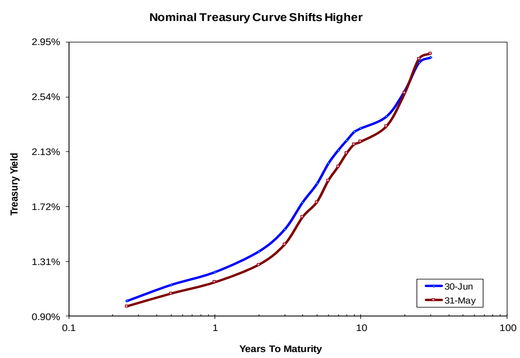
The Macro Environment For Financial Markets

This past week proved once again how markets pining for volatility are like twelve-year-old boys discussing their impending conquests: They are unable to handle success. A few remarks by otherwise obtuse central bankers led to multiple reversals in all asset classes and demonstrated just how comfortable everyone was holding their crowded trades. In reality, little changed to the downside and the same limited-upside trades will become crowded once again. The causal chain now is:

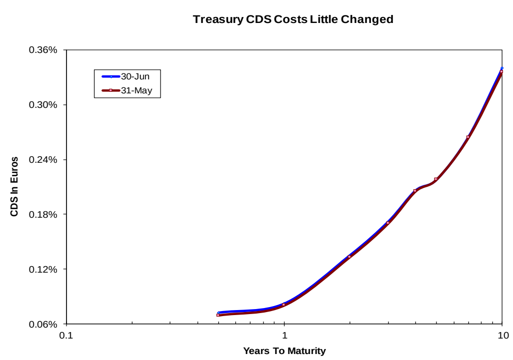
1. The market still is pricing in higher short-term rates in 2017, now possibly outside of the U.S., too;
2. Inflationary expectations remain under pressure;
3. The U.S. yield curve continues in its secular flattening trend despite last week's bearish steepening;
4. Short-term borrowers are close to terming out short-term debt into the bond market;
5. Swap spreads have stopped declining for the short-term; and
6. CDS costs remain consistent with a bull market in risky assets.

Key Market Indications

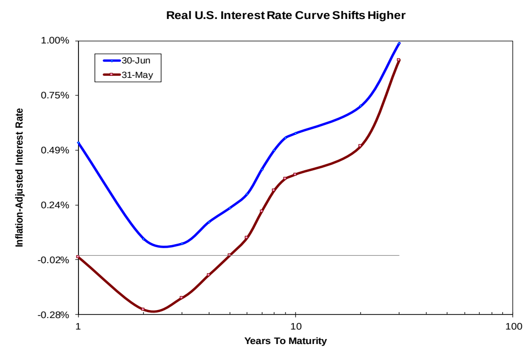
The fixed-income markets have been vulnerable to higher rates overseas threatening the reverse carry trade, and this is exactly what happened this past week. However, the longer-term trends of declining inflation expectations, flatter yield curves and demand for "safe" long-term assets did not disappear.



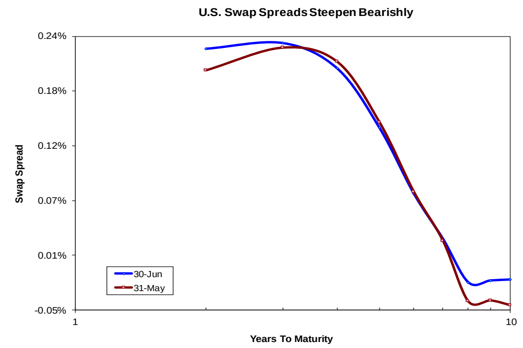
CDS costs on UST have changed little over the past month. This market remains unconcerned about the U.S. debt ceiling.



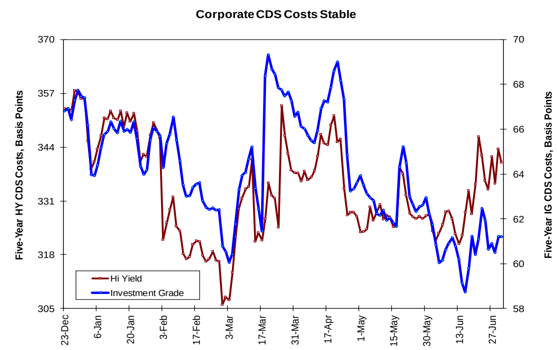
The pseudo-real yield curve shifted higher across the maturity spectrum. This contributed to declines to both precious metals and to risky financial assets.



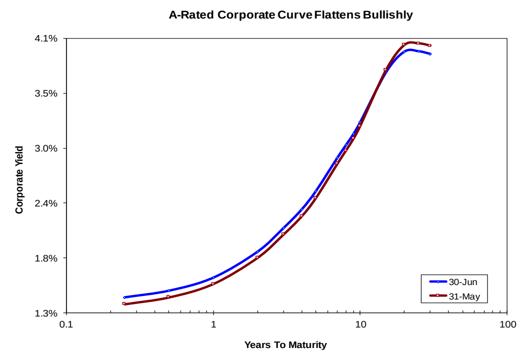
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted higher at both ends of the yield curve in response to perceptions of greater central bank tightening.



CDS costs rose from recent lows, but these were minor moves within the context of a secular bull market. We would need evidence of much higher short-term rates and of rising recessionary pressures to reverse these trends.



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



Market Structure

Grains and Industrial Metals reversed into structural uptrends and, Natural Gas turned transitional amongst the physical commodities. Ten-year UST moved into a structural downtrend within the financials.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate July 3 - 7
BBerg	29	Trending	0.105	8.3%	
BBerg Grain	28	Trending	0.269	15.2%	0.10%
BBerg Ind. Metl	27	Trending	0.272	12.2%	0.39%
BBerg Pre. Metl	6	Sideways	-0.034	11.7%	
BBerg Softs	29	Trending	-0.163	15.5%	-0.63%
BBerg Nat. Gas	12	Transitional	0.042	21.0%	
BBerg Petroleum	29	Trending	-0.009	23.5%	-0.83%
BBerg Livestock	25	Trending	-0.012	13.7%	-0.77%
Dollar Index	17	Transitional	-0.265	5.3%	
S&P 500 Index	11	Transitional	-0.065	6.7%	
EAFE Index	16	Transitional	-0.053	8.4%	
EM Index	17	Transitional	-0.011	7.8%	
Ten-year UST (price)	29	Trending	-0.215	3.9%	-0.07%

Performance Measures

The Grains markets are perhaps the most studied from a fundamental standpoint of any, and yet every USDA report manages to catch the markets offsides. Maybe a few satellites would help. Oh, they do? If we add in some short-covering in the Energy, Softs and Livestock markets, we have yet another demonstration why CTAs hate trading bear markets. They would much rather underperform in bull markets.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	3.74%	0.41%	-3.67%	-7.37%
Grains Sub-Index	6.25%	5.85%	2.98%	-8.07%
Corn	4.26%	0.28%	1.26%	-5.21%
Soybeans	4.82%	3.03%	-6.41%	-19.47%
Wheat	11.11%	18.74%	18.71%	2.58%
Energy Sub-Index	5.73%	-2.00%	-16.14%	-16.02%
Petroleum Sub-Index	6.87%	-2.93%	-16.06%	-14.18%
WTI	7.00%	-3.80%	-16.43%	-18.02%
Brent	6.62%	-2.85%	-15.12%	-13.90%
ULSD	7.47%	-0.87%	-14.45%	-11.69%
Gasoline	6.57%	-3.48%	-19.04%	-8.60%
Natural Gas	2.80%	0.57%	-16.50%	-20.77%
Precious Metals Sub-Index	-0.94%	-3.57%	4.81%	-10.66%
Gold	-1.10%	-2.89%	6.43%	-8.22%
Silver	-0.46%	-5.46%	0.47%	-16.71%
Industrial Metals Sub-Index	2.82%	3.93%	7.34%	15.36%
Copper	2.92%	4.94%	7.66%	19.94%
Aluminum	2.91%	-0.69%	12.68%	13.05%
Nickel	3.40%	5.19%	-5.97%	-7.27%
Zinc	1.90%	9.06%	8.89%	26.15%
Softs Sub-Index	3.29%	-6.64%	-18.40%	-22.59%
Coffee	2.21%	-1.57%	-12.71%	-21.72%
Sugar	4.88%	-0.82%	-33.29%	-36.00%
Cotton	2.36%	-6.77%	-3.64%	5.70%
Livestock Sub-Index	3.10%	-3.50%	13.96%	6.32%
Cattle	0.91%	-7.66%	15.63%	15.80%
Hogs	6.50%	3.33%	11.19%	-5.61%

Central bank prattle took all of the major currencies save the JPY higher as the Federal Reserve has no need to follow suit on its own lead. This is unlikely to be the start of a longer-term trend lower in the USD, however.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	2.07%	1.62%	9.29%	2.88%
Chinese yuan	0.82%	0.55%	2.42%	-1.96%
Japanese yen	-0.99%	-1.43%	4.59%	-8.18%
British pound	2.41%	1.05%	6.08%	-2.15%
Swiss franc	1.19%	1.03%	6.85%	1.89%
Canadian dollar	2.34%	4.13%	3.69%	-0.31%
Australian dollar	1.60%	3.49%	7.03%	3.19%
Swedish krona	3.43%	3.04%	8.38%	0.33%
Norwegian krone	1.25%	1.07%	3.75%	0.20%
New Zealand dollar	0.66%	3.50%	5.91%	2.79%
Indian rupee	-0.10%	-0.11%	5.65%	4.56%
Brazilian real	1.04%	-2.45%	-0.67%	-2.88%
Mexican peso	-0.62%	2.76%	14.42%	0.88%
Chilean peso	-0.37%	1.30%	0.98%	-0.10%
Colombian peso	-0.73%	-4.25%	-1.43%	-4.11%
Bloomberg-JP Morgan Asian dollar index (spot)	0.21%	0.23%	3.22%	-0.58%

We should never forget how much of the equity bull market has been driven by the TINA argument. Any rise in interest rates threatens this. However, nothing yet suggests anything more than a normal bullish consolidation is impending.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.40%	-0.82%	10.59%	18.34%
North America	-0.48%	0.72%	9.18%	17.70%
Latin America	2.22%	-0.48%	10.32%	15.40%
Emerging Market Free	0.14%	0.45%	18.60%	24.17%
EAFE	-0.25%	0.23%	14.23%	20.83%
Pacific	-0.19%	-0.87%	11.81%	18.97%
Eurozone	-0.84%	-2.47%	18.11%	27.36%

Both CTAs and hedge funds lost heavily, suggesting their likely long positions in both equities and sovereign debt did not serve them well. Moreover, the burst of short-covering in physical commodities apparently trapped CTAs.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-3.09%	-0.52%	-4.04%	-10.64%
Newedge Trend	-2.45%	-0.88%	-1.94%	-7.83%
Newedge Short-Term	-0.60%	-0.44%	-6.63%	-11.53%
HFR Global Hedge Fund	-0.06%	0.31%	2.72%	6.39%
HFR Macro/CTA	-0.61%	0.68%	0.32%	-2.32%
HFR Macro: Sytematic Diversified CTA	-1.58%	0.24%	-2.18%	-5.71%