Bedrock Newsletter

Friday, April 13th 2012

It is Friday 13th an appropriate termination for what has been a rather scary week. Equity markets broke-down taking some technical indicators through "important" support levels, the DJIA falling through the 13K level, the NASDAQ through its recently re-attained 3K level. The VIX, commonly called the "fear index" ran-up through 20 from a comfortable 15 level. The bond markets joined in scaring the market - just days ago bonds were falling in price, yields rising and this week a major reversal with ten year Treasury notes breaking through 2%, German Bunds hitting all-time yield lows at 1.65% and their 2 year yields breaking below Japan's. A first. This as Italian 10 year yields rise to 5.76% and Spain touching 6% as renewed fears of Greek-style debacles are engulfing Europe. Gold underlined all this action, rising briskly from $1'618 on the 4th to 1'680 by Thursday. What a way to celebrate Easter and Passover… As analysts were issuing scares on imminent Q1 earnings, now predicting earnings growth at zero to low single digits on the back of stalling GDP growth in China and the US and European recession.

China surprised with a large trade surplus for March against the analysts' expectations for yet another deficit. Germany replied with a surplus of their own. Amazing numbers, China a 5bn or so and Germany at 3 times that figure.

On Wednesday Alcoa showed a Q1 profit of 10 cents per share shaming these analysts who expected a 4 cent loss. To top this, the company's outlook was pleasantly reassuring. Somehow they managed to increase sales as the price of aluminum fell by 20% and expect further increases. The markets showed their appreciation and lifted Alcoa (AA) by 6% and the entire market followed bringing the DJIA to within a hair of the 13K level. Rising talk of QE(III) abated as the equities rose and the VIX fell back to the 17 level. This morning we got the Chinese GDP showing an 8.1% growth, somewhat less than the 8.3% expectation and a soft slowdown from the previous 8.9% level. Clearly a soft landing, of the data if not of the economy itself…

Arguably the markets are surfing on central banks' liquidity. As bad news arrive, investors see the good side in the increased probability for further quantitative easing, so the Bernanke Put takes hold. Is this the proverbial silver lining of the dark cloud?

As could be expected, the US$ traded in concert with the emotions of the markets. Rising as fears rose, falling as these abated. The Euro/US$ exchange rate at 1.3160 as we write is smack on its average for the year, but did swing heavily in a large range between 1.26 and 1.35 The Swiss National Bank reiterated its "cap" on the Euro/Swiss exchange at 1.20 as rumors persist that they plan to move the cap to 1.25 which would make sense for the Swiss economy. Then we have Oil. Sinking a little but at close to $104 basically unchanged for the month. Less chatter about Iran helps here… we remain concerned with the risk of a spike upwards from geopolitics whilst the downside is protected by the ongoing increase in global consumption.

We will leave you with a thought from CNBC- postulated last week that Tiger Woods is the new hemline; traditionally the stock market has risen and fallen in sync with the length of women's dresses, an indicator that has lost its relevance as hemlines no longer obey any standard. CNBC observed and put forth the thought that Tiger's results are highly correlated with the markets… Since, he didn't win at the Masters in Augusta, let's not hurry to use this indicator and continue enjoying rising hemlines. Have a good one ☺

Currencies

- The EURUSD pair sold off earlier in the week, as fears escalated over the EUR region debt crisis, triggered by rising Italian and Spanish yields. The pair reached as low as 1.3055 before losses were offset by prospects of further ECB bond purchases. The EUR appreciated further on Thursday due to successful Italian auctions, reaching as high as 1.3200.
- The SNB have reaffirmed their presence in the market and confirmed that as the Swiss Franc is still overvalued, the SF 1.20 cap to the EUR remains. EURCHF traded at a tight range of 1.2010-1.2033. USDCHF therefore mirrored the EURUSD movements and has traded up to a high of 0.9210 before returning to 0.9125 now.
- The JPY appreciated as the BOJ refrained from easing and kept its key policy rate at a range of 0-0.1%. Additionally, rising risk aversion drove investors back into this familiar safe haven currency. USDJPY and EURJPY dropped to 1.5 month lows of 80.60 and 105.50 respectively. The pairs since have regained some ground and are now trading at 80.94 and 106.60.
- The AUD appreciated for the week as Australian Payrolls report rose by almost 7 times analysts' estimates, overshadowing worries that the Australian economy could suffer from slower global growth. The AUDUSD traded at a range of 1.0225- 1.0450 and is currently trading at 1.0385.
- GBP was little changed for the week, trading as low as 1.5810 against the greenback and is currently at 1.5930.

Fixed Income

- US Treasury yields fell this week as worse than expected jobless claims figures and China's GDP expectations drove investors into safer assets. As a result, the US 30-year, 10-year and 2-year yields fell by 3 bps each to 3.184%, 2.025% and 0.282% respectively.
- On the European front, Italian bonds rose on Thursday as the nation sold 4.88 billion Euros of securities, close to its 5 billion-euro maximum target for the sale. Starting the week at 5.441%, Italian yields reached a high at 5.673% on Tuesday before falling all the way to 5.380%.
- Spanish bonds plunged last week amid concern demand for the nation's debt is waning after borrowing costs rose and it sold just above the minimum amount it planned at an auction. Spain 10-year yields rose to as much as 6% on Tuesday (from 5.74%) - approaching the levels that pushed Greece, Ireland and Portugal into eventual bailouts - before falling to more reasonable levels around 5.81%.
- Both Italy and Spain are still struggling to reduce their deficits and debts while also trying to stimulate stagnant growth. Some analysts and investors fear they will need help from their European peers to keep their borrowing costs in line.
- Sovereigns and US Corporates were the best performers this week (+0.61% and 0.48% respectively), while the worst performers were Convertibles and EU High Yield bonds (-2.48% and -0.77% respectively), while EU Corporates and US High Yields were also negative.

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Equities

- Developed equity markets slid this week, with the MSCI losing 0.37% as of yesterday's close. The week started on quite a negative note as investors were still daunted by reminders that Europe has not solved its debt crisis but an encouraging start to earnings season helped stocks rebound on Wednesday from five days of losses.
- European equities slumped during the week, with the EuroStoxx 50 retreating by 2.10% on renewed tensions around sovereign deficit issues, with Italy and Spain leading the losses falling by 2.7%% and 3% respectively.
- Meanwhile, the S&P 500 dropped by 0.75%. US Stocks fell sharply until Tuesday, before rebounding on Wednesday and Thursday on higher than expected earnings, although jobless claims figures disappointed and PPI data did not exactly sway opinions on the Fed's stance for more accommodation.
- This surprising uptick was also caused by "whisper" numbers calling for better than anticipated China's first-quarter GDP figures. While this was not the case, this could either weigh on US stocks on growth concerns or bolster optimism that some easing measures will finally be implemented.
- Meanwhile, the Nikkei lost 0.52% as the Yen's rise against its major counterparts and China's worse than expected GDP figures pressured export-oriented companies.
- In terms of sectors, Energy and Healthcare stocks were the main laggards this week, while Materials and Industrials were the only sectors to be positive. Information Technology and Consumer Discretionary are still the best performers so far this year. Outperformance of these sectors is due to investors' risk-on approach during Q1, favouring high beta segments. However, the incredible run experienced by these stocks just started to fade away.
- After a very decent first quarter in terms of performance, equity indices kept correcting down despite some improvement on Thursday. While some correction remains in view, we believe that the US are poised for a secular bull market with the housing sector bottoming, a manufacturing revival underway, the potential for an energy boom in North America thanks to shale gas and a new wave of technology growth in internet and cloud computing.

Emerging Markets

- Emerging Markets' equities declined for the week (-1.14% as measured by the MSCI EM Index). The index has reached its lowest level in more than 2 months after Chinese import growth figures have come out less than expected, signalling fears a global slowdown. However, losses were partly offset by prospects of an ECB intervention to curb the impact of the EU's deteriorating debt crisis.
- The worst performing region was Asia, down by 1.62% as measured by the corresponding MSCI index, followed by Latin America (-0.34%) and Emerging Europe (+0.05%).
- The Shanghai Composite rallied for the week, up by 2.27% reaching a 2 week high. Weak import data as well as slower than forecast growth fuelled speculation that the government will ease monetary policy and property sales and new lending will rebound.
- The Brazilian BOVESPA fell 0.74% on Chinese growth concerns. However, the Index rose the most in a month on Thursday as signals from US and Japanese policy makers will stimulate economic growth, lifted Brazilian producers. Vale SA rallied as much as 6.43%!

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- Our view on EM assets remains intact. While EM economies will undoubtedly be affected by a slowdown in global growth, valuations seem more attractive in the Emerging world with a PE ratio of 11.7 on average for the MSCI EM compared to 14.8 for the MSCI World. Therefore, we maintain our exposures to EM equities and EM corporate bonds, as well as our CNY and SGD positions.

Commodities

- Commodities were modestly negative this week, losing 0.23% as measured by the S&P GSCI broad commodity index. However, performance varied strongly by type of commodity.
- Brent crude was the biggest decliner this week down by 1.96% Agriculture and Industrial metals followed with losses of 0.79% and 0.48% respectively. Precious Metals rallied as much as 3%
- Gold rallied by 2.50% this week, currently trading around $1'671 an ounce. Gold futures rallied as India resumed Gold imports and Investors increased bets on the Fed boosting stimulus.
- Crude Oil remained flat this week (-0.04%), currently trading at $103.08 a barrel. Oil fell as low as $100.70 on Tuesday as API reported in increase in stockpiles, as well as renewed worries on the EU debt crisis. Oil rebounded as Fuel supplies dropped and the ECB signalled support to the region. All eyes are on the nuclear talks between Iran and UN Security Council taking place tomorrow in Istanbul. Sanctions on Iranian oil exports have yet again proven harmful, as they have been reported to attempt to lure nations to buy their oil on highly advantageous credit terms.
- We remain constructive on oil given supply/demand dynamics as well as Middle East tensions, and on gold, which should continue to find support on the medium to long term as global central banks provide liquidity to markets.

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