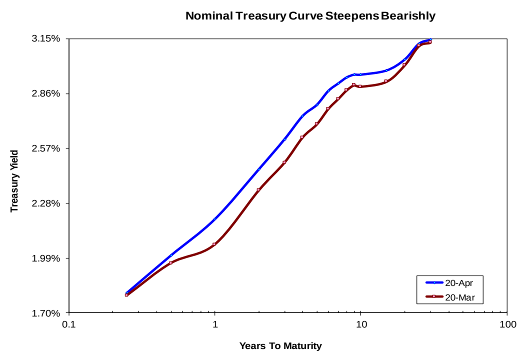
The Macro Environment For Financial Markets

Every now and then stock investors have to remind themselves profits depend on things like selling cigarettes and overpriced smartphones. The indices cannot weather bad news for mega-capitalization stocks very well and with short-term interest rates being pushed higher on seeming autopilot, this will require earnings to rise at an unsustainable rate if the bull market is to continue. Shorter duration of investment horizons is warranted. The causal chain now is:

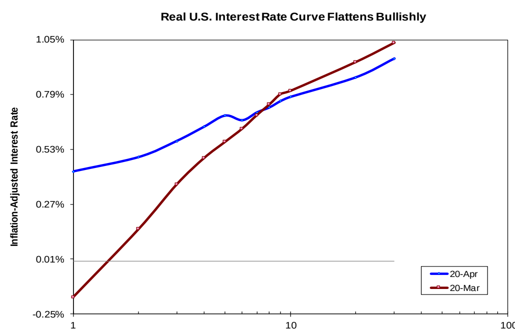
1. The market is pricing in June, September and increasingly December 2018 rate hikes;
2. Inflationary expectations are rising;
3. The yield curve has ended its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap spreads continue to invert bullishly; and
6. CDS costs continue to reflect equity market fluctuations more than credit market conditions.

Key Market Indications

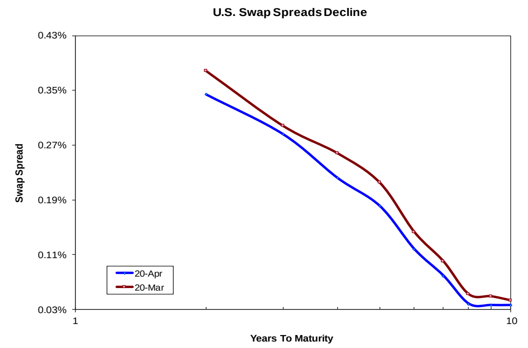
Inflation expectations rose and combined with continued expectations for higher short-term rates to produce year-to-date highs in long-term rates. A market that had returned to a long-term bullish flattening over the past month reversed course into a bearish steepening and looks poised to test 3.05%.



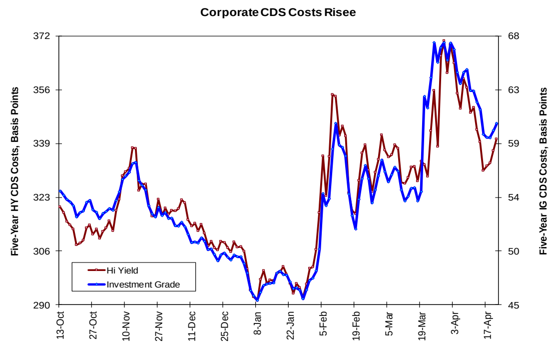
The pseudo-real yield curve continued to shift higher at the short end of the yield curve and decline at the long end. This bullish flattening will support risky assets and should start to be a negative for gold.



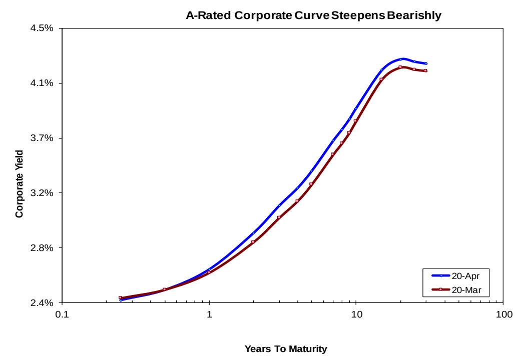
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower even as UST rates rose. This may be an optimistic assessment of how far and how fast UST rates can rise once they start to move higher.



CDS costs continue to reflect movements in equities as correlation trades between stock options and CDS dominate individual issues' credit concerns.



The A-rated corporate yield curve steepened bearishly in line with UST. Rising LIBOR has not posed a threat to this market yet but must be considered a negative given how it affects carrying costs.



Market Structure
Grains joined Softs and Natural Gas in structural downtrends within physical markets. Within financial markets, the dollar index reversed into a downtrend, the dollar index moved into an uptrend while the EM index and ten-year UST joined the S&P 500 in structural downtrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 23 - 27
BBerg	29	Trending	0.245	8.5%	0.04%
BBerg Grain	24	Trending	-0.031	15.6%	-0.06%
BBerg Ind. Metl	29	Trending	0.255	21.5%	0.19%
BBerg Pre. Metl	26	Trending	0.076	10.3%	0.05%
BBerg Softs	29	Trending	-0.231	11.3%	-0.06%
BBerg Nat. Gas	28	Trending	0.000	18.9%	-0.08%
BBerg Petroleum	29	Trending	0.323	17.9%	0.51%
BBerg Livestock	13	Transitional	0.029	18.7%	
Dollar Index	25	Trending	0.095	5.4%	0.03%
S&P 500 Index	29	Trending	-0.004	16.7%	-0.11%
EAFE Index	29	Trending	0.119	9.2%	0.12%
EM Index	29	Trending	-0.127	10.4%	-0.13%
Ten-year UST (price)	29	Trending	-0.257	4.1%	-0.16%

Performance Measures

The run in Industrial Metals continues under a combination of sanctions and prospective tariffs, and the move higher in the Petroleum complex continues under the continued adherence to production ceilings by OPEC and Russia. While none of this reflects monetary conditions, it appears to be eliciting a monetary response in the U.S.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.68%	2.89%	5.72%	8.43%
Grains Sub-Index	-2.32%	0.31%	1.86%	-2.59%
Corn	-2.25%	0.89%	4.11%	-6.56%
Soybeans	-2.29%	0.28%	2.33%	4.26%
Wheat	-2.42%	0.43%	-0.42%	-5.17%
Energy Sub-Index	1.36%	4.36%	14.92%	17.06%
Petroleum Sub-Index	1.77%	4.70%	27.71%	36.96%
WTI	1.80%	4.10%	33.59%	36.10%
Brent	2.01%	5.91%	32.34%	42.66%
ULSD	1.34%	5.30%	20.58%	36.46%
Gasoline	1.63%	3.04%	15.30%	27.16%
Natural Gas	0.14%	3.40%	-17.38%	-27.51%
Precious Metals Sub-Index	0.16%	-0.10%	3.03%	0.85%
Gold	-0.68%	-1.15%	4.05%	3.02%
Silver	3.01%	3.55%	0.09%	-5.13%
Industrial Metals Sub-Index	4.82%	10.05%	7.54%	28.81%
Copper	2.09%	4.93%	-2.16%	21.50%
Aluminum	8.40%	21.83%	16.09%	26.89%
Nickel	6.39%	14.55%	24.83%	57.24%
Zinc	3.84%	0.63%	4.11%	27.09%
Softs Sub-Index	-1.26%	-2.79%	-5.37%	-18.60%
Coffee	-1.47%	-1.11%	-10.23%	-19.07%
Sugar	-2.67%	-5.90%	-13.91%	-30.87%
Cotton	1.69%	2.63%	26.13%	11.63%
Livestock Sub-Index	0.03%	0.29%	-8.51%	-3.57%
Cattle	0.11%	-2.20%	-9.71%	-10.63%
Hogs	-0.09%	4.73%	-7.92%	8.04%

Only the SEK and BRL managed gains this week as the U.S. is diverging to the hawkish side on short-term rates. Both Canada and the U.K. are diverging to the downside.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.35%	0.38%	4.28%	14.66%
Chinese yuan	-0.34%	0.60%	5.15%	9.30%
Japanese yen	-0.29%	-1.05%	5.44%	1.54%
British pound	-1.67%	0.01%	6.14%	9.26%
Swiss franc	-1.27%	-1.86%	0.99%	2.47%
Canadian dollar	-1.20%	2.43%	-1.05%	5.55%
Australian dollar	-1.19%	-0.14%	-1.85%	1.93%
Swedish krona	0.33%	-2.65%	-3.36%	6.40%
Norwegian krone	-0.61%	-0.98%	2.04%	10.25%
New Zealand dollar	-2.15%	0.32%	3.50%	2.80%
Indian rupee	-1.35%	-1.38%	-1.62%	-2.34%
Brazilian real	0.28%	-2.99%	-6.44%	-7.80%
Mexican peso	-2.62%	1.29%	2.52%	1.40%
Chilean peso	-0.25%	2.45%	5.53%	8.98%
Colombian peso	-1.72%	4.00%	6.43%	3.34%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.29%	0.11%	3.56%	5.69%

The question of which will dominate, higher earnings or higher short-term interest rates, will be answered in favor of higher short-term interest rates eventually. In the meantime, the general return to risk-seeking behavior dominates.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.57%	3.40%	4.61%	16.79%
North America	0.60%	-1.39%	4.47%	15.27%
Latin America	0.24%	0.86%	5.30%	19.78%
Emerging Market Free	-0.13%	-3.25%	5.20%	25.08%
EAFE	0.53%	1.81%	4.10%	18.64%
Pacific	0.55%	2.45%	5.31%	17.46%
Eurozone	0.81%	2.60%	3.56%	22.19%

Both CTAs and hedge funds managed gains during a second positive week for equities. The trend toward higher bond yields should provide easy returns for aggressive hedge funds, but this has yet to materialize.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.91%	1.89%	1.68%	3.04%
Newedge Trend	0.57%	1.67%	1.25%	2.04%
Newedge Short-Term	0.19%	-0.09%	0.65%	-0.19%
HFR Global Hedge Fund	0.54%	0.07%	1.01%	4.32%
HFR Macro/CTA	0.67%	0.78%	0.78%	2.95%
HFR Macro: Sytematic Diversified CTA	0.59%	2.16%	3.29%	5.72%