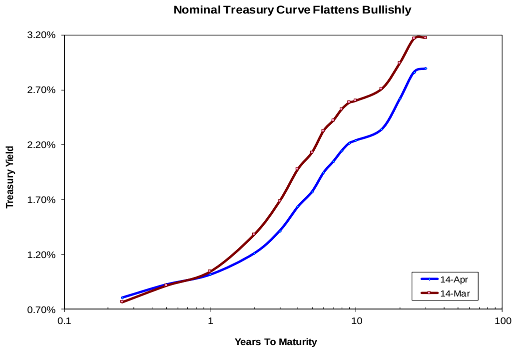
The Macro Environment For Financial Markets

Can random and disconnected military actions produce a geopolitical shock in a world that has been in continuous low-level warfare since 1990? The more interesting question is why central banks are going to end their unproductive forays into QE, ZIRP and NIRP without having any sense of what the consequences of their actions will be. The next time this too-smart-for-the-room crowd breaks something, it is going to remain broken for a very long time. The causal chain is:

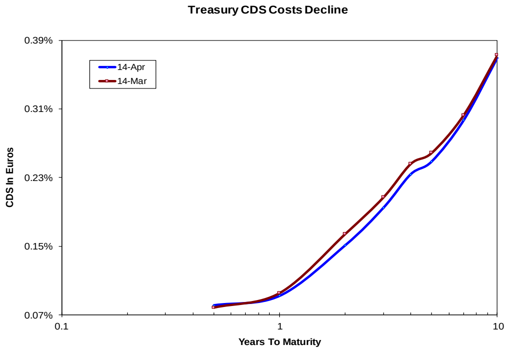
1. The market still is pricing in higher short-term rates in 2017;
2. Inflationary expectations are declining;
3. The U.S. yield curve continues in its secular flattening trend;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads are ending their increase;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

Key Market Indications

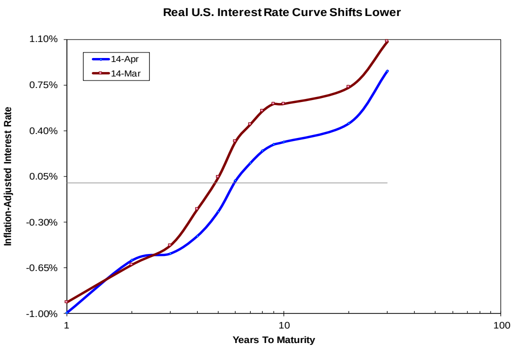
The flattening of the yield curve, which had been driven by higher short-term rates, is being driven now by lower long-term rates. As long as central banks own the long end and cannot liquidate their portfolios, long-term rates will not rise until and unless fiscal policy turns strongly stimulative.



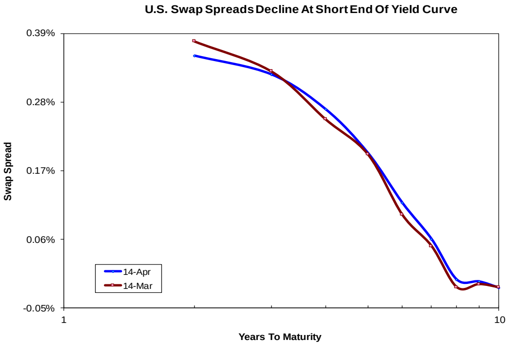
CDS costs on UST have moved very slightly lower. The idle chatter about a debt ceiling impasse is just that for now; it is doubtful Congress would want to look so incompetent twice in two months.



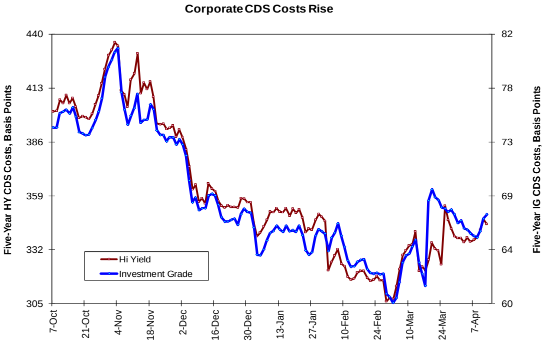
The pseudo-real yield curve shifted lower. While the decline at the long end of the yield curve has not propelled risky assets higher, it will eventually.



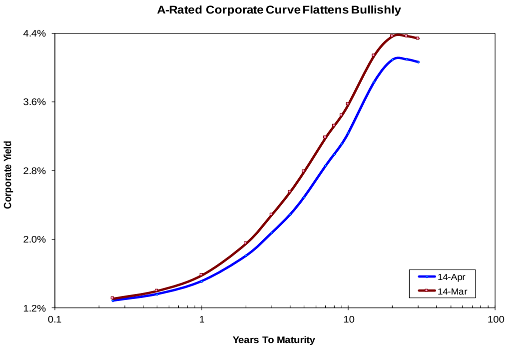
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower at the short end of the yield curve. All of the action over the winter to become floating-rate receivers and fixed-rate payors did what responses to credible forecasts always do, and that is engage in self-defeat.



CDS costs moved higher. As has been the case for the past month, moves here are not so much credit events as correlation trades. Credit has become the inverse of equities.



The A-rated corporate yield curve flattened bullishly and in parallel to the UST curve. This shift will stabilize other risky assets.



Market Structure

Petroleum and Natural Gas joined Precious Metals and Livestock in structural uptrends while Industrial Metals entered a downtrend. The dollar index reversed into a downtrend. None of the equity indices remain in uptrends, but ten-year UST have.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 17 - 21
BBerg	15	Transitional	0.163	6.8%	
BBerg Grain	9	Sideways	0.083	10.3%	
BBerg Ind. Metl	24	Trending	-0.167	15.3%	-0.10%
BBerg Pre. Metl	29	Trending	0.401	9.3%	0.11%
BBerg Softs	6	Sideways	-0.027	13.5%	
BBerg Nat. Gas	29	Trending	0.168	21.9%	0.40%
BBerg Petroleum	29	Trending	0.280	19.2%	0.80%
BBerg Livestock	29	Trending	0.194	10.0%	0.04%
Dollar Index	29	Trending	-0.014	5.5%	-0.04%
S&P 500 Index	13	Transitional	-0.149	7.6%	
EAFE Index	4	Sideways	-0.028	6.4%	
EM Index	11	Transitional	0.008	6.7%	
Ten-year UST (price)	29	Trending	0.335	4.5%	0.10%

Performance Measures

The entire Energy complex moved strongly higher on a combination of political risk and the same vain hope OPEC will enforce production quotas. The economically sensitive Industrial Metals sold off strongly, but this was an exception as Grains and Precious Metals joined Energy to push the main Bloomberg index higher.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.66%	2.92%	0.23%	7.46%
Grains Sub-Index	2.03%	-0.70%	-1.93%	-9.09%
Corn	2.75%	2.37%	0.27%	-9.62%
Soybeans	1.44%	-4.37%	-3.35%	-0.84%
Wheat	1.53%	-0.13%	-4.65%	-19.74%
Energy Sub-Index	0.79%	9.36%	-4.26%	11.63%
Petroleum Sub-Index	2.18%	9.83%	-0.54%	10.48%
WTI	2.92%	10.11%	-1.49%	7.71%
Brent	2.19%	9.93%	0.30%	13.32%
ULSD	2.36%	10.20%	0.19%	18.33%
Gasoline	0.74%	8.82%	-0.63%	3.69%
Natural Gas	-3.00%	8.02%	-13.57%	16.97%
Precious Metals Sub-Index	2.45%	7.60%	2.97%	6.21%
Gold	2.82%	6.93%	2.08%	3.87%
Silver	1.46%	9.44%	5.34%	12.49%
Industrial Metals Sub-Index	-3.10%	-1.77%	13.77%	19.96%
Copper	-3.27%	-2.37%	20.99%	16.45%
Aluminum	-2.37%	2.51%	13.13%	20.01%
Nickel	-3.34%	-4.83%	-7.75%	6.64%
Zinc	-3.77%	-4.83%	15.38%	38.61%
Softs Sub-Index	-0.30%	-4.91%	-17.45%	12.02%
Coffee	0.89%	-1.56%	-13.71%	3.16%
Sugar	0.73%	-8.71%	-27.40%	12.05%
Cotton	0.71%	-2.69%	3.98%	20.36%
Livestock Sub-Index	1.93%	0.89%	26.72%	-2.21%
Cattle	4.17%	7.37%	28.36%	5.18%
Hogs	-1.61%	-8.37%	24.13%	-13.40%

The JPY resumed its role as a risk-off currency. The USD was weaker across the board except for the corruption-affected BRL and the COP. Does the U.S. have a weak-dollar policy now?

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.25%	0.13%	-3.23%	-5.77%
Chinese yuan	0.22%	0.43%	-2.28%	-5.85%
Japanese yen	2.26%	5.62%	-4.11%	0.70%
British pound	1.23%	3.04%	2.72%	-11.53%
Swiss franc	0.36%	0.47%	-1.51%	-3.84%
Canadian dollar	0.55%	1.16%	-1.40%	-3.61%
Australian dollar	1.05%	0.26%	-0.51%	-1.51%
Swedish krona	0.36%	-0.78%	-2.20%	-10.03%
Norwegian krone	0.87%	0.33%	-4.24%	-4.10%
New Zealand dollar	0.82%	1.14%	-1.26%	2.21%
Indian rupee	0.19%	3.41%	3.92%	3.47%
Brazilian real	-0.03%	0.28%	1.10%	11.26%
Mexican peso	0.78%	6.19%	2.63%	-5.81%
Chilean peso	0.92%	2.97%	3.20%	2.22%
Colombian peso	-0.14%	4.55%	1.93%	4.46%
Bloomberg-JP Morgan Asian dollar index (spot)	0.29%	0.91%	-0.64%	-2.36%

Equities remained surprisingly well-bid given the geopolitical stresses and the strong haven bids seen in markets such as the JPY and in UST. There is a hesitance to sell into markets that have not had much more than a short-term pullback for years.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.68%	-1.39%	9.83%	12.52%
North America	-1.03%	-1.18%	10.16%	14.40%
Latin America	-1.53%	2.82%	5.83%	20.57%
Emerging Market Free	-0.09%	2.39%	7.96%	16.69%
EAFE	-0.07%	1.32%	8.23%	9.13%
Pacific	-0.04%	-1.54%	6.04%	11.20%
Eurozone	-1.16%	-0.71%	10.92%	10.71%

The dependence of both CTAs and hedge funds on long equity exposure once again led to losses for both classes of professional traders this past week. One senses a great deal of resistance to return to long sovereign debt positions after the selloff in November-December 2016.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.62%	-1.95%	-4.12%	-10.21%
Newedge Trend	-0.39%	-0.82%	-2.55%	-6.93%
Newedge Short-Term	-0.63%	-0.86%	-6.30%	-10.98%
HFR Global Hedge Fund	-0.14%	0.08%	2.94%	6.31%
HFR Macro/CTA	-0.36%	-0.40%	-2.38%	-4.05%
HFR Macro: Sytematic Diversified CTA	-0.47%	-0.77%	-3.08%	-5.80%