The Macro Environment For Financial Markets

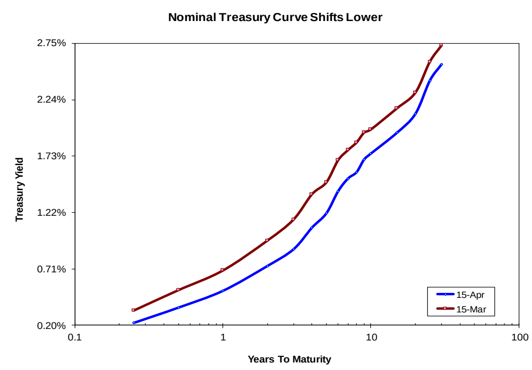
These are not GDP futures we are trading. If they were, we would be struggling at best, and would be at much lower levels. But so long as the policy responses have been what they are, we will continue to reward financial assets over investment in real plant and equipment, pull consumption forward in time, and expand transfer payments. This will have the effect of making populist politics more acceptable, at the inevitable cost of long-term impoverishment. We can continue to meander along this path for a while longer without having the whole thing collapse. China unwittingly showed the fragility of the global system in both August 2015 and January 2016 with its shifts lower in the yuan. Has anyone else noticed how a stable yuan and rising risk-acceptance seem to go hand in hand? What will happen when China's reserve position erodes to the point where they run out of other peoples' money to sell?

The causal chain now is:

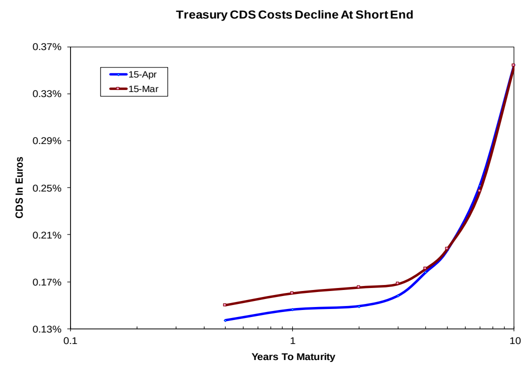
1. The market once again has pushed back the prospects for higher short-term rates in the U.S. ;
2. Disinflationary pressures will persist globally while inflationary pressures are rising in the U.S.;
3. Inflation expectations as measured by TIPS and inflation swaps have established a strong tradable bottom;
4. The U.S. yield curve retains its long-term bias toward flattening;
5. Short-term borrowers are terming out their short-term debt obligations to reduce rollover risk;
6. Swap spreads are moving higher at last; and
7. CDS costs have retreated to resistance levels.

Key Market Indications

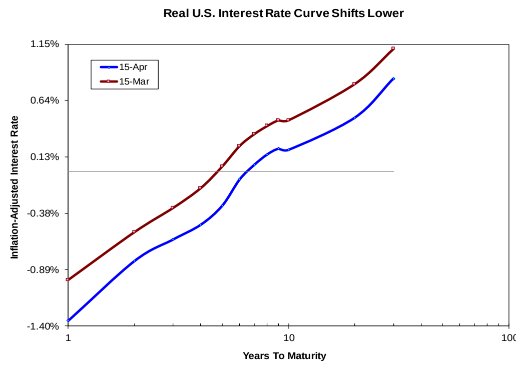
The hardest trade in the world is to stay with a long-running trend, especially when it has moved to a fundamentally ridiculous point. Let's state the obvious: Anyone who is willing to receive the real rates offered on UST should be living in a cabin in Montana. The corollary is that person has been on the right side of the market for years, with no change in sight.



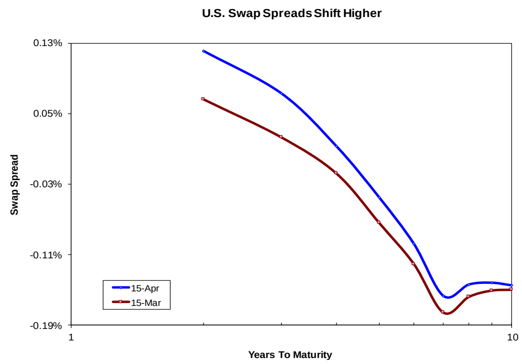
CDS costs for short-term UST continue to drift lower. We should ask ourselves why, in a world awash with negative interest rates where the U.S. is somewhat high-yielding and issues the prime reserve currency, these costs are even this high.



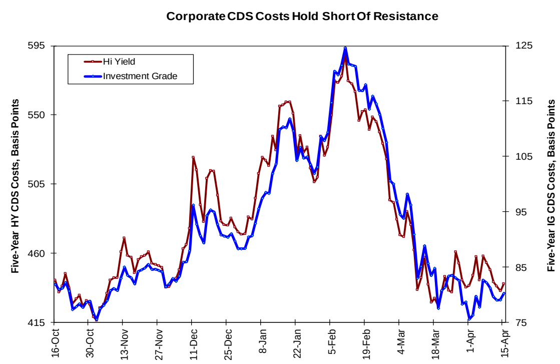
The pseudo-real rate curve shifted lower over the past month and is negative through six years. The strong move lower at the short end of the yield curve is attributable to a large increase in breakevens intersecting with smaller changes in nominal rates. The decline in pseudo-real rates remains positive for precious metals.



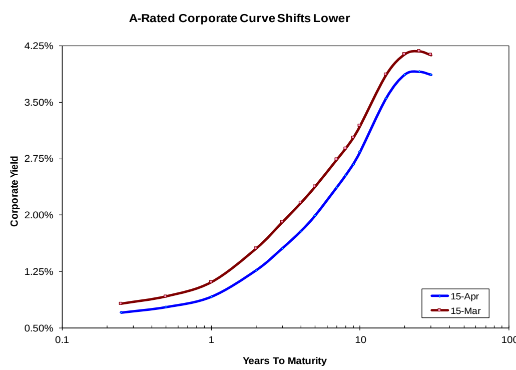
Swap spreads, which rise when floating-rate borrowers want to fix their payments, have shifted higher over the past month and remain inverted. The inversion of this curve is confirmed in the swaption market as well. The belief seems to be that long-term rates will remain constrained even if short-term rates are pushed higher.



Both high-yield and investment-grade CDS indices are holding in front of resistance levels. The combination of expected easier monetary policy in a non-recessionary environment is going to keep these costs suppressed until further notice.



The A-rated corporate yield curve is shifting lower as the search for yield is pushing investors out of UST and into corporate bonds. This advance will continue to support risky assets.



Market Structure

Only Livestock is in a structural downtrend amongst the physical markets; Petroleum remains in an uptrend and was joined there by Grains. Ten-year UST remain in an uptrend, while the dollar index moved into a downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate April 18 - 29
BBerg	17	Transitional	0.142	10.6%	
BBerg Grain	29	Trending	0.187	11.6%	0.12%
BBerg Ind. Metl	28	Trending	0.032	15.4%	
BBerg Pre. Metl	24	Trending	0.087	13.4%	
BBerg Softs	5	Sideways	0.104	18.0%	
BBerg Nat. Gas	11	Transitional	-0.060	27.2%	
BBerg Petroleum	29	Trending	0.088	26.4%	0.30%
BBerg Livestock	29	Trending	-0.211	10.2%	-0.28%
Dollar Index	29	Trending	-0.079	8.9%	-0.10%
S&P 500 Index	10	Sideways	0.104	8.8%	
EAFE Index	17	Transitional	0.219	12.4%	
EM Index	16	Transitional	0.220	11.5%	
Ten-year UST (price)	29	Trending	0.139	4.9%	0.22%

Performance Measures

The key question in the Petroleum index will be if the market can continue to advance even if no production ceiling is reached. If it does, we are in a bull market. The economically sensitive Industrial Metals index is advancing, a confirmation that the world recession fears of this past winter were overblown once again. Grains' advance is probably just the first triumph of hope over experience we will see in this subindex this year.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	1.73%	-0.43%	-10.35%	-20.94%
Grains Sub-Index	3.34%	3.26%	-1.82%	-7.45%
Corn	4.61%	3.29%	-2.89%	-9.87%
Soybeans	4.24%	6.49%	5.18%	0.00%
Wheat	0.16%	-0.46%	-7.73%	-9.18%
Energy Sub-Index	0.80%	-0.72%	-28.14%	-43.04%
Petroleum Sub-Index	1.94%	-0.05%	-25.61%	-42.08%
WTI	1.69%	-1.86%	-31.93%	-47.66%
Brent	2.48%	1.92%	-24.73%	-43.91%
ULSD	2.68%	-1.45%	-26.21%	-43.21%
Gasoline	0.63%	0.76%	-16.70%	-28.90%
Natural Gas	-3.13%	-2.96%	-38.16%	-47.79%
Precious Metals Sub-Index	1.05%	-0.35%	3.45%	1.55%
Gold	-0.74%	-1.64%	4.27%	2.26%
Silver	6.04%	3.19%	0.89%	-0.68%
Industrial Metals Sub-Index	3.69%	-1.43%	-6.91%	-21.62%
Copper	3.23%	-5.63%	-10.82%	-22.96%
Aluminum	2.41%	2.07%	-2.37%	-18.98%
Nickel	4.31%	2.83%	-16.44%	-30.00%
Zinc	6.51%	1.31%	2.60%	-17.65%
Softs Sub-Index	1.69%	-1.15%	-0.51%	-3.74%
Coffee	2.04%	-8.48%	-6.71%	-20.25%
Sugar	1.81%	-6.33%	5.52%	2.63%
Cotton	0.73%	5.86%	-6.22%	-6.44%
Livestock Sub-Index	-2.65%	-6.31%	-7.98%	-10.38%
Cattle	-1.49%	-5.34%	-7.12%	-15.20%
Hogs	-4.01%	-7.46%	-9.50%	-0.72%

The recent pattern of the USD weakening against the majors and gaining against the emerging market currencies broke this week as increasing risk acceptance and a move higher in crude oil contributed to a rally in the EM currencies. The relief rally in these currencies should have incorporated both the rebound in crude oil and the pricing out of an imminent increase in U.S. short-term rates.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.01%	1.58%	-0.90%	5.62%
Chinese yuan	-0.18%	0.60%	-2.00%	-4.18%
Japanese yen	-0.63%	4.06%	9.32%	9.54%
British pound	0.52%	0.36%	-8.13%	-4.31%
Swiss franc	-1.48%	1.99%	-1.79%	-0.35%
Canadian dollar	1.29%	4.16%	0.33%	-4.15%
Australian dollar	2.24%	3.59%	5.40%	0.56%
Swedish krona	0.27%	2.25%	1.27%	7.34%
Norwegian krone	-0.17%	3.60%	-1.86%	-5.16%
New Zealand dollar	1.62%	4.82%	0.98%	-8.86%
Indian rupee	0.02%	0.69%	-2.19%	-6.21%
Brazilian real	1.65%	6.64%	7.57%	-14.25%
Mexican peso	1.27%	1.92%	-6.63%	-12.98%
Chilean peso	2.44%	3.12%	1.12%	-7.49%
Colombian peso	3.10%	5.58%	-3.44%	-16.31%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.06%	1.34%	-0.98%	-3.84%

We are back to a familiar environment for equities: In the absence of news to the contrary, investors will convince themselves the embedded call option will be worth accepting the risk of the embedded short put option. It is either that or stay with grossly overvalued fixed-income investments.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	2.41%	3.51%	0.95%	-3.89%
North America	1.70%	3.62%	3.24%	-0.74%
Latin America	5.91%	12.40%	10.86%	-13.05%
Emerging Market Free	3.69%	7.30%	-1.24%	-16.02%
EAFE	3.61%	3.35%	-2.66%	-8.77%
Pacific	5.49%	4.12%	1.11%	-7.24%
Eurozone	3.44%	1.82%	-4.64%	-10.35%

CTAs had a poor week, which is odd considering there were very few whipsaw reversals in the major markets. Maybe they were just trying too hard? Hedge funds returned to form, gaining during a week of advancing equities.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.32%	1.02%	4.36%	-6.79%
Newedge Trend	-0.71%	1.31%	6.46%	-2.82%
Newedge Short-Term	-0.72%	0.75%	5.22%	-2.82%
HFR Global Hedge Fund	0.36%	0.62%	-2.89%	-8.20%
HFR Macro/CTA	0.25%	0.30%	2.16%	-5.49%
HFR Macro: Sytematic Diversified CTA	-0.07%	1.19%	5.34%	-3.11%