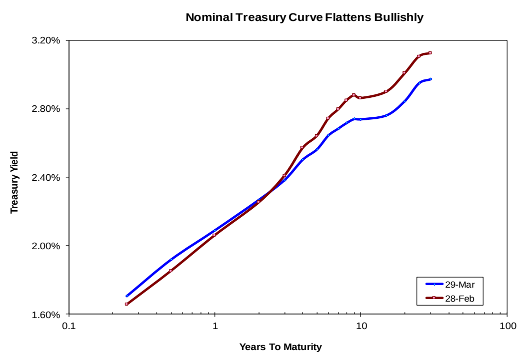
The Macro Environment For Financial Markets

A hallmark of the post-September 1981 bull market in bonds was a succession of lower highs as an increasingly leveraged economy retreated whenever borrowing costs rose. While this trend was violated in January, the mechanism appears intact. Whether this and a troublesome rise in LIBOR relative to other short-term rates leads the Federal Reserve to pull back from its planned succession of rate hikes is uncertain; their long-term history is they tighten until they break something. Now would be an excellent time for a behavioral change. The causal chain now is:

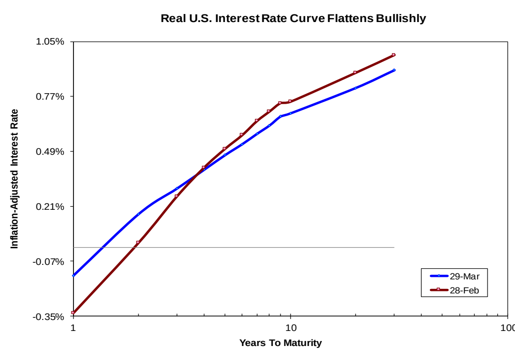
1. The market is pricing in June and September 2018 rate hikes;
2. Inflationary expectations are declining slowly;
3. The yield curve has returned to its bullish flattening;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue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

Key Market Indications

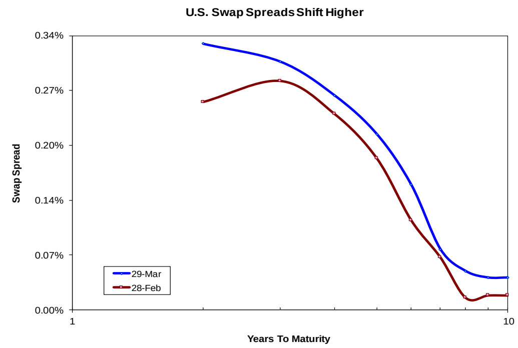
Just two months ago, the only question about ten-year UST rates breaking 3.05% was how ugly it would be. Now that investors have rediscovered the virtues of risk-aversion, it looks like a test of minor resistance at 2.65% is likely. Ten-year breakevens appear headed below 2.00%, and the yield curve has reached its flattest level since the secular move began in November 2013.



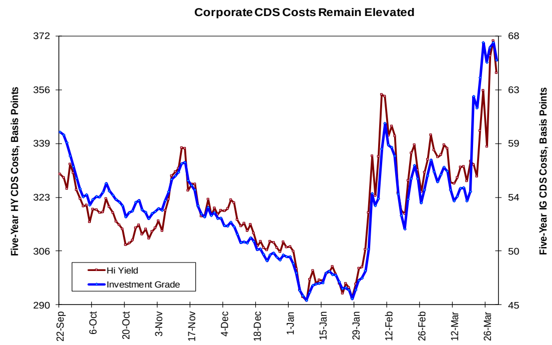
The pseudo-real yield curve shifted higher at the short end of the yield curve but declined stable at the long end. This bullish flattening will support risky assets at the very time risk-aversion is on the rise.



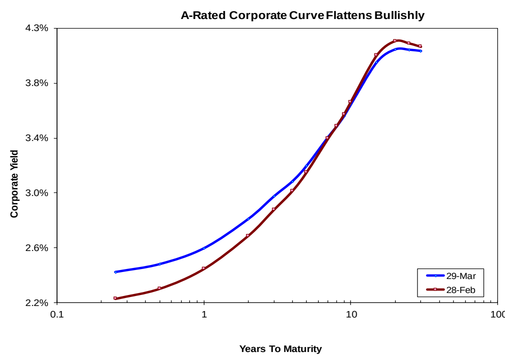
Swap spreads, which rise when floating-rate borrowers want to fix their payments, rose across all tenors. The market continues to rise fastest at shorter tenors as the case for a bear market at longer tenors weakens.



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



The A-rated corporate yield curve continues to flatten. Rising LIBOR has not posed a threat to this market yet but must be considered a negative given how it affects carrying costs.



Market Structure

Both Petroleum and Natural Gas moved into structural uptrends within the physical markets, while everything else but Grains remains negative. Within financial markets, the dollar index reversed into a structural uptrend and was joined by ten-year UST while both the S&P 500 and EM index are in downtrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 2 - 6
BBerg	27	Trending	-0.030	7.6%	-0.13%
BBerg Grain	18	Transitional	-0.003	13.4%	
BBerg Ind. Metl	29	Trending	-0.208	14.9%	-0.19%
BBerg Pre. Metl	26	Trending	-0.044	9.8%	-0.05%
BBerg Softs	26	Trending	-0.205	12.8%	-0.06%
BBerg Nat. Gas	29	Trending	0.054	18.3%	0.55%
BBerg Petroleum	29	Trending	0.212	18.4%	0.51%
BBerg Livestock	29	Trending	-0.561	11.6%	-0.07%
Dollar Index	26	Trending	0.044	6.0%	0.04%
S&P 500 Index	29	Trending	-0.170	15.4%	-0.11%
EAFE Index	16	Transitional	-0.112	10.7%	
EM Index	29	Trending	-0.229	11.1%	-0.08%
Ten-year UST (price)	20	Trending	0.180	4.6%	0.06%

Performance Measures

The Petroleum indices gained again on ever-present hopes for production discipline. Precious Metals retreated on higher implied short-term real rates. The Grains moved higher on planned reductions in acreage, but this ignores the possibility this may be offset by rising yields. The economically sensitive Industrial Metals remain under pressure as the world awaits the ultimately peaceable resolution of the U.S.-China trade dispute.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.46%	-0.62%	4.29%	3.71%
Grains Sub-Index	1.45%	-2.37%	1.93%	-3.13%
Corn	3.16%	1.65%	3.73%	-4.12%
Soybeans	1.49%	-0.88%	5.09%	4.25%
Wheat	-1.01%	-8.76%	-5.23%	-10.13%
Energy Sub-Index	1.51%	4.87%	10.85%	10.53%
Petroleum Sub-Index	1.03%	6.08%	21.86%	27.43%
WTI	1.03%	5.79%	26.23%	26.28%
Brent	1.36%	7.25%	25.67%	31.45%
ULSD	1.34%	6.23%	13.56%	28.91%
Gasoline	0.17%	4.34%	14.69%	19.44%
Natural Gas	2.93%	1.51%	-17.82%	-28.58%
Precious Metals Sub-Index	-0.47%	0.15%	1.51%	0.80%
Gold	-0.41%	0.41%	2.84%	5.48%
Silver	-0.69%	-0.71%	-2.81%	-11.74%
Industrial Metals Sub-Index	-0.23%	-4.36%	3.82%	11.42%
Copper	0.22%	-3.28%	1.78%	11.19%
Aluminum	-3.44%	-6.22%	-5.34%	-0.49%
Nickel	0.84%	-3.57%	26.41%	29.88%
Zinc	2.31%	-4.90%	5.10%	15.54%
Softs Sub-Index	-1.82%	-4.72%	-5.46%	-19.94%
Coffee	-0.68%	-3.02%	-11.04%	-22.51%
Sugar	-3.26%	-7.57%	-11.42%	-29.06%
Cotton	-0.81%	-1.64%	17.86%	8.59%
Livestock Sub-Index	-2.90%	-7.07%	-7.06%	-4.64%
Cattle	-5.34%	-10.45%	-9.58%	-7.03%
Hogs	1.46%	-0.64%	-3.72%	-1.92%

The USD gained against all majors save the CAD, but the real story is getting to be the engineered rise of the CNY. Two and one-half years ago, the consensus was the CNY was overvalued and had to weaken. Now China appears to be pushing it higher to appease U.S. protectionists. This will not end well.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.29%	1.01%	4.98%	15.39%
Chinese yuan	0.62%	0.86%	5.99%	9.75%
Japanese yen	-1.36%	0.47%	6.21%	5.41%
British pound	-0.70%	1.98%	5.70%	12.55%
Swiss franc	-0.83%	-1.12%	2.03%	4.80%
Canadian dollar	0.03%	-0.47%	-2.97%	3.49%
Australian dollar	-0.18%	-0.99%	-1.81%	0.58%
Swedish krona	-1.31%	-0.80%	-2.25%	7.01%
Norwegian krone	-0.95%	0.88%	2.14%	9.33%
New Zealand dollar	0.00%	0.29%	0.51%	3.39%
Indian rupee	0.05%	0.00%	0.51%	-0.20%
Brazilian real	0.25%	-1.78%	-4.35%	-5.64%
Mexican peso	1.90%	3.62%	0.27%	2.94%
Chilean peso	0.52%	-1.71%	5.70%	9.71%
Colombian peso	2.38%	2.52%	5.14%	3.14%
Bloomberg-JP Morgan Asian dollar index (spot)	0.58%	0.80%	4.31%	6.07%

Equity markets stabilized in the face of a spate of negative specific-issue stories, especially in the technology sector. Guess what; when this is all over people will continue to use things to which they have become addicted.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.54%	-2.18%	4.33%	13.76%
North America	-0.13%	-2.36%	5.36%	13.60%
Latin America	0.15%	-0.93%	5.68%	17.32%
Emerging Market Free	-2.20%	-1.97%	8.93%	23.49%
EAFE	-0.40%	-1.87%	2.62%	14.65%
Pacific	0.77%	-3.14%	6.90%	14.38%
Eurozone	1.31%	-1.18%	0.16%	17.11%

Both CTAs and hedge funds lost on the week, suggesting they embraced the risk-off trade in equities a little too forcefully.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.35%	-0.43%	3.48%	-0.97%
Newedge Trend	-0.73%	-0.44%	2.31%	-0.63%
Newedge Short-Term	0.18%	-0.58%	1.40%	-1.16%
HFR Global Hedge Fund	-0.45%	-1.13%	0.43%	3.29%
HFR Macro/CTA	-0.86%	-0.30%	0.99%	1.36%
HFR Macro: Sytematic Diversified CTA	-1.11%	0.21%	4.13%	3.41%