The Macro Environment For Financial Markets

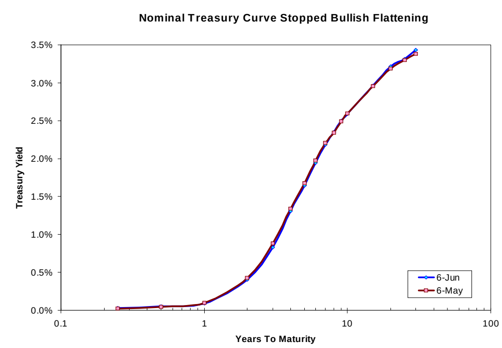
The European Central Bank's move toward negative deposit facility rates will have little immediate effect but will serve as a longer-term impetus for an eventual euro carry trade. Unless the ECB moves toward QE, its moves created an incentive for capital inflows that will keep the euro bid and reward Eurozone financial assets but not the real Eurozone economy. Eurozone financial markets are poised to outperform the U.S. until a euro carry trade can be created, a difficult task considering how other major central banks remain stimulative.

The causal chain is now:

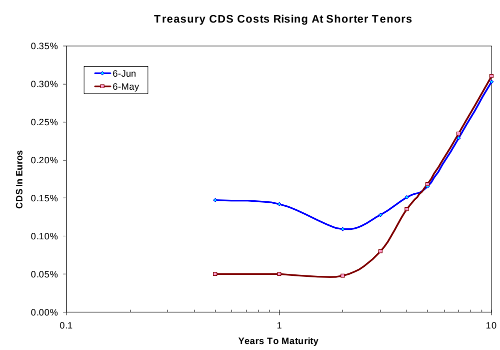
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve. Rising levels of risk-aversion will push real long-term rates lower;
2. Nominal long-term rates will retrace some of their recent bullish move, but the longer-term uptrend remains intact;
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 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 continue their downward trend as investors reluctantly increase their levels of risk acceptance

Key Market Indications

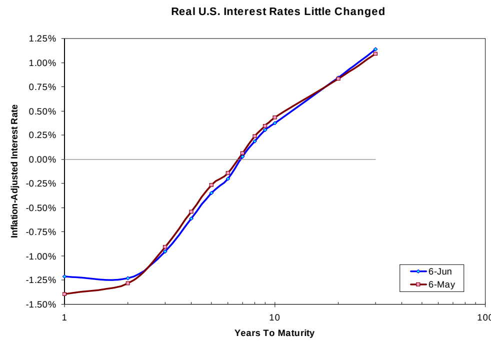
The Treasury yield curve's bullish flattening stopped as the long end hit resistance. Small rebounds in the ten- and thirty-year to 2.66% and 3.59%, respectively, are likely within what is still a bull market.



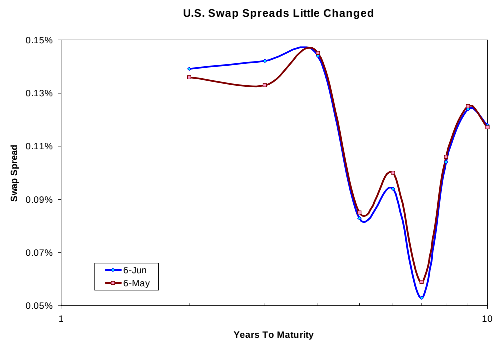
Euro-denominated CDS costs on U.S. Treasuries increased slightly at short-dated tenors over month-ago levels, but the changes are minor.



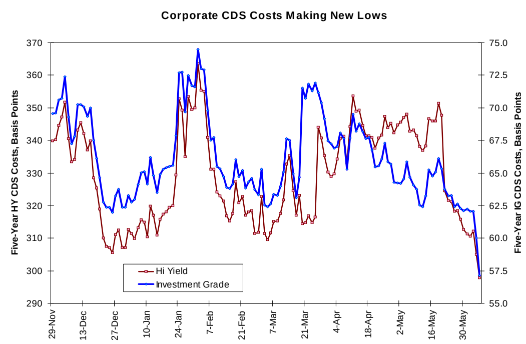
Real rates remain negative out to the six-year horizon. Levels of risk-aversion as evidenced by higher short-term and lower long-term real rates have declined over the past month. The combination is negative for precious metals and supportive for risky financial assets.



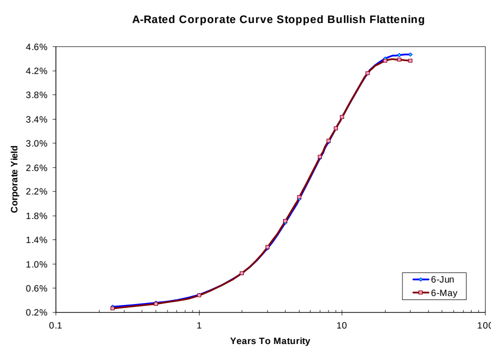
Swap spreads, which rise when floating-rate borrowers want to fix their payments, once again increased at the one- and two-year tenors as floating-rate borrowers realize there is little room for these yields to decline.



Five-year CDS costs for both investment-grade and high-yield bonds moved to new lows in the cycle as interest rates are forced lower in the absence of overt corporate financial stress. This is bullish for equities.



The A-rated yield curve has moved similarly to the Treasury yield curve. The continued compression of credit spreads and will keep the bullish tone of this market intact until an overt policy reversal signal is given.



Market Structure

While the Petroleum and Natural Gas indices moved higher, the Grains, Softs, and Precious Metals markets remained under pressure. Long-term Treasuries moved out of their uptrend structure.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For June 9-13
DJ-UBS	29	Trending	-0.208	5.6%	-0.09%
DJ-UBS Grain	29	Trending	-0.336	13.5%	-0.36%
DJ-UBS Ind. Metl	10	Sideways	-0.050	12.1%	
DJ-UBS Pre. Metl	29	Trending	-0.179	11.6%	-0.09%
DJ-UBS Softs	29	Trending	-0.289	16.8%	-0.30%
DJ-UBS Nat. Gas	29	Trending	0.131	19.2%	
DJ-UBS Petroleum	28	Trending	0.034	8.1%	0.04%
DJ-UBS Livestock	11	Transitional	0.141	8.6%	
Dollar Index	29	Trending	0.123	4.0%	0.04%
S&P 500 Index	29	Trending	0.397	6.8%	0.15%
EAFE Index	25	Trending	0.278	5.4%	0.09%
EM Index	29	Trending	0.185	8.9%	0.18%
Ten-year UST (price)	29	Trending	-0.044	4.8%	

Performance Measures

The main DJ-UBS index and both Precious and Industrial Metals joined Grains, Softs and Livestock in moving lower. Only the Petroleum index showed positive returns.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Dow Jones-UBS	-0.09%	-1.51%	6.16%	1.89%
Grains Sub-Index	-1.56%	-8.22%	3.79%	-8.86%
Corn	-1.45%	-9.55%	2.24%	-24.40%
Soybeans	-2.43%	-2.02%	12.19%	14.40%
Wheat	-1.43%	-14.43%	-6.00%	-16.38%
Energy Sub-Index	0.76%	2.40%	8.38%	11.03%
Petroleum Sub-Index	-0.50%	1.82%	3.63%	8.05%
WTI	-0.05%	3.38%	8.49%	12.12%
ULSD	-0.59%	-1.05%	-2.79%	0.88%
Gasoline	-1.11%	2.12%	4.62%	5.02%
Natural Gas	3.70%	3.75%	19.26%	17.04%
Precious Metals Sub-Index	0.81%	-2.23%	-0.01%	-10.76%
Gold	0.52%	-2.75%	1.41%	-9.71%
Silver	1.65%	-0.68%	-3.93%	-13.58%
Industrial Metals Sub-Index	-0.26%	1.03%	3.61%	-2.28%
Copper	-2.32%	-1.04%	-5.88%	-7.06%
Aluminum	2.52%	7.07%	1.41%	-11.07%
Nickel	-2.07%	-5.33%	34.45%	23.35%
Zinc	2.39%	3.32%	8.66%	5.81%
Softs Sub-Index	-2.64%	-8.38%	14.91%	3.80%
Coffee	-3.04%	-6.41%	57.89%	23.72%
Sugar	-2.65%	-1.63%	-3.16%	-7.21%
Cotton	-1.73%	-8.21%	3.71%	-1.54%
Livestock Sub-Index	2.74%	1.07%	14.01%	19.38%
Cattle	1.95%	2.10%	11.29%	15.21%
Hogs	3.74%	-0.17%	18.37%	26.25%

The USD weakened against the European currencies as the lack of a defined QE program kept the euro from declining but gained against the JPY, CAD and the Latin American currencies.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.06%	-2.05%	-0.46%	3.00%
Japanese yen	-0.69%	-0.78%	0.42%	-5.38%
British pound	0.28%	-1.02%	2.77%	7.71%
Swiss franc	0.18%	-2.16%	-0.19%	3.98%
Canadian dollar	-0.78%	-0.33%	-2.66%	-6.10%
Australian dollar	0.25%	-0.19%	2.54%	-2.75%
Swedish krona	0.90%	-2.00%	-1.86%	-1.28%
Norwegian krone	0.47%	-0.38%	3.66%	-3.35%
New Zealand dollar	0.02%	-2.75%	2.63%	5.93%
Indian rupee	-0.14%	1.55%	3.77%	-3.94%
Brazilian real	-0.26%	-0.80%	3.77%	-5.23%
Mexican peso	-0.55%	0.76%	0.02%	-0.97%
Chilean peso	0.03%	3.11%	-4.31%	-8.18%
Colombian peso	0.75%	1.88%	2.62%	1.15%
Bloomberg-JP Morgan Asian dollar index (spot)	0.17%	0.13%	-0.41%	-1.11%

The EM index reversed recent losses on the back of increased prospects for greater global liquidity and has joined North American and EAFE markets in the uptrend.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.18%	3.46%	9.14%	22.27%
North America	1.37%	4.41%	9.23%	22.53%
Latin America	3.21%	0.71%	6.89%	0.77%
Emerging Market Free	1.75%	4.38%	5.47%	8.93%
EAFE	0.91%	2.13%	9.00%	21.89%
Pacific	1.08%	2.67%	3.49%	13.13%
Eurozone	1.46%	3.49%	12.60%	31.22%

Both CTAs and macro-oriented funds gave back some recent gains. This suggests they were too exposed to the sovereign debt and very possibly to the short side of the euro.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-1.90%	1.99%	-0.14%	-1.70%
Newedge Trend	-1.22%	1.79%	1.74%	-0.28%
Newedge Short-Term	-0.98%	2.29%	3.26%	1.76%
HFR Global Hedge Fund	0.44%	0.85%	2.42%	4.02%
HFR Macro/CTA	-0.01%	1.34%	0.03%	-1.62%
HFR Macro: Sytematic Diversified CTA	-0.68%	1.05%	-1.66%	-1.88%