The Macro Environment For Financial Markets

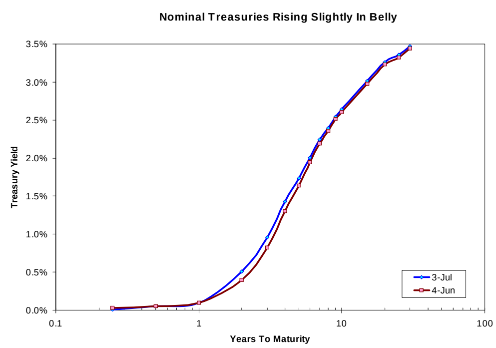
Can news be too good? Janet Yellen's affirmation of the obvious, Mario Draghi's continued bias toward ease and supportive U.S. employment data have created a risk-on environment being welcomed by those supposed to be in charge of the punchbowl. While this will end eventually, the path of least resistance for risky assets remains higher.

The causal chain is now:

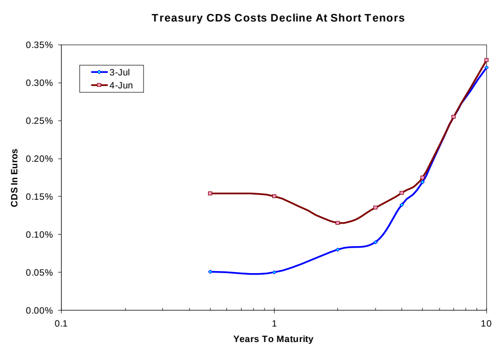
1. Short-term interest rates will remain artificially low and will keep real rates negative below the middle range of the yield curve;
2. The longer-term uptrend in senior sovereign debt remains intact but is facing increasing resistance;
3. Inflation expectations as measured by the TIPS market will threaten the top end of their year-long range and must remain below 2.47% basis the ten-year;
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 not move higher in the absence of overt event risk.

Key Market Indications

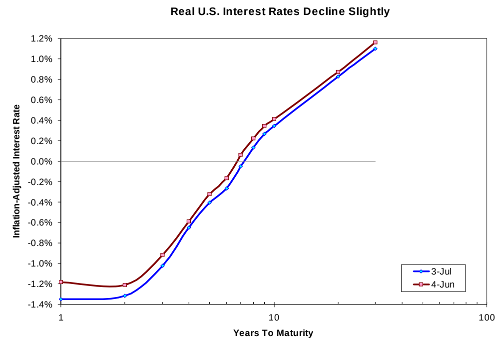
The Treasury yield curve has increased slightly in the belly of the curve but has remained virtually unchanged at both the long and short ends. The yield curve has started to flatten as the employment data increased speculation – again – of higher short-term rates beginning in 2015.



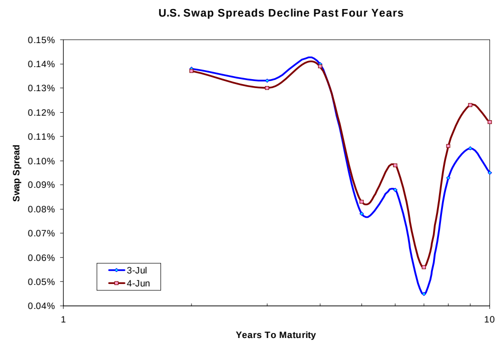
Euro-denominated CDS costs on U.S. Treasuries fell at short-dated tenors but remained unchanged at longer tenors over month-ago levels.



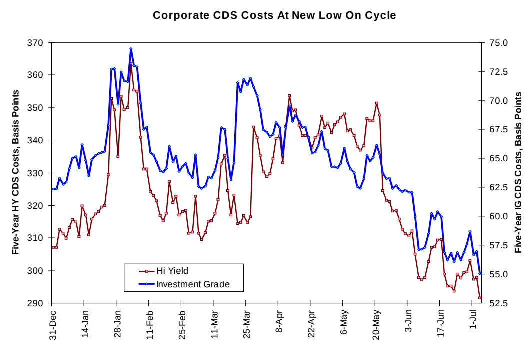
Real rates remain negative out to the seven-year horizon. The inability of short-dated real rates to rise provides some measure of support for the precious metals and maintains a general positive tone for risky financial assets.



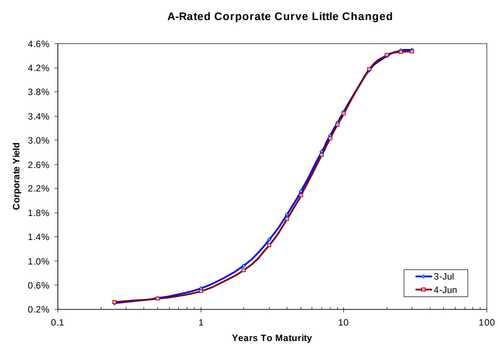
Swap spreads, which rise when floating-rate borrowers want to fix their payments, remain little changed over the past month and reflect the ongoing complacency in fixed-income markets. The pattern of longer tenors' spreads declining while shorter tenors' spreads rise has resumed.



Five-year CDS costs for both investment-grade and high-yield broke through resistance on the back of U.S. employment data. While incremental declines are going to become harder to achieve, the long-term downtrend in credit spread compression remains intact.



The A-rated yield curve has moved similarly to the Treasury yield curve. However, until and unless credit spreads expand, the bullish tone of this market remains intact until an overt policy reversal signal is given.



Market Structure

The broad Bloomberg index turned lower on declines in Grain, but both Industrial Metals and Livestock remain in upward channels. The burst higher in equity indices has put them into the first phase of a consolidative top. Long-term Treasuries are in a weak downtrend.

	N-Day Speed	Market Structure	Trend Oscillator	HLC Volatility	Daily Trend Rate For July 7-11
BBerg	29	Trending	-0.007	5.2%	-0.04%
BBerg Grain	13	Transitional	-0.279	15.4%	
BBerg Ind. Metl	27	Trending	0.359	12.1%	0.28%
BBerg Pre. Metl	5	Sideways	-0.016	12.2%	
BBerg Softs	16	Transitional	-0.104	15.2%	
BBerg Nat. Gas	28	Trending	-0.173	20.0%	-0.70%
BBerg Petroleum	29	Trending	0.057	8.3%	
BBerg Livestock	29	Trending	0.479	10.3%	0.30%
Dollar Index	29	Trending	-0.062	3.7%	-0.03%
S&P 500 Index	8	Sideways	0.160	6.4%	
EAFE Index	10	Sideways	0.164	5.4%	
EM Index	15	Transitional	0.235	5.5%	
Ten-year UST (price)	24	Trending	-0.076	4.7%	-0.01%

Performance Measures

Large declines in Grains, Energy and Softs are the result of supply increases and have little macroeconomic import. The increases in Industrial Metals should be viewed as a positive macro indicator, however.

Commodity Total Returns

	Five-Days	One Month	Six Months	One Year
Bloomberg Index	-1.57%	0.70%	7.47%	5.89%
Grains Sub-Index	-6.11%	-8.73%	-0.47%	-10.38%
Corn	-6.72%	-9.52%	-4.90%	-24.58%
Soybeans	-8.90%	-9.44%	8.00%	11.18%
Wheat	-0.90%	-7.54%	-7.23%	-18.56%
Energy Sub-Index	-1.38%	0.75%	9.62%	11.02%
Petroleum Sub-Index	-1.71%	3.19%	9.80%	8.44%
WTI	-1.52%	2.56%	15.28%	9.50%
ULSD	-2.72%	2.90%	2.16%	1.10%
Gasoline	-1.31%	4.27%	10.77%	10.28%
Natural Gas	-0.56%	-4.78%	9.64%	14.62%
Precious Metals Sub-Index	0.17%	7.68%	5.90%	5.38%
Gold	0.27%	6.13%	6.54%	5.17%
Silver	-0.12%	12.24%	4.01%	6.17%
Industrial Metals Sub-Index	3.17%	5.52%	7.50%	8.48%
Copper	3.39%	6.15%	-1.66%	3.44%
Aluminum	2.00%	4.57%	5.56%	-1.68%
Nickel	5.68%	4.28%	42.67%	41.14%
Zinc	2.05%	7.27%	8.97%	15.09%
Softs Sub-Index	-4.73%	-2.39%	11.49%	4.99%
Coffee	-5.00%	-0.61%	41.51%	29.07%
Sugar	-4.91%	-0.20%	0.18%	-4.70%
Cotton	-3.44%	-7.80%	-5.93%	-10.39%
Livestock Sub-Index	1.78%	7.83%	20.62%	23.64%
Cattle	1.47%	10.58%	19.16%	23.56%
Hogs	2.17%	4.51%	24.66%	25.22%

Currencies continue to diverge as the GBP and CAD move higher and other major currencies move lower in anticipation of success competitive devaluation moves. The BRL, MXN and INR turned lower as well.

Currency Returns

	Five-Days	One Month	Six Months	One Year
Euro	-0.44%	-0.07%	-0.29%	5.23%
Japanese yen	-0.64%	0.67%	2.11%	-1.99%
British pound	0.68%	2.47%	4.53%	13.79%
Swiss franc	-0.44%	0.29%	1.05%	6.92%
Canadian dollar	0.29%	2.87%	0.20%	-1.13%
Australian dollar	-0.77%	0.83%	4.32%	2.26%
Swedish krona	-1.66%	-2.98%	-4.90%	-2.55%
Norwegian krone	-0.91%	-2.90%	-0.21%	-1.23%
New Zealand dollar	-0.34%	3.87%	5.49%	11.68%
Indian rupee	0.59%	-0.67%	4.33%	0.66%
Brazilian real	-0.95%	2.93%	7.45%	1.53%
Mexican peso	-0.16%	-0.47%	0.83%	-0.52%
Chilean peso	0.63%	0.90%	-2.91%	-8.33%
Colombian peso	1.97%	2.95%	5.10%	3.69%
Bloomberg-JP Morgan Asian dollar index (spot)	0.30%	0.69%	0.41%	0.54%

The dual rededication of the Federal Reserve and the ECB toward monetary ease combined with arguably supportive U.S. employment data propelled all major indices higher.

Equity Total Returns

	Five-Days	One Month	Six Months	One Year
MSCI World Free	1.58%	3.00%	8.77%	25.57%
North America	1.52%	3.57%	9.77%	25.91%
Latin America	0.85%	4.28%	10.67%	14.41%
Emerging Market Free	1.68%	3.14%	10.20%	19.59%
EAFE	1.66%	2.18%	7.36%	25.08%
Pacific	0.53%	3.14%	3.68%	12.69%
Eurozone	1.99%	1.51%	9.32%	38.04%

Trend-following CTAs and macro hedge funds had a strong week after two weeks of declines, suggesting their performance increasingly is linked to the long equity index trade.

CTA/Hedge Fund Returns

	Five-Days	One Month	Six Months	One Year
Newedge CTA	0.81%	2.50%	1.91%	2.06%
Newedge Trend	0.37%	1.24%	2.65%	1.31%
Newedge Short-Term	0.19%	0.64%	2.61%	2.25%
HFR Global Hedge Fund	0.43%	1.13%	2.23%	5.41%
HFR Macro/CTA	-0.01%	0.38%	-0.11%	-1.05%
HFR Macro: Sytematic Diversified CTA	0.46%	1.09%	-1.63%	-0.70%