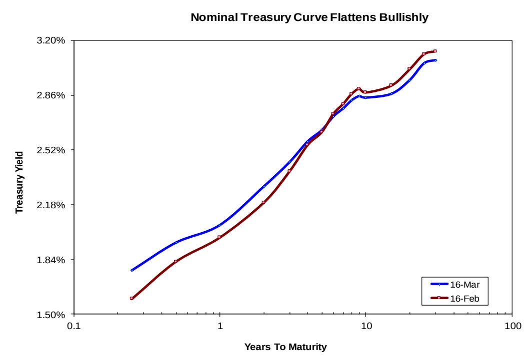
The Macro Environment For Financial Markets

Can you have rising growth, a tightening labor market and a combination still-stimulative monetary policy and a stimulative fiscal policy while keeping inflation under control? So far, the answer is yes as market efficiencies continue to keep price increases tame. Moreover, long-term interest rates cannot rise very far in a highly leveraged economy without dampening activity, as seen recently in both autos and housing. Learn to love a flat yield curve and ignore the prattle it signals an imminent recession. The causal chain now is:

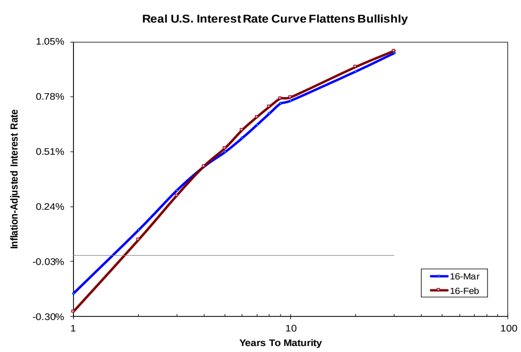
1. The market is pricing in March and June 2018 rate hikes and is likely to pricing in September soon;
2. Inflationary expectations have stopped rising;
3. The yield curve has returned to its bullish flattening;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to invert bullishly; and
6. CDS costs continue to reflect equity market fluctuations more than credit market conditions.

Key Market Indications

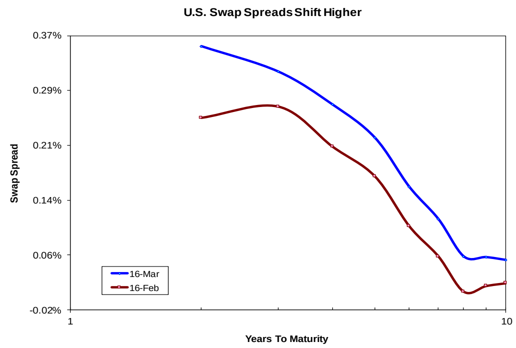
Not only have ten-year UST failed to test their resistance at 3.05%, the recent bearish steepening of the yield curve has reversed back into its four-year+ flattening trend. We need to remember rising employment is positive for federal finances as it increases tax revenue and reduces various welfare commitments. However, any glance at the chart will tell you yields have formed a bull flag and are most likely to push through resistance eventually.



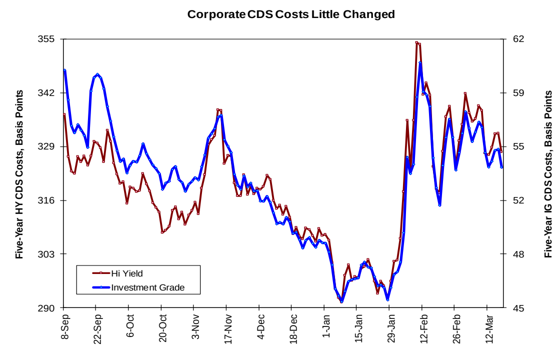
The pseudo-real yield curve shifted higher at the short end of the yield curve but declined slightly at the long end. As noted last week, this is a propitious time for fixed-income investors to shorten duration.



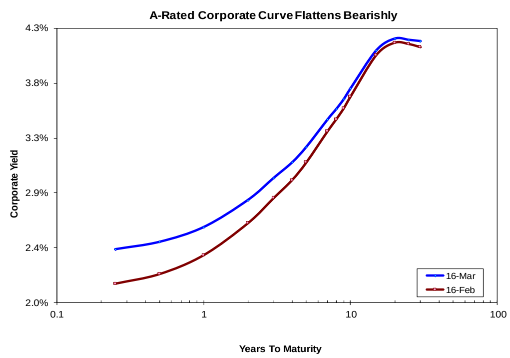
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across all tenors. The market at last is realizing long-term rates can move higher.



CDS costs continue to reflect movements in equities as correlation trades between stock options and CDS dominate individual issues' credit concerns. As equities moved sideways this past week, so did the CDS indices.



The A-rated corporate yield curve continues to flatten bearishly. However, the overall risk/reward profile of the market has benefited from the combination of higher UST rates and tame movements in both swap spreads and credit spreads.



Market Structure

Only Natural Gas is in a structural uptrend within the physical commodities. Within financial markets, the dollar index and both the EM index and the S&P 500 moved into structural uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Mar. 19 - 23
BBerg	22	Trending	-0.080	8.8%	-0.13%
BBerg Grain	7	Sideways	-0.116	12.0%	
BBerg Ind. Metl	29	Trending	-0.134	16.4%	-0.19%
BBerg Pre. Metl	29	Trending	-0.108	10.9%	-0.12%
BBerg Softs	17	Transitional	-0.171	12.8%	-0.06%
BBerg Nat. Gas	29	Trending	0.060	20.8%	0.21%
BBerg Petroleum	14	Transitional	0.081	19.8%	
BBerg Livestock	29	Trending	-0.236	10.3%	-0.07%
Dollar Index	20	Trending	0.052	6.2%	0.04%
S&P 500 Index	28	Trending	0.072	18.5%	0.29%
EAFE Index	14	Transitional	0.024	9.3%	
EM Index	29	Trending	0.113	13.4%	0.33%
Ten-year UST (price)	16	Transitional	0.025	4.8%	

Performance Measures

The Petroleum indices managed to close the week with some minor gains, but this was not sufficient to push the main Bloomberg index higher. The economically sensitive Industrial Metals softened on continued speculation Chinese growth is about to turn lower; this is quite the perennial story, is it not? The Softs continued to decline; the aggregate subindex is down almost 22% on the year. The terms of trade have been terrible for primary agricultural producers over the past year.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.64%	-0.83%	3.65%	3.79%
Grains Sub-Index	-1.58%	1.41%	4.02%	-5.74%
Corn	-1.95%	2.20%	4.41%	-7.96%
Soybeans	1.02%	1.78%	5.83%	0.81%
Wheat	-4.36%	-0.67%	-0.58%	-10.08%
Energy Sub-Index	0.52%	2.26%	7.74%	10.79%
Petroleum Sub-Index	1.26%	1.89%	19.75%	25.43%
WTI	0.82%	2.11%	25.58%	23.88%
Brent	1.17%	2.73%	24.07%	28.47%
ULSD	1.47%	0.81%	10.40%	25.91%
Gasoline	2.07%	0.89%	10.03%	20.59%
Natural Gas	-1.52%	3.33%	-22.67%	-24.63%
Precious Metals Sub-Index	-1.12%	-3.09%	-1.45%	2.33%
Gold	-0.86%	-3.12%	0.08%	5.96%
Silver	-1.99%	-3.00%	-6.21%	-7.73%
Industrial Metals Sub-Index	-1.15%	-5.28%	5.22%	14.39%
Copper	-0.88%	-4.80%	4.00%	13.32%
Aluminum	-1.66%	-5.70%	-2.65%	6.78%
Nickel	-1.72%	-2.13%	21.88%	31.35%
Zinc	-0.46%	-8.71%	6.57%	14.29%
Softs Sub-Index	-1.65%	-1.17%	-10.51%	-21.94%
Coffee	-1.72%	-1.87%	-15.93%	-24.10%
Sugar	-1.45%	-4.62%	-11.01%	-32.80%
Cotton	-1.94%	7.51%	18.42%	7.40%
Livestock Sub-Index	-0.77%	-3.50%	0.48%	0.91%
Cattle	-2.27%	-5.79%	0.08%	2.35%
Hogs	2.02%	1.29%	-0.14%	-2.69%

This was a bad week for commodity-linked currencies such as the CAD and AUD. While the COP firmed, the BRL, MXN and CLP all declined, which is unusual considering the strength of the Latin American equity markets. The GBP and JPY moved higher as both countries are expected to join the renormalization parade.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.14%	-0.94%	2.81%	14.16%
Chinese yuan	-0.01%	0.11%	3.79%	8.89%
Japanese yen	0.76%	0.19%	5.24%	6.89%
British pound	0.66%	-0.60%	3.31%	12.80%
Swiss franc	-0.07%	-2.63%	1.00%	4.67%
Canadian dollar	-2.17%	-4.11%	-6.15%	1.70%
Australian dollar	-1.67%	-2.43%	-3.08%	0.46%
Swedish krona	0.62%	-2.75%	-2.83%	7.64%
Norwegian krone	0.82%	0.85%	1.54%	10.30%
New Zealand dollar	-0.85%	-2.27%	-0.62%	3.31%
Indian rupee	0.35%	-1.12%	-1.23%	0.72%
Brazilian real	-0.75%	-1.50%	-4.35%	-4.91%
Mexican peso	-0.37%	-0.88%	-4.98%	3.08%
Chilean peso	-0.91%	-2.44%	2.75%	8.90%
Colombian peso	0.55%	-0.59%	1.87%	2.37%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.05%	-0.43%	2.72%	5.85%

Equity markets felt as if they were marking time this week, with both the North and Latin American indices declining and the EAFE and EM indices rising.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.65%	0.13%	7.98%	17.33%
North America	-1.15%	0.80%	10.45%	17.27%
Latin America	-2.88%	-2.07%	3.27%	19.22%
Emerging Market Free	0.52%	1.25%	10.86%	29.23%
EAFE	0.22%	-1.24%	5.13%	17.30%
Pacific	1.17%	-1.48%	8.44%	17.02%
Eurozone	-0.09%	-0.09%	2.20%	20.51%

While the main and trend-following CTA indices gained on the week, hedge funds reverted to their typical pattern of declining in the face of soft equity returns.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.42%	-2.09%	1.76%	-2.08%
Newedge Trend	0.13%	-1.45%	0.93%	-1.26%
Newedge Short-Term	-0.37%	-1.20%	1.48%	-0.79%
HFR Global Hedge Fund	-0.38%	-1.14%	1.87%	4.40%
HFR Macro/CTA	-0.12%	-2.32%	0.34%	1.61%
HFR Macro: Sytematic Diversified CTA	-0.41%	-2.73%	1.79%	1.79%