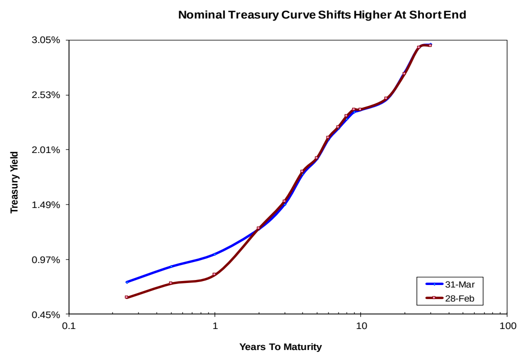
The Macro Environment For Financial Markets

When are central banks going to admit their targeting of the yield curve's short end has little effect on long-term rates, inflation, output or almost anything else? Never, really; that would require an admission of impotence. We are left with this sideshow intersecting with a good corporate backdrop and nothing but confusion on the fiscal side. Here's a suggestion to policymakers: Go home and see if anyone notices. The causal chain remains:

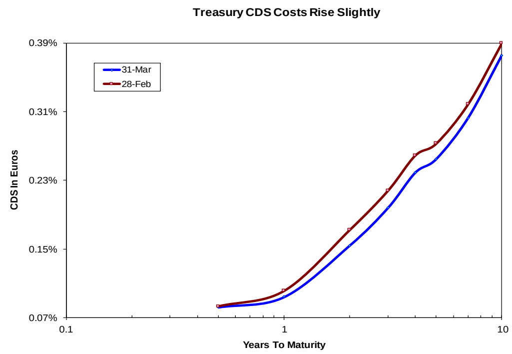
1. The market still is pricing in higher short-term rates in 2017;
2. Inflationary expectations have stopped rising;
3. The U.S. yield curve continues in its secular flattening trend;
4. Short-term borrowers have stopped terming out short-term debt into the bond market;
5. Swap spreads are lowering their expectation of higher future short-term rates; and
6. CDS costs remain consistent with a bull market in risky assets.

Key Market Indications

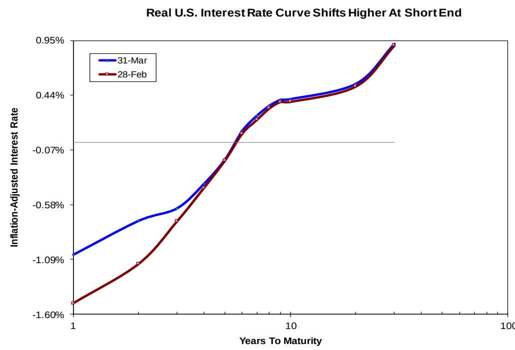
The flattening of the yield curve via relatively higher short-term rates continues. The threat of a UST selloff in the face of excessive fiscal stimulus will prevent the federal government from going overboard on that stimulus. It is doubtful tax cuts will arrive at the pace expected earlier, and this will keep the long end of the yield curve well-bid.



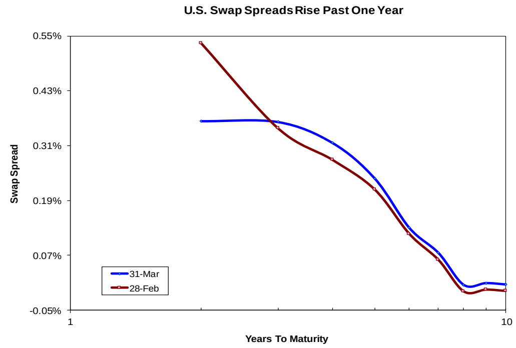
CDS costs on UST have moved very slightly lower. The idle chatter about a debt ceiling impasse is just that for now; it is doubtful Congress would want to look so incompetent twice in two months.



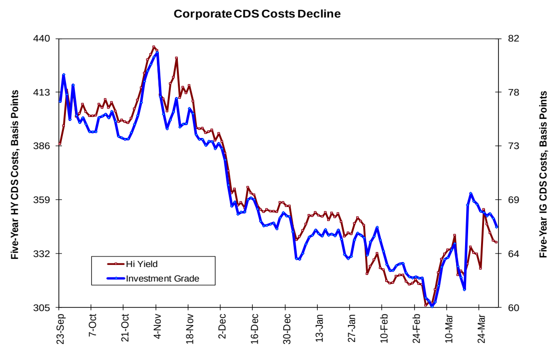
The pseudo-real yield curve rose inside of five years. This has started to cap the gains made in precious metals. The small increase at the long end of the yield curve did not affect risky assets.



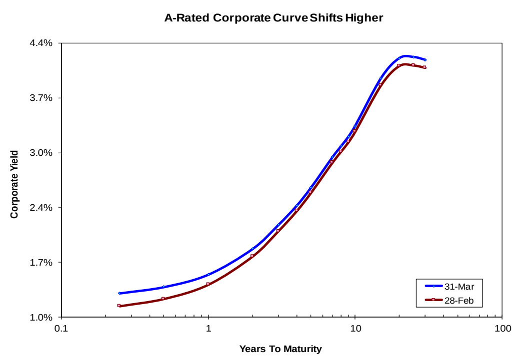
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted higher past one year. The small increases are consistent with moderating expectations for rate hikes going forward in 2017.



CDS costs resumed their decline. As noted last week, moves here are not so much credit events as correlation trades. Credit has become the inverse of equities.



The A-rated corporate yield curve sold off across the maturity spectrum in response to higher credit spreads. This is a pause in a bull market, for now, but the risk/reward simply does not favor strong gains while the yield curve is flattening bearishly.



Market Structure

The physical markets have turned mixed, with Grains, Softs and Livestock in structural downtrends while Precious Metals and Natural Gas are in uptrends. The dollar index remains in a downtrend, while ten-year UST reversed into an uptrend within the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 3 - 7
BBerg	9	Sideways	0.077	6.5%	
BBerg Grain	29	Trending	-0.216	13.1%	-0.44%
BBerg Ind. Metl	22	Trending	0.034	14.7%	
BBerg Pre. Metl	29	Trending	0.172	9.2%	0.11%
BBerg Softs	29	Trending	-0.327	13.6%	-0.23%
BBerg Nat. Gas	24	Trending	0.147	24.1%	0.40%
BBerg Petroleum	29	Trending	0.005	19.2%	
BBerg Livestock	29	Trending	-0.023	9.8%	-0.17%
Dollar Index	29	Trending	-0.086	5.7%	-0.20%
S&P 500 Index	18	Transitional	-0.001	7.5%	
EAFE Index	6	Sideways	-0.059	7.4%	
EM Index	23	Trending	0.074	8.9%	0.43%
Ten-year UST (price)	29	Trending	0.131	4.3%	0.10%

Performance Measures

The world has been dealing with OPEC since 1960 and still has yet to figure out they cheat on their own production quotas. The mere threat of another cutback was sufficient to induce short-covering. U.S. farmers have tired of competing in the wheat market, but have increased their intended planting of soybeans.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.99%	-2.05%	-0.04%	9.95%
Grains Sub-Index	-0.07%	-6.48%	-1.46%	-7.96%
Corn	2.26%	-4.28%	0.88%	-5.92%
Soybeans	-3.03%	-8.77%	-5.28%	1.35%
Wheat	0.43%	-5.90%	0.73%	-22.98%
Energy Sub-Index	4.13%	-0.56%	-3.00%	17.26%
Petroleum Sub-Index	5.24%	-3.52%	-2.72%	17.44%
WTI	5.50%	-5.86%	-3.60%	14.79%
Brent	5.16%	-4.53%	-2.12%	21.14%
ULSD	4.72%	-1.85%	-3.14%	24.70%
Gasoline	5.44%	1.25%	-1.62%	9.33%
Natural Gas	1.19%	8.61%	-3.52%	17.17%
Precious Metals Sub-Index	0.76%	2.11%	-4.92%	5.78%
Gold	-0.02%	1.79%	-5.21%	1.09%
Silver	2.88%	2.97%	-3.98%	19.23%
Industrial Metals Sub-Index	0.54%	-1.05%	14.64%	26.02%
Copper	0.83%	-1.58%	20.17%	20.58%
Aluminum	1.16%	3.60%	16.28%	25.48%
Nickel	1.54%	-8.93%	-3.86%	18.64%
Zinc	-2.19%	-0.29%	14.27%	46.05%
Softs Sub-Index	-1.92%	-6.21%	-15.52%	8.74%
Coffee	1.25%	-2.74%	-8.91%	0.05%
Sugar	-5.35%	-14.09%	-25.79%	5.56%
Cotton	-0.17%	-0.79%	10.36%	28.49%
Livestock Sub-Index	-2.03%	1.75%	20.92%	-5.61%
Cattle	-1.74%	4.43%	20.92%	0.15%
Hogs	-2.49%	-2.01%	20.84%	-14.31%

The USD had a very mixed performance across the board, but this is to be expected given quarter-end book-squaring. If we step back and look at weekly or even monthly charts, we see the USD bull market ongoing since 2008 remains very much intact.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.35%	0.72%	-5.19%	-6.40%
Chinese yuan	-0.05%	-0.29%	-3.13%	-6.30%
Japanese yen	-0.04%	1.24%	-9.01%	1.06%
British pound	0.62%	1.37%	-3.25%	-12.60%
Swiss franc	-1.12%	0.32%	-3.11%	-4.07%
Canadian dollar	0.45%	-0.13%	-1.43%	-2.36%
Australian dollar	0.08%	-0.37%	-0.46%	-0.37%
Swedish krona	-1.81%	0.73%	-4.42%	-9.51%
Norwegian krone	-1.20%	-2.38%	-7.14%	-3.84%
New Zealand dollar	-0.31%	-2.59%	-3.84%	1.40%
Indian rupee	0.87%	2.84%	2.72%	2.16%
Brazilian real	-0.45%	-0.37%	4.50%	15.06%
Mexican peso	0.18%	7.39%	3.53%	-7.72%
Chilean peso	0.05%	-1.53%	-0.43%	1.14%
Colombian peso	0.83%	1.80%	0.28%	4.46%
Bloomberg-JP Morgan Asian dollar index (spot)	0.09%	0.51%	-1.77%	-2.76%

Emerging markets, led by Latin America, turned lower this week, but the EAFE moved ahead on the basis of a strong performance in the Eurozone. The one trade working consistently, buying the U.S., is starting to scare people.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.57%	0.53%	8.80%	15.98%
North America	0.86%	0.16%	9.78%	17.34%
Latin America	-0.38%	0.57%	11.27%	23.65%
Emerging Market Free	-1.05%	2.55%	6.93%	17.65%
EAFE	0.06%	2.87%	6.66%	12.25%
Pacific	-0.45%	1.45%	5.54%	19.60%
Eurozone	0.70%	4.49%	11.09%	16.11%

The pattern continues: If the world is risk-on, CTAs and hedge funds gain, and vice-versa. Of course, you get much the same result and with much lower cost with a handful of passive investments, and therein lies the rub.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.95%	-1.92%	-4.74%	-9.01%
Newedge Trend	0.74%	-0.61%	-3.35%	-6.03%
Newedge Short-Term	-0.01%	0.77%	-5.74%	-10.00%
HFR Global Hedge Fund	0.21%	0.00%	2.80%	6.14%
HFR Macro/CTA	-0.03%	-0.59%	-2.16%	-3.84%
HFR Macro: Sytematic Diversified CTA	0.42%	-1.58%	-4.24%	-5.49%