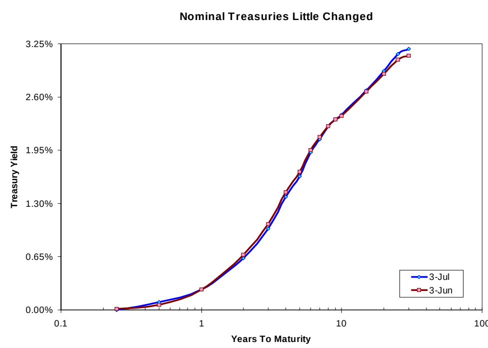
# The Macro Environment For Financial Markets

There is signal and there is noise, and participants in financial markets have to get used to the two year-old with the drum set hanging around the office these days. The signal has changed little: We are in a low macro growth, low earnings growth and still-stimulative monetary environment wherein every asset yielding more than zero is overpriced and all assets yielding less than zero are overpriced by definition. If you do not like this, you will like the alternatives less. To acknowledge the noise, the rest of Europe simply should put Greece into receivership, a form of international time-out, until they knock off the blackmail attempts and the Peoples' Bank of China should stop acting like a pyromaniac in charge of the fire department.
The causal chain remains:

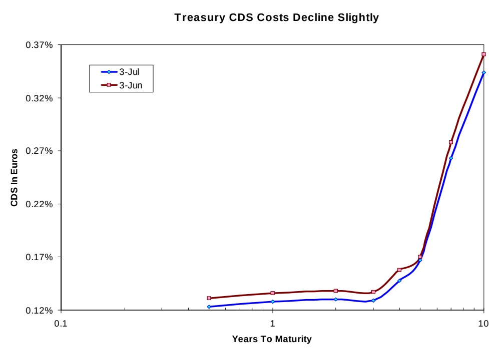
1. Short-term interest rates will remain artificially low globally but will start moving higher in the U.S. at some point, arguably as early as September;
2. Disinflationary pressures have ended;
3. Inflation expectations as measured by the TIPS market will appear to be rising so long as nominal interest rates continue rising and vice-versa;
4. The U.S. yield curve has resumed its long-term bias toward flattening, but this will be a tenuous process until the next drumbeat of expectation for higher short-term interest rates;
5. Short-term borrowers are terming out commercial paper into the bond market in an attempt to lower rollover risk;
6. Swap spreads will remain tame until monetary policy indications turn more hawkish; and
7. Credit spreads will not rise significantly barring event risk until short-term interest rates are pushed higher.

**Key Market Indications**

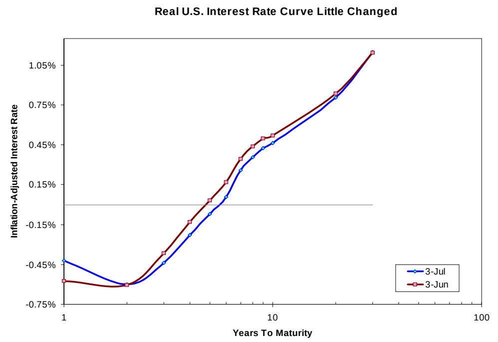
In a coincidence, the yield curve remains almost exactly where it was one month ago; score one for sound and fury signifying nothing. Not only is support holding at the long end of the yield curve, it has not even been challenged seriously. It will take a solid combination of risk-seeking behavior coming out of the Eurozone or an inexplicably aggressive Federal Reserve to push yields higher and a renewed willingness to lend money for nothing to push yields lower.



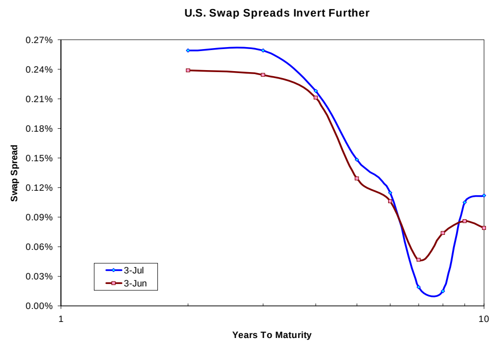

This market continues to have little reason to shift in either direction. The small shift lower in CDS costs at the short end of the yield curve can be ignored once again.



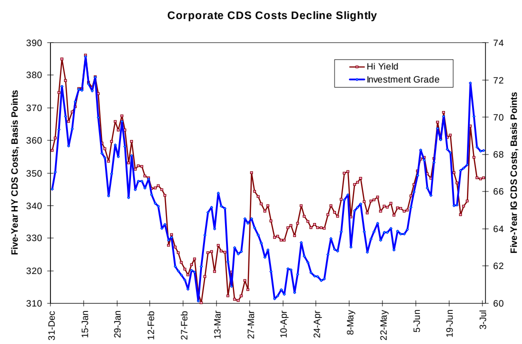
Pseudo-real rates drifted lower past the two-year horizon over the past month, but the moves were small. This shift was insufficient to push risky financial assets higher. The small increase at the one-year maturity has been negative for precious metals. These rates are negative out to five years.



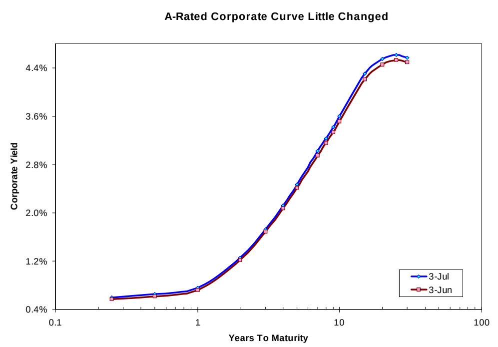

Swap spreads, which rise when floating-rate borrowers want to fix their payments, have moved higher at the short end of the yield curve over the past month. This increased demand to fix short-term payments coexists with a willingness to remain floating at the long end of the yield curve.




Maybe UST rates are rising and maybe the stock market is moving toward a correction, but this does not mean balance sheets are about to deteriorate. Both investment-grade and high-yield CDS levels have held support and declined over the past week.




The A-rated yield curve changed little over the past month. Unless long-dated swap spreads or CDS costs decline unexpectedly, the potential for a bullish shift in investment-grade corporate bonds will remain slight. That in turn will cap the ability of equities to rise independently of actual earnings growth.



## Market Structure

Grains have moved into an overbought zone. Livestock and Petroleum remain in downtrends. Within the financial markets, the EAFE and S&P 500 remain in structural downtrends.

| | N-Day Speed | Market Structure | Trend Oscillator | HLC Volatility | Daily Trend Rate July 6 - 10 |
|---|---|---|---|---|---|
| BBerg | 14 | Transitional | 0.071 | 10.8% | |
| BBerg Grain | 29 | Trending | 0.520 | 20.6% | 0.18% |
| BBerg Ind. Metl | 6 | Sideways | 0.012 | 14.5% | |
| BBerg Pre. Metl | 14 | Transitional | -0.129 | 11.8% | |
| BBerg Softs | 15 | Transitional | 0.053 | 15.2% | |
| BBerg Nat. Gas | 28 | Trending | 0.024 | 30.3% | |
| BBerg Petroleum | 26 | Trending | -0.154 | 22.5% | -0.37% |
| BBerg Livestock | 29 | Trending | -0.085 | 9.7% | -0.37% |
| Dollar Index | 28 | Trending | 0.060 | 10.2% | |
| S&P 500 Index | 27 | Trending | -0.141 | 7.8% | -0.85% |
| EAFE Index | 29 | Trending | -0.146 | 12.2% | -0.10% |
| EM Index | 12 | Transitional | -0.078 | 8.7% | |
| Ten-year UST (price) | 13 | Transitional | -0.021 | 7.1% | |

## Performance Measures

Grains continue to shoot higher as buyers had been content to remain floating on the price only three weeks ago and are scrambling to lock in fixed prices. The energy markets continue to move lower under rising supplies for petroleum and a cool summer for natural gas. The biggest surprise over the past week has been the inability to gold to advance in the face of political stress and losses in risky financial assets. When a market does not do what it should, it is in trouble.

**Commodity Total Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| **Bloomberg Index** | 0.96% | 0.87% | -1.91% | -24.09% |
| **Grains Sub-Index** | 9.23% | 14.86% | 1.65% | -7.93% |
| Corn | 11.95% | 17.06% | 1.92% | -7.70% |
| Soybeans | 5.37% | 13.36% | 4.24% | -8.69% |
| Wheat | 9.76% | 14.21% | 0.72% | -3.17% |
| **Energy Sub-Index** | -2.00% | -1.21% | -0.49% | -43.82% |
| Petroleum Sub-Index | -2.19% | -3.30% | 3.10% | -45.29% |
| WTI | -4.50% | -5.19% | -3.12% | -49.26% |
| Brent | -1.87% | -3.93% | -0.42% | -50.07% |
| ULSD | -1.39% | -3.09% | 3.60% | -36.40% |
| Gasoline | 0.84% | 1.00% | 21.06% | -37.13% |
| Natural Gas | -1.43% | 6.07% | -12.66% | -44.03% |
| **Precious Metals Sub-Index** | -0.98% | -2.88% | -2.21% | -16.31% |
| Gold | -0.71% | -1.81% | -2.15% | -12.25% |
| Silver | -1.76% | -5.82% | -2.08% | -27.42% |
| **Industrial Metals Sub-Index** | -0.38% | -4.07% | -8.75% | -20.40% |
| Copper | 0.44% | -3.67% | -6.83% | -20.19% |
| Aluminum | -0.12% | -2.25% | -8.30% | -15.35% |
| Nickel | -3.96% | -6.22% | -18.35% | -39.66% |
| Zinc | -0.76% | -7.12% | -9.21% | -11.57% |
| **Softs Sub-Index** | 0.23% | -1.66% | -11.59% | -30.42% |
| Coffee | -5.70% | -6.69% | -24.95% | -32.79% |
| Sugar | 3.62% | -0.95% | -14.89% | -41.53% |
| Cotton | 3.07% | 2.14% | 11.16% | -6.03% |
| **Livestock Sub-Index** | 3.30% | -2.49% | -9.91% | -17.00% |
| Cattle | 1.78% | 0.40% | -1.70% | 0.74% |
| Hogs | 5.86% | -6.82% | -22.54% | -41.37% |

China must be wondering what they would have to do to drive the CNY lower, and Japan must be wondering why the JPY has become a haven currency. We can add to that the Federal Reserve's reluctance to talk short-term rates higher for fear of what it will do to the USD. There are two things countries hate to happen to their currencies: They strengthen or they weaken.

**Currency Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| Euro | -0.47% | -1.43% | -6.86% | -18.34% |
| Chinese yuan | 0.06% | -0.13% | 0.24% | 0.12% |
| Japanese yen | 0.86% | 1.19% | -2.57% | -16.78% |
| British pound | -1.12% | 1.49% | 2.10% | -9.24% |
| Swiss franc | -0.76% | -0.70% | 7.07% | -5.01% |
| Canadian dollar | -2.01% | -0.97% | -6.45% | -15.43% |
| Australian dollar | -1.72% | -3.39% | -6.93% | -19.51% |
| Swedish krona | -1.79% | -1.77% | -6.10% | -19.29% |
| Norwegian krone | -1.89% | -3.01% | -4.38% | -22.52% |
| New Zealand dollar | -2.41% | -6.45% | -12.95% | -23.57% |
| Indian rupee | 0.32% | 0.73% | -0.03% | -5.83% |
| Brazilian real | -0.16% | -0.02% | -13.66% | -29.47% |
| Mexican peso | -1.09% | -1.35% | -4.99% | -17.65% |
| Chilean peso | -0.22% | -1.41% | -3.05% | -13.78% |
| Colombian peso | -2.01% | -2.23% | -7.87% | -30.07% |
| Bloomberg-JP Morgan Asian dollar index (spot) | 0.10% | -0.35% | -0.57% | -3.98% |

The good news is the bad news was not worse. Maybe the time to buy is when there is blood in the streets, but you have to make sure the blood is not yours. Unless earnings growth accelerates, there is little reason for equities to advance; they will at best tread water and benefit only by comparison to unpalatable alternatives.

**Equity Total Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| **MSCI World Free** | -1.76% | -2.37% | 3.79% | 1.29% |
| North America | -1.19% | -1.70% | 1.86% | 5.38% |
| Latin America | -2.16% | -1.78% | -4.17% | -24.72% |
| Emerging Market Free | -1.37% | -2.47% | 2.61% | -6.66% |
| EAFE | -2.64% | -3.42% | 6.99% | -4.63% |
| Pacific | -0.50% | -1.44% | 9.79% | 2.78% |
| Eurozone | -4.90% | -4.99% | 4.94% | -10.14% |

Money managers managed to lose a lot of money in the aftermath of the Greek decision to engage in further brinksmanship. This suggests hedge funds were leaning toward long equities and short bonds and against haven trades such as being long the yen. When in doubt, get out. When you are not sure at all, do not get into new positions. Trading is not gambling.

**CTA/Hedge Fund Returns**

| | Five-Days | One Month | Six Months | One Year |
|---|---|---|---|---|
| Newedge CTA | -1.88% | -4.30% | -2.14% | 17.05% |
| Newedge Trend | -1.32% | -3.50% | -1.92% | 11.66% |
| Newedge Short-Term | -1.91% | -3.93% | -4.27% | 2.85% |
| HFR Global Hedge Fund | -1.14% | -1.37% | 1.38% | -1.17% |
| HFR Macro/CTA | -2.24% | -2.67% | -1.39% | 4.20% |
| HFR Macro: Sytematic Diversified CTA | -2.73% | -3.74% | -3.06% | 2.26% |