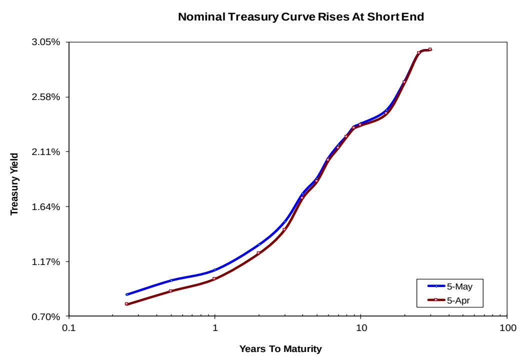
The Macro Environment For Financial Markets

Perhaps the best thing about the combination of the depopulation of the trading community, the focus on HFT and the Volcker Rule is it has eliminated all of the short-term hysterics that used to accompany things like the House passage of the AHCA or the umpteenth downturn in crude oil prices or more gibberish from the FOMC. Charlie don't surf and passive indexers don't panic. Remember that and you will save yourself some transaction costs. The causal chain is:

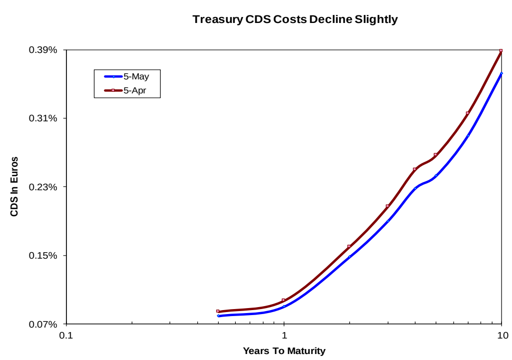
1. The market still is pricing in higher short-term rates in 2017, but the conviction level is declining;
2. Inflationary expectations remain under pressure;
3. The U.S. yield curve continues in its secular flattening trend;
4. Short-term borrowers are close to terming out short-term debt into the bond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

Key Market Indications

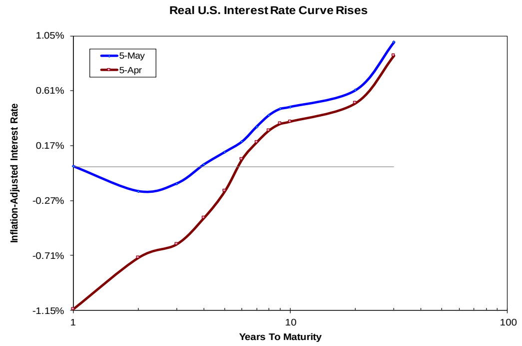
The flattening of the yield curve via higher short-term rates is continuing. As long as central banks own the long end and cannot liquidate their portfolios, long-term rates will not rise until and unless fiscal policy turns strongly stimulative. The market is skeptical of that outcome.



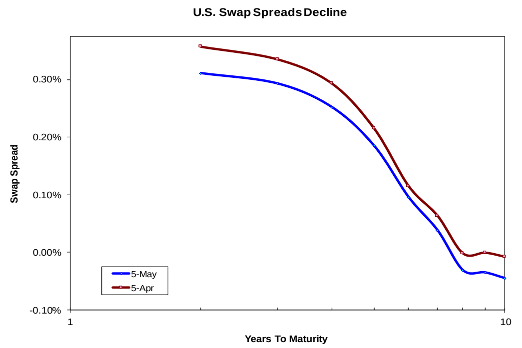
CDS costs on UST declined as Congress decided to keep the government operating for the time being. This market does not scare much anymore.



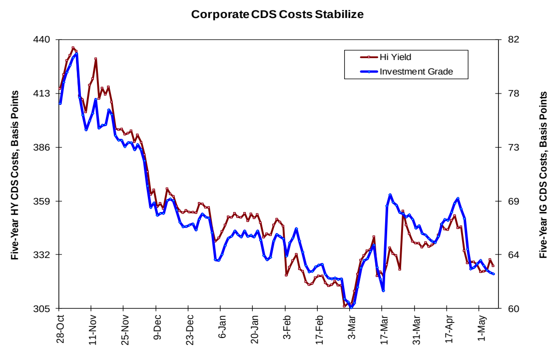
The pseudo-real yield curve shifted higher at the short end of the yield curve. This augmented the downward movement in gold. Small increases at the long end of the yield curve did not affect capital markets.



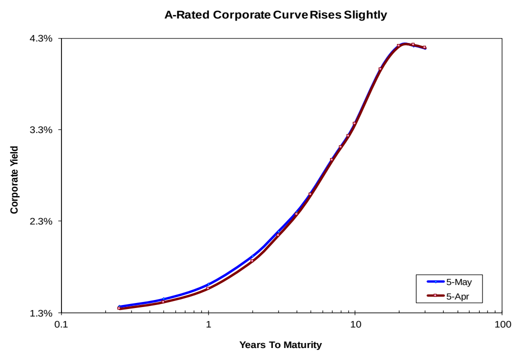
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower across tenors. This is one more piece of evidence of how the reflation trade has disappeared.



CDS costs stabilized, but the real story is how high-yield CDS levels did not jump in reaction to the sharp downturn in crude oil prices. The sector is showing its capacity to meet its bills with lower revenue, and that will attract more capital in return.



The A-rated corporate yield curve flattened slightly via higher short-term rates. This remains a bull market with limited upside potential.



Market Structure

Petroleum and both Industrial and Precious Metals drove lower, moving the main Bloomberg index into a structural downtrend. The dollar index remains in a downtrend and all of the equity indices remain in uptrends. Ten-year UST moved out of an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate May 8 - 12
BBerg	28	Trending	-0.313	8.4%	-0.24%
BBerg Grain	19	Transitional	0.050	14.5%	
BBerg Ind. Metl	28	Trending	-0.198	15.0%	-0.31%
BBerg Pre. Metl	29	Trending	-0.505	9.2%	-0.38%
BBerg Softs	6	Sideways	-0.075	16.5%	
BBerg Nat. Gas	7	Sideways	0.062	21.4%	
BBerg Petroleum	28	Trending	-0.371	22.4%	-0.08%
BBerg Livestock	29	Trending	0.345	12.6%	0.15%
Dollar Index	26	Trending	-0.214	5.7%	-0.04%
S&P 500 Index	29	Trending	0.209	6.9%	0.12%
EAFE Index	27	Trending	0.435	7.2%	0.16%
EM Index	26	Trending	0.147	6.7%	0.08%
Ten-year UST (price)	29	Trending	-0.061	4.7%	

Performance Measures

The long-term secular bear market in physical commodities continues; the decline in the Petroleum subindex really emphasized just how much the supply overhang from last decade's investment has affected price. The risk-off environment torpedoed Precious Metals and higher short-term rates in China hurt prospects for Industrial Metals. The U.S. agricultural sector remains an exception, but some winter kill in wheat will not change the outlook for corn and soybeans.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.57%	-3.62%	-1.02%	-0.40%
Grains Sub-Index	1.70%	1.67%	-3.57%	-11.63%
Corn	1.18%	1.18%	-1.59%	-11.21%
Soybeans	1.77%	2.15%	-6.60%	-7.69%
Wheat	2.33%	1.29%	-3.36%	-19.28%
Energy Sub-Index	-3.71%	-9.23%	0.61%	-2.69%
Petroleum Sub-Index	-5.15%	-12.09%	-3.20%	-7.21%
WTI	-6.07%	-11.94%	-4.31%	-10.74%
Brent	-5.65%	-11.52%	-0.15%	-4.67%
ULSD	-4.71%	-12.11%	-4.30%	-2.70%
Gasoline	-2.87%	-13.42%	-5.89%	-9.06%
Natural Gas	-0.06%	-1.62%	10.77%	12.08%
Precious Metals Sub-Index	-3.89%	-4.64%	-6.50%	-6.86%
Gold	-3.25%	-2.36%	-4.22%	-6.22%
Silver	-5.71%	-10.65%	-12.33%	-8.86%
Industrial Metals Sub-Index	-2.11%	-5.03%	2.28%	16.90%
Copper	-3.01%	-4.98%	4.94%	15.25%
Aluminum	-0.47%	-3.12%	9.07%	16.70%
Nickel	-3.30%	-10.32%	-19.45%	-0.76%
Zinc	-1.58%	-3.95%	3.49%	34.90%
Softs Sub-Index	-1.82%	-2.50%	-20.57%	2.92%
Coffee	1.74%	-4.62%	-23.09%	-0.38%
Sugar	-5.07%	-8.66%	-30.03%	-5.45%
Cotton	-1.38%	3.84%	8.50%	20.40%
Livestock Sub-Index	3.35%	11.07%	28.90%	4.96%
Cattle	3.46%	14.83%	36.33%	18.69%
Hogs	3.16%	4.95%	17.17%	-13.46%

The EUR rally continues and has helped pull the other European currencies higher. In a continuation of a risk-on pattern, the JPY moved lower. The USD gained against the Latin currencies and against the commodity-linked AUD.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.95%	3.14%	-0.39%	-3.57%
Chinese yuan	-0.14%	-0.12%	-1.83%	-5.69%
Japanese yen	-1.08%	-1.78%	-7.32%	-4.84%
British pound	0.24%	4.00%	4.73%	-10.38%
Swiss franc	0.70%	1.74%	-1.36%	-2.02%
Canadian dollar	0.01%	-1.59%	-2.11%	-5.85%
Australian dollar	-0.85%	-1.93%	-3.93%	-0.55%
Swedish krona	0.65%	2.22%	2.59%	-7.79%
Norwegian krone	-0.09%	0.20%	-4.16%	-4.85%
New Zealand dollar	0.76%	-0.66%	-5.80%	0.49%
Indian rupee	-0.20%	0.79%	3.67%	3.39%
Brazilian real	-0.02%	-1.79%	0.90%	11.24%
Mexican peso	-0.88%	-0.83%	-2.07%	-5.77%
Chilean peso	-0.71%	-2.04%	-2.76%	-0.85%
Colombian peso	-0.21%	-3.04%	3.07%	0.15%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.03%	0.14%	-0.56%	-1.87%

Will the solution to richly valued U.S. equities be a richly valued EAFE? Why not; barring another round of sovereign debt and currency crisis in Europe, these markets have a long way to go and a lot of free money to get there.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.06%	3.01%	15.69%	18.51%
North America	0.59%	1.89%	15.72%	19.24%
Latin America	0.83%	-1.29%	8.21%	24.62%
Emerging Market Free	0.08%	1.11%	12.19%	24.16%
EAFE	1.86%	4.94%	15.62%	17.28%
Pacific	-0.37%	0.57%	7.92%	15.86%
Eurozone	4.13%	9.44%	23.50%	24.28%

CTAs managed to gain on a week of strong downward movement, which should be an obvious statement but one that has been rare. Hedge funds continued to bleed and the outflow of AUM continues.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.36%	-0.41%	0.06%	-6.00%
Newedge Trend	0.16%	0.04%	0.17%	-3.96%
Newedge Short-Term	0.23%	-0.71%	-3.25%	-10.10%
HFR Global Hedge Fund	0.00%	0.57%	4.85%	6.87%
HFR Macro/CTA	-0.12%	-0.13%	0.24%	-3.50%
HFR Macro: Sytematic Diversified CTA	-0.01%	-0.56%	0.34%	-4.27%