The Macro Environment For Financial Markets

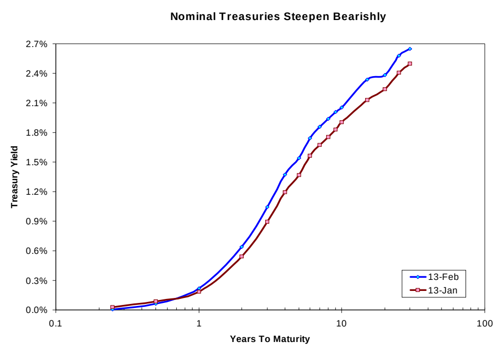
Huey Long famously said the people of Louisiana would get good government one day and would not like it. The same can be said for financial markets and economic growth; one day the Eurozone's rolling crises will end and one day everyone's short-term interest rates will rise over zero and risk will have to be repriced accordingly. That day will not be tomorrow or the week after that; as Japan has shown, near-zero short-term rates become embedded and removing them is very costly. The U.S. cannot move unilaterally here and watch a soaring dollar kneecap both U.S. exporters and global banks with USD liabilities. The impending move back over 5,000 for the NASDAQ will receive much comment, and unlike the last foray over that round number, it will be the beginning and not the end of higher equity prices to come.

The causal chain now is:

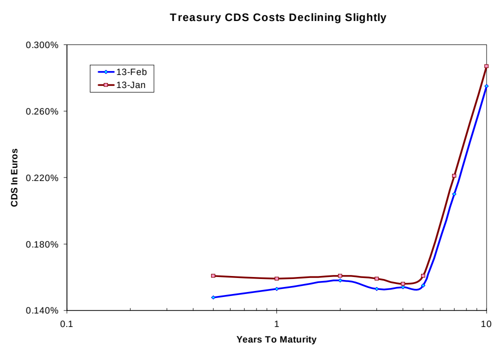
1. Short-term interest rates will remain artificially low globally;
2. Disinflationary pressures will remain so long as the global banking system remains unable to expand credit;
3. Inflation expectations as measured by the TIPS market will remain subdued;
4. Sovereign debt yields will retrace toward levels seen in 2014:Q4 as the supply of risk-averse lenders appears to have been exhausted;
5. The U.S. yield will retain a bias toward flattening, but via higher short-term rates;
6. Short-term borrowers will continue to accept rollover risk;
7. Swap spreads will continue their move higher as floating-rate payors move to fix their payments; and
8. Credit spreads will remain range-bound barring an external shock.

Key Market Indications

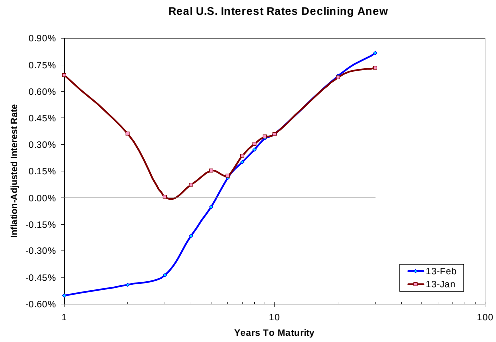
As noted last week, ten-year yields ranged between 2.09% and 2.37% over 2014:Q4. They held support this week and the long-term bull market remains intact, but we are likely entering a period of consolidation through the end of the first quarter. The yield curve actually steepened slightly at the end of the week as two-year yields backed away from their recent highs.



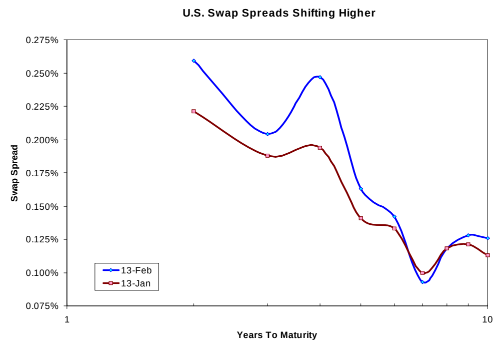
While charges of "threatened government shutdown" were bandied about in reference to DHS funding, the CDS market drifted lower. Really; who wants to bet on the U.S. defaulting on its Treasury debt during a low-rate economic recovery only to get reimbursed in euros?



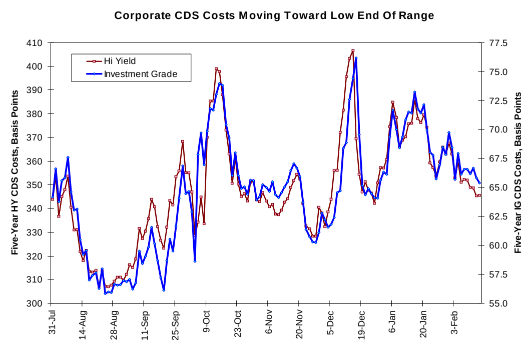
Implied real rates have shifted sharply lower over the past month but increased over the past week as nominal interest rates rose. The shift is not yet a threat to risky financial assets, but as it was not produced by higher inflation expectations, it is a negative for precious metals.



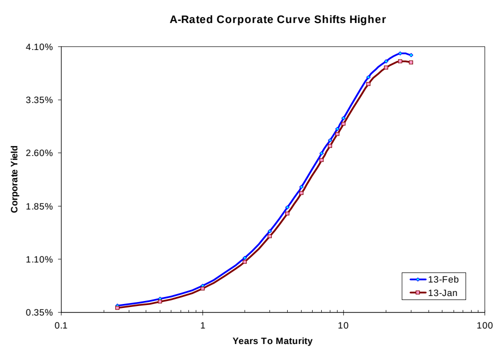
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue their small move higher, but the term structure remains strongly inverted. These long-term swap spreads do not constitute an impediment to either corporate bonds or, by extension, to equities. However, these rising swap spreads eventually will lead to higher credit spreads for corporate bonds.



Both the IG and HY CDS indices moved toward the lower end of their range. The move in high-yield is intriguing as the always-present bottom-fishers and yield hogs have decided now is the time to move into energy sector debt. Free money does wonderful things when you let it.



The A-rated yield curve continues to mimic the UST yield curve. If the UST yield curve steepens bearishly – a statement and not a forecast – the A-rated yield curve is unlikely to steepen as rapidly as it was not suppressed as much.



Market Structure

Precious Metals and Softs have returned to downtrend structures, while the Petroleum index has entered an uptrend. The EAFE and S&P 500 indices are in uptrends amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 16 - 20
BBerg	15	Transitional	0.162	14.1%	
BBerg Grain	9	Sideways	0.037	18.4%	
BBerg Ind. Metl	11	Transitional	0.003	15.5%	
BBerg Pre. Metl	29	Trending	-0.081	17.1%	-0.33%
BBerg Softs	26	Trending	-0.067	17.2%	-0.21%
BBerg Nat. Gas	18	Transitional	0.047	41.3%	
BBerg Petroleum	22	Trending	0.232	40.8%	0.64%
BBerg Livestock	5	Sideways	0.049	15.9%	
Dollar Index	10	Sideways	-0.010	8.6%	
S&P 500 Index	29	Trending	0.210	13.4%	0.13%
EAFE Index	23	Trending	0.196	13.6%	0.20%
EM Index	8	Sideways	0.107	11.0%	
Ten-year UST (price)	17	Transitional	-0.201	8.1%	

Performance Measures

Commodities are not equities; when their prices fall, producers adjust output and reduce investment. The Energy and Grain markets have put in price bottoms even if they cannot be described as being in bull markets. Precious Metals have declined as implied real short-term interest rates in the Eurozone have ceased declining and as the Eurozone itself appears ready to remain intact for our future amusement.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.78%	3.14%	-17.25%	-19.67%
Grains Sub-Index	0.76%	-1.19%	-3.14%	-16.31%
Corn	0.35%	0.35%	1.26%	-19.04%
Soybeans	1.68%	-1.41%	-6.81%	-12.11%
Wheat	0.45%	-3.40%	-4.22%	-17.22%
Energy Sub-Index	4.69%	12.46%	-38.01%	-41.33%
Petroleum Sub-Index	3.64%	19.65%	-41.69%	-41.82%
WTI	2.12%	13.49%	-44.76%	-43.82%
ULSD	5.77%	21.47%	-32.02%	-33.90%
Gasoline	3.21%	23.48%	-38.37%	-39.39%
Natural Gas	7.98%	-5.02%	-32.01%	-43.37%
Precious Metals Sub-Index	0.49%	-0.26%	-8.35%	-8.46%
Gold	-0.61%	-0.66%	-6.77%	-5.86%
Silver	3.58%	0.79%	-13.42%	-16.21%
Industrial Metals Sub-Index	-0.80%	0.52%	-14.45%	-7.86%
Copper	0.82%	-1.41%	-16.63%	-19.51%
Aluminum	-1.92%	2.29%	-11.09%	0.27%
Nickel	-3.93%	-0.16%	-21.79%	1.99%
Zinc	-0.64%	3.26%	-6.72%	3.86%
Softs Sub-Index	1.27%	-1.12%	-14.27%	-12.97%
Coffee	-1.91%	-7.50%	-15.64%	7.25%
Sugar	2.55%	0.07%	-19.79%	-26.14%
Cotton	2.38%	4.83%	-0.39%	-20.68%
Livestock Sub-Index	-0.75%	-6.51%	-8.86%	-5.74%
Cattle	1.46%	-1.85%	2.92%	9.31%
Hogs	-4.69%	-13.84%	-27.60%	-27.17%

You would think the USD is on a one-way ticket higher against all other currencies, but it retreated against the EUR, JPY, GBP and CAD. While the bond market is pricing in higher short-term rates, the currency market remains skeptical the U.S. will allow the USD to appreciate unchecked. Tellingly, when the Swedes went to negative interest rates, the SEK's retreat was minor.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.69%	-3.22%	-14.74%	-16.72%
Chinese yuan	0.07%	-0.66%	-1.38%	-2.83%
Japanese yen	0.31%	-0.69%	-13.75%	-13.96%
British pound	1.00%	1.55%	-7.75%	-7.59%
Swiss franc	-0.58%	9.43%	-2.65%	-4.16%
Canadian dollar	0.63%	-3.93%	-12.32%	-11.82%
Australian dollar	-0.44%	-4.95%	-16.58%	-13.55%
Swedish krona	-0.32%	-4.19%	-18.40%	-23.36%
Norwegian krone	0.54%	2.22%	-18.84%	-19.57%
New Zealand dollar	1.28%	-3.63%	-11.83%	-10.61%
Indian rupee	-0.79%	-0.08%	-1.56%	0.40%
Brazilian real	-1.86%	-6.76%	-19.51%	-15.56%
Mexican peso	-0.25%	-1.82%	-11.75%	-10.92%
Chilean peso	1.34%	0.05%	-6.91%	-11.49%
Colombian peso	-0.13%	2.39%	-21.10%	-14.85%
Bloomberg-JP Morgan Asian dollar index (spot)	0.02%	-0.59%	-3.33%	-2.80%

If you can't cheat an honest person, then the implications of markets rallying on stories like a Greek debt settlement or a peace agreement in Ukraine are today's gains are tomorrow's losses. Even the bedraggled Latin American markets put moved higher until a wall of global liquidity.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.90%	4.58%	3.56%	9.32%
North America	2.12%	4.05%	7.46%	15.62%
Latin America	1.42%	0.69%	-21.68%	-6.44%
Emerging Market Free	0.88%	2.91%	-7.01%	7.32%
EAFE	1.56%	5.47%	-2.24%	0.36%
Pacific	1.68%	4.40%	-2.09%	5.47%
Eurozone	2.01%	6.74%	-1.74%	-3.49%

CTAs are like the weekend poker player who can do well when dealt a royal flush but struggles otherwise. Memo to file: When the trend changes, change your position. The positive performance of hedge funds is attributable to rising equity markets; most mutual funds do the same and charge less.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.67%	-0.17%	25.17%	31.87%
Newedge Trend	-0.61%	-0.03%	18.58%	22.79%
Newedge Short-Term	-0.01%	1.46%	9.19%	10.78%
HFR Global Hedge Fund	0.22%	0.86%	-0.44%	-0.04%
HFR Macro/CTA	-0.21%	0.53%	8.29%	8.86%
HFR Macro: Sytematic Diversified CTA	-0.44%	0.53%	9.47%	7.93%