The Macro Environment For Financial Markets

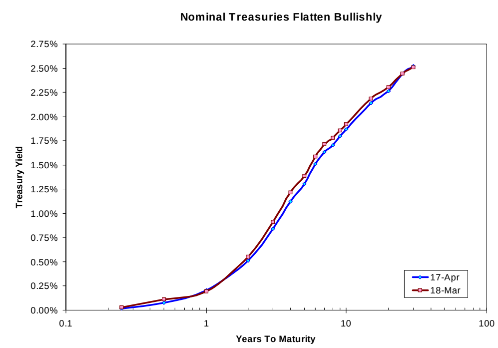
For all of the wasted energy talking about Greece exiting the euro, there has been no talk of putting the country into receivership. The only way the rest of the EMU, the IMF, the ECB and for all I know the KGB and your local PTA are going to get their money back is recognize Greece as a failed state and operate it as such. Bye-bye Grexit; hello spanakopita! An equal amount of verbiage has been spilled on if and when the Federal Reserve is going to raise rates. The answer is the socioeconomic expected loss of getting such a move wrong dwarfs the gains from getting it right, which means they will keep rolling it forward until inflation gets out of hand and then they will find someone to blame for it. I hope you like the term "macroprudential regulation" because you will hear it aplenty in the coming years.

The causal chain continues unchanged:

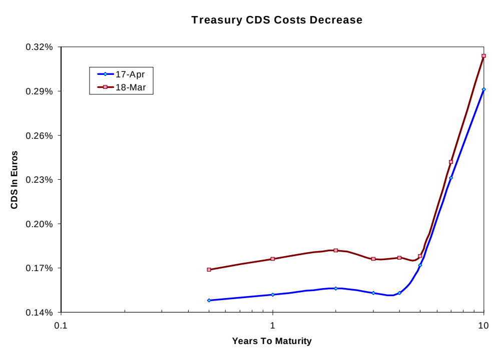
1. Short-term interest rates will remain artificially low globally but will start moving higher in the U.S. at some point;
2. Disinflationary pressures will remain so long as the global banking system remains unable to expand credit;
3. Inflation expectations as measured by the TIPS market have reached their bear market retracement level near 1.95% for ten-year breakevens and may rise up to 2.10%;
4. Sovereign debt yields will remain in their secular bull market;
5. The U.S. yield curve will retain a bias toward flattening;
6. Short-term borrowers will continue to accept rollover risk;
7. Swap spreads will remain tame until monetary policy indications turn more hawkish; and
8. Credit spreads will remain well-confined at historically low levels.

Key Market Indications

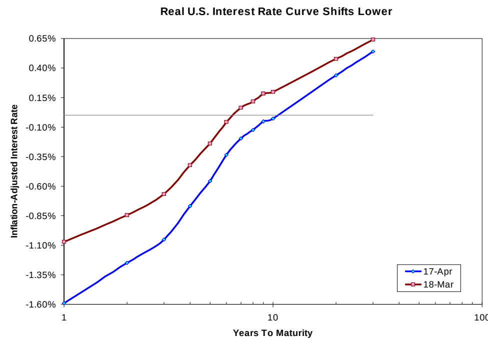
Just as the key question in recent months was why the USD was not even stronger, the key question in the Treasury market is why yields have not fallen even further. The probable answer is foreign buyers are hesitant to assume currency risk along with duration risk until and unless the USD weakens. They then will push Treasury yields lower and the USD higher very quickly until the trade closes.



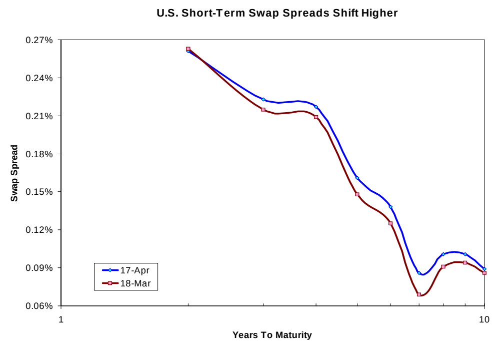
CDS costs moved back down on the week. If we look at some of the Eurozone CDS costs for issuers with negative sovereign debt rates, we find the interesting philosophical question of whether such an issuer could lower its debt service costs by expanding the quantity of bonds issued. If this sounds absurd, it is mathematically true; besides, haven't we seen cases of mortgagors getting paid by their mortgagees in the Eurozone?



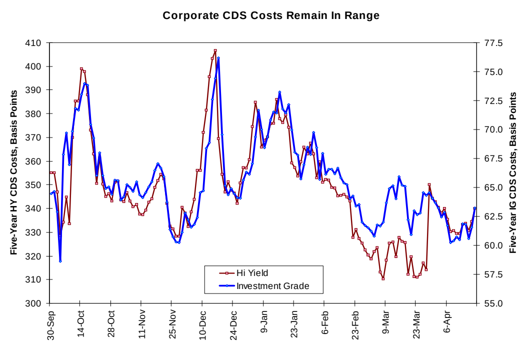
Pseudo-real rates are negative out to ten years. This shift is attributable to rising inflation breakevens being subtracted from stable nominal rates. Their continued decline will support both precious metals and risky financial assets simultaneously.



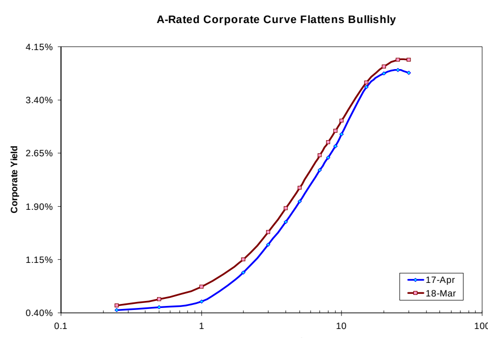
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain strongly inverted as floating-rate payors are willing to stay floating on the long end but are willing to pay to lock in ultralow short-term rates. The small shift higher over the past month is too minor to constitute a major fundamental shift in this market's assessment of interest rate risks.



Both investment-grade and high-yield CDS costs remain in their downward-sloping trading range. The postponement of a rate hike should maintain this downward drift barring a more serious macro shock.



The A-rated yield curve has flattened bullishly over the past month. It should remain less volatile than the UST yield curve. Until this yield curve starts steepening bearishly, it will not present a threat to equity gains.



Market Structure

The main Bloomberg index reversed into a structural uptrend, where it is joined by the Industrial and Precious Metals, Livestock and Petroleum subindices. All the major equity indices are in structural uptrends even after the strong global selloff on Friday.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 20 - 24
BBerg	20	Trending	0.141	10.5%	0.51%
BBerg Grain	29	Trending	-0.129	14.9%	-0.70%
BBerg Ind. Metl	29	Trending	0.095	15.2%	0.17%
BBerg Pre. Metl	23	Trending	0.010	12.4%	0.10%
BBerg Softs	9	Sideways	0.028	15.8%	
BBerg Nat. Gas	29	Trending	-0.066	29.8%	-1.02%
BBerg Petroleum	29	Trending	0.242	30.1%	0.36%
BBerg Livestock	26	Trending	0.004	12.1%	0.01%
Dollar Index	19	Transitional	-0.038	10.7%	
S&P 500 Index	29	Trending	0.009	9.4%	0.28%
EAFE Index	29	Trending	0.121	11.5%	0.16%
EM Index	29	Trending	0.483	11.3%	0.20%
Ten-year UST (price)	8	Sideways	0.066	5.4%	

Performance Measures

The best cure for low prices is low prices; that certainly seems to have been the case in the petroleum markets over the past month. A similar phenomenon is seen in the industrial metals markets; at least gold has the real fundamental of negative short-term real rates going for it. Of course, even the hope of higher prices will be sufficient to keep marginal producers in the game and dampen the potential for sustained, longer-term advances.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	2.36%	2.29%	-12.67%	-26.03%
Grains Sub-Index	-1.05%	-2.92%	-0.79%	-29.42%
Corn	0.54%	-1.56%	3.08%	-29.93%
Soybeans	1.65%	-0.69%	0.46%	-25.22%
Wheat	-6.72%	-7.37%	-5.62%	-33.99%
Energy Sub-Index	6.51%	7.88%	-29.30%	-43.94%
Petroleum Sub-Index	7.06%	12.90%	-29.81%	-43.29%
WTI	6.93%	18.94%	-35.03%	-46.07%
Brent	7.50%	12.09%	-31.82%	-46.51%
ULSD	6.52%	9.46%	-21.01%	-35.63%
Gasoline	6.99%	7.69%	-23.77%	-39.83%
Natural Gas	4.72%	-6.15%	-33.04%	-49.28%
Precious Metals Sub-Index	-0.34%	0.03%	-4.41%	-10.13%
Gold	-0.12%	1.50%	-3.56%	-7.33%
Silver	-0.93%	-3.87%	-7.01%	-18.23%
Industrial Metals Sub-Index	1.35%	-0.10%	-8.12%	-9.46%
Copper	1.25%	0.25%	-7.19%	-8.92%
Aluminum	2.91%	0.66%	-9.47%	-6.82%
Nickel	-0.54%	-12.00%	-18.98%	-31.18%
Zinc	0.13%	7.17%	-0.91%	5.15%
Softs Sub-Index	1.67%	3.07%	-22.43%	-32.95%
Coffee	2.72%	-3.22%	-33.17%	-37.15%
Sugar	3.46%	4.74%	-20.16%	-36.64%
Cotton	-3.22%	0.55%	3.24%	-23.28%
Livestock Sub-Index	-0.85%	0.62%	-15.43%	-12.66%
Cattle	0.13%	-0.98%	-6.25%	13.22%
Hogs	-2.40%	3.29%	-29.96%	-43.00%

The EUR downturn is almost one year old and has been propelled by promises of QE, actual QE and negative interest rates. Those negative rates are causing positive problems in terms of a scarcity of Bunds and a too-exuberant rally in Eurozone equities. On the other side, the USD's rally has been propelled by hollow promises of higher short-term rates, something U.S. short-term interest rate markets find unconvincing. The net result is the USD rally is over for the time being.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.90%	1.97%	-15.32%	-21.78%
Chinese yuan	0.17%	0.84%	-1.17%	0.34%
Japanese yen	1.11%	2.08%	-10.11%	-13.89%
British pound	2.26%	1.44%	-7.03%	-10.91%
Swiss franc	2.84%	5.68%	-0.61%	-7.24%
Canadian dollar	2.61%	4.43%	-7.91%	-10.15%
Australian dollar	1.30%	2.17%	-11.00%	-16.59%
Swedish krona	2.20%	0.59%	-16.86%	-23.56%
Norwegian krone	3.41%	6.13%	-16.44%	-23.57%
New Zealand dollar	1.88%	5.09%	-3.08%	-10.41%
Indian rupee	-0.07%	0.56%	-1.48%	-3.33%
Brazilian real	1.14%	6.54%	-19.91%	-26.44%
Mexican peso	-0.71%	0.26%	-11.82%	-14.92%
Chilean peso	1.22%	4.82%	-4.28%	-9.06%
Colombian peso	0.36%	6.40%	-17.44%	-22.76%
Bloomberg-JP Morgan Asian dollar index (spot)	0.42%	1.55%	-2.09%	-2.34%

Markets allegedly do not discount the same thing twice, although my observation is they are perfectly willing to do so three or more times. EMU equities stopped rallying on negative sovereign rates and on the dumbfounding realization Greece is a deadbeat and an unapologetic one at that. Oh, and I'm shocked – shocked! – to see the Chinese are gambling in their stock markets.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.56%	2.13%	10.86%	8.55%
North America	-0.78%	0.95%	11.10%	13.11%
Latin America	0.18%	10.38%	-15.96%	-17.77%
Emerging Market Free	0.83%	10.09%	7.64%	6.19%
EAFE	-0.22%	4.03%	10.48%	2.03%
Pacific	0.64%	4.54%	15.55%	11.85%
Eurozone	-2.17%	2.06%	7.37%	-4.89%

Both CTAs and macro-oriented hedge funds turned lower as their probable reliance on long equity and long USD positions reversed this week.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.34%	0.37%	21.39%	37.50%
Newedge Trend	-0.53%	0.10%	16.27%	25.03%
Newedge Short-Term	0.07%	-0.95%	6.12%	11.44%
HFR Global Hedge Fund	0.27%	1.41%	4.89%	2.46%
HFR Macro/CTA	-0.33%	-0.23%	8.08%	11.03%
HFR Macro: Sytematic Diversified CTA	-0.39%	-0.02%	10.56%	12.59%