The Macro Environment For Financial Markets

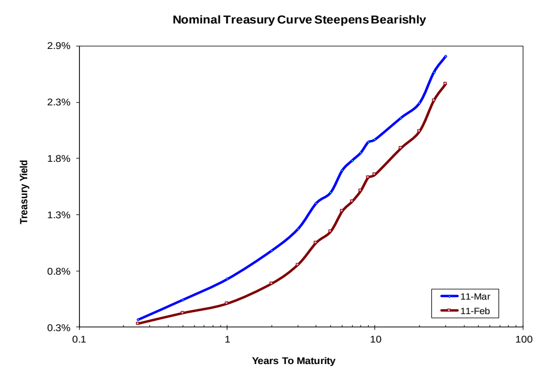
If you listen hard enough to American political debates you can hear some discussion over fiscal policy and the concept of replacing the income tax in all or part with a value-added tax. What remains silent, both in the U.S. and in the negative-rate world, is how those negative rates actually operate as a wealth tax on the risk-averse: You put money in a bank or in a government bond, and you pay for the privilege of doing so. Schmendrick! The alternatives include paying up for risky assets that become overpriced by definition, spending, giving it away or salting it away in non-productive assets such as gold. In the meantime, the issuer of negative-yield bonds uses the funds in a manner any dog standing next to a fire hydrant would understand. This colossal farce is presented to the public as “stimulus.”

The causal chain now is:

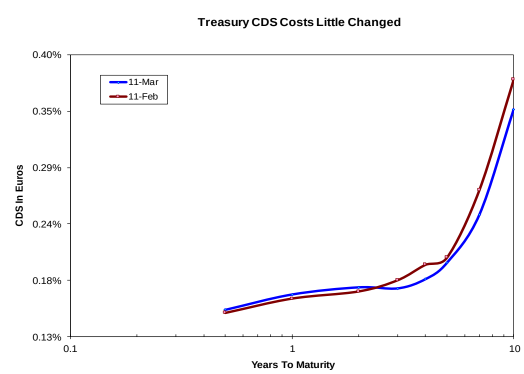
1. The market is leaning back toward higher short-term rates in the U.S. ;
2. Disinflationary pressures will persist globally but are starting to dissipate in the U.S.;
3. Inflation expectations as measured by TIPS and inflation swaps have established a strong tradable bottom;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are reducing rollover risk;
6. Swap spreads will remain low; and
7. Credit spreads have declined to resistance levels.

Key Market Indications

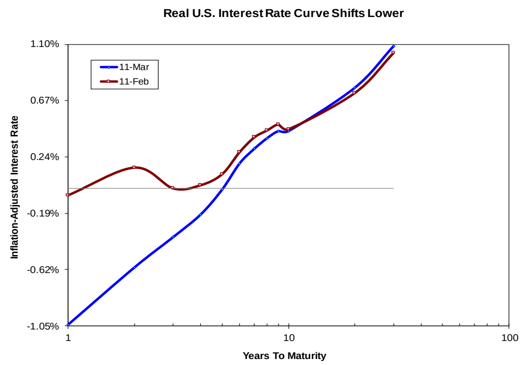
The continued flattening of the yield curve via higher short-term rates reflects the still-strong demand for anything longer-date and positively yielding in the world of fixed-income. If the current risk-somewhat-on phase continues, we should see ten-year UST rise back toward 2.12%. This is what constitutes a selloff in the Treasury market these days.



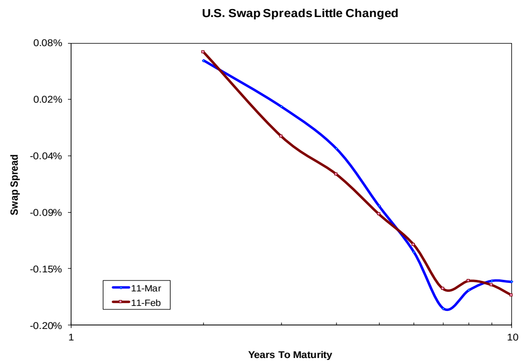
The CDS market for Treasuries has been completely dormant, as it should be. The next irruption here may come during the election season once foreign creditors come to the realization one of the current crop of Presidential candidates will win.



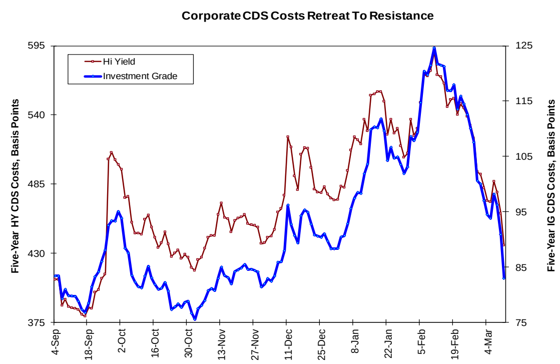
The pseudo-real rate curve shifted lower over the past month and is negative through five years. The strong move lower at the short end of the yield curve is attributable to a large increase in breakevens intersecting with smaller changes in nominal rates. The decline in pseudo-real rates remains positive for precious metals.



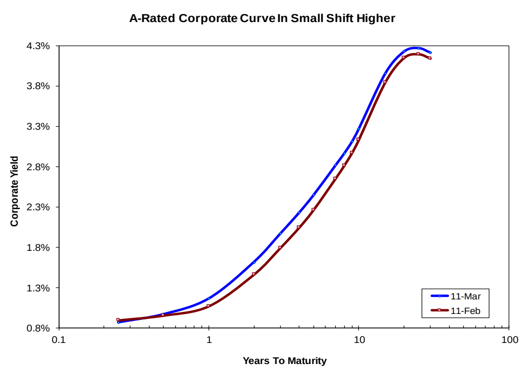
Swap spreads, which rise when floating-rate borrowers want to fix their payments, have moved in a mixed fashion across tenors over the past month. We should not expect a continued decline of any significance; the key warning will come if and when swap spreads of five years' tenor and longer start to move back toward positive levels.



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. These costs have receded more rapidly than they rose, which is a tribute to the illiquidity in the corporate bond market and to the use of equity correlation trades in pricing CDS.



The A-rated yield curve shifted slightly higher over the past month, but as its OAS declined rapidly, this rate increase was both less than that of the UST yield curve and insufficient to pose a threat to the performance of riskier assets.



Market Structure

None of the physical commodities are in structural downtrends. The dollar index left its downtrend, and the uptrends for the equity indices all moved strongly higher with the EM index entering overbought territory.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Mar. 14 - 18
BBerg	29	Trending	0.352	12.5%	0.36%
BBerg Grain	29	Trending	0.129	9.9%	
BBerg Ind. Metl	29	Trending	0.202	18.2%	0.39%
BBerg Pre. Metl	4	Sideways	0.000	18.5%	
BBerg Softs	29	Trending	0.354	15.9%	0.41%
BBerg Nat. Gas	9	Sideways	0.143	31.8%	
BBerg Petroleum	29	Trending	0.244	41.3%	0.71%
BBerg Livestock	24	Trending	0.231	9.7%	0.31%
Dollar Index	19	Transitional	-0.123	9.4%	
S&P 500 Index	29	Trending	0.293	15.2%	0.42%
EAFE Index	23	Trending	0.267	17.2%	0.58%
EM Index	29	Trending	0.486	13.1%	0.28%
Ten-year UST (price)	18	Transitional	-0.208	6.6%	

Performance Measures

If Industrial Metals were moving higher on the hopes China would resuming buying them for no reason at all, that trade is over at least for one week. The rest of the physical markets are pricing out both an immediate fear of a Chinese collapse and in the critical case of the energy markets, expanding production in the face of lower prices. Even the Natural Gas index, something that turned \$100 in January 1991 to \$0.77 today, managed a 7.17% return.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	2.00%	8.13%	-10.01%	-19.46%
Grains Sub-Index	2.25%	1.59%	-4.66%	-12.54%
Corn	1.89%	0.03%	-8.97%	-15.89%
Soybeans	1.97%	2.08%	1.18%	-8.71%
Wheat	3.26%	2.67%	-3.33%	-7.77%
Energy Sub-Index	5.93%	17.60%	-30.79%	-41.57%
Petroleum Sub-Index	5.61%	28.22%	-25.93%	-38.39%
WTI	6.21%	30.36%	-29.25%	-42.45%
Brent	4.56%	31.55%	-26.73%	-41.63%
ULSD	4.35%	22.34%	-29.63%	-40.61%
Gasoline	7.78%	24.04%	-17.11%	-24.40%
Natural Gas	7.17%	-10.03%	-45.59%	-52.19%
Precious Metals Sub-Index	-0.79%	0.36%	12.29%	6.72%
Gold	-0.87%	0.97%	14.15%	9.07%
Silver	-0.56%	-1.29%	7.20%	0.34%
Industrial Metals Sub-Index	-2.31%	9.40%	-8.00%	-17.16%
Copper	-1.47%	11.55%	-9.11%	-14.88%
Aluminum	-1.65%	5.25%	-6.77%	-15.31%
Nickel	-5.52%	16.19%	-14.86%	-36.80%
Zinc	-2.98%	5.54%	-2.14%	-11.83%
Softs Sub-Index	2.26%	10.19%	10.16%	-1.84%
Coffee	3.93%	9.42%	3.09%	-14.05%
Sugar	2.03%	16.24%	22.13%	4.90%
Cotton	0.08%	-2.63%	-10.42%	-7.48%
Livestock Sub-Index	1.88%	5.87%	-2.18%	-4.24%
Cattle	2.12%	7.52%	-4.31%	-9.48%
Hogs	1.53%	3.53%	1.33%	5.91%

Interest rate parity remains the dominant theory for currency markets. Why I do not know; outside of the Phillips Curve purporting a tradeoff between inflation and unemployment, nothing seems to get you to the wrong answer faster. The ECB joined the Bank of Japan, the Riksbank and the SNB in discovering increasingly negative nominal rates can mask higher implied real rates.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.37%	-1.47%	-1.61%	5.77%
Chinese yuan	0.21%	1.23%	-1.84%	-3.57%
Japanese yen	-0.11%	-1.26%	5.91%	6.67%
British pound	1.08%	-0.66%	-6.79%	-3.67%
Swiss franc	1.05%	-1.01%	-1.34%	2.74%
Canadian dollar	0.82%	5.51%	0.42%	-3.47%
Australian dollar	1.69%	6.41%	6.67%	-0.41%
Swedish krona	1.72%	0.42%	-1.26%	3.59%
Norwegian krone	0.75%	1.74%	-3.10%	-2.44%
New Zealand dollar	-0.91%	0.48%	6.82%	-7.47%
Indian rupee	0.06%	1.86%	-0.76%	-6.37%
Brazilian real	4.67%	11.35%	7.95%	-12.81%
Mexican peso	0.43%	8.19%	-4.86%	-12.44%
Chilean peso	-0.44%	4.46%	0.72%	-6.61%
Colombian peso	0.20%	9.17%	-3.43%	-16.70%
Bloomberg-JP Morgan Asian dollar index (spot)	0.35%	1.10%	0.19%	-3.28%

The next Latin American leader facing impeachment should buy call options on the national stock index; Dilma Rousseff would have done well thereby and would not have lost much sleep over insider trading issues.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.19%	11.03%	1.09%	-2.50%
North America	1.29%	11.40%	3.31%	-0.18%
Latin America	2.03%	24.80%	7.71%	-10.79%
Emerging Market Free	1.29%	12.48%	0.62%	-12.67%
EAFE	1.04%	10.43%	-2.45%	-6.19%
Pacific	0.04%	8.66%	0.71%	-5.68%
Eurozone	2.48%	12.37%	-3.23%	-7.16%

As CTAs tend to latch on to uptrends in physical commodities, their losses this past week were most likely attributable to getting wrong-footed by the ECB in the currency and sovereign debt markets. The poor showing by hedge funds in the face of rising equities is more surprising.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.26%	-3.73%	2.53%	-2.07%
Newedge Trend	-1.70%	-3.22%	4.50%	-0.09%
Newedge Short-Term	-0.42%	-0.65%	4.62%	-2.70%
HFR Global Hedge Fund	-0.19%	1.80%	-4.97%	-7.33%
HFR Macro/CTA	-0.88%	-0.89%	-0.46%	-4.50%
HFR Macro: Sytematic Diversified CTA	-2.37%	-3.11%	2.11%	-1.81%