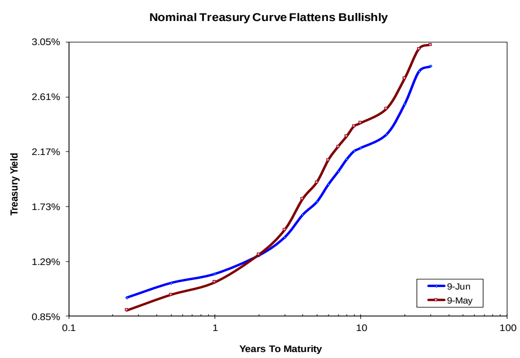
The Macro Environment For Financial Markets

Markets continue to remain steady in the face of events that only a few years ago would have produced wholesale ululation. While it has become fashionable to describe this as complacency, a better description remains a rational response to suppressive policies. The ease with which large-capitalization tech stocks fell in the U.S. on Friday should stand as a warning, though: First, you take profits and sell what you can. Next you try to sell the rest and encounter lower liquidity. The causal chain remains:

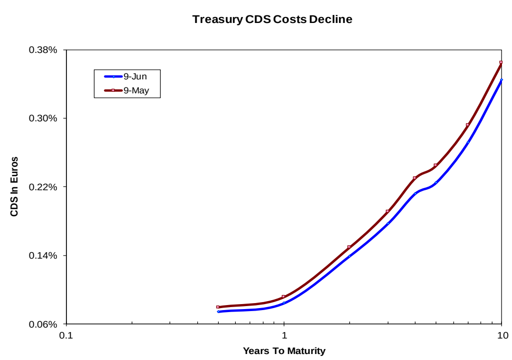
1. The market still is pricing in higher short-term rates in 2017, but the conviction level is declining;
2. Inflationary expectations remain under pressure;
3. The U.S. yield curve continues in its secular flattening trend;
4. Short-term borrowers are close to terming out short-term debt into the bond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

Key Market Indications

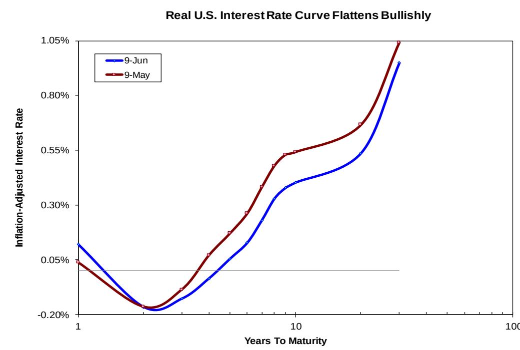
The UST market continues to flatten bullishly. Declines in long-term sovereign rates in the Eurozone and in the U.K. are reviving the trade seen throughout 2015-2016 of swapping those bonds for UST. The large central bank holders of UST are not going to sell against themselves, and with inflation expectations declining, it is difficult to see a bear market emerging at the long end of the yield curve.



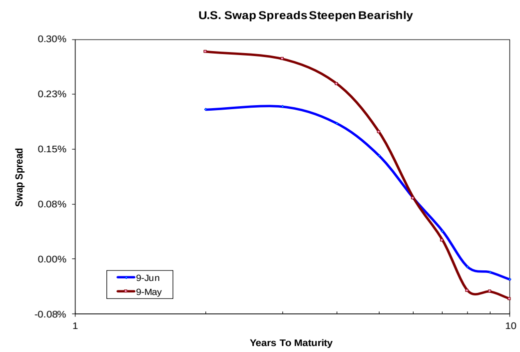
CDS costs on UST declined. This market remains unconcerned about the U.S. debt ceiling.



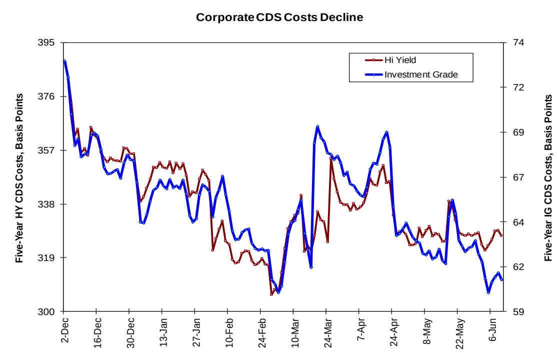
The pseudo-real yield curve shifted higher at the short end of the yield curve but declined from three years onward. These declines are bullish for risky assets.



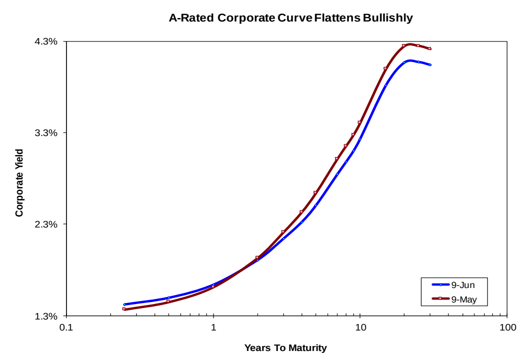
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted lower at tenors shorter than six years. The market clearly is backing away from a belief in rate hikes after June.



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

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

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate June 12 - 16
BBerg	20	Trending	-0.113	8.2%	-0.10%
BBerg Grain	26	Trending	0.199	12.6%	0.07%
BBerg Ind. Metl	19	Transitional	0.044	13.2%	
BBerg Pre. Metl	29	Trending	0.137	10.0%	0.16%
BBerg Softs	29	Trending	-0.314	14.8%	-0.63%
BBerg Nat. Gas	29	Trending	-0.249	23.1%	-1.59%
BBerg Petroleum	21	Trending	-0.238	24.1%	-0.83%
BBerg Livestock	4	Sideways	0.032	15.0%	
Dollar Index	9	Sideways	0.063	5.4%	
S&P 500 Index	29	Trending	0.194	5.8%	0.12%
EAFE Index	12	Transitional	-0.029	6.4%	
EM Index	16	Transitional	0.101	8.2%	
Ten-year UST (price)	29	Trending	0.140	3.9%	0.15%

Performance Measures

Grains turned in strong gains, while the Petroleum markets and Precious Metals sank on supply issues and the removal of some political uncertainties, respectively. Softs and the economically sensitive Industrial Metals posted gains.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	0.13%	-1.20%	-6.20%	-6.85%
Grains Sub-Index	3.49%	2.10%	-1.98%	-19.83%
Corn	4.08%	4.63%	3.75%	-17.18%
Soybeans	2.28%	-2.11%	-11.31%	-21.86%
Wheat	3.81%	3.08%	1.15%	-23.83%
Energy Sub-Index	-2.47%	-7.29%	-18.15%	-14.87%
Petroleum Sub-Index	-3.82%	-4.83%	-17.54%	-16.12%
WTI	-3.83%	-4.79%	-18.43%	-18.99%
Brent	-3.39%	-5.15%	-16.90%	-15.46%
ULSD	-3.62%	-4.50%	-17.02%	-14.34%
Gasoline	-4.82%	-4.59%	-17.21%	-12.74%
Natural Gas	1.24%	-13.15%	-20.01%	-10.39%
Precious Metals Sub-Index	-0.94%	3.80%	5.99%	-1.66%
Gold	-0.67%	3.35%	8.54%	-1.47%
Silver	-1.70%	5.08%	-0.24%	-2.39%
Industrial Metals Sub-Index	0.97%	1.71%	-1.92%	20.42%
Copper	2.89%	5.01%	0.36%	28.18%
Aluminum	-1.28%	0.71%	9.18%	18.97%
Nickel	0.65%	-3.74%	-21.16%	-0.98%
Zinc	0.04%	-1.05%	-7.91%	19.60%
Softs Sub-Index	1.48%	-5.76%	-14.79%	-16.77%
Coffee	0.81%	-6.16%	-13.46%	-15.47%
Sugar	3.90%	-7.90%	-25.52%	-29.42%
Cotton	-1.25%	-7.80%	2.22%	11.84%
Livestock Sub-Index	-0.76%	3.07%	19.43%	5.52%
Cattle	-1.73%	1.78%	25.20%	18.67%
Hogs	0.80%	5.19%	10.82%	-10.91%

The combination of the U.K. election and a somewhat dovish stance from the ECB pulled the European currencies lower while commodity-linked currencies such as the CAD, AUD and MXN recovered some of last week's losses. The currency markets look as if they will be in trading ranges through the summer.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.74%	2.95%	6.00%	-1.07%
Chinese yuan	0.18%	1.61%	1.62%	-3.47%
Japanese yen	0.07%	3.32%	4.53%	-2.92%
British pound	-1.10%	-1.45%	1.38%	-11.84%
Swiss franc	-0.65%	3.92%	4.92%	-0.50%
Canadian dollar	0.13%	1.86%	-2.16%	-5.54%
Australian dollar	1.13%	2.48%	1.05%	1.29%
Swedish krona	-1.06%	1.99%	5.44%	-6.18%
Norwegian krone	-0.97%	2.20%	0.04%	-4.04%
New Zealand dollar	0.99%	4.61%	1.08%	1.52%
Indian rupee	0.29%	0.58%	4.92%	3.84%
Brazilian real	-1.55%	-3.26%	2.53%	3.14%
Mexican peso	2.80%	5.51%	12.20%	0.42%
Chilean peso	0.91%	2.17%	-1.80%	2.39%
Colombian peso	-0.74%	1.80%	3.05%	0.75%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.01%	1.27%	2.45%	-0.75%

The old adage of you either wear 'em out or scare 'em out of a bull run leaned toward the former this week as active traders moved to take profits before expirations. Even though valuations are high, we are still left with the conundrum of "sell and do what?"

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-0.60%	1.86%	10.80%	18.41%
North America	-0.27%	1.69%	8.34%	16.83%
Latin America	-0.39%	-3.47%	9.98%	19.34%
Emerging Market Free	0.36%	3.00%	17.24%	24.90%
EAFE	-1.17%	2.33%	15.19%	16.63%
Pacific	-1.14%	2.15%	8.61%	17.31%
Eurozone	-0.81%	2.18%	21.73%	26.60%

While CTAs managed gains on the back of strong trends in grain and energy markets, hedge funds reverted to the normal pattern of losing money during equity market downturns.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.34%	0.79%	-0.85%	-6.55%
Newedge Trend	0.37%	1.03%	1.14%	-3.62%
Newedge Short-Term	0.01%	0.13%	-5.12%	-11.09%
HFR Global Hedge Fund	-0.24%	0.36%	2.78%	5.33%
HFR Macro/CTA	-0.23%	1.69%	1.12%	-2.36%
HFR Macro: Sytematic Diversified CTA	-0.63%	1.65%	-0.32%	-3.45%