# The Macro Environment For Financial Markets

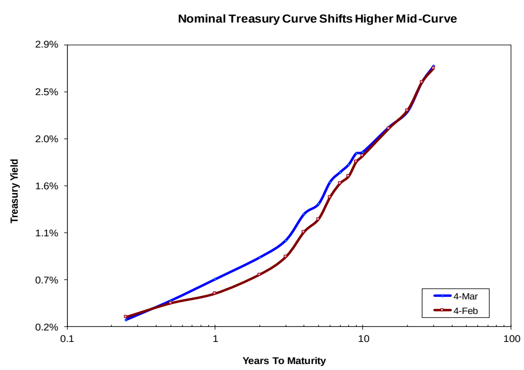
The employment situation report has been referred to, correctly, as a Rorschach Test for nerds. We can parse the data endlessly to reach any number of conditional conclusions, but the most important one is the U.S. is not contracting. If we combine that with the rising probability a long-term bottom in petroleum prices has been reached and China will be able to keep kicking the Peoples' Can down the road, we have a situation almost opposite of what we saw between mid-December and mid-February. To this we can add some improbable developments, such as the good people of Latin America entering one of their periodic efforts to clean up their politics; this could be good for the equity world's equivalent of a dash-to-trash in emerging markets. Investing is a game of alternatives, and right now the cheapest and most out-of-the-money embedded call options are in commodity-linked and emerging market equities.

The causal chain now is:

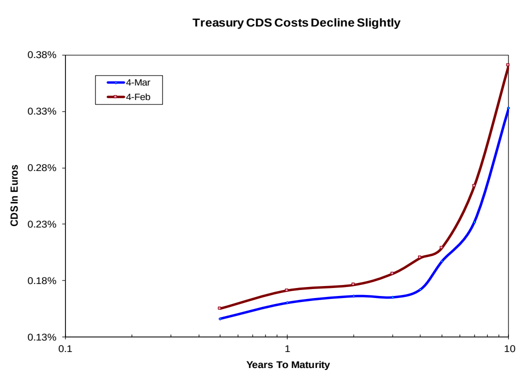
1. The market is leaning back toward higher short-term rates in the U.S. If 2015 is a guide, this opinion should be written in pencil with a large eraser nearby;
2. Disinflationary pressures will persist globally but are starting to dissipate in the U.S.;
3. Inflation expectations as measured by TIPS 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 starting to reduce rollover risk;
6. Swap spreads will remain low; and
7. Credit spreads have broken their uptrend.

**Key Market Indications**

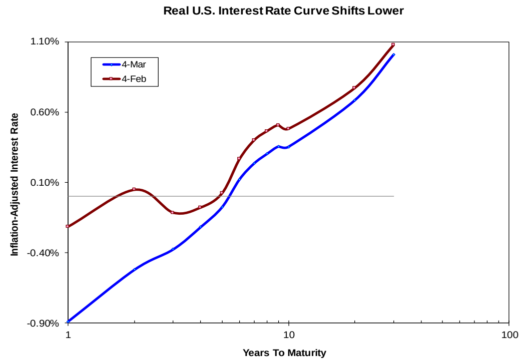
The relative rise in the mid-curve segment tells us this is where risk-averse money fled during the January-February risk-off period. It is consistent as well with the picture of rising forward rates seen in the Eurodollar futures curve.



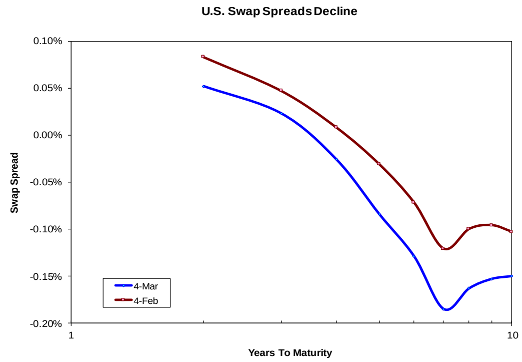

The CDS market for Treasuries has been completely dormant, as it should be. The next irruption here may come during the election season once foreign creditors come to the realization one of the current crop of Presidential candidates will win.



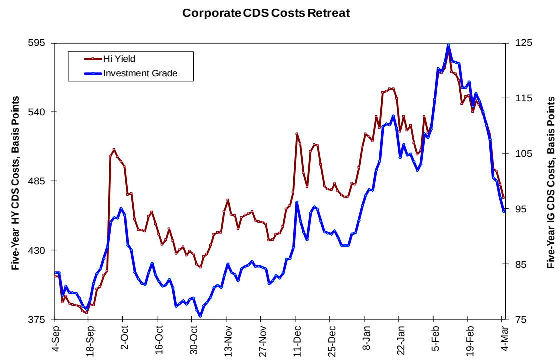
The pseudo-real rate curve shifted lower over the past month and is negative through five years. Unlike the previous week, but consistent with previous relationships, this propelled precious metals higher.



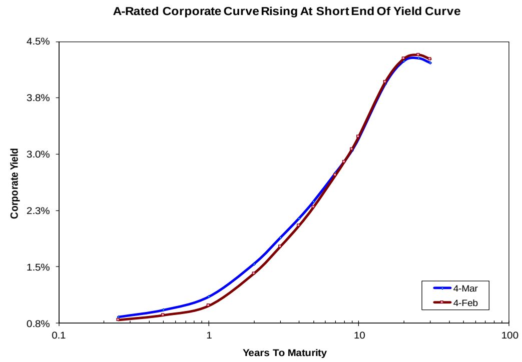

Swap spreads, which rise when floating-rate borrowers want to fix their payments, retreated over the past month and are negative for tenors longer than three years. This lack of fear about higher long-term rates continues to signal high complacency levels, especially with a renewed move higher in breakevens, perceived lower recession risk and dependence on unstably low non-U.S. long-term rates.




CDS costs for both the investment-grade and high-yield indices continued to move lower as larger-scale bankruptcy concerns, especially for the financial sector, receded. These costs have receded more rapidly than they rose, which is a tribute to the illiquidity in the corporate bond market and to the use of equity correlation trades in pricing CDS.




The A-rated yield curve started to flatten via higher short-term rates. This will not present an impediment to risky financial assets; that would come from a bearish steepening of this yield curve



## Market Structure

Only Grains remain in a structural downtrend amongst the physical commodities. Within the financials, the dollar index has moved into a structural downtrend and ten-year UST have moved out of their uptrend while the equity indices have entered structural uptrends.

| | N-Day Speed | Market Structure | Trend Oscillator | HLC Volatility | Daily Trend Rate Mar. 7 - 11 |
|---|---|---|---|---|---|
| BBerg | 27 | Trending | 0.267 | 13.2% | 0.36% |
| BBerg Grain | 29 | Trending | -0.111 | 9.8% | -0.08% |
| BBerg Ind. Metl | 29 | Trending | 0.391 | 17.9% | 0.39% |
| BBerg Pre. Metl | 10 | Sideways | 0.173 | 17.1% | |
| BBerg Softs | 29 | Trending | 0.253 | 15.6% | 0.41% |
| BBerg Nat. Gas | 4 | Sideways | -0.001 | 31.6% | |
| BBerg Petroleum | 20 | Trending | 0.189 | 44.2% | 0.71% |
| BBerg Livestock | 21 | Trending | 0.141 | 9.9% | 0.31% |
| Dollar Index | 29 | Trending | -0.026 | 8.4% | -0.05% |
| S&P 500 Index | 22 | Trending | 0.258 | 15.8% | 0.42% |
| EAFE Index | 22 | Trending | 0.252 | 17.6% | 0.58% |
| EM Index | 23 | Trending | 0.457 | 13.8% | 0.28% |
| Ten-year UST (price) | 12 | Transitional | -0.120 | 6.7% | |

## Performance Measures

The economically important Petroleum and Industrial Metals indices both continue to move higher in the face of still-bearish short-term supply/demand balances. The burst higher in the Precious Metals index is attributable once again to negative carrying costs; not even the gains in risky financial assets could dissuade buyers from converting cash into metal. Barring a debt implosion in China and its associated demand disruption, it appears as if the mid-January lows in the broad Bloomberg index defined the point at which low prices became the cure for low prices.

**Commodity Total Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| **Bloomberg Index** | 3.88% | 3.71% | -11.34% | -22.13% |
| **Grains Sub-Index** | 0.98% | -1.51% | -3.03% | -13.07% |
| Corn | -0.34% | -3.34% | -4.75% | -16.38% |
| Soybeans | 1.74% | 0.81% | 0.12% | -9.77% |
| Wheat | 1.89% | -2.17% | -2.93% | -7.63% |
| **Energy Sub-Index** | 5.14% | 2.07% | -35.87% | -46.26% |
| Petroleum Sub-Index | 8.07% | 9.24% | -31.91% | -43.52% |
| WTI | 9.17% | 7.61% | -35.48% | -47.34% |
| Brent | 9.26% | 11.42% | -31.92% | -46.27% |
| ULSD | 8.37% | 8.32% | -34.42% | -44.78% |
| Gasoline | 3.64% | 9.23% | -25.18% | -31.99% |
| Natural Gas | -4.59% | -18.28% | -48.75% | -55.73% |
| **Precious Metals Sub-Index** | 4.78% | 8.78% | 11.74% | 5.85% |
| Gold | 4.13% | 9.79% | 13.30% | 8.73% |
| Silver | 6.67% | 6.07% | 7.48% | -1.92% |
| **Industrial Metals Sub-Index** | 5.72% | 8.69% | -2.14% | -16.35% |
| Copper | 7.04% | 8.03% | -2.11% | -13.71% |
| Aluminum | 1.62% | 5.90% | -3.45% | -15.74% |
| Nickel | 9.99% | 14.39% | -6.77% | -35.91% |
| Zinc | 5.65% | 10.69% | 2.41% | -10.21% |
| **Softs Sub-Index** | 4.37% | 4.79% | 8.71% | -6.91% |
| Coffee | 5.08% | -1.21% | -2.97% | -22.12% |
| Sugar | 5.94% | 12.41% | 22.59% | 0.52% |
| Cotton | -0.72% | -5.58% | -9.76% | -11.43% |
| **Livestock Sub-Index** | -0.31% | 1.18% | -4.80% | -7.10% |
| Cattle | -0.47% | 1.48% | -6.29% | -11.04% |
| Hogs | -0.06% | 0.74% | -2.47% | 0.44% |

I noted last week the divergence trade has been absorbed several times over; no better evidence of this is available than the USD's across-the-board pullback against both major, emerging market and commodity-linked currencies in a week when speculation over further monetary accommodation in the Eurozone was being considered.

**Currency Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| Euro | 0.65% | -1.82% | -1.29% | -0.66% |
| Chinese yuan | 0.50% | 0.95% | -2.34% | -3.64% |
| Japanese yen | 0.23% | 2.67% | 4.62% | 5.22% |
| British pound | 2.58% | -2.47% | -6.20% | -6.79% |
| Swiss franc | 0.41% | 0.06% | -2.15% | -2.97% |
| Canadian dollar | 1.47% | 3.28% | -0.26% | -6.68% |
| Australian dollar | 4.39% | 3.31% | 7.69% | -4.84% |
| Swedish krona | 0.94% | -0.99% | -0.56% | -1.84% |
| Norwegian krone | 2.46% | 0.32% | -1.98% | -8.25% |
| New Zealand dollar | 2.75% | 1.31% | 8.37% | -10.26% |
| Indian rupee | 2.29% | 0.70% | -0.94% | -7.20% |
| Brazilian real | 6.58% | 3.66% | 2.41% | -20.60% |
| Mexican peso | 2.81% | 2.85% | -4.70% | -15.30% |
| Chilean peso | 1.70% | 2.52% | 1.79% | -8.91% |
| Colombian peso | 5.86% | 5.15% | -0.98% | -19.50% |
| Bloomberg-JP Morgan Asian dollar index (spot) | 1.66% | 0.81% | 0.07% | -4.28% |

It would be easier to get enthusiastic about the huge rise in emerging markets in general and Brazil in particular if the latter's rally was not fueled by the rising odds of impeachment. However, so long as the world skirts outright recession and is plagued with negative interest rates, equities will remain the best investment alternative.

**Equity Total Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| **MSCI World Free** | 3.52% | 4.12% | 1.91% | -6.32% |
| North America | 2.84% | 4.69% | 4.03% | -4.17% |
| Latin America | 14.79% | 14.70% | 4.47% | -16.99% |
| Emerging Market Free | 6.92% | 7.10% | 1.20% | -16.70% |
| EAFE | 4.67% | 3.19% | -1.45% | -9.74% |
| Pacific | 5.89% | 3.80% | 2.41% | -7.66% |
| Eurozone | 4.29% | 2.69% | -3.77% | -11.61% |

The good streak of positive CTA and macro hedge fund performance came to an end. This suggests these traders were late in closing risk-off positions in emerging market debt and currencies and in physical commodities.

**CTA/Hedge Fund Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| Newedge CTA | -2.37% | -0.41% | 4.07% | -0.06% |
| Newedge Trend | -2.01% | 0.33% | 6.18% | 1.80% |
| Newedge Short-Term | -0.07% | 2.22% | 5.51% | -1.80% |
| HFR Global Hedge Fund | 0.78% | 0.76% | -4.88% | -7.74% |
| HFR Macro/CTA | -0.67% | -0.01% | -0.09% | -3.52% |
| HFR Macro: Sytematic Diversified CTA | -1.46% | 1.02% | 4.02% | 0.99% |