The Macro Environment For Financial Markets

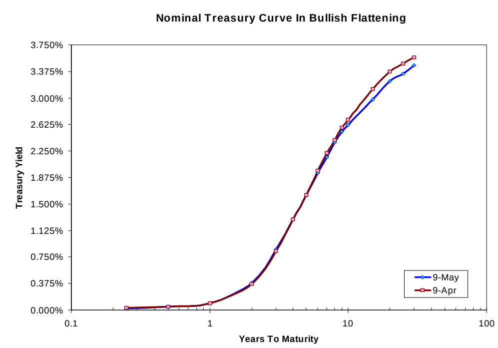
The notion tapering of QE has been a credit-tightening move has proven to be an illusion as a host of short-term interest rates including three-month LIBOR remain near all-time lows, and both U.S. and Eurozone investment-grade OAS levels are their post-crisis lows and the European Central Bank is increasingly likely to offset U.S. moves and begin a euro carry trade. Credit markets are becoming overvalued; oddly, equity investors have been more risk-averse than fixed-income investors. However, the persistence of negative short-term real interest rates and bullish flattenings of yield curves will continue to support the more yield-dependent sectors of equity markets and will eventually lead to a shift back out the risk curve both within sectors and internationally.

The causal chain is now:

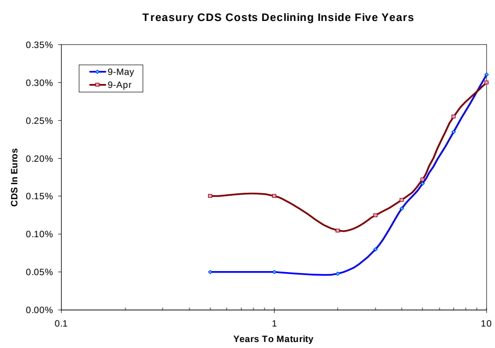
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve. Rising levels of risk-aversion will push real long-term rates lower;
2. Nominal long-term rates will push through resistance levels after consolidating recent gains;
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 shift lower as the demand to fix rates will dissipate; and
6. Credit spreads will continue their downward trend led by investment-grade bonds as investors reluctantly increase their levels of risk acceptance

Key Market Indications

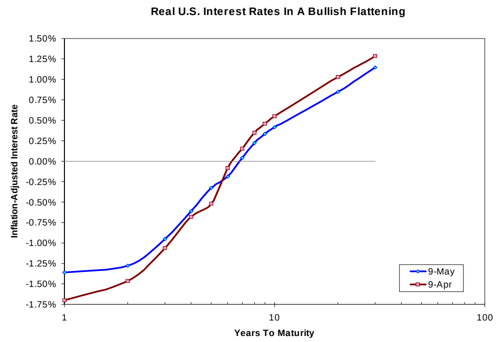
The Treasury yield curve maintained its bullish flattening on increased haven bids. However, the ten-year has not been able to breach resistance at 2.60% and the 30-year stopped at its 3.39% resistance.



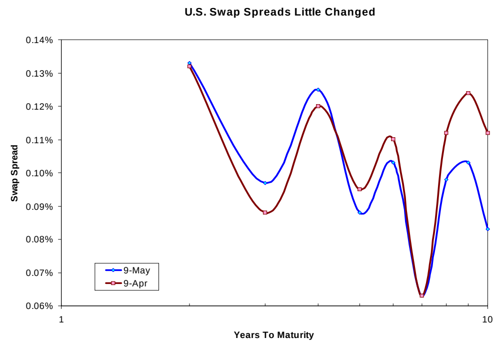
Euro-denominated CDS costs on U.S. Treasuries have declined inside of five years as issues of federal finances have receded.



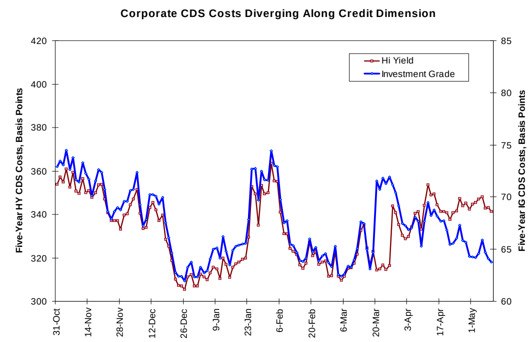
Real rates remain negative out to the six-year horizon. Levels of risk-aversion as evidenced by lower short-term real rates have remained unchanged over the past month. The combination is negative for precious metals and supportive for risky financial assets.



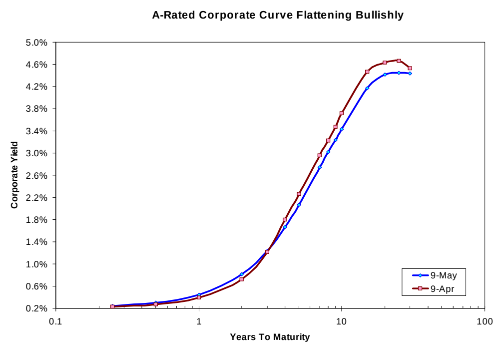
Swap spreads, which rise when floating-rate borrowers want to fix their payments, have decreased past four years' tenor. The ranges are too small to be of great significance.



Five-year CDS costs for both investment-grade and high-yield continue to diverge as investment-grade CDS costs and OAS levels continue to press lower while high-yield CDS costs and OAS levels have been unable to challenge early April lows.



The A-rated yield curve has moved similarly to the Treasury yield curve. The bullish flattening still reflects a preference for investment-grade debt over other risky assets.



Market Structure

Commodity subindex trends are diverging with Grains, Livestock and Industrial Metals in uptrends and Softs, Petroleum and Natural Gas in downtrends. Both Treasuries and the S&P 500 are in uptrends, an unusual combination of late.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For May 12-16
DJ-UBS	29	Trending	-0.076	6.5%	
DJ-UBS Grain	21	Trending	0.033	15.3%	0.18%
DJ-UBS Ind. Metl	29	Trending	0.104	11.5%	0.36%
DJ-UBS Pre. Metl	17	Transitional	-0.059	13.6%	
DJ-UBS Softs	29	Trending	-0.160	21.1%	-0.30%
DJ-UBS Nat. Gas	29	Trending	-0.125	21.6%	-0.41%
DJ-UBS Petroleum	29	Trending	-0.090	10.1%	-0.25%
DJ-UBS Livestock	27	Trending	0.216	10.3%	0.24%
Dollar Index	29	Trending	0.036	3.8%	
S&P 500 Index	29	Trending	0.062	9.1%	0.15%
EAFE Index	4	Sideways	-0.013	5.8%	
EM Index	15	Transitional	0.037	11.1%	
Ten-year UST (price)	29	Trending	0.082	4.7%	0.23%

Performance Measures

Energy markets, Softs and Precious Metals moved lower and have taken the main DJ-UBS index down. The advance in Industrial Metals is the result of production disruptions in nickel.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Dow Jones-UBS	-0.67%	-0.47%	10.30%	2.94%
Grains Sub-Index	1.25%	3.60%	13.24%	3.77%
Corn	1.60%	0.60%	11.57%	-12.47%
Soybeans	1.11%	2.75%	17.02%	27.54%
Wheat	0.91%	8.12%	8.99%	-3.39%
Energy Sub-Index	-1.37%	-1.79%	14.49%	7.23%
Petroleum Sub-Index	-0.42%	-1.33%	6.08%	6.32%
WTI	0.27%	-2.21%	9.23%	8.17%
ULSD	-0.60%	-0.77%	3.62%	1.77%
Gasoline	-1.39%	-1.96%	6.47%	3.75%
Natural Gas	-3.49%	-2.84%	32.64%	9.05%
Precious Metals Sub-Index	-1.43%	-2.86%	-1.40%	-13.17%
Gold	-1.18%	-2.38%	1.16%	-10.70%
Silver	-2.17%	-4.29%	-8.54%	-20.03%
Industrial Metals Sub-Index	1.14%	0.82%	3.01%	-3.49%
Copper	0.42%	1.68%	-4.47%	-8.45%
Aluminum	-1.59%	-7.19%	-6.36%	-14.44%
Nickel	8.88%	14.33%	45.27%	27.48%
Zinc	-0.45%	0.19%	7.10%	4.22%
Softs Sub-Index	-4.76%	-4.53%	16.15%	1.06%
Coffee	-9.50%	-9.65%	64.54%	16.19%
Sugar	-1.43%	-1.49%	-8.82%	-11.09%
Cotton	-2.08%	2.11%	16.00%	5.26%
Livestock Sub-Index	-0.42%	0.87%	11.43%	20.01%
Cattle	0.12%	1.80%	7.98%	11.40%
Hogs	-1.08%	-0.27%	16.56%	33.93%

The USD gained against the European currencies save the NOK but retreated against the CAD, AUD and a wide range of minor currencies. The incipient drive to weaken the EUR continues to raise the possibility of a euro carry trade.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.80%	-0.70%	2.62%	5.48%
Japanese yen	0.33%	0.14%	-2.65%	-1.25%
British pound	-0.11%	0.35%	5.39%	9.08%
Swiss franc	-0.95%	-0.77%	3.72%	6.96%
Canadian dollar	0.68%	-0.17%	-3.87%	-7.62%
Australian dollar	0.92%	-0.31%	0.03%	-7.23%
Swedish krona	-0.97%	-1.38%	-0.19%	-0.24%
Norwegian krone	0.42%	0.42%	3.96%	-2.23%
New Zealand dollar	-0.57%	-1.17%	4.36%	2.63%
Indian rupee	0.23%	0.18%	5.35%	-9.63%
Brazilian real	0.39%	-1.17%	5.38%	-9.01%
Mexican peso	0.52%	0.25%	2.07%	-7.34%
Chilean peso	1.39%	-0.88%	-6.12%	-14.93%
Colombian peso	1.17%	1.28%	1.01%	-3.86%
Bloomberg-JP Morgan Asian dollar index (spot)	0.34%	-0.22%	-0.30%	-2.30%

Equity indices continue to struggle at resistance but have no incentive to retreat. As the upside is capped, the downside remains unusually vulnerable to event risk.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.20%	0.81%	6.84%	15.39%
North America	-0.14%	0.46%	7.10%	17.39%
Latin America	0.58%	2.51%	5.33%	-9.17%
Emerging Market Free	0.38%	-0.55%	2.14%	-2.38%
EAFE	-0.30%	1.32%	6.47%	12.64%
Pacific	-0.40%	0.78%	-0.72%	-1.03%
Eurozone	-0.25%	0.50%	9.84%	24.48%

CTAs gained on the week, but macro funds continued their recent downturn. The continued low volatility in currencies and downward convergence of interest rates continues to vex macro funds.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.58%	1.99%	-0.13%	-8.61%
Newedge Trend	0.39%	0.62%	1.08%	-4.83%
Newedge Short-Term	-1.17%	-2.53%	2.46%	-2.64%
HFR Global Hedge Fund	-0.23%	-0.51%	1.60%	2.39%
HFR Macro/CTA	-0.48%	-0.80%	-1.14%	-4.17%
HFR Macro: Sytematic Diversified CTA	-0.54%	-0.33%	-1.60%	-4.10%