%	0.69%	-2.14%	-1.82%

Chinese stimulus is pointless and bullish. The Eurozone/Greek drama is farcical and bullish. Slow growth and delayed interest rate hikes in the U.S. are bullish. Beating low earnings expectations is bullish. There seems to be a common theme here.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.82%	1.85%	9.18%	9.74%
North America	1.67%	1.64%	8.58%	14.21%
Latin America	4.67%	9.89%	-8.78%	-13.74%
Emerging Market Free	1.76%	8.62%	8.68%	8.52%
EAFE	2.06%	2.18%	10.12%	3.36%
Pacific	1.83%	3.28%	13.73%	13.87%
Eurozone	2.12%	-0.06%	7.88%	-3.80%

Both CTAs and macro-oriented hedge funds declined for a second week despite the upturn in equity markets. This suggests an over-reliance on long bond and USD positions in both cases.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.90%	0.10%	20.03%	36.14%
Newedge Trend	-0.97%	-0.61%	14.63%	24.01%
Newedge Short-Term	-1.20%	-1.47%	5.73%	11.11%
HFR Global Hedge Fund	-0.34%	0.71%	3.06%	1.68%
HFR Macro/CTA	-0.95%	-0.80%	6.16%	10.14%
HFR Macro: Sytematic Diversified CTA	-1.55%	-1.04%	8.25%	11.02%