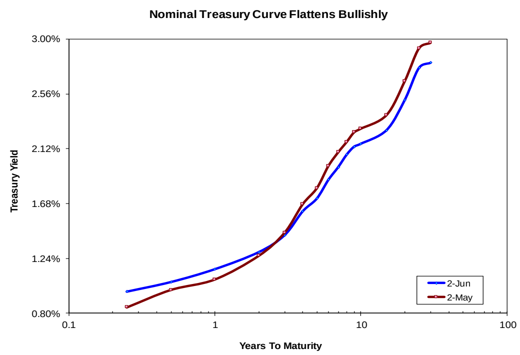
The Macro Environment For Financial Markets

If investors lost their mojo between 2000 and 2009, they certainly have found it since then. The combination of rising earnings, excessive monetary ease globally, declining factor input prices and, more critically than most allow, the absence of bank proprietary desks and trading floors to push trading limits have combined to produce a rally that dwarfs the 1990s. We still are at risk for a melt-up as anyone who has exited the market in recent years has regretted it. The causal chain remains:

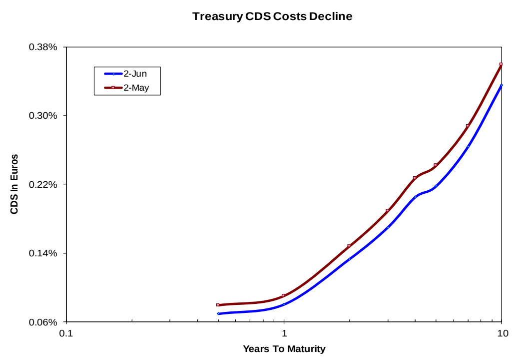
1. The market still is pricing in higher short-term rates in 2017, but the conviction level is declining;
2. Inflationary expectations remain under pressure;
3. The U.S. yield curve continues in its secular flattening trend;
4. Short-term borrowers are close to terming out short-term debt into the bond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

Key Market Indications

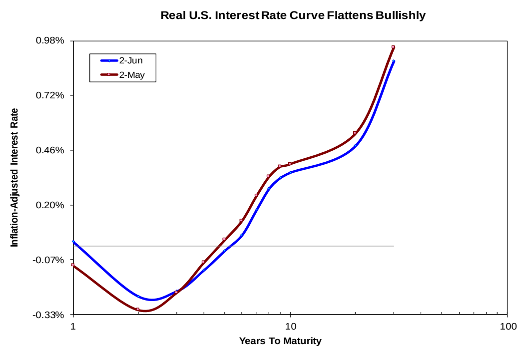
The UST market moved higher at the short end as nothing yet suggests a reversal of the Federal Reserve's stated intentions to raise short-term rates. The demand for long-dated, high-quality bonds remains strong and central bank owners of these bonds are not going to sell them just yet. The yield curve continues its rapid bullish flattening.



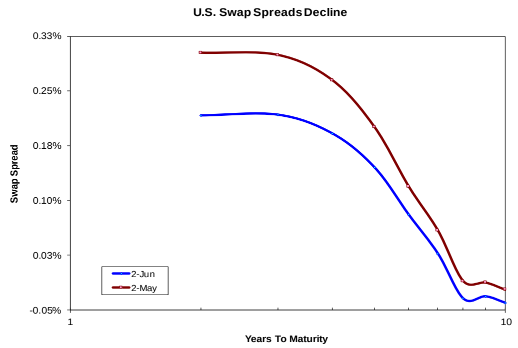
CDS costs on UST declined. While corporate borrowers have to be regarded as well-managed to receive creditor confidence, government borrowers do not labor under such constraints.



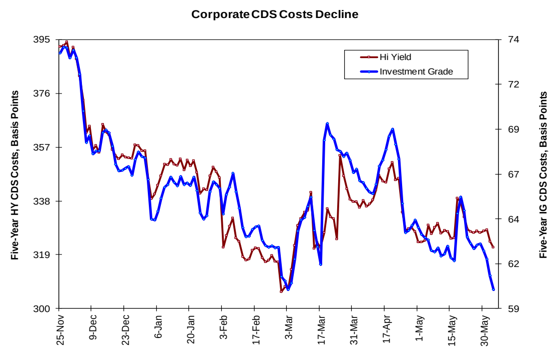
The pseudo-real yield curve shifted higher at the short end of the yield curve but declined at the long end. While the small decline at the long end coincided with gains in risky assets, the rise at the short end of the yield curve did nothing to derail the rise in precious metals. These rates are, after all, effectively zero.



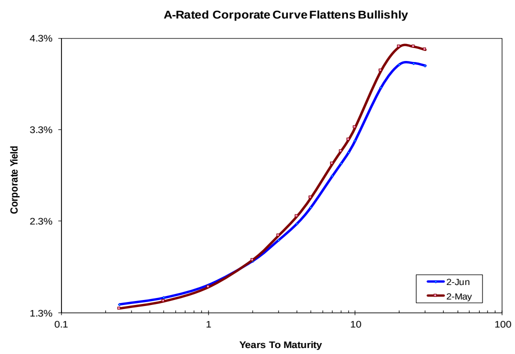
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower across tenors. This is one more piece of evidence of how the reflation trade has disappeared.



CDS costs declined across both asset classes, but especially for investment-grade bonds. With a still-supportive monetary environment, steady if unspectacular growth and no hedging from equity correlation trades, why should these rates rise?



The A-rated corporate yield curve flattened bullishly. This remains a bull market with limited upside potential.



Market Structure

Only Precious Metals remain in a structural uptrend amongst the physical commodities, while Grains, Softs, Natural Gas and Petroleum are in structural downtrends. The S&P 500 and ten-year UST are in structural uptrends amongst the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate June 5 - 9
BBerg	16	Transitional	-0.181	8.3%	
BBerg Grain	28	Trending	-0.051	13.2%	-0.11%
BBerg Ind. Metl	16	Transitional	-0.034	13.9%	
BBerg Pre. Metl	29	Trending	0.243	10.0%	0.16%
BBerg Softs	25	Trending	-0.466	15.2%	-0.63%
BBerg Nat. Gas	27	Trending	-0.368	22.7%	-1.59%
BBerg Petroleum	29	Trending	-0.096	25.8%	-0.83%
BBerg Livestock	17	Transitional	0.197	13.1%	
Dollar Index	6	Sideways	-0.078	5.6%	
S&P 500 Index	29	Trending	0.319	5.5%	0.12%
EAFE Index	11	Transitional	0.180	7.7%	
EM Index	8	Sideways	0.080	6.0%	
Ten-year UST (price)	28	Trending	0.259	4.0%	0.15%

Performance Measures

This week's tribute to what thin trading conditions can do goes to sugar and Natural Gas, with their -12.24% -8.40% returns. Precious Metals advanced on a softer interest rate outlook, while Livestock continued their very strong year-to-date rallies.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.63%	-0.36%	-6.50%	-5.04%
Grains Sub-Index	-0.20%	-2.19%	-5.14%	-20.94%
Corn	0.97%	0.61%	0.04%	-19.38%
Soybeans	-1.92%	-5.25%	-14.27%	-20.07%
Wheat	-0.27%	-2.81%	-0.41%	-26.86%
Energy Sub-Index	-4.48%	-1.34%	-16.25%	-10.92%
Petroleum Sub-Index	-2.97%	2.44%	-13.36%	-12.01%
WTI	-2.52%	2.35%	-13.78%	-14.86%
Brent	-3.36%	1.18%	-12.78%	-10.80%
ULSD	-4.51%	2.92%	-13.18%	-9.38%
Gasoline	-1.53%	4.66%	-13.83%	-10.86%
Natural Gas	-8.40%	-10.41%	-23.72%	-6.11%
Precious Metals Sub-Index	1.72%	5.06%	6.86%	2.80%
Gold	1.64%	4.12%	8.29%	1.83%
Silver	1.95%	7.76%	3.23%	5.16%
Industrial Metals Sub-Index	-1.62%	0.54%	-4.76%	19.62%
Copper	-0.86%	1.89%	-5.31%	19.68%
Aluminum	-1.56%	1.35%	10.44%	22.78%
Nickel	-1.39%	-2.57%	-23.99%	3.33%
Zinc	-4.10%	-2.20%	-9.10%	25.09%
Softs Sub-Index	-6.18%	-8.98%	-16.91%	-11.38%
Coffee	-2.88%	-7.41%	-15.64%	-9.67%
Sugar	-12.24%	-10.19%	-27.13%	-28.73%
Cotton	-0.59%	-1.32%	4.52%	14.90%
Livestock Sub-Index	3.04%	3.79%	29.42%	6.22%
Cattle	3.85%	1.78%	32.06%	20.30%
Hogs	1.76%	7.32%	24.74%	-11.45%

Declines in the commodity-linked CAD, AUD, MXN and NOK pulled those currencies lower against the USD, but everything else gained against the USD as markets continue to have a softer view of the U.S. interest rate outlook and, more importantly, of U.S. fiscal stimulus than do policymakers.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.86%	3.19%	5.77%	1.15%
Chinese yuan	0.67%	1.26%	1.03%	-3.31%
Japanese yen	0.84%	1.44%	2.82%	-1.39%
British pound	0.66%	-0.39%	1.25%	-10.64%
Swiss franc	1.14%	2.96%	4.98%	2.83%
Canadian dollar	-0.30%	1.65%	-1.45%	-2.90%
Australian dollar	-0.07%	-1.23%	-0.19%	2.96%
Swedish krona	0.78%	2.11%	6.87%	-3.41%
Norwegian krone	-0.46%	2.07%	0.05%	-0.98%
New Zealand dollar	1.15%	2.98%	0.01%	4.88%
Indian rupee	0.01%	-0.36%	5.87%	4.42%
Brazilian real	0.45%	-2.91%	7.12%	10.72%
Mexican peso	-0.89%	0.47%	10.42%	-0.02%
Chilean peso	0.38%	-0.20%	0.22%	3.01%
Colombian peso	0.53%	1.62%	6.66%	6.57%
Bloomberg-JP Morgan Asian dollar index (spot)	0.35%	0.79%	2.36%	0.12%

Poor performance in the Latin markets dragged the EM index lower, but this was more than offset by strong gains in the EAFE and in the U.S. These markets are pricy but are likely to become pricier still.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.63%	2.39%	14.14%	17.83%
North America	0.99%	2.18%	11.99%	17.90%
Latin America	-0.30%	-2.58%	15.94%	27.87%
Emerging Market Free	-0.55%	3.13%	18.67%	28.33%
EAFE	1.74%	4.50%	19.95%	19.68%
Pacific	0.57%	1.16%	9.88%	18.29%
Eurozone	0.40%	4.44%	27.86%	22.99%

Both CTAs and hedge funds managed gains this week on the back of strong trends in fixed-income, currencies and especially in the energy markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	1.01%	0.43%	-0.77%	-4.91%
Newedge Trend	0.82%	0.63%	1.34%	-2.39%
Newedge Short-Term	0.29%	0.67%	-4.56%	-9.37%
HFR Global Hedge Fund	0.20%	0.52%	3.49%	6.16%
HFR Macro/CTA	0.57%	1.15%	0.64%	-1.47%
HFR Macro: Sytematic Diversified CTA	0.85%	1.12%	-0.40%	-1.36%