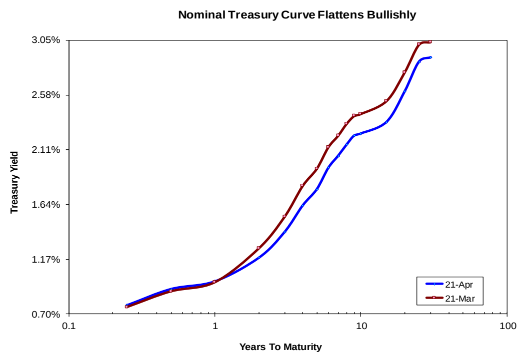
The Macro Environment For Financial Markets

If and when the U.S. adopts a consistent fiscal policy, will it be a case of buy the rumor and sell the news? We may not get the answer for months, but that tease will keep risky assets bid regardless of topline economic growth. We are returning to the familiar environment of high levels of risk aversion for some investors transfer gains to risk-seeking investors. The causal chain is:

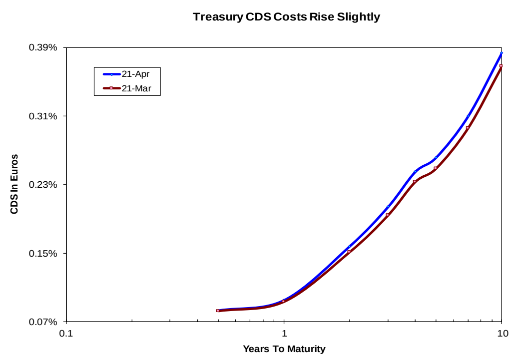
1. The market still is pricing in higher short-term rates in 2017, but the conviction level is declining;
2. Inflationary expectations are declining;
3. The U.S. yield curve continues in its secular flattening trend;
4. Short-term borrowers are close to terming out short-term debt into the bond market;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

Key Market Indications

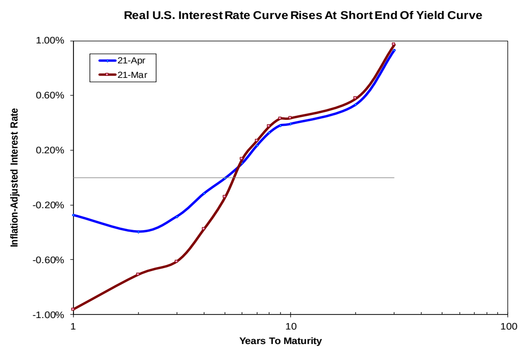
The flattening of the yield curve, which had been driven by higher short-term rates, is being driven now by lower long-term rates. As long as central banks own the long end and cannot liquidate their portfolios, long-term rates will not rise until and unless fiscal policy turns strongly stimulative.



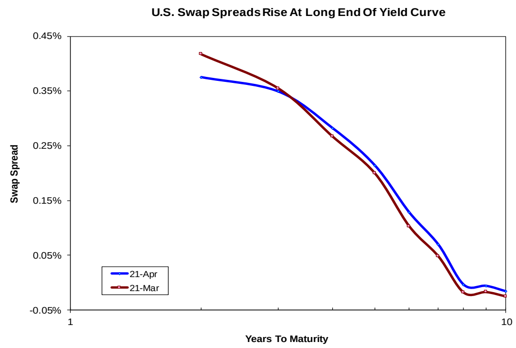
CDS costs on UST have moved very slightly higher. The idle chatter about a debt ceiling impasse is just that for now; it is doubtful Congress would want to look so incompetent twice in two months.



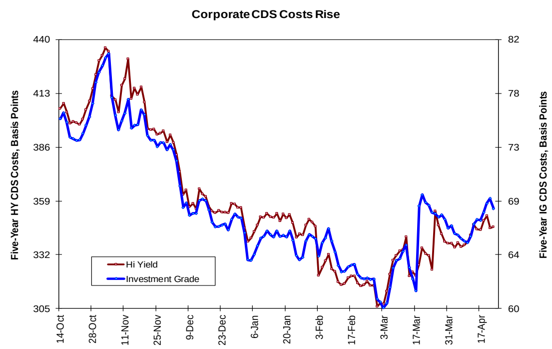
The pseudo-real yield curve shifted higher at the short end of the yield curve. This did not push precious metals lower as gold is being held as insurance against political risk right now.



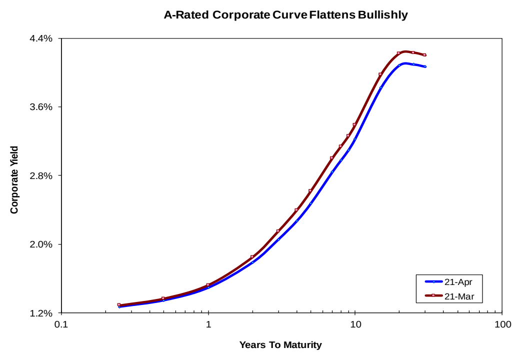
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower at the short end of the yield curve and slightly higher at the long end of the yield curve. All of the action over the winter to become floating-rate receivers and fixed-rate payors did what responses to credible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



CDS costs moved higher, but not markedly so. 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 continue to stabilize other risky assets.



Market Structure

The main Bloomberg index moved into a downtrend as the energy markets exited their structural uptrends. The dollar index remains in a downtrend and ten-year UST remain in an uptrend amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 24 - 28
BBerg	21	Trending	-0.189	7.4%	-0.07%
BBerg Grain	15	Transitional	-0.128	12.4%	
BBerg Ind. Metl	27	Trending	-0.196	15.5%	-0.10%
BBerg Pre. Metl	29	Trending	0.200	9.4%	0.11%
BBerg Softs	10	Sideways	-0.111	17.5%	
BBerg Nat. Gas	29	Trending	-0.025	21.7%	
BBerg Petroleum	29	Trending	-0.071	17.8%	
BBerg Livestock	19	Transitional	0.122	10.4%	
Dollar Index	29	Trending	-0.062	5.5%	-0.04%
S&P 500 Index	16	Transitional	-0.020	7.3%	
EAFE Index	8	Sideways	-0.009	6.0%	
EM Index	5	Sideways	0.048	6.6%	
Ten-year UST (price)	29	Trending	0.213	4.6%	0.10%

Performance Measures

The entire Energy complex reversed last week's gain; how many times can OPEC fail and still command attention? The economically sensitive Industrial Metals continue to move lower and were joined by strong downturns in Softs, Grains and Livestock.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-2.76%	-0.67%	-2.33%	1.47%
Grains Sub-Index	-3.05%	-1.85%	-4.61%	-13.18%
Corn	-3.75%	0.17%	-1.84%	-12.44%
Soybeans	-0.55%	-2.63%	-6.96%	-5.35%
Wheat	-4.89%	-3.75%	-5.16%	-24.84%
Energy Sub-Index	-5.72%	1.75%	-8.47%	0.79%
Petroleum Sub-Index	-6.67%	2.63%	-7.08%	0.30%
WTI	-7.33%	2.83%	-8.54%	-2.63%
Brent	-6.95%	2.57%	-6.31%	2.46%
ULSD	-6.03%	3.19%	-6.22%	6.83%
Gasoline	-5.54%	1.91%	-6.28%	-3.94%
Natural Gas	-3.12%	-0.69%	-12.34%	2.94%
Precious Metals Sub-Index	-0.90%	2.42%	1.28%	3.72%
Gold	0.06%	3.05%	1.47%	3.64%
Silver	-3.47%	0.71%	0.73%	3.85%
Industrial Metals Sub-Index	-1.01%	-3.83%	13.88%	14.27%
Copper	-1.34%	-3.55%	20.36%	10.38%
Aluminum	1.24%	-0.60%	17.64%	14.51%
Nickel	-4.17%	-5.45%	-8.24%	1.15%
Zinc	-1.51%	-8.96%	10.92%	33.42%
Softs Sub-Index	-1.42%	-5.02%	-18.05%	4.63%
Coffee	-5.89%	-4.92%	-20.09%	-1.55%
Sugar	-0.34%	-6.73%	-28.56%	3.72%
Cotton	3.66%	0.44%	10.60%	19.20%
Livestock Sub-Index	-1.04%	-1.66%	19.08%	-1.05%
Cattle	1.76%	3.48%	22.09%	13.66%
Hogs	-5.74%	-9.75%	14.35%	-20.14%

The GBP rallied on the news of a snap election; more interesting, though, was the ability of the EUR to gain before the French election. The USD gained against the main commodity-linked and emerging market currencies in what looked to be a risk-off move.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	1.04%	-0.77%	-1.43%	-4.96%
Chinese yuan	-0.01%	0.02%	-1.73%	-5.86%
Japanese yen	-0.41%	2.40%	-4.85%	0.34%
British pound	2.35%	2.72%	4.77%	-10.51%
Swiss franc	0.92%	-0.24%	-0.26%	-2.12%
Canadian dollar	-1.28%	-1.08%	-1.23%	-5.65%
Australian dollar	-0.50%	-1.95%	-0.88%	-2.55%
Swedish krona	0.51%	-2.18%	-0.88%	-9.50%
Norwegian krone	-0.99%	-2.33%	-4.86%	-5.39%
New Zealand dollar	0.34%	-0.28%	-1.94%	1.59%
Indian rupee	-0.31%	1.03%	3.52%	2.76%
Brazilian real	-0.10%	-2.38%	-0.17%	12.15%
Mexican peso	-1.54%	1.53%	-1.15%	-7.13%
Chilean peso	-0.42%	1.01%	2.12%	1.93%
Colombian peso	-0.41%	1.37%	1.90%	2.21%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.07%	0.11%	-0.53%	-2.66%

Equities have an underlying strength and continue to benefit whenever sovereign yields decline. No one with long-dated liabilities can meet the obligations in any other asset class.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.57%	0.07%	9.23%	12.07%
North America	0.76%	0.41%	10.51%	14.60%
Latin America	-0.02%	0.55%	1.60%	19.12%
Emerging Market Free	0.17%	-0.95%	6.46%	15.72%
EAFE	0.23%	-0.56%	7.95%	7.20%
Pacific	0.76%	-0.45%	5.97%	10.63%
Eurozone	0.53%	-0.74%	9.65%	9.12%

The bad returns just keep coming for professional traders, which means AUM will just keep going. CTAs tend to react badly to the start of downtrends in physical markets, and macro hedge funds have been slow to embrace declining yields once again.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.75%	-2.97%	-5.25%	-9.85%
Newedge Trend	-0.53%	-1.63%	-3.48%	-6.81%
Newedge Short-Term	0.14%	-1.00%	-5.63%	-11.47%
HFR Global Hedge Fund	0.17%	0.01%	2.86%	5.54%
HFR Macro/CTA	-0.30%	-0.69%	-2.18%	-4.70%
HFR Macro: Sytematic Diversified CTA	-0.50%	-1.40%	-2.93%	-6.49%