The Macro Environment For Financial Markets

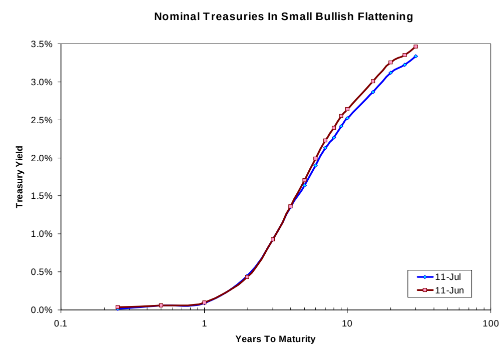
Should anyone be surprised short-term interest rates in the U.S. will have to rise at some point and that the continuous game of rearranging bad debt within the Eurozone's banking system had another irruption? The likely outcome in the Eurozone will be a continued flight into Bunds followed by a de fact extension of the German balance sheet to Portugal. The Federal Reserve is in no hurry either to raise short-term interest rates or to tighten credit conditions, and neither growth nor inflation expectations will be sufficiently strong to pressure them into doing so.

The causal chain is now:

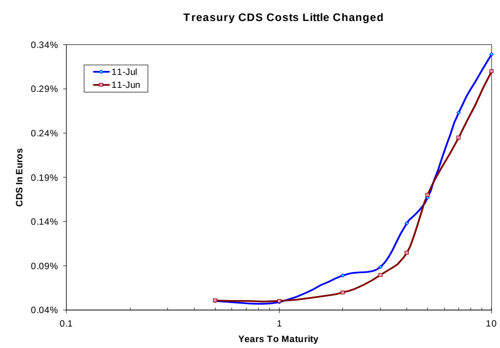
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve;
2. The longer-term uptrend in senior sovereign debt remains intact but is facing increasing resistance;
3. The expansion of Eurozone sovereign debt spreads is likely to remain a short-term affair;
4. 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;
5. Short-term borrowers will continue to accept rollover risk and keep their effective maturities as short as possible;
6. 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
7. Credit spreads will not move higher in the absence of overt event risk or unless swap spreads move back toward levels last seen in August 2013.

Key Market Indications

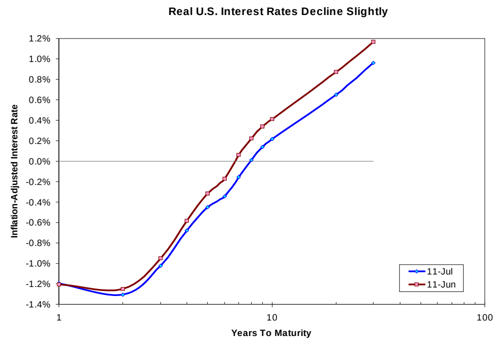
The Treasury yield curve resumed its long-term trend toward a bullish flattening, but the ten-year is likely to encounter formidable resistance at 2.39%. Increased speculation of higher short-term rates in 2015 will dampen growth and inflation expectations and increase the attractiveness of long-term Treasuries to risk-averse investors.



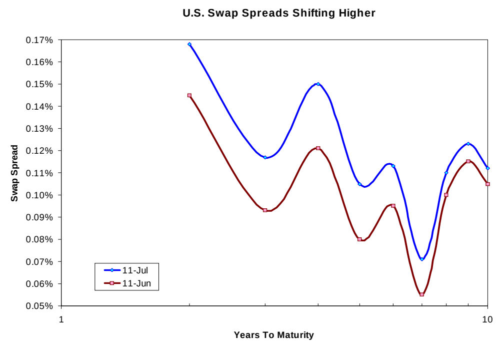
Euro-denominated CDS costs on U.S. Treasuries have remained little changed. Interestingly, though, they have not declined over the past month even as the Treasury's borrowing needs continue to shrink.



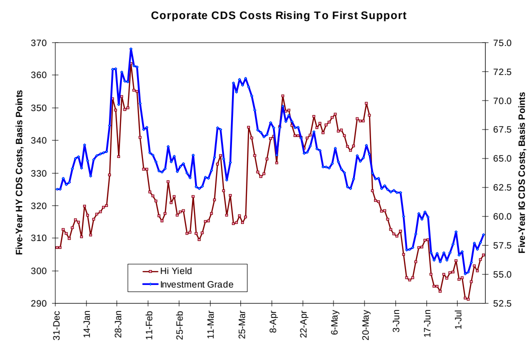
Real rates remain negative out to the seven-year horizon. The bullish shift in their term structure is bullish for risky financial assets. The inability of short-term real rates to decline removes one of the important supports for gold but is not yet bearish.



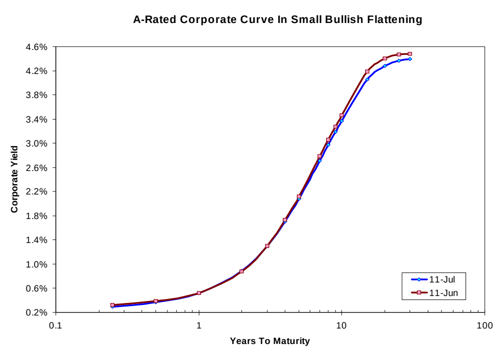
Swap spreads, which rise when floating-rate borrowers want to fix their payments, shifted higher across tenors. This simply represents a decrease in the overt complacency of fixed-income markets. If the trend expands, however, the longer-term rally in corporate debt will grind to a halt.



Five-year CDS costs for both investment-grade and high-yield bonds rose from last week's lows on the cycle to a logical first resistance point. Nothing yet signals a cyclical increase in these costs.



The A-rated yield curve continues to move similarly to the Treasury yield curve. Until and unless credit spreads break through resistance, the bullish tone of this market will remain intact until an overt policy reversal signal is given or until an event occurs.



Market Structure

The broad Bloomberg index remains in a downtrend structure. Grains, Softs and Natural Gas are in such structures as well, and Petroleum is on the cusp of a downtrend. The EAFE is in a downtrend while ten-year Treasuries returned to an uptrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For July 14-18
BBerg	25	Trending	-0.425	5.9%	-0.04%
BBerg Grain	29	Trending	-0.767	15.4%	-0.76%
BBerg Ind. Metl	29	Trending	0.284	12.5%	0.28%
BBerg Pre. Metl	8	Sideways	0.085	11.0%	
BBerg Softs	20	Trending	-0.303	15.8%	-0.29%
BBerg Nat. Gas	29	Trending	-0.399	19.7%	-0.70%
BBerg Petroleum	29	Trending	-0.247	8.8%	
BBerg Livestock	4	Sideways	-0.017	19.9%	
Dollar Index	21	Trending	-0.022	3.2%	-0.03%
S&P 500 Index	13	Transitional	0.006	6.6%	
EAFE Index	26	Trending	-0.211	6.3%	-0.05%
EM Index	18	Transitional	0.108	5.5%	
Ten-year UST (price)	28	Trending	0.121	4.7%	0.01%

Performance Measures

All major subindices save for Precious Metals declined significantly, but primarily for strong supply outlooks. The macroeconomic implications therefore are neutral for consumers but are negative for commodity producers both at the firm and at the national level.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-3.00%	-3.40%	4.34%	1.40%
Grains Sub-Index	-7.17%	-13.00%	-8.22%	-18.25%
Corn	-7.63%	-14.61%	-13.79%	-32.03%
Soybeans	-5.16%	-11.97%	-0.38%	4.90%
Wheat	-9.23%	-11.82%	-11.95%	-27.82%
Energy Sub-Index	-3.84%	-6.65%	6.22%	4.30%
Petroleum Sub-Index	-3.00%	-4.05%	7.73%	0.91%
WTI	-3.10%	-4.54%	13.34%	1.64%
ULSD	-2.38%	-4.27%	0.26%	-3.76%
Gasoline	-3.41%	-3.38%	8.12%	-1.48%
Natural Gas	-5.89%	-12.63%	2.39%	9.20%
Precious Metals Sub-Index	1.35%	6.00%	6.76%	5.05%
Gold	1.28%	4.98%	7.32%	4.39%
Silver	1.53%	8.95%	5.23%	7.30%
Industrial Metals Sub-Index	-0.12%	7.27%	7.15%	7.79%
Copper	-0.32%	7.98%	-1.41%	3.75%
Aluminum	0.16%	4.97%	6.81%	-3.34%
Nickel	-2.52%	7.17%	34.29%	38.45%
Zinc	2.74%	10.14%	9.92%	16.02%
Softs Sub-Index	-5.05%	-6.09%	6.48%	0.46%
Coffee	-6.05%	-8.53%	29.77%	23.28%
Sugar	-4.15%	-4.37%	-0.33%	-6.61%
Cotton	-5.47%	-12.38%	-11.91%	-14.63%
Livestock Sub-Index	-3.26%	-0.11%	16.62%	20.40%
Cattle	-3.80%	1.69%	13.65%	18.94%
Hogs	-2.54%	-2.29%	23.15%	23.87%

While short-term currency market conditions remain noisy, the medium-term outlook for a weaker dollar will remain intact until the ECB finds a way to push the EUR lower. Gains in higher-yielding currencies such as the GBP, CAD and NZD will make them and not the USD the first target of carry trades and dampen the relative performance of U.S. markets.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	0.10%	0.56%	-0.46%	3.90%
Japanese yen	0.75%	0.76%	1.68%	-2.31%
British pound	-0.26%	1.95%	4.47%	12.72%
Swiss franc	0.21%	0.86%	0.76%	6.14%
Canadian dollar	-0.75%	1.25%	1.20%	-3.43%
Australian dollar	0.29%	0.10%	3.73%	2.22%
Swedish krona	0.74%	-1.37%	-4.26%	-1.99%
Norwegian krone	0.17%	-2.87%	-1.00%	-1.88%
New Zealand dollar	0.81%	3.05%	5.17%	12.19%
Indian rupee	-0.34%	-1.10%	2.63%	-0.43%
Brazilian real	-0.32%	0.57%	6.14%	1.56%
Mexican peso	-0.16%	0.10%	0.69%	-1.46%
Chilean peso	-0.90%	0.08%	-4.94%	-8.80%
Colombian peso	-0.59%	1.38%	3.79%	2.85%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.03%	0.24%	0.16%	0.17%

Equity markets shifted lower using both anticipation of higher interest rates in the U.S. and the Portuguese situation as an excuse. These conditions have devolved into bullish outcomes in recent years, especially in the Eurozone, as ECB liquidity generation will remain high.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	-1.52%	0.43%	6.47%	18.94%
North America	-0.92%	1.51%	8.21%	20.23%
Latin America	0.56%	0.71%	13.07%	14.37%
Emerging Market Free	-0.29%	0.89%	11.01%	15.38%
EAFE	-2.40%	-1.12%	4.01%	17.09%
Pacific	-1.19%	1.43%	3.31%	8.04%
Eurozone	-3.33%	-3.39%	3.45%	26.34%

Trend-following CTAs and macro hedge funds had very poor weeks. This reinforces previous observations they were overly exposed to the long equity trade. That they were not aided by continued strong breaks in physical commodity markets suggests they remain biased to the long side of these markets.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	-0.71%	1.39%	2.30%	0.45%
Newedge Trend	-0.54%	0.37%	2.71%	0.21%
Newedge Short-Term	-0.49%	0.34%	2.52%	1.83%
HFR Global Hedge Fund	-0.49%	-0.05%	1.37%	4.44%
HFR Macro/CTA	-0.13%	-0.52%	-0.33%	-1.56%
HFR Macro: Sytematic Diversified CTA	-0.11%	0.25%	-1.49%	-1.41%