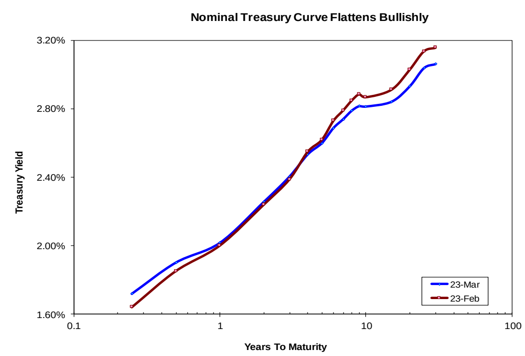
The Macro Environment For Financial Markets

The old saying bull markets do not die but are killed is coming into focus. We cannot over-estimate the macroeconomic danger of rising protectionism; global supply chains depend on the predictable pricing of free-flowing goods and services. If we add rising short-term interest rates, quantitative tightening and the public's shock – shock! – social networking firms are selling their information, we have a toxic brew indeed. We need more, not fewer, adults in the room right now. The causal chain now is:

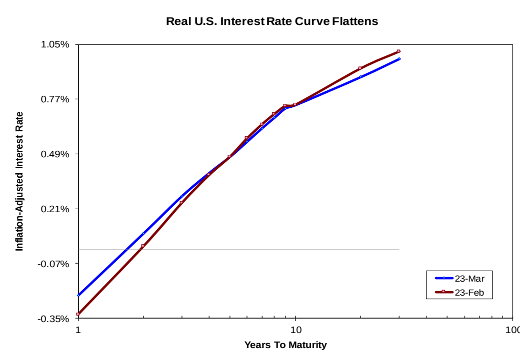
1. The market is pricing in June and September 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve has returned to its bullish flattening;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue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

Key Market Indications

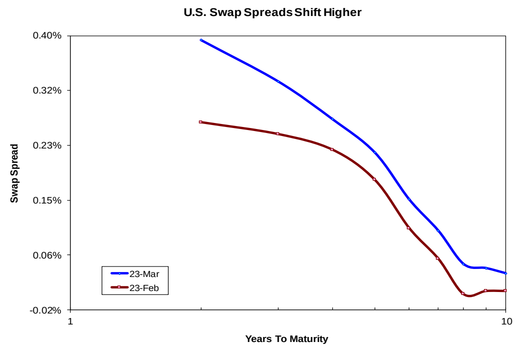
To repeat verbatim from last week, not only have ten-year UST failed to test their resistance at 3.05%, the recent bearish steepening of the yield curve has reversed back into its four-year+ flattening trend. The early-year chatter about rising inflation seems a distant memory now. However, barring a major recessionary collapse, there is little reason to expect a strong movement down in long-term yields.



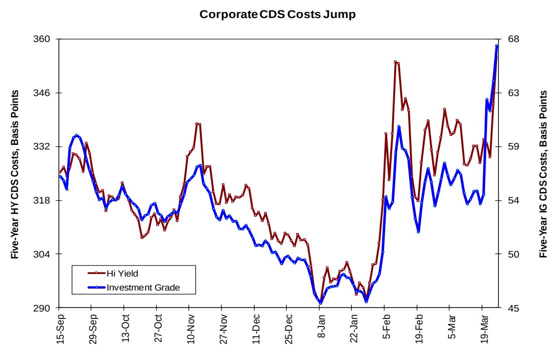
The pseudo-real yield curve shifted higher at the short end of the yield curve but remained stable at the long end. As noted over the past month, this is a propitious time for fixed-income investors to shorten duration.



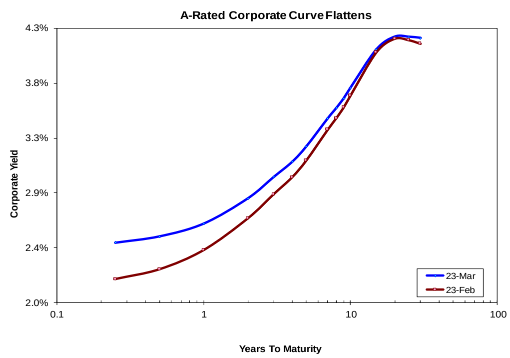
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across all tenors. The market continues to rise fastest at shorter tenors as the case for a bear market at longer tenors weakens.



CDS costs continue to reflect movements in equities as correlation trades between stock options and CDS dominate individual issues' credit concerns. As equities declined this past week the CDS indices rose sharply.



The A-rated corporate yield curve continues to flatten. 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 Precious Metals are in a structural uptrend within the physical commodities. Within financial markets, the dollar index and both the EM index and the S&P 500 reversed into structural downtrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Mar. 26 - 30
BBerg	27	Trending	-0.039	8.5%	-0.13%
BBerg Grain	23	Trending	-0.140	13.4%	
BBerg Ind. Metl	28	Trending	-0.297	15.8%	-0.19%
BBerg Pre. Metl	28	Trending	0.137	10.4%	0.08%
BBerg Softs	23	Trending	-0.183	12.9%	-0.06%
BBerg Nat. Gas	28	Trending	-0.067	19.3%	-0.20%
BBerg Petroleum	18	Transitional	0.285	19.0%	
BBerg Livestock	29	Trending	-0.639	10.2%	-0.07%
Dollar Index	25	Trending	-0.088	6.2%	
S&P 500 Index	29	Trending	-0.345	14.6%	-0.11%
EAFE Index	15	Transitional	-0.211	10.1%	
EM Index	29	Trending	-0.205	11.3%	-0.08%
Ten-year UST (price)	18	Transitional	0.070	4.8%	

Performance Measures

The Petroleum indices gained once again, this time on the amusing idea a strident U.S. will increase supply risk. Precious Metals gained on a rare haven bid, but the economically important Industrial Metals declined.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.12%	-1.68%	3.83%	4.67%
Grains Sub-Index	-1.86%	-1.25%	1.01%	-4.69%
Corn	-1.40%	0.12%	1.76%	-6.40%
Soybeans	-1.99%	-1.58%	3.91%	1.24%
Wheat	-1.57%	-2.53%	-4.48%	-9.11%
Energy Sub-Index	3.14%	1.51%	9.26%	14.14%
Petroleum Sub-Index	5.32%	3.00%	20.95%	34.25%
WTI	5.60%	3.43%	27.52%	34.44%
Brent	5.51%	3.90%	24.29%	38.16%
ULSD	5.45%	1.96%	11.78%	33.74%
Gasoline	4.34%	1.45%	11.77%	25.75%
Natural Gas	-3.02%	-2.76%	-20.65%	-30.37%
Precious Metals Sub-Index	2.68%	1.05%	2.28%	3.39%
Gold	2.89%	1.39%	3.66%	7.40%
Silver	1.94%	-0.12%	-2.16%	-7.73%
Industrial Metals Sub-Index	-2.97%	-6.71%	3.64%	12.56%
Copper	-3.65%	-7.07%	1.91%	11.67%
Aluminum	-1.71%	-4.31%	-4.26%	3.53%
Nickel	-4.96%	-7.04%	23.30%	29.79%
Zinc	-1.21%	-8.86%	4.81%	14.98%
Softs Sub-Index	-0.76%	-3.76%	-8.03%	-20.94%
Coffee	-0.69%	-3.74%	-14.57%	-22.19%
Sugar	-0.60%	-6.29%	-8.63%	-31.47%
Cotton	-1.20%	-0.27%	17.86%	7.32%
Livestock Sub-Index	-5.41%	-7.65%	-4.15%	-5.44%
Cattle	-4.93%	-7.84%	-4.94%	-5.45%
Hogs	-6.26%	-7.53%	-3.79%	-6.89%

The JPY gained, which is about the last thing Japan needs in a protectionist world. While the AUD, SEK, NOK, BRL and INR all retreated, the USD remained on the defensive elsewhere as the Federal Reserve's policies now have a wait-and-see quality to them.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.51%	0.47%	4.26%	14.56%
Chinese yuan	0.30%	0.34%	4.84%	9.03%
Japanese yen	1.21%	2.05%	6.67%	5.92%
British pound	1.36%	1.15%	4.95%	12.87%
Swiss franc	0.49%	-1.19%	2.03%	4.86%
Canadian dollar	1.56%	-2.03%	-4.06%	3.53%
Australian dollar	-0.18%	-1.84%	-3.00%	0.94%
Swedish krona	-0.66%	-0.91%	-2.48%	7.05%
Norwegian krone	-0.55%	1.21%	0.77%	9.44%
New Zealand dollar	0.21%	-0.94%	-0.43%	2.90%
Indian rupee	-0.11%	-0.44%	0.17%	0.80%
Brazilian real	-0.97%	-2.22%	-4.61%	-5.18%
Mexican peso	0.89%	0.16%	-3.24%	2.18%
Chilean peso	0.07%	-2.70%	3.56%	9.12%
Colombian peso	0.44%	0.13%	2.96%	2.69%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.12%	-0.07%	2.93%	5.57%

Equity markets lost across the globe as markets try to price in the combination of higher short-term rates, protectionism and specific risk to various technology issues. This now has a serious feel to it.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-4.53%	-5.50%	3.74%	13.03%
North America	-5.67%	-5.42%	4.03%	12.28%
Latin America	-1.11%	-4.88%	2.26%	19.37%
Emerging Market Free	-3.35%	-3.52%	7.11%	24.23%
EAFE	-2.57%	-3.36%	1.72%	14.47%
Pacific	-2.81%	-4.26%	6.46%	14.13%
Eurozone	-2.99%	-3.68%	0.83%	16.26%

CTAs gained on the week again, which suggests they were positioned for the risk-off trade. Global hedge funds declined, which is to be expected whenever equities decline.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.49%	-1.20%	2.65%	0.06%
Newedge Trend	0.48%	-0.84%	1.74%	0.16%
Newedge Short-Term	-0.06%	-0.58%	1.52%	-1.01%
HFR Global Hedge Fund	-0.52%	-1.33%	1.20%	4.35%
HFR Macro/CTA	0.28%	-0.88%	0.92%	2.16%
HFR Macro: Sytematic Diversified CTA	0.97%	-1.19%	3.69%	3.86%