The Macro Environment For Financial Markets

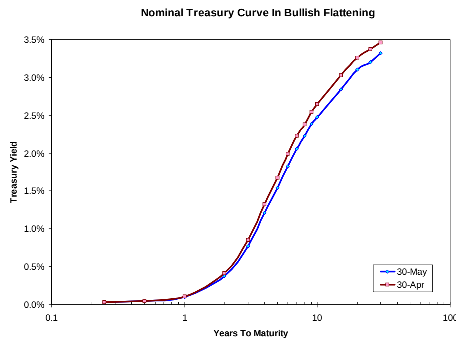
The course of the dollar remains the best single indicator for risk-acceptance as it will rise if policies loosen in the Eurozone and/or Japan. As short-term rates remain artificially low with no change in sight and policymakers unwilling to risk even the sort of minor deleveraging in risky assets seen in January, investors have to move out on both the risk and duration curves. The bullish flattening of the yield curve is removing some of the impediments to investment in real plant and equipment. If this trend continues, the real economy may benefit relative to financial assets for the first time in the QE era.

The causal chain is now:

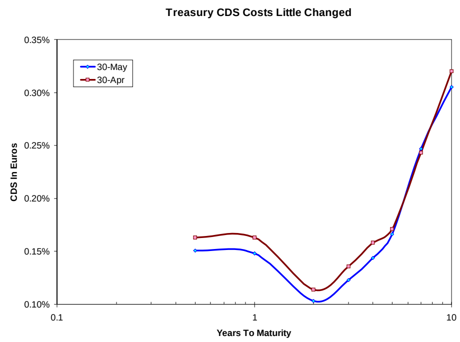
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve. Rising levels of risk-aversion will push real long-term rates lower;
2. Nominal long-term rates will be biased lower, but not significantly so;
3. Inflation expectations 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

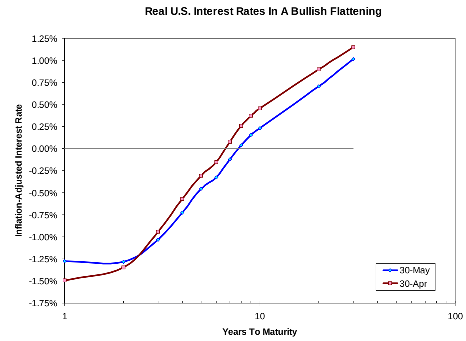
The Treasury yield curve's bullish flattening continues and will continue given the likely expansion of global liquidity creation and banks' demand for assets that meet regulatory requirements for safety.



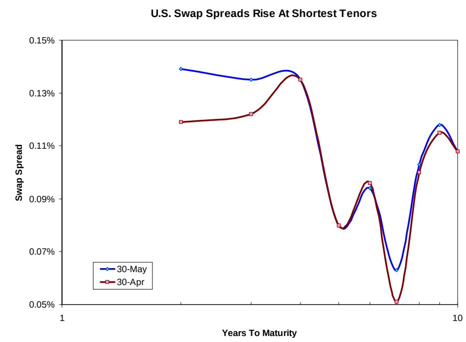
Euro-denominated CDS costs on U.S. Treasuries decreased slightly at short-dated tenors over month-ago levels, but the changes are minor.



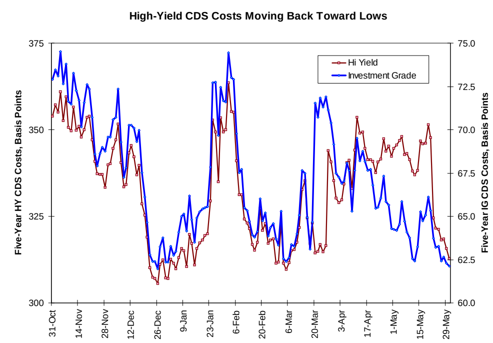
Real rates remain negative out to the eight-year horizon. Levels of risk-aversion as evidenced by higher short-term and lower long-term real rates have declined over the past month. The combination is negative for precious metals and supportive for risky financial assets.



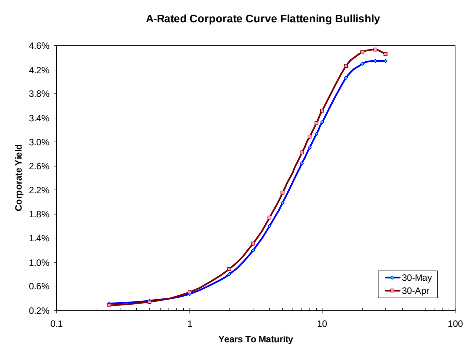
Swap spreads, which rise when floating-rate borrowers want to fix their payments, once again increased at the one- and two-year tenors as floating-rate borrowers realize there is little room for these yields to decline.



Five-year CDS costs for both investment-grade and high-yield bonds are moving back toward their lows as interest rates are forced lower in the absence of overt corporate financial stress. This is bullish for equities.



The A-rated yield curve has moved similarly to the Treasury yield curve. As in the UST case, the bullish flattening will continue until an overt policy reversal signal is given.



Market Structure

Treasuries, major equity indices and the dollar index remain in uptrends. The physical commodity indices except for Petroleum and Industrial Metals are predominantly in structural downtrends.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For June 2-6
DJ-UBS	22	Trending	-0.268	5.5%	-0.09%
DJ-UBS Grain	29	Trending	-0.388	13.5%	-0.36%
DJ-UBS Ind. Metl	9	Sideways	-0.021	12.2%	
DJ-UBS Pre. Metl	26	Trending	-0.297	11.8%	-0.09%
DJ-UBS Softs	29	Trending	-0.249	17.4%	-0.30%
DJ-UBS Nat. Gas	29	Trending	-0.102	19.3%	-0.41%
DJ-UBS Petroleum	25	Trending	0.079	8.5%	0.04%
DJ-UBS Livestock	29	Trending	0.102	8.8%	0.24%
Dollar Index	29	Trending	0.162	3.6%	0.04%
S&P 500 Index	27	Trending	0.249	7.6%	0.15%
EAFE Index	22	Trending	0.210	5.6%	0.09%
EM Index	29	Trending	0.097	9.7%	0.18%
Ten-year UST (price)	29	Trending	0.192	4.6%	0.23%

Performance Measures

The main DJ-UBS index and both Precious and Industrial Metals joined Grains, Softs and Livestock in moving lower. Only the Petroleum index showed positive returns.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Dow Jones-UBS	-1.30%	-2.08%	8.05%	2.50%
Grains Sub-Index	-2.67%	-5.60%	6.66%	-7.16%
Corn	-2.31%	-6.75%	7.04%	-22.79%
Soybeans	-1.68%	1.53%	16.91%	18.66%
Wheat	-4.85%	-12.39%	-6.25%	-16.28%
Energy Sub-Index	0.49%	0.24%	10.60%	11.48%
Petroleum Sub-Index	-1.03%	1.90%	5.14%	13.19%
WTI	-0.99%	3.71%	12.60%	17.13%
ULSD	-2.10%	-1.06%	-3.36%	5.55%
Gasoline	-0.55%	1.82%	5.67%	10.70%
Natural Gas	4.25%	-3.44%	21.98%	8.44%
Precious Metals Sub-Index	-3.92%	-4.40%	0.45%	-12.44%
Gold	-3.80%	-4.39%	1.90%	-10.82%
Silver	-4.29%	-4.42%	-3.47%	-16.90%
Industrial Metals Sub-Index	-0.09%	2.45%	6.58%	-1.91%
Copper	-0.59%	1.74%	-1.36%	-5.54%
Aluminum	2.58%	2.78%	1.61%	-11.87%
Nickel	-2.31%	5.26%	41.73%	27.82%
Zinc	-1.16%	0.45%	8.77%	1.86%
Softs Sub-Index	-1.10%	-7.79%	15.35%	8.55%
Coffee	-2.12%	-12.65%	57.22%	27.50%
Sugar	0.00%	-0.40%	-2.99%	-5.38%
Cotton	-1.72%	-8.53%	7.87%	7.14%
Livestock Sub-Index	-1.77%	-2.04%	10.06%	16.69%
Cattle	-0.04%	0.27%	8.16%	11.86%
Hogs	-3.87%	-4.81%	13.35%	24.75%

Currency markets were non-thematic with the USD weakening against the JPY, CHF, CAD, AUD and EUR amongst the majors but holding gains elsewhere.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.04%	-1.67%	0.69%	4.48%
Japanese yen	0.20%	0.46%	1.15%	-1.02%
British pound	-0.46%	-0.70%	2.44%	10.00%
Swiss franc	0.07%	-1.65%	1.51%	6.47%
Canadian dollar	0.14%	1.07%	-1.86%	-5.06%
Australian dollar	0.86%	0.25%	2.24%	-3.64%
Swedish krona	-0.65%	-2.78%	-1.84%	-1.90%
Norwegian krone	-0.22%	-0.41%	2.45%	-2.49%
New Zealand dollar	-0.60%	-1.37%	3.82%	5.26%
Indian rupee	-1.01%	2.09%	5.44%	-4.61%
Brazilian real	-0.81%	-0.41%	4.99%	-5.84%
Mexican peso	-0.01%	1.72%	2.79%	-0.55%
Chilean peso	0.73%	2.73%	-3.12%	-10.00%
Colombian peso	0.68%	2.07%	1.95%	-0.37%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.21%	0.35%	-0.20%	-1.12%

While the North American and EAFE indices continued their gains, a decline in EM assets led by Brazilian and Indian markets pulled the EM index lower.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.06%	2.06%	6.86%	17.92%
North America	1.11%	2.27%	7.69%	18.49%
Latin America	-2.65%	-0.04%	0.63%	-5.41%
Emerging Market Free	-1.36%	3.51%	2.03%	3.89%
EAFE	0.99%	1.76%	5.68%	17.10%
Pacific	1.40%	3.23%	0.08%	8.00%
Eurozone	1.54%	1.37%	7.79%	25.30%

Both CTAs and macro-oriented funds built on recent gains. This suggests a general long position bias in favor of the bullish flattening of sovereign yield curves and in equities along with a general short position bias in precious metals and grains.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.79%	3.40%	-1.33%	-4.02%
Newedge Trend	1.38%	2.14%	0.71%	-2.39%
Newedge Short-Term	2.40%	2.05%	3.98%	0.03%
HFR Global Hedge Fund	0.65%	0.47%	1.40%	2.73%
HFR Macro/CTA	1.26%	0.94%	-0.70%	-2.21%
HFR Macro: Sytematic Diversified CTA	1.60%	1.43%	-1.94%	-1.96%