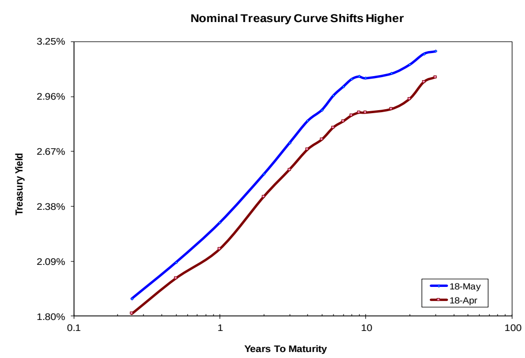
The Macro Environment For Financial Markets

You know when you are getting old when you cannot remember how many Argentinean defaults you have seen. Events here and in Turkey are going to force the Federal Reserve to stand down from continuous rate hikes. With the world's commercial banks laden with USD liabilities, what other choice will they have? The causal chain now is:

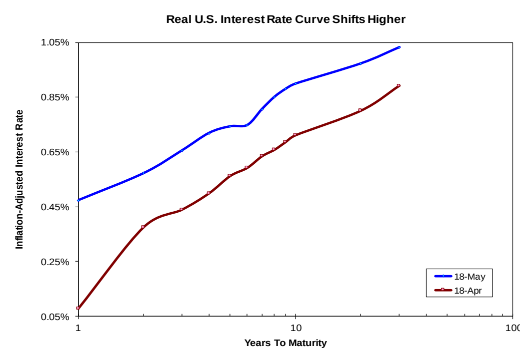
1. The market is pricing in June, September and increasingly December 2018 rate hikes;
2. Inflationary expectations have stopped rising;
3. The yield curve has paused in its flattening trend;
4. Short-term borrowers are accepting rollover risk rather than term-out borrowing in the bond market;
5. Swap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

Key Market Indications

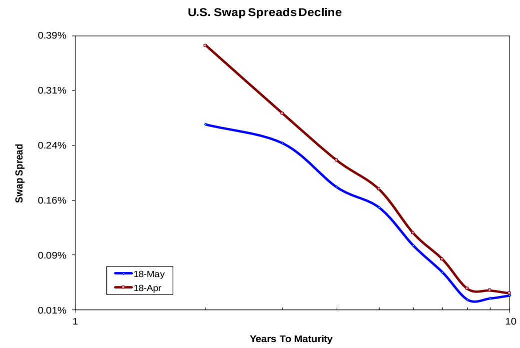
The ten-year UST finally broke support at 3.05%. However, with inflation expectations quiescent and with markets starting to price in an end to rate hikes after 2018, there really was no follow-through and no collateral damage in other markets.



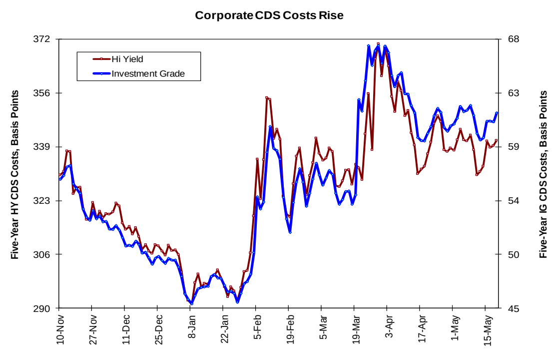
The pseudo-real yield curve continued to shift higher at the short end of the yield curve. This is a major negative fundamental for gold. However, the rise at the long end of the yield curve will start to be a negative for risky assets.



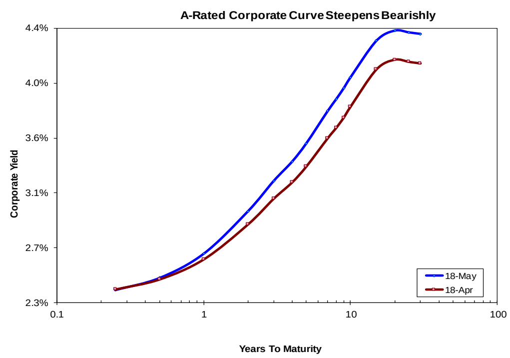
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower across all tenors, but especially at the short end of the yield curve. This is consistent with rate hikes ending in 2018.



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 once again steepened bearishly. This is a direct result of higher short-term borrowing costs lowering the carry into the long end of the yield curve. Traders who once sought yield are starting to get paid to wait.



Market Structure

Grains, Natural Gas and Petroleum are in structural uptrends within the financials while Precious Metals and Livestock are in downtrends. Ten-year UST moved into a structural downtrend in the financials while the S&P 500 moved into an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate May 21 - 25
BBerg	16	Transitional	0.087	7.1%	
BBerg Grain	29	Trending	0.053	12.2%	0.13%
BBerg Ind. Metl	18	Transitional	0.037	15.5%	
BBerg Pre. Metl	29	Trending	-0.224	9.3%	-0.43%
BBerg Softs	14	Transitional	0.042	11.9%	
BBerg Nat. Gas	29	Trending	0.144	17.8%	0.11%
BBerg Petroleum	29	Trending	0.277	18.8%	0.34%
BBerg Livestock	28	Trending	-0.375	12.8%	-0.18%
Dollar Index	7	Sideways	0.099	6.1%	
S&P 500 Index	29	Trending	0.108	11.7%	0.10%
EAFE Index	26	Trending	0.023	6.5%	0.06%
EM Index	9	Sideways	-0.111	10.9%	
Ten-year UST (price)	29	Trending	-0.225	3.7%	-0.33%

Performance Measures

The Energy markets continue to move higher as the combination of rising global demand, OPEC discipline and the political situations in Iran and Venezuela are offsetting rising shale production. Higher short-term implied real interest rates are pushing Precious Metals lower.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.45%	0.77%	5.37%	8.15%
Grains Sub-Index	1.59%	2.67%	6.37%	-1.75%
Corn	1.55%	4.56%	9.16%	-4.53%
Soybeans	-0.44%	-3.88%	-1.53%	0.97%
Wheat	3.95%	8.75%	11.44%	-0.32%
Energy Sub-Index	1.79%	5.52%	15.16%	21.45%
Petroleum Sub-Index	1.74%	6.47%	24.73%	43.88%
WTI	1.01%	4.83%	28.22%	40.61%
Brent	2.14%	7.72%	30.59%	51.21%
ULSD	2.01%	7.15%	19.21%	44.01%
Gasoline	2.08%	6.54%	12.76%	34.91%
Natural Gas	1.95%	2.68%	-10.62%	-27.45%
Precious Metals Sub-Index	-2.12%	-3.63%	-0.69%	0.90%
Gold	-2.23%	-3.42%	0.32%	2.28%
Silver	-1.74%	-4.31%	-3.71%	-3.12%
Industrial Metals Sub-Index	0.29%	-3.86%	4.65%	22.77%
Copper	-1.51%	-2.78%	-3.21%	16.65%
Aluminum	-0.40%	-7.42%	10.53%	16.96%
Nickel	4.95%	-0.53%	24.16%	56.27%
Zinc	0.72%	-3.98%	-2.01%	20.47%
Softs Sub-Index	1.71%	0.63%	-9.36%	-16.88%
Coffee	-1.14%	0.40%	-9.23%	-18.31%
Sugar	3.96%	-1.63%	-21.08%	-31.50%
Cotton	2.32%	2.29%	23.26%	13.62%
Livestock Sub-Index	-3.56%	-2.60%	-10.13%	-15.37%
Cattle	-5.90%	-3.04%	-13.72%	-19.36%
Hogs	0.39%	-2.01%	-4.75%	-9.70%

The USD gained strongly against everything but the CHF, with the gains being especially strong against the Latin currencies. Much of this USD rally is making up for its 2017 weakness when it was assumed the rest of the major central banks would tighten along with the Federal Reserve.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-1.43%	-4.87%	0.33%	6.03%
Chinese yuan	-0.72%	-1.66%	4.03%	7.98%
Japanese yen	-1.25%	-3.20%	1.66%	0.64%
British pound	-0.54%	-5.17%	1.77%	4.10%
Swiss franc	0.18%	-2.94%	-0.46%	-1.81%
Canadian dollar	-0.70%	-1.98%	-0.50%	5.57%
Australian dollar	-0.42%	-3.51%	-0.52%	1.24%
Swedish krona	-1.74%	-3.98%	-3.07%	0.61%
Norwegian krone	-1.45%	-4.42%	2.10%	4.51%
New Zealand dollar	-0.89%	-5.63%	1.44%	0.12%
Indian rupee	-0.99%	-3.45%	-4.29%	-4.65%
Brazilian real	-3.67%	-9.56%	-12.85%	-9.68%
Mexican peso	-2.65%	-9.36%	-4.80%	-5.59%
Chilean peso	-2.66%	-6.61%	0.11%	6.03%
Colombian peso	-2.99%	-7.29%	3.11%	0.10%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.53%	-1.77%	1.50%	4.01%

Equities can survive the gradual move higher in long-term rates, but the inexorable rise in short-term rates is going to present problems, not only through higher borrowing costs but through a stronger USD.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.42%	1.39%	4.98%	14.66%
North America	-0.40%	0.49%	6.08%	17.00%
Latin America	-5.87%	-12.35%	-0.84%	12.95%
Emerging Market Free	-2.25%	-3.12%	1.04%	18.10%
EAFE	-0.45%	-0.11%	5.09%	13.04%
Pacific	-0.12%	1.27%	4.72%	17.34%
Eurozone	-1.09%	-0.81%	3.69%	10.21%

Both CTAs and hedge funds rose for a second week despite general downturns in equity markets. The CTA gains suggest continued long position in the USD and in energy markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.22%	1.74%	1.53%	5.13%
Newedge Trend	0.83%	0.56%	0.24%	2.14%
Newedge Short-Term	0.81%	2.17%	2.27%	1.33%
HFR Global Hedge Fund	0.44%	0.20%	1.36%	3.99%
HFR Macro/CTA	1.44%	2.28%	2.41%	4.97%
HFR Macro: Sytematic Diversified CTA	1.76%	2.43%	3.51%	8.26%