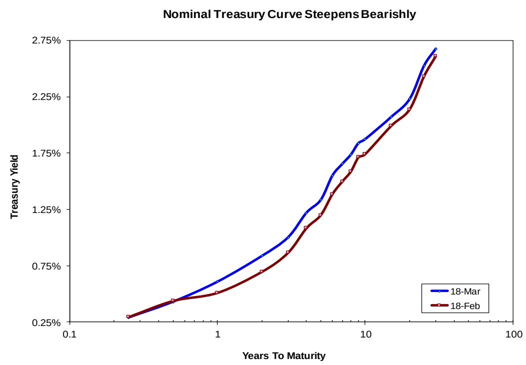
The Macro Environment For Financial Markets

Would things be materially different if Humpty Dumpty chaired the FOMC? The eloquent egg did declare, “When I use a word, it means just what I choose it to mean – neither more nor less.” Such has been the case with “data dependency.” You can data to justify what you want to justify, or you can ignore them to suit your needs of the moment. And really, whoever believed those silly dot-plots, anyway? They were always for the tourists. All that matters is the least creditworthy borrowers in the most rickety economies are setting the marginal price for short-term funds globally. Negative rates elsewhere mean low rates in the U.S., and if the USD stops rising and its concomitant threat to exporters and non-U.S. banks with USD liabilities is lessened, that simply is an added bonus. The only fly in this ointment is the financial asset inflation of the past seven years may be replaced by actual price inflation, and if and when that happens, the present leadership will have no more clue as to how to break it than they did in the 1970s.

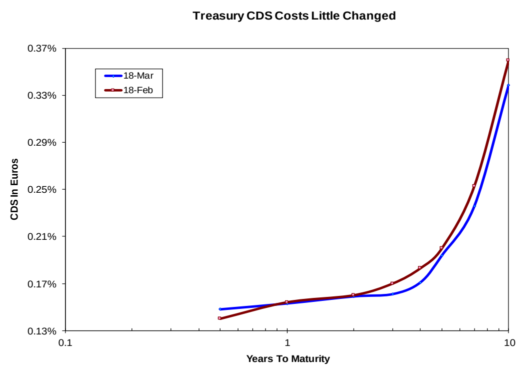
The causal chain now is:

1. The market has once again priced out 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 failed to break resistance levels.

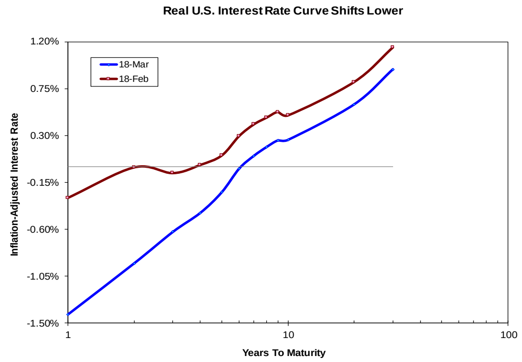
Key Market Indications
While the yield curve remains in the secular flattening starting in November 2013, it has short irruptions of steepening whenever short-term rates decline. Such as move happened following the FOMC signal the pace of future rate hikes will be slower than expected. Until the demand for high-quality, long-dated, positively yield instruments disappears, the long end of the yield curve will remain bid.



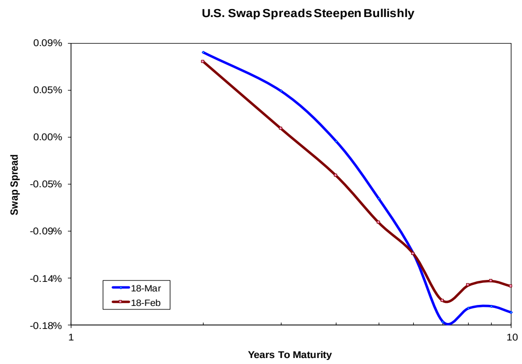
The CDS market for Treasuries has been completely dormant, as it should be. The next irruption here may come during the election season once foreign creditors come to the realization one of the current crop of Presidential candidates will win.



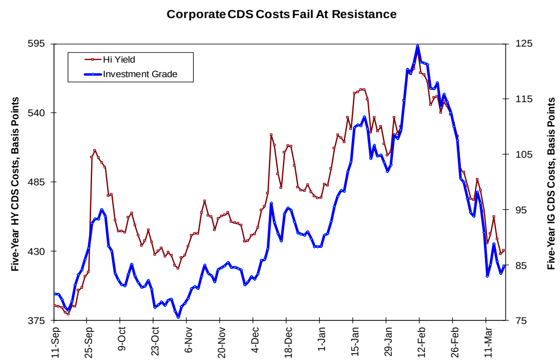
The pseudo-real rate curve shifted lower over the past month and is negative through six years. The strong move lower at the short end of the yield curve is attributable to a large increase in breakevens intersecting with smaller changes in nominal rates. The decline in pseudo-real rates remains positive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



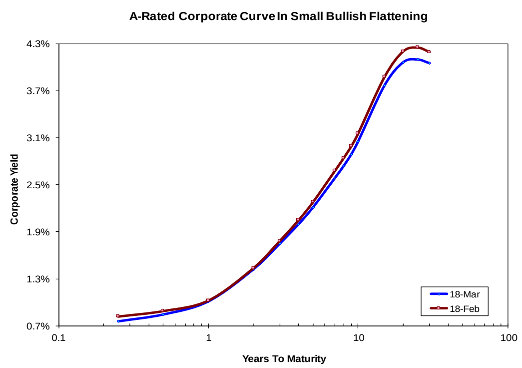
Swap spreads, which rise when floating-rate borrowers want to fix their payments, have moved in a mixed fashion across tenors over the past month. The inversion of this curve is confirmed in the swaption market as well. The belief seems to be that long-term rates will remain constrained even if short-term rates are pushed higher.



CDS costs for both the investment-grade and high-yield indices failed at resistance from late 2014. They are likely to stay near these levels as credit conditions are not worsening in sectors such as finance, energy and basic materials nor are they improving significantly in response to the continuation of low and negative short-term rates globally.



The A-rated yield curve had a small bullish flattening over the past month, a divergence from the UST curve's bearish steepening, but this decline in credit spreads is relatively minor. Please remember the A-rated yield curve never worsened significantly during the January-February selloff; this market has been a buffer in general and a haven for longer-term investors.



Market Structure

None of the physical commodities are in structural downtrends. Both ten-year UST and the dollar index moved into structural downtrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Mar. 21 - 25
BBerg	29	Trending	0.368	11.9%	0.36%
BBerg Grain	29	Trending	0.112	9.8%	0.25%
BBerg Ind. Metl	9	Sideways	0.053	17.2%	
BBerg Pre. Metl	16	Transitional	0.067	15.7%	
BBerg Softs	29	Trending	0.525	16.1%	0.41%
BBerg Nat. Gas	12	Transitional	0.142	31.6%	
BBerg Petroleum	29	Trending	0.233	39.2%	0.71%
BBerg Livestock	29	Trending	0.202	9.4%	0.31%
Dollar Index	24	Trending	-0.212	9.4%	-0.19%
S&P 500 Index	29	Trending	0.349	13.5%	0.42%
EAFE Index	26	Trending	0.275	15.7%	0.58%
EM Index	29	Trending	0.591	13.2%	0.28%
Ten-year UST (price)	24	Trending	-0.051	6.2%	-0.08%

Performance Measures

Remember when $40 crude oil seemed ridiculously low? It is back on a combination of reduced U.S. supply, a realization demand is not going to crater, and the realization of the embedded option in crude oil storage. You might hear some other claptrap about the USD and commodities, but the implied gearing of these prices to changes in the USD is out of the realm of economic reality. Once the short-covering trades are over, the physical markets will struggle to recover in the face still-slow Chinese demand growth and the overhang of production capacity.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.02%	7.55%	-8.73%	-18.78%
Grains Sub-Index	-0.39%	0.27%	-5.26%	-12.99%
Corn	0.55%	-0.58%	-7.87%	-14.10%
Soybeans	0.20%	1.93%	1.39%	-6.74%
Wheat	-2.67%	-0.78%	-8.15%	-15.49%
Energy Sub-Index	1.96%	16.47%	-29.14%	-38.11%
Petroleum Sub-Index	1.45%	21.12%	-25.75%	-34.57%
WTI	2.63%	23.24%	-30.17%	-36.57%
Brent	1.50%	22.23%	-25.21%	-38.30%
ULSD	1.72%	17.83%	-27.02%	-36.93%
Gasoline	-1.04%	18.30%	-19.62%	-24.01%
Natural Gas	3.88%	2.30%	-40.81%	-49.50%
Precious Metals Sub-Index	0.05%	2.13%	8.81%	1.95%
Gold	-0.41%	1.94%	10.72%	5.53%
Silver	1.33%	2.67%	3.51%	-7.47%
Industrial Metals Sub-Index	0.18%	4.58%	-4.70%	-20.55%
Copper	1.86%	9.74%	-4.91%	-18.16%
Aluminum	-2.85%	-2.26%	-8.18%	-20.10%
Nickel	-1.97%	0.83%	-12.81%	-40.09%
Zinc	2.26%	5.56%	9.65%	-12.89%
Softs Sub-Index	4.94%	15.58%	20.26%	2.28%
Coffee	6.76%	15.26%	9.40%	-15.67%
Sugar	5.56%	26.08%	37.74%	14.75%
Cotton	0.02%	-3.97%	-6.95%	-11.13%
Livestock Sub-Index	0.69%	4.83%	-1.60%	-3.75%
Cattle	0.43%	4.41%	-2.11%	-11.29%
Hogs	1.00%	5.39%	-1.30%	10.81%

Markets reacted to the expected decision by the FOMC to hold rates steady by being surprised by the expected. As noted last week, the theory of interest rate parity seems to be collapsing spectacularly in the face of negative interest rates. Regardless, the divergence trade is being unwound and the USD is declining even though the next trade will be the resurrection of the divergence trade.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.02%	1.47%	-0.25%	3.74%
Chinese yuan	0.35%	0.72%	-1.66%	-3.74%
Japanese yen	2.07%	1.52%	7.56%	7.67%
British pound	0.65%	0.97%	-6.82%	-3.35%
Swiss franc	1.33%	2.42%	-0.05%	0.92%
Canadian dollar	1.58%	5.55%	1.71%	-3.37%
Australian dollar	0.57%	6.30%	5.83%	-2.14%
Swedish krona	1.33%	2.58%	0.19%	4.21%
Norwegian krone	0.52%	2.64%	-2.48%	-2.43%
New Zealand dollar	0.81%	2.41%	6.33%	-9.13%
Indian rupee	0.82%	2.95%	-1.25%	-5.73%
Brazilian real	-1.07%	11.18%	8.86%	-11.41%
Mexican peso	1.76%	5.19%	-4.26%	-13.21%
Chilean peso	1.11%	3.94%	0.68%	-4.90%
Colombian peso	2.54%	8.81%	-2.88%	-14.44%
Bloomberg-JP Morgan Asian dollar index (spot)	0.53%	2.16%	0.16%	-3.48%

To paraphrase Samuel Johnson on reality: "The central banks are powerless? I refute it thus!" None of them got hawkish and the ongoing downtrends in the USD and uptrend in petroleum removed a great deal of credit stress. A good time will be had until the next bad time.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.23%	6.89%	2.08%	-3.77%
North America	1.36%	7.29%	4.66%	-1.63%
Latin America	3.38%	21.89%	8.60%	-8.35%
Emerging Market Free	3.28%	10.99%	0.44%	-11.12%
EAFE	1.02%	6.22%	-2.00%	-7.18%
Pacific	0.98%	6.49%	1.06%	-7.65%
Eurozone	0.99%	7.36%	-2.36%	-7.34%

It is very odd to see trend-following CTAs lose during a week when CTAs gained and there were few reversals. Hedge funds, seemingly biased forever to the long side of the equity markets, navigated the week well, suggesting no one got too clever in trying to outfox the central banks.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.62%	-2.60%	3.23%	-5.82%
Newedge Trend	-1.10%	-3.69%	4.82%	-3.22%
Newedge Short-Term	0.48%	-0.02%	4.93%	-3.95%
HFR Global Hedge Fund	0.37%	1.58%	-4.83%	-7.56%
HFR Macro/CTA	0.03%	-0.90%	0.01%	-5.74%
HFR Macro: Sytematic Diversified CTA	0.88%	-1.59%	3.86%	-3.05%