The Macro Environment For Financial Markets

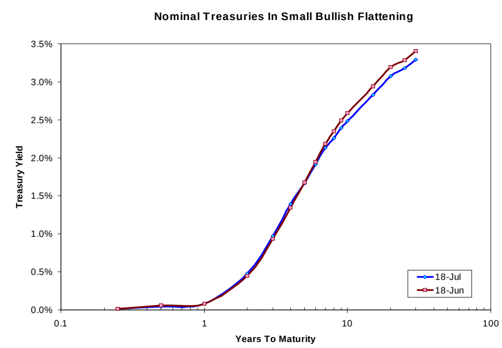
While the tone of economic data remain consistent with a tepid and unspectacular expansion and the Federal Reserve defended its right to operate on an ad hoc basis, the most important signal came from markets' initial reaction to geopolitical news: The impulse to sell, take profits and buy insurance against further declines was extreme. Even though it was negated swiftly, it tells us we are living in a world of low convictions where good assets will be sold early and often as they are the most liquid. This will be deadly for those who adhere to fundamental analysis. The exposure of global economies to markets' continued high valuation levels will force policymakers into defending those valuations until they are pushed to unsustainable levels with all of the negative consequences pertaining thereto.

The causal chain is now:

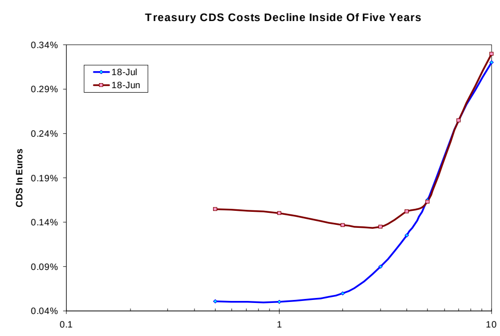
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve;
2. The longer-term uptrend in senior sovereign debt remains intact but is facing increasing resistance;
3. The expansion of Eurozone sovereign debt spreads is likely 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 not revisit their recent lows for some time and will act to cap the corporate bond rally even as credit spreads will not move higher in the absence of overt event risk.

Key Market Indications

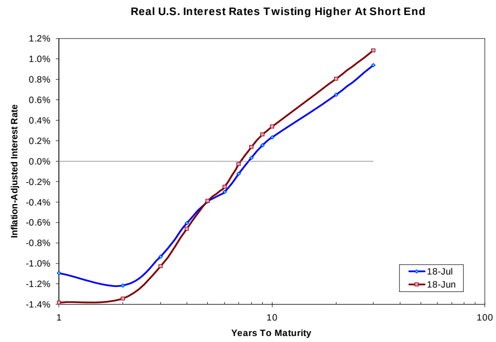
The Treasury yield curve remains in its long-term trend toward a bullish flattening, but the ten-year has been unable to break formidable resistance at 2.39%. Increased speculation of higher short-term rates in 2015 will dampen growth and inflation expectations and increase the attractiveness of long-term Treasuries to risk-averse investors. The noise surrounding haven bids is just that, noise.



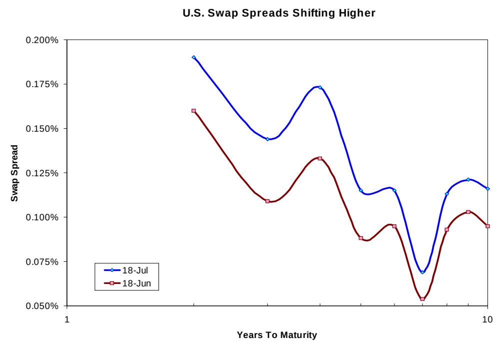
Euro-denominated CDS costs on U.S. Treasuries have declined at short-dated tenors. As noted last week, this should have been the case as the Treasury's borrowing needs continue to shrink.



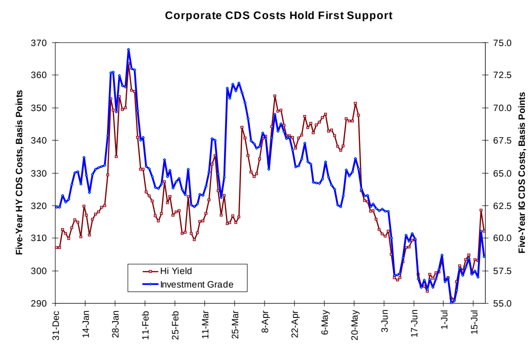
Real rates remain negative out to the seven-year horizon. The increase at short-dated maturities is a negative for precious metals; the decline at longer maturities remains bullish for risky financial assets.



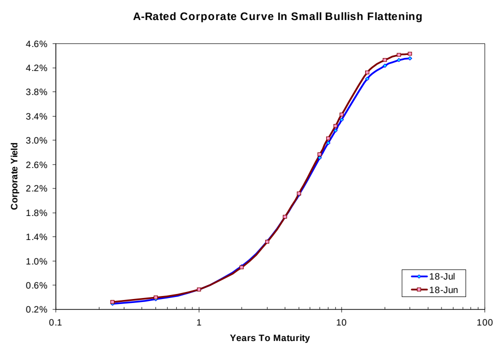
Swap spreads, which rise when floating-rate borrowers want to fix their payments, continue to shift higher across tenors. A continuation of this trend will lead to an end of corporate bonds' credit spread compression.



Five-year CDS costs for both investment-grade and high-yield bonds held their first support levels after last week's Portuguese-related expansion. Nothing yet signals a cyclical increase in these costs. Indeed, the very factors such as improved economic growth that may lead to higher swap spreads should maintain a cap on credit spreads and CDS 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 as do both Softs and Natural Gas. The remaining physical markets are trendless as are the equity indices. Ten-year Treasuries remain in an uptrend, where they are about to be joined by the dollar index.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For July 21-25
BBerg	26	Trending	-0.466	6.3%	-0.04%
BBerg Grain	4	Sideways	-0.044	23.8%	
BBerg Ind. Metl	6	Sideways	-0.072	10.7%	
BBerg Pre. Metl	11	Transitional	-0.049	13.1%	
BBerg Softs	25	Trending	-0.191	15.0%	-0.29%
BBerg Nat. Gas	29	Trending	-0.513	19.5%	-0.70%
BBerg Petroleum	4	Sideways	-0.007	9.3%	
BBerg Livestock	6	Sideways	0.035	12.1%	
Dollar Index	25	Trending	0.103	3.1%	
S&P 500 Index	7	Sideways	0.044	7.8%	
EAFE Index	18	Transitional	-0.122	6.4%	
EM Index	6	Sideways	-0.004	6.6%	
Ten-year UST (price)	29	Trending	0.166	4.4%	0.01%

Performance Measures

Both Softs and Livestock rebounded on short-term strength in coffee and cattle, respectively, but neither has any particular macroeconomic import. The bounce in the Petroleum index is a temporary artifact of the Ukraine situation. Both Industrial and Precious Metals moved lower, but neither move appears to be a function of eroding demand conditions.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-0.69%	-5.32%	3.49%	-0.24%
Grains Sub-Index	-0.28%	-13.83%	-6.65%	-18.31%
Corn	-1.85%	-17.18%	-14.09%	-33.10%
Soybeans	0.95%	-11.87%	2.65%	4.51%
Wheat	1.19%	-10.28%	-8.21%	-25.14%
Energy Sub-Index	-1.08%	-7.61%	3.81%	0.96%
Petroleum Sub-Index	0.23%	-5.45%	6.58%	-0.17%
WTI	1.65%	-3.79%	12.54%	1.09%
ULSD	-0.56%	-6.79%	-1.69%	-6.15%
Gasoline	-1.60%	-7.12%	6.47%	-3.50%
Natural Gas	-4.37%	-12.86%	-3.06%	0.45%
Precious Metals Sub-Index	-2.24%	-0.52%	5.19%	2.21%
Gold	-2.08%	-0.53%	5.42%	1.07%
Silver	-2.68%	-0.51%	4.54%	6.20%
Industrial Metals Sub-Index	-1.11%	3.28%	4.62%	7.25%
Copper	-2.58%	2.30%	-4.39%	1.55%
Aluminum	2.08%	4.81%	6.87%	-0.04%
Nickel	-3.76%	1.29%	25.86%	29.61%
Zinc	-0.27%	5.23%	8.29%	18.39%
Softs Sub-Index	2.15%	-4.99%	9.80%	1.41%
Coffee	6.82%	-1.76%	42.19%	28.14%
Sugar	-0.59%	-9.49%	0.84%	-8.47%
Cotton	-0.56%	-12.12%	-16.78%	-16.19%
Livestock Sub-Index	0.90%	1.64%	15.58%	20.97%
Cattle	1.69%	3.62%	13.58%	20.81%
Hogs	-0.30%	-0.99%	20.51%	22.37%

The Ukraine situation did what ECB jawboning has been unable to do, push the EUR lower. The short-term flight into the USD will devolve into carry trade-driven moves into higher-yielding currencies such as the CAD, AUD and NZD and will act to maintain their relative asset performance.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.62%	-0.52%	-0.21%	3.17%
Japanese yen	-0.04%	0.58%	2.80%	-0.90%
British pound	-0.16%	0.55%	4.01%	12.22%
Swiss franc	-0.70%	-0.31%	1.28%	5.14%
Canadian dollar	0.01%	0.96%	2.01%	-3.31%
Australian dollar	-0.02%	-0.19%	6.57%	2.40%
Swedish krona	-0.69%	-2.89%	-5.11%	-3.91%
Norwegian krone	-0.15%	-2.91%	-0.20%	-3.31%
New Zealand dollar	-1.40%	-0.54%	4.34%	9.95%
Indian rupee	-0.58%	0.19%	2.22%	-1.02%
Brazilian real	-0.23%	0.06%	5.26%	0.06%
Mexican peso	0.37%	0.24%	2.23%	-3.45%
Chilean peso	-2.35%	-1.62%	-4.72%	-11.87%
Colombian peso	-0.62%	1.12%	5.48%	0.84%
Bloomberg-JP Morgan Asian dollar index (spot)	-0.12%	0.16%	0.42%	0.26%

Equity markets rebounded after the previous week's selloff on the Portuguese excuse; all previous Eurozone credit crises have led to further infusions of liquidity and bullish flattenings of high-quality sovereign yield curves, and this episode was no exception.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	0.49%	0.51%	6.83%	18.36%
North America	0.60%	1.34%	8.96%	19.84%
Latin America	2.16%	3.64%	17.15%	12.61%
Emerging Market Free	0.67%	2.50%	11.49%	14.28%
EAFE	0.34%	-0.69%	3.84%	16.25%
Pacific	0.59%	2.31%	4.56%	8.36%
Eurozone	-0.29%	-3.66%	2.12%	23.92%

CTA and macro-oriented CTA/hedge fund performance rebounded, once again confirming previous observations they are exposed heavily to the long equity trade. The rapid reversals surrounding the Ukraine situation appeared to catch short-term oriented CTAs off-side, however. Trading news can be hazardous to your financial health.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.43%	2.07%	1.56%	1.40%
Newedge Trend	0.16%	1.00%	1.89%	1.19%
Newedge Short-Term	-0.44%	0.23%	1.50%	2.17%
HFR Global Hedge Fund	0.00%	-0.15%	0.72%	3.54%
HFR Macro/CTA	0.27%	-0.03%	-0.95%	-2.24%
HFR Macro: Sytematic Diversified CTA	-0.27%	0.56%	-2.89%	-2.12%