The Macro Environment For Financial Markets

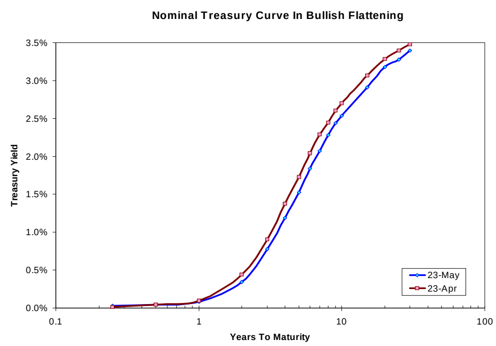
Markets collectively realized U.S. tapering has not been credit-tightening and that the Eurozone, Japan and China all are poised to loosen further. This will combine with some marginally better U.S. economic data to push the USD higher against the major currencies and induce a flow of global liquidity into the U.S. This is bullish, pure and simple, and the trend will continue until someone decides not to simply stand there but to do something foolish. Until such time, the course of the dollar will remain the best single indicator for risk-acceptance.

The causal chain is now:

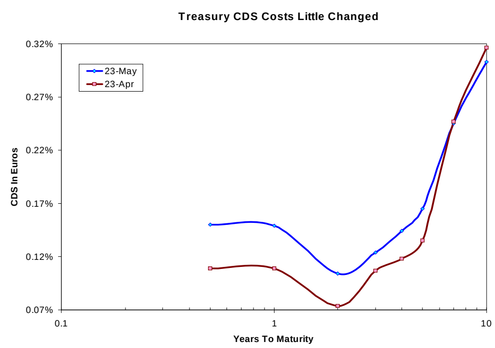
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve. Rising levels of risk-aversion will push real long-term rates lower;
2. Nominal long-term rates will pause but not reverse in their downtrends;
3. Inflation expectations as measured by the TIPS market will remain confined in the year-long range;
4. Short-term borrowers will continue to accept rollover risk and keep their effective maturities as short as possible;
5. Swap spreads will remain low at longer tenors but will be biased toward rising at shorter tenors as there is little room for these rates to decline; and
6. Credit spreads will continue their downward trend as investors reluctantly increase their levels of risk acceptance

Key Market Indications

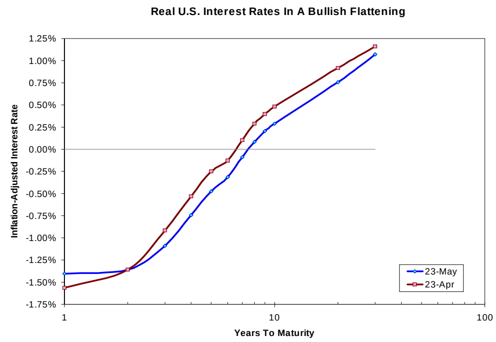
The Treasury yield curve's bullish flattening stalled in front of resistance at the long end of the yield curve. The longer-term trend toward a bullish flattening remains intact.



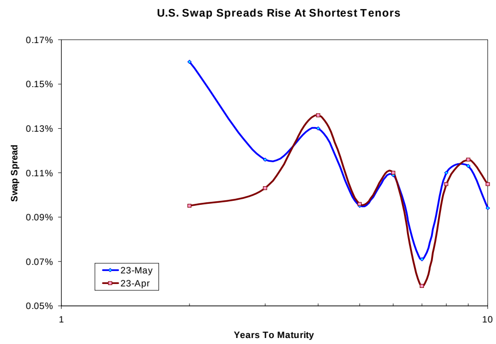
Euro-denominated CDS costs on U.S. Treasuries increased slightly at short-dated tenors over month-ago levels, but the changes are minor.



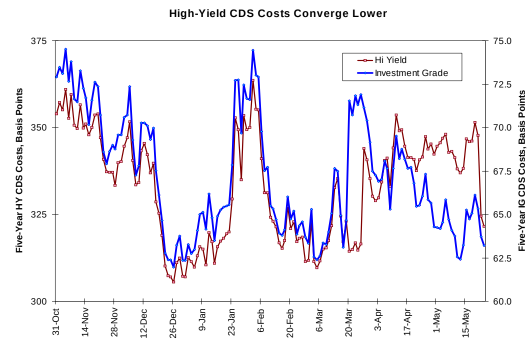
Real rates remain negative out to the seven-year horizon. Levels of risk-aversion as evidenced by higher short-term and lower long-term real rates have declined over the past month. The combination is negative for precious metals and supportive for risky financial assets.



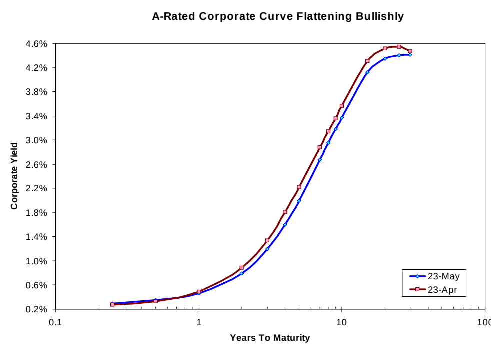
Swap spreads, which rise when floating-rate borrowers want to fix their payments, increased at the one- and two-year tenors as floating-rate borrowers realize there is little room for these yields to decline.



Five-year CDS costs for high-yield bonds shifted lower as improved housing-related data lowered perceived economic credit risk. This is bullish for equities.



The A-rated yield curve has moved similarly to the Treasury yield curve. The pause in the bullish flattening of this yield curve does not represent a trend reversal.



Market Structure

Both Treasuries and the S&P 500 remain in uptrends, and are joined by the dollar index. The physical commodity indices are in weak and divergent trends with Grains, Softs and Natural Gas in downtrends and Petroleum, Livestock and Industrial Metals in uptrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For May 26-30
DJ-UBS	5	Sideways	0.005	5.3%	
DJ-UBS Grain	29	Trending	-0.177	14.6%	-0.36%
DJ-UBS Ind. Metl	20	Trending	0.132	12.3%	0.20%
DJ-UBS Pre. Metl	21	Trending	-0.019	12.1%	
DJ-UBS Softs	29	Trending	-0.200	19.0%	-0.30%
DJ-UBS Nat. Gas	29	Trending	-0.277	20.3%	-0.41%
DJ-UBS Petroleum	21	Trending	0.246	8.9%	0.04%
DJ-UBS Livestock	29	Trending	0.106	8.7%	0.24%
Dollar Index	29	Trending	0.194	3.7%	0.04%
S&P 500 Index	28	Trending	0.143	8.2%	0.15%
EAFE Index	8	Sideways	0.072	5.8%	
EM Index	24	Trending	0.266	10.1%	0.18%
Ten-year UST (price)	29	Trending	0.139	4.7%	0.23%

Performance Measures

Grains, Softs and Livestock all moved lower, but the main DJ-UBS index moved higher on strength in Petroleum and Industrial Metals.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Dow Jones-UBS	0.35%	-1.69%	9.62%	2.88%
Grains Sub-Index	-0.16%	-4.18%	9.37%	-3.55%
Corn	-1.14%	-6.78%	9.79%	-20.19%
Soybeans	3.45%	1.42%	17.93%	23.18%
Wheat	-3.23%	-7.87%	-1.62%	-11.91%
Energy Sub-Index	1.05%	-0.47%	12.22%	6.99%
Petroleum Sub-Index	1.63%	1.99%	6.98%	12.16%
WTI	2.73%	4.32%	14.57%	16.25%
ULSD	0.21%	-0.67%	-0.88%	5.23%
Gasoline	1.73%	0.67%	6.74%	9.09%
Natural Gas	-0.36%	-6.02%	22.10%	-2.19%
Precious Metals Sub-Index	0.02%	-0.91%	2.21%	-9.13%
Gold	-0.13%	-0.71%	3.99%	-7.17%
Silver	0.46%	-1.52%	-2.71%	-14.59%
Industrial Metals Sub-Index	1.60%	1.37%	6.12%	0.25%
Copper	0.65%	2.41%	-1.10%	-4.30%
Aluminum	2.51%	-2.69%	-1.83%	-10.22%
Nickel	3.06%	6.16%	44.95%	30.29%
Zinc	0.82%	1.05%	9.71%	7.22%
Softs Sub-Index	-2.67%	-8.68%	17.25%	7.64%
Coffee	-1.70%	-12.12%	62.82%	30.46%
Sugar	-3.01%	-2.69%	-4.89%	-7.07%
Cotton	-3.91%	-7.44%	7.22%	4.39%
Livestock Sub-Index	-1.05%	-1.77%	11.39%	18.39%
Cattle	-0.90%	0.12%	8.02%	11.81%
Hogs	-1.22%	-4.05%	16.47%	28.87%

The USD gained against the European currencies save the GBP and against the CAD and JPY but retreated against the Latin American currencies and the INR. The incipient drives to weaken the EUR and JPY continue to raise the possibility of dual carry trades.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.47%	-1.36%	0.83%	5.37%
Japanese yen	-0.46%	0.56%	-0.29%	0.05%
British pound	0.12%	0.30%	4.19%	11.42%
Swiss franc	-0.35%	-1.38%	1.79%	8.15%
Canadian dollar	0.00%	1.57%	-2.93%	-5.12%
Australian dollar	-1.38%	-0.65%	0.76%	-5.32%
Swedish krona	-1.20%	-1.02%	-1.13%	0.03%
Norwegian krone	-0.43%	0.59%	2.42%	-2.18%
New Zealand dollar	-0.89%	-0.43%	4.15%	5.10%
Indian rupee	0.47%	4.41%	6.82%	-5.00%
Brazilian real	-0.38%	-0.06%	2.97%	-8.06%
Mexican peso	0.36%	1.62%	1.48%	-3.57%
Chilean peso	-0.53%	1.63%	-5.95%	-12.04%
Colombian peso	0.78%	1.15%	0.81%	-2.32%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.10%	0.77%	-0.15%	-1.07%

Equity indices finally broke out to the upside on the back of the same news they have been ignoring since February, the continuation and expansion of global monetary accommodation.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.92%	1.58%	6.11%	16.62%
North America	1.29%	1.66%	6.54%	17.55%
Latin America	-1.61%	3.44%	2.78%	-5.78%
Emerging Market Free	1.12%	4.13%	4.39%	4.42%
EAFE	0.41%	1.45%	5.52%	15.31%
Pacific	0.75%	0.90%	-1.41%	2.72%
Eurozone	0.76%	0.89%	8.04%	25.76%

CTAs continued their monthly gains and were joined at last by macro funds. The prospect of directional moves in currencies, equities and long-term bonds should outweigh the drag of low realized volatility.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.46%	1.74%	-1.57%	-9.51%
Newedge Trend	0.27%	0.54%	0.13%	-5.94%
Newedge Short-Term	-0.08%	-1.56%	2.02%	-3.62%
HFR Global Hedge Fund	0.35%	-0.48%	1.14%	1.79%
HFR Macro/CTA	0.09%	-0.30%	-1.54%	-4.31%
HFR Macro: Sytematic Diversified CTA	-0.02%	-0.33%	-2.64%	-4.53%