The Macro Environment For Financial Markets

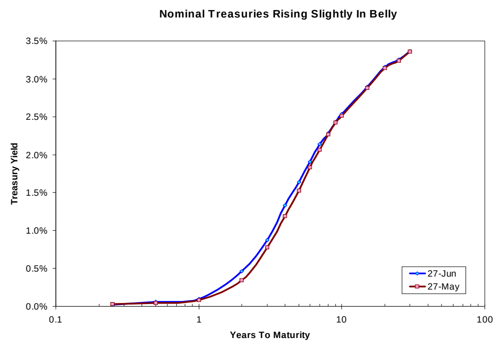
The unexpectedly poor GDP data for the first quarter is likely to keep the Federal Reserve on hold with the policies that have contributed to supporting financial assets relative to real plant and equipment. While monetary accommodation in the U.S. and elsewhere has failed to produce positive macroeconomic results, its cessation would produce very negative financial market outcomes that would have a negative macroeconomic impact.

The causal chain is now:

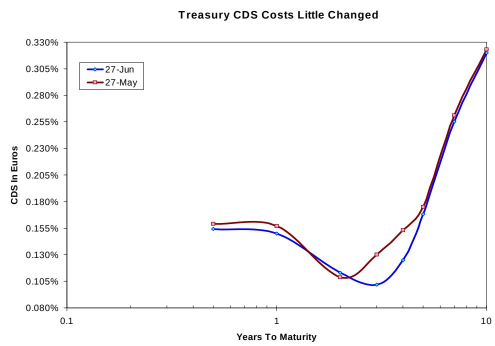
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve;
2. The longer-term uptrend in senior sovereign debt remains intact;
3. Inflation expectations as measured by the TIPS market will threaten the top end of their year-long range and must remain below 2.47% basis the ten-year;
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 not move higher in the absence of overt event risk.

Key Market Indications

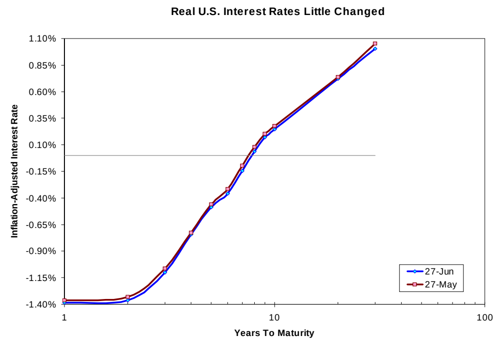
The Treasury yield curve has increased slightly in the belly of the curve but has remained virtually unchanged at both the long and short ends. The longer-term trend toward a bullish flattening will remain intact so long as global monetary policies remain accommodative.



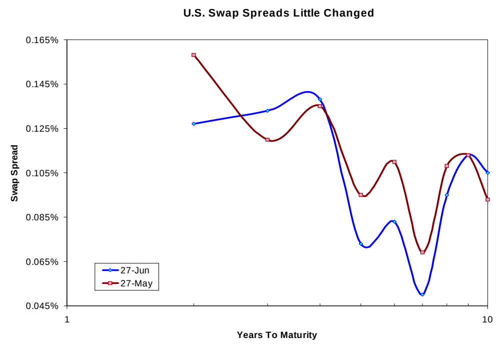
Euro-denominated CDS costs on U.S. Treasuries increased slightly at short-dated tenors over month-ago levels, but the changes are minor.



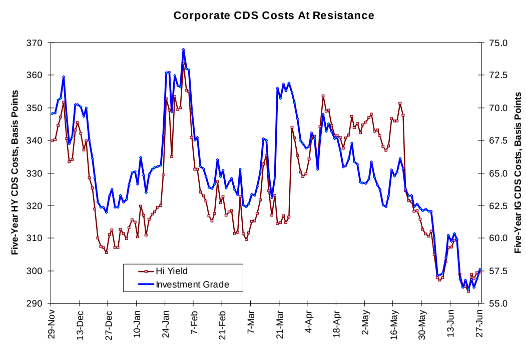
Real rates remain negative out to the seven-year horizon. The inability of short-dated real rates to rise provides some measure of support for the precious metals and maintains a general positive tone for risky financial assets.



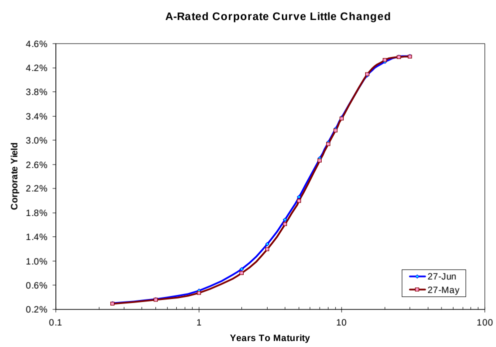
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain little changed over the past month and reflect the ongoing complacency in fixed-income markets.



Five-year CDS costs for both investment-grade and high-yield rose from last week's lows on the cycle. While incremental declines are going to become harder to achieve, the long-term downtrend in credit spread compression remains intact.



The A-rated yield curve has moved similarly to the Treasury yield curve. However, until and unless credit spreads expand, the bullish tone of this market remains intact until an overt policy reversal signal is given.



Market Structure

Only the Precious and Industrial Metals indices are in structural uptrends within physical commodities. Natural Gas has shifted into a downtrend. The financial markets remain similarly trendless with only the EAFE in a trending structure higher.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For June 23-27
DJ-UBS	4	Sideways	-0.051	5.5%	
DJ-UBS Grain	5	Sideways	0.040	14.3%	
DJ-UBS Ind. Metl	28	Trending	0.145	11.5%	0.28%
DJ-UBS Pre. Metl	29	Trending	0.351	11.6%	0.68%
DJ-UBS Softs	13	Transitional	-0.027	16.1%	
DJ-UBS Nat. Gas	29	Trending	-0.179	19.6%	-0.70%
DJ-UBS Petroleum	5	Sideways	-0.038	9.0%	
DJ-UBS Livestock	9	Sideways	0.059	12.2%	
Dollar Index	17	Transitional	-0.128	4.2%	
S&P 500 Index	4	Sideways	0.027	7.6%	
EAFE Index	29	Trending	0.050	6.0%	0.09%
EM Index	10	Sideways	0.014	5.6%	
Ten-year UST (price)	20	Trending	0.103	4.7%	

Performance Measures

Every FOMC meeting with a predictable dovish outcome leads to a burst higher in the Precious Metals, and this week was no exception. Reversals in Grains, Industrial Metals, Softs and Livestock from the previous week are a common occurrence in mid-June as quarterly positions are adjusted.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Dow Jones-UBS	-0.49%	1.54%	8.08%	9.23%
Grains Sub-Index	-0.60%	-4.03%	5.78%	-5.08%
Corn	-1.34%	-4.27%	3.07%	-20.78%
Soybeans	-0.28%	-2.59%	15.08%	20.33%
Wheat	0.08%	-7.19%	-4.87%	-15.64%
Energy Sub-Index	-1.72%	2.11%	8.85%	16.82%
Petroleum Sub-Index	-1.07%	4.25%	6.97%	14.91%
WTI	-0.88%	4.00%	11.74%	16.50%
ULSD	-1.77%	3.81%	0.13%	6.76%
Gasoline	-0.63%	4.72%	7.45%	16.99%
Natural Gas	-3.30%	-2.86%	11.81%	18.65%
Precious Metals Sub-Index	0.37%	7.68%	9.39%	7.48%
Gold	0.26%	5.94%	9.71%	7.54%
Silver	0.67%	12.89%	8.51%	7.41%
Industrial Metals Sub-Index	1.17%	1.71%	2.70%	7.41%
Copper	1.77%	1.54%	-6.16%	3.75%
Aluminum	-0.18%	2.06%	1.08%	-2.54%
Nickel	2.82%	-1.92%	35.33%	35.78%
Zinc	0.39%	6.15%	5.14%	12.98%
Softs Sub-Index	-2.16%	-1.15%	12.27%	5.97%
Coffee	-1.68%	-4.28%	49.39%	30.71%
Sugar	-2.29%	0.65%	0.97%	-4.86%
Cotton	-2.89%	-4.44%	-4.25%	-5.00%
Livestock Sub-Index	2.05%	6.74%	19.78%	20.82%
Cattle	3.28%	9.04%	17.63%	20.40%
Hogs	0.52%	3.97%	24.78%	22.77%

The unexpectedly weak U.S. GDP data contributed to a weaker USD against all currencies of significance except for the Nordics. The downside to the USD should be limited, however, as competitive devaluation remains the order of the day.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.36%	0.10%	-0.73%	4.69%
Japanese yen	0.64%	0.55%	3.70%	-3.03%
British pound	0.13%	1.34%	3.35%	11.64%
Swiss franc	0.48%	0.66%	0.08%	6.12%
Canadian dollar	0.86%	1.80%	0.38%	-1.77%
Australian dollar	0.42%	1.81%	6.28%	1.64%
Swedish krona	-0.33%	-1.62%	-3.23%	0.05%
Norwegian krone	-0.15%	-2.84%	0.31%	-1.36%
New Zealand dollar	0.91%	2.50%	7.69%	12.60%
Indian rupee	0.17%	-1.74%	2.93%	0.19%
Brazilian real	1.65%	2.00%	6.59%	0.23%
Mexican peso	0.22%	-0.82%	0.72%	0.45%
Chilean peso	0.80%	0.70%	-4.95%	-8.59%
Colombian peso	0.13%	1.94%	2.62%	2.27%
Bloomberg-JP Morgan Asian dollar index (spot)	0.16%	0.19%	0.19%	0.35%

While the EM index reversed its decline of the previous week, both the North American and EAFE indices saw mixed performance with the Eurozone being especially weak.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.32%	2.16%	6.81%	24.31%
North America	0.03%	2.95%	7.92%	24.64%
Latin America	-0.71%	2.58%	7.51%	10.34%
Emerging Market Free	0.31%	1.76%	6.38%	16.78%
EAFE	-0.82%	1.03%	5.25%	23.85%
Pacific	0.08%	3.76%	3.91%	14.50%
Eurozone	-1.54%	-0.08%	5.22%	33.36%

Trend-following CTAs and macro hedge funds continued their negative performance from last week. The stall in equity indices appears to be the most likely contributor to this negative performance.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.42%	2.16%	-0.10%	1.93%
Newedge Trend	-0.15%	1.26%	1.56%	1.25%
Newedge Short-Term	0.03%	1.62%	2.20%	1.35%
HFR Global Hedge Fund	-0.20%	1.24%	1.88%	5.54%
HFR Macro/CTA	-0.49%	1.08%	-0.35%	-1.15%
HFR Macro: Sytematic Diversified CTA	-0.32%	1.34%	-2.27%	-0.87%