The Macro Environment For Financial Markets

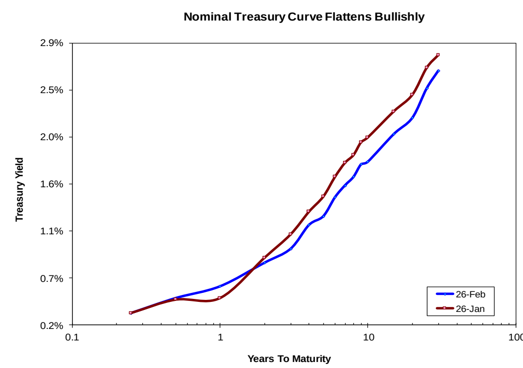
If anyone doubts the resilience of a market-based economy, and clearly many in our political system do unless they happen to be trolling for campaign funds at the moment, they should consider how amazing it is to have even slow growth after all of the misallocations of capital we have seen over the past decade. We now have the truly bizarre spectacle of investors cheering higher crude oil prices and inflation expectations; it was not too long ago these would have triggered a selloff in all capital markets. Be careful what you wish for; central bankers in the 1970s were no more successful in ending inflation than they have been in stimulating credit demands via lower short-term interest rates. They were, you will be pleased to know, equally arrogant and much less transparent. If we have learned anything, a doubtful proposition, it should be postponing small recessions via policy manipulations and refusal to take small losses is no more successful for governments and central banks than it is for traders. The consequences in terms of foregone collective wealth are, however, distributed more widely. As the waggish definition goes, a socialist is someone who has nothing and wants to share it with everybody.

The causal chain now is:

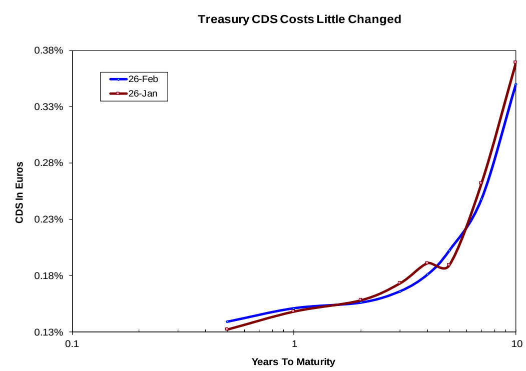
1. The market has priced out higher short-term rates in the U.S. in March, but remains confused for the rest of 2016;
2. Disinflationary pressures will persist globally but are starting to dissipate in the U.S.;
3. Inflation expectations as measured by TIPS and inflation swaps have established a strong tradable bottom;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are continuing to accept rollover risk;
6. Swap spreads will remain low; and
7. Credit spreads will remain biased toward increasing.

Key Market Indications

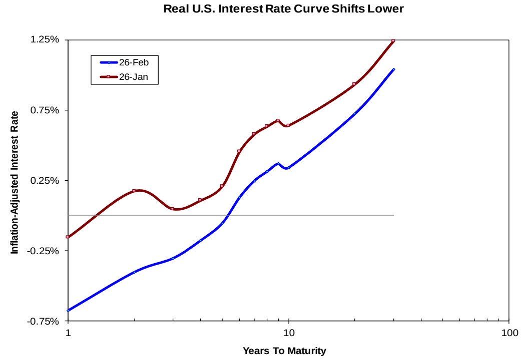
A little basic arithmetic tells us flat nominal rates less rising breakevens implies declining real rates. Those are consistent with a declining demand for credit and a slowing economy. As the current data are not consistent with such a growth contraction, we should conclude a forward-looking market is pricing in the effects of a combination of global stress and the anticipated effects of higher short-term interest rates.



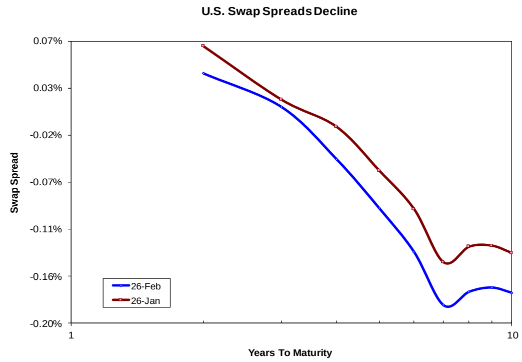
The CDS market for Treasuries has been completely dormant, as it should be. The next irruption here may come during the election season once foreign creditors come to the realization one of the current crop of Presidential candidates will win.



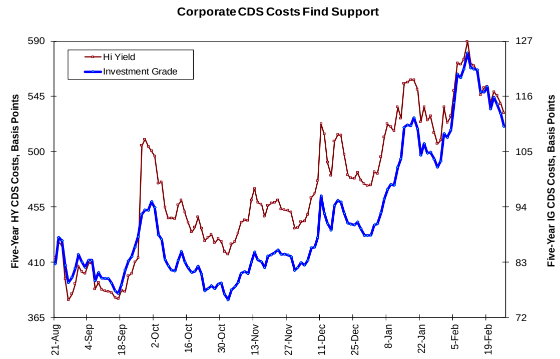
The pseudo-real rate curve shifted lower over the past month and is negative through five years. To repeat from last week, the inability of gold to advance in the face of this decline is a market failing to advance on bullish news. Lower long-term implied real rates are supportive for risky financial assets.



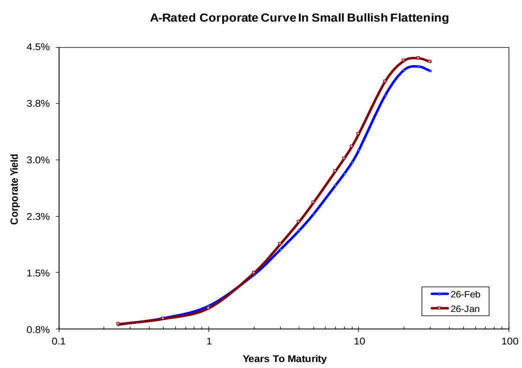
Swap spreads, which rise when floating-rate borrowers want to fix their payments, retreated over the past month and are negative for tenors longer than three years. This lack of fear about higher long-term rates signals a buildup in complacency that will make any interest rate scare a fairly abrupt one. Please recall how the move toward ever-lower long-term rates in the Eurozone ended in April 2015.



CDS costs for both the investment-grade and high-yield indices continued to move lower as larger-scale bankruptcy concerns, especially for the financial sector, receded. However, the move toward higher short-term rates in the U.S. is going to elevate the risk for this sector for the remainder of 2016. The longer-term trend toward greater corporate credit risk remains intact.



The A-rated yield curve continues to shift lower. The inability of longer-term investment-grade rates to rise remains one of the few pieces of good news for risky financial assets so far in 2016.



Market Structure

Livestock reversed into a structural uptrend, while Grains, Softs and Natural Gas remain in downtrends. None of the financial indices are in structural trends; this usually signals a consolidation within longer-term primary trends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Feb. 29 - Mar. 4
BBerg	19	Transitional	0.006	13.6%	
BBerg Grain	29	Trending	-0.259	10.2%	-0.08%
BBerg Ind. Metl	29	Trending	0.183	18.0%	0.39%
BBerg Pre. Metl	8	Sideways	-0.070	17.1%	
BBerg Softs	29	Trending	-0.008	15.8%	-0.28%
BBerg Nat. Gas	29	Trending	-0.414	29.3%	-0.41%
BBerg Petroleum	15	Transitional	0.063	48.0%	
BBerg Livestock	21	Trending	0.094	10.5%	0.31%
Dollar Index	29	Trending	0.047	8.3%	
S&P 500 Index	18	Transitional	0.143	16.9%	
EAFE Index	16	Transitional	0.047	19.0%	
EM Index	13	Transitional	0.061	12.7%	
Ten-year UST (price)	8	Sideways	-0.013	7.1%	

Performance Measures

The economically important Petroleum and Industrial Metals indices both moved higher, although the reliance of the Petroleum markets on crude oil producers talking their book makes it somewhat suspicious. Natural Gas remains in a strong downtrend, as does the Grains index. Gold was unable to build on previous advances as even a modest rebound in equity markets provided a compelling alternative.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.48%	-2.26%	-16.95%	-26.97%
Grains Sub-Index	-2.50%	-4.40%	-6.85%	-16.96%
Corn	-2.63%	-4.63%	-7.54%	-17.64%
Soybeans	-1.95%	-2.57%	-3.93%	-15.33%
Wheat	-3.10%	-6.48%	-8.12%	-14.73%
Energy Sub-Index	2.56%	-10.46%	-42.18%	-49.83%
Petroleum Sub-Index	4.61%	-5.82%	-41.29%	-49.61%
WTI	3.57%	-9.43%	-44.81%	-52.39%
Brent	5.42%	-3.72%	-42.78%	-53.14%
ULSD	2.44%	-1.86%	-43.17%	-51.35%
Gasoline	7.03%	-7.59%	-31.71%	-37.38%
Natural Gas	-3.69%	-23.11%	-46.67%	-51.91%
Precious Metals Sub-Index	-1.80%	7.68%	5.79%	-3.19%
Gold	-0.84%	9.34%	7.74%	0.22%
Silver	-4.47%	3.18%	0.50%	-12.22%
Industrial Metals Sub-Index	1.08%	2.87%	-8.18%	-22.50%
Copper	2.15%	2.69%	-9.55%	-21.86%
Aluminum	0.65%	2.47%	-4.95%	-18.72%
Nickel	-1.03%	-1.61%	-16.19%	-40.62%
Zinc	0.71%	8.06%	-4.45%	-16.93%
Softs Sub-Index	3.81%	-2.20%	7.03%	-13.96%
Coffee	-1.15%	-2.71%	-11.49%	-26.21%
Sugar	10.50%	7.17%	22.00%	-7.38%
Cotton	-3.37%	-6.69%	-9.65%	-13.47%
Livestock Sub-Index	2.50%	1.44%	-5.07%	-6.30%
Cattle	2.28%	2.26%	-7.64%	-8.88%
Hogs	2.84%	0.24%	-0.79%	-1.51%

While it seems as if the EUR has been in a long-term downtrend, it actually has been moving sideways for a year. This suggests the divergence trade has been absorbed many times over. Of greater note is the strengthening of the CAD and what this says about an incipient end to both the energy and basic materials markets.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.76%	0.59%	-3.36%	-2.36%
Chinese yuan	-0.28%	0.65%	-2.00%	-4.31%
Japanese yen	-1.20%	3.88%	5.19%	4.75%
British pound	-3.71%	-3.34%	-10.30%	-9.97%
Swiss franc	-0.64%	2.01%	-4.21%	-4.42%
Canadian dollar	1.87%	4.48%	-1.64%	-7.39%
Australian dollar	-0.31%	1.73%	0.06%	-8.64%
Swedish krona	-1.34%	-0.30%	-0.85%	-1.86%
Norwegian krone	-1.47%	0.20%	-3.52%	-11.82%
New Zealand dollar	-0.05%	2.00%	2.95%	-12.02%
Indian rupee	-0.24%	-1.16%	-3.63%	-10.02%
Brazilian real	0.55%	1.29%	-10.09%	-27.35%
Mexican peso	-0.29%	1.02%	-6.90%	-17.93%
Chilean peso	1.20%	3.76%	2.22%	-10.67%
Colombian peso	0.42%	0.70%	-2.41%	-25.48%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.25%	-0.14%	-1.97%	-6.14%

To turn Mark Twain on his head, rumors of emerging markets' resuscitation were greatly exaggerated, at least for this week. Other indices managed gains, but until there is some evidence of topline revenue and earnings growth, these are going to remain limited.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.13%	1.52%	-2.77%	-10.14%
North America	1.71%	2.72%	0.42%	-7.32%
Latin America	1.55%	10.05%	-8.97%	-30.81%
Emerging Market Free	-0.09%	4.61%	-5.13%	-23.44%
EAFE	0.17%	-0.45%	-7.75%	-14.57%
Pacific	0.31%	0.96%	-5.84%	-13.14%
Eurozone	0.17%	-2.24%	-9.86%	-16.13%

CTAs managed a rebound in what was more of a risk-on week than we have seen recently. The most likely source of this strong performance, and that of hedge funds, was s combination of long equity and USD positions.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.35%	1.94%	4.47%	2.31%
Newedge Trend	1.39%	2.47%	6.71%	3.88%
Newedge Short-Term	0.57%	2.84%	4.58%	-1.67%
HFR Global Hedge Fund	0.52%	-0.26%	-4.91%	-8.12%
HFR Macro/CTA	0.48%	0.62%	0.37%	-2.68%
HFR Macro: Sytematic Diversified CTA	0.94%	2.54%	4.69%	1.99%