The Macro Environment For Financial Markets

There is nothing in our armamentarium strong enough to clobber those who reprise their own version of too fast, too furious every month following the release of the employment situation report. Last month we were told it iced the case for a brutal rate hike, all the way to 0.50%, by June or mid-year, whichever came first. Then the FOMC said not so fast and not so furious; this was followed by the poor employment situation report for March. Hiring slowed after strong gains and in the face of a collapsing energy industry and headwinds from a stronger dollar; who could have seen that coming? Mind you, none of this is amenable to a monetary policy response. To attribute previous employment gains to massive stimulus begun six years ago is to engage in cargo-cult thinking and think any 25-bp twitch here or there will derail skilled labor demand in certain industries is equally silly. Worse, a poorly timed rate hike could upend financial markets, lead to wealth destruction and solve the “problem” of low unemployment swiftly and decisively in a way no one would want.

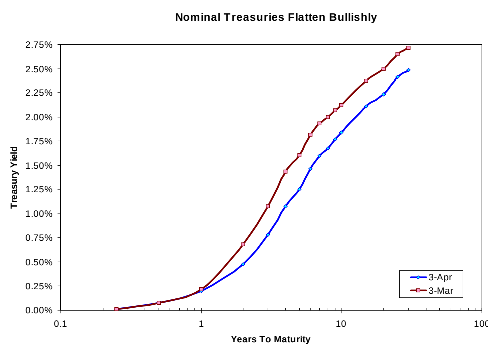
The causal chain continues unchanged:

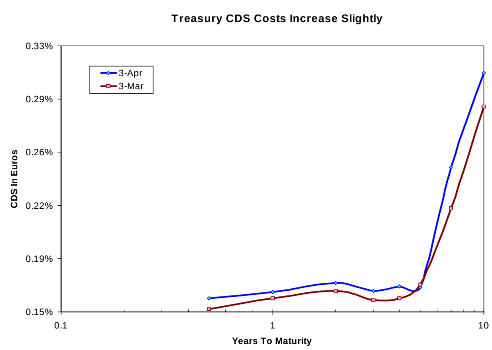
1. Short-term interest rates will remain artificially low globally but will start moving higher in the U.S. at some point;
2. Disinflationary pressures will remain so long as the global banking system remains unable to expand credit;
3. Inflation expectations as measured by the TIPS market will remain confined as the demand for inflation protection will recede in a more risk-seeking environment;
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

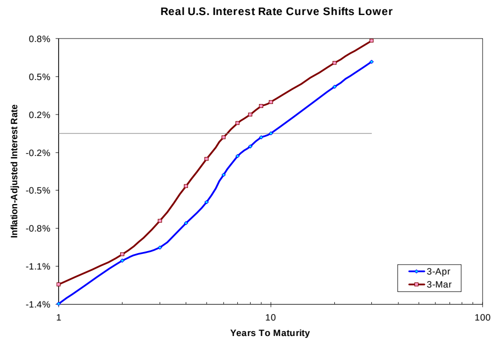
It is amusing to hear the inside-baseball of the bond market with its talk of negative repo rates, prepayment risk in mortgage-backed securities, extension risk, the FOMC’s dot-plots to amuse the easily distracted and the like. I go back to a sign on a brokerage house board in the late 1980s: “Bonds are bullish. Look at the monthly chart.” That was more than a quarter-century ago and still that admonition to keep it simple, stupid, remains sound.

This market continues to remain uninteresting. I guess we can add manufactured crises to the things we do not make in the U.S. anymore.

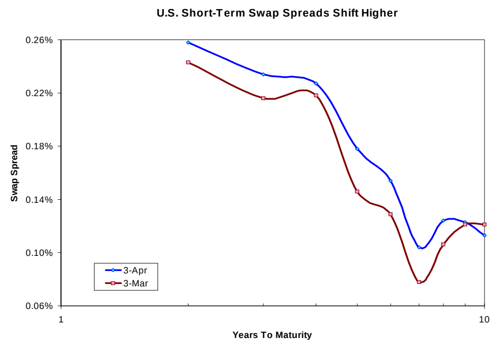




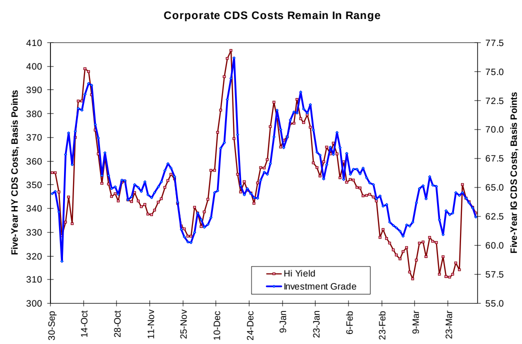
Pseudo-real rates are negative out to nine years; this is something associated more with the start of one of our dearly departed QE programs that with talk of a stronger economy. This downward shift will continue to support both precious metals and risky financial assets simultaneously.



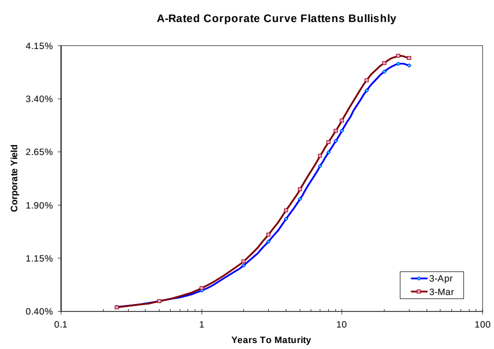
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain strongly inverted as floating-rate payors are willing to stay floating on the long end but are willing to pay to lock in ultralow short-term rates. The small shift higher in the term structure over the past month reflects the timing of the two most recent employment situation reports and carries no great import.



Both investment-grade and high-yield CDS costs retreated and 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

While the main Bloomberg index and the energy subindices remain in structural downtrend, Grains and both Industrial and Precious Metals have entered uptrends. Both the EAFE and EM indices moved into uptrends by the end of the week.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate Apr. 6 - 10
BBerg	29	Trending	-0.039	11.9%	-0.44%
BBerg Grain	28	Trending	0.086	15.9%	0.24%
BBerg Ind. Metl	29	Trending	0.036	15.3%	0.17%
BBerg Pre. Metl	29	Trending	0.123	13.2%	0.27%
BBerg Softs	12	Transitional	0.048	17.8%	
BBerg Nat. Gas	20	Trending	-0.010	75.7%	-1.02%
BBerg Petroleum	29	Trending	-0.117	30.0%	-1.11%
BBerg Livestock	26	Trending	0.069	13.9%	
Dollar Index	12	Transitional	-0.023	16.1%	
S&P 500 Index	13	Transitional	-0.057	10.2%	
EAFE Index	20	Trending	0.071	12.4%	0.16%
EM Index	29	Trending	0.239	9.6%	0.20%
Ten-year UST (price)	29	Trending	0.140	6.2%	0.13%

Performance Measures

Maybe there is too much of everything in the physical commodity world and maybe demand growth is going to be slow, but with the exception of the Petroleum markets, prices are finding some support. Even corn managed to stay afloat after a bearish Planting Intentions report. However, we should be aware any and all rallies are occurring in the context of a three year-long secular bear market in physical commodities. All rallies are suspect and should be viewed as selling opportunities.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.34%	-2.34%	-15.51%	-25.73%
Grains Sub-Index	1.46%	0.24%	9.21%	-25.83%
Corn	-1.15%	-1.15%	13.26%	-29.31%
Soybeans	1.94%	-2.59%	5.99%	-21.44%
Wheat	5.61%	5.98%	8.98%	-26.30%
Energy Sub-Index	-0.16%	-7.27%	-39.90%	-45.88%
Petroleum Sub-Index	-1.13%	-9.14%	-42.20%	-47.43%
WTI	0.55%	-6.40%	-47.01%	-50.26%
Brent	-1.88%	-10.52%	-44.42%	-51.11%
ULSD	-1.95%	-11.45%	-33.16%	-40.23%
Gasoline	-1.98%	-9.36%	-36.72%	-42.51%
Natural Gas	2.81%	-1.38%	-37.01%	-44.70%
Precious Metals Sub-Index	-0.54%	0.40%	0.11%	-9.30%
Gold	0.02%	-0.38%	0.45%	-6.83%
Silver	-2.04%	2.60%	-1.20%	-16.65%
Industrial Metals Sub-Index	-0.46%	1.22%	-9.84%	-8.07%
Copper	-1.21%	2.92%	-8.65%	-9.48%
Aluminum	-0.03%	-0.82%	-8.29%	-6.81%
Nickel	-1.99%	-4.88%	-21.99%	-21.49%
Zinc	2.31%	4.95%	-6.86%	5.07%
Softs Sub-Index	3.06%	-0.72%	-22.49%	-30.92%
Coffee	1.95%	8.60%	-34.46%	-26.21%
Sugar	5.03%	-5.28%	-22.29%	-40.80%
Cotton	0.22%	0.10%	3.80%	-22.33%
Livestock Sub-Index	0.51%	2.99%	-14.62%	-11.99%
Cattle	0.26%	7.34%	-2.25%	14.00%
Hogs	0.93%	-3.96%	-33.39%	-42.84%

The currency markets identified the Federal Reserve's hesitance to push short-term interest rates higher early on in 2015 and effectively embedded a short call option on the USD. However, nothing suggests the next move of significance for the USD is lower; we simply are entering a broad trading range until the next round of speculation on higher short-term rates in the U.S. begins.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.82%	-1.77%	-12.29%	-19.99%
Chinese yuan	0.34%	1.30%	-0.89%	0.27%
Japanese yen	0.13%	0.64%	-7.74%	-12.64%
British pound	0.23%	-2.92%	-6.64%	-10.15%
Swiss franc	0.92%	0.87%	1.52%	-6.52%
Canadian dollar	1.05%	0.14%	-9.89%	-11.56%
Australian dollar	-1.47%	-2.29%	-11.95%	-17.27%
Swedish krona	0.48%	-3.18%	-14.84%	-23.46%
Norwegian krone	0.47%	-2.84%	-17.79%	-24.37%
New Zealand dollar	0.34%	0.58%	-2.19%	-11.12%
Indian rupee	-0.40%	-1.01%	-1.18%	-4.17%
Brazilian real	1.93%	-7.28%	-20.11%	-27.35%
Mexican peso	2.88%	1.26%	-8.92%	-11.44%
Chilean peso	1.26%	0.33%	-2.87%	-9.46%
Colombian peso	-0.32%	-0.47%	-20.99%	-23.36%
Bloomberg-JP Morgan Asian dollar index (spot)	1.03%	1.03%	-1.33%	-1.68%

Anyone looking to sell equities on the back of a weak U.S. jobs report should consider the past month of poor performance following a strong jobs report. The combination of low short-term rates and a softer USD along with incredibly overpriced fixed-income alternatives will keep a bid under U.S. equities in general and non-U.S. equities in particular.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.38%	-1.21%	6.03%	6.27%
North America	0.63%	-2.02%	6.59%	10.53%
Latin America	4.64%	-2.40%	-16.86%	-18.79%
Emerging Market Free	3.20%	0.65%	0.87%	1.63%
EAFE	0.21%	0.68%	5.69%	0.34%
Pacific	-0.43%	1.26%	8.93%	8.03%
Eurozone	1.07%	2.06%	5.88%	-3.73%

Considering most CTAs are trend-followers, it is somewhat unusual to see a positive week for the equal-weighted index and declines for both trend-followers and short-term traders. This suggests discretionary traders have exited the long-term prevailing trends of the past three quarters and are setting new positions.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.79%	2.47%	20.13%	36.34%
Newedge Trend	-0.27%	1.59%	15.15%	24.74%
Newedge Short-Term	-0.55%	-0.84%	7.75%	11.05%
HFR Global Hedge Fund	0.19%	0.27%	0.78%	0.10%
HFR Macro/CTA	-0.14%	0.38%	6.04%	9.57%
HFR Macro: Sytematic Diversified CTA	0.33%	1.05%	9.29%	10.86%