# Bedrock Newsletter

## Friday, April 27th 2012

It is Friday yet again, closing a rather hectic week;

Last Sunday we had the French Presidential elections which gave us Sarkozy vs. Hollande in the Finals scheduled for Sunday 6th May. Whilst unsurprising, the rise of the so-called Right (FN Le Pen) was too strong to ignore. Markets responded with a distinct dislike and the thought of Sell Before May and Pray did cross our minds… But then Apple gave us a mind-blowing Q1 set of results and gained about $50 billion in market capitalization, dragging all equity indices upwards with it. Wow… we forgot Sarko's troubles. At least for a moment… Walmart's Mexican subsidiary was caught in a $23 million bribery of officials and was immediately punished to the tune of $15 billion is market value fall. Another thought crossed our minds; Buy in April at your peril… Should we be looking at forward in Dis-May? Perhaps not… Earnings keep coming-in at a fast clip and mostly beating expectations. Corporate outlooks where offered are solid and seem to negate much of the rather dismal economic data- The UK showing its second consecutive negative GDP growth, Spain now officially in recession (as if we didn't know!), Holland lost its government amid budget disaccords, Hollande is leading. Uncomfortable everywhere…

But then, debt issuance by France, Italy, Spain and others were well received. China isn't collapsing; some data on the real estate in the US shows stabilization, US bond market are holding their ground with 10 year yields still vacillating around the 2.00% mark. Gold seems to like the $1'650 level and the severely bad-mouthed Euro has crept up a smidgen through 1.32 vs. the almighty greenback. In concert with these references, oil has also progressed slightly through the $104 level. Here we note the surprising collapse of the spread between Brent and WTI type oil. It used to be that WTI traded at a small premium to Brent, then we experienced a switch to Brent at premium, widening continuously roughly from 2005 through 2011. Now, the spread is closing somewhat- hardly logical as US production is rising and Brent slowing… We doubt this trend can continue for long. We look at natural gas prices which continue to fall into rising production and recall Texas Oil overproduction in the early 20th century. Same problem - producing fast into a non-existent distribution infrastructure. We venture that within 5 years distribution will induce usage and prices for the gas will catch-up with reality and alternatives. We would worry about coal prices and related equities' valuations as gas is likely to replace coal.

Big Ben (Bernanke) spoke after the Fed minutes were released. He repeated that things were getting better but not as quickly as required. The message was "Don't worry, the Fed stands behind you…" so the markets rose.

Then Amazon told us that it sold and earned much much more than anyone had expected. The stock rose 15% in after-hours trading Thursday. Friday morning gave us a brake on this exuberance with Standard & Poor's downgrading Spain to BBB+, hardly a surprise, but then again, it re-focuses the minds of players on the pending issues. The real question is whether the generally applied "solution" of austerity is indeed the right route to be taking. Should our leaders not reconsider and agree to suspend budget overdrafts for somewhat longer and foster growth?

Going into the weekend, remember the movie "back to the Future"? Greece is collapsing, Iranians are getting aggressive and Rome is in disarray. Welcome back to 430 BC!

# Bedrock Newsletter

---

**Currencies**

- EURUSD – we started the week at 1.32 and we end the week at 1.32. As expected, Hollande finished in first place for the French first round election, and predictably the EUR sank 100 points to 1.3110. However, with no real change in the status quo at the FOMC and the BOJ stepping in line with expectations, we have settled in the familiar pattern of sell on Monday and creep back up for the end of the week. In the absence of any news, the Forex markets, in general, seem to be in the doldrums.
- EURCHF traded in an even tighter range than last week of 1.2015-1.2020, although as we write the pair is slipping to 1.2011, really nothing new for now. USDCHF again mirrored EURUSD and traded up to a high of 0.9170 before returning to 0.9070.
- The week started with the Yen strengthening from 81.60 to 80.80 before the BOJ meeting. The BOJ have been, if nothing else, predictable, and stuck to their word by increasing the asset purchase program by 10 Trillion Yen (roughly 125Bn USD) and keeping the interest rate at 0.1%. The weakening strategy worked for 30 minutes seeing the Yen plummet from 80.60 to 81.50. However this has not lasted and market forces have pushed the pair back to 80.70 in light of general market positive mood.
- The general mood on Monday of risk-off, allowed the AUD to drop to 1.03 only to see it rally back to 1.0425. In the absence of any "real" news the money flows to the higher yielding currency, and so it happened this week. Let's wait for the NBA to cut rates before we believe in the AUD rally though, as structurally there are cracks in the Australian economy.
- The UK is in recession again, or so the bureau of governmental statistics tells us, however there were record retail sales with consumer confidence well above the expected figures. The GBP as a result has caught another bid and is continuing its ascent, trading from 1.6120 to 1.6220.
- In the aftermath of the Brazilian Selic rate cut the BRL has sat very neatly in a narrow trading band at or around 1.88, it looks like the decision is working… for now.

---

**Fixed Income**

- US Treasury yields fell this week as worse than expected jobless claims figures pushed investors into safer assets. As a result, the US 30-year dropped 3 Bps to 3.09%, 10-year dropped 4 Bps to 1.92% and the 2-year yields fell by 1 bps to 0.254%.
- On the European front, Spanish bonds led a decline among the euro-region's higher-yielding government securities after Standard & Poor's cut the nation's credit rating by two notches from A to BBB+, adding to concern that Europe's debt crisis is spreading.
- As a result, Spain's 10-year bond yield jumped by 13 basis points to 5.96%, whereas it fell to 5.77% earlier in the week. The extra yield investors demand to hold the securities over similar-maturity German bunds widened 14 basis points to 429 basis points. The spread expanded to a euro-era record 503 basis points on November 18.
- Meanwhile, Italian bonds rose steadily through to Wednesday, but then sharply sold off seeing the yields trading to 5.72% from a low of 5.63% earlier in the week. Both Italy and Spain are still struggling to reduce their deficits and debts while also trying to stimulate stagnant growth.

- Higher yielding securities reigned supreme this week with Emerging Markets Credit, as well as US and EU High Yield rising by 0.51%, 0.56% and 0.46% respectively, while US Corporates and Sovereigns lagged (-0.03% and 0.01% respectively). On a year-to-date basis, European High Yield which saw an increase of 11.5% so far remains the top performing fixed income sector, while Convertibles and EM Credit also performed very well (7.2% and 6.5% respectively).

---

**Equities**

- Developed equity markets rallied this week, with the MSCI gaining 0.91% as of yesterday's close. At the start of the week, worrying news from Europe on a collapsing Dutch government, a potentially socialist French government and an increasing level of European Government debt, drove global stocks lower. Equities recovered their losses as corporate earnings came in better than expected and home sales data indicated stabilization in the Real-Estate market. In addition, the Fed's chairman Ben Bernanke confirmed willingness to stimulate growth if necessary.
- European equities ended the week relatively flat, with the EuroStoxx 50 rising by 0.13%. However, on Thursday evening the S&P cut Spain's credit rating by two notches to BBB+, yet Spanish Economy Minister Luis de Guindos was quick to rule out seeking a bailout.
- US stocks rallied 1.67% this week on an improved economic outlook and strong corporate earnings. The star of the week was Apple, reporting earnings which almost doubled last year's reported earnings, much due to Chinese demand for the products which have increased fivefold. The stock surged 8.9% the following session and was the main contributor to the Nasdaq's biggest jump in 2012 (+2.7%!).
- The Nikkei lost 0.80% as Investors shrugged off a report from the BOJ expanding its asset-purchase fund to 40Tn Yen from 30Tn. Worries among Investors are that the BOJ might tighten its monetary policy instead of ease it in order to curb a potential rise in inflation.
- In terms of sectors, Info Tech and Energy stocks were the leaders this week (+2.17% and +2.09% respectively), while Materials and Consumer Staples lagged. Corporate earnings so far seem to outperform the most among Info Tech stocks while the slowdown in growth of the global economy weighs on Materials.
- Markets' attention is still focused on the deterioration of Europe and the slowdown in global growth. However, 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' declined for the week, losing 0.55% as measured by the MSCI EM Index. Reports on contracting Chinese and European Manufacturing weighed on the high beta markets.
- The worst performing region was Emerging Europe, down by 1.51% as measured by the corresponding MSCI index, followed by Latin America (-1.00%) and Asia (-0.38%).
- The Shanghai Composite declined by 0.44% for the week, as Chinese corporate earnings came in lower than expected, further proving the economic slowdown in the region.

- The Brazilian Bovespa fell 0.67% for the week as Brazilian growth expectations were revised downward to 3.21% for the year. Brazilian banks were driven lower as Itau Unibanco SA said it expects losses from bad loans to rise in the second quarter. In addition, Vale SA reported earnings which nearly halved those of the preceding year, mostly due to slowdown in Chinese growth. However, the company expects Chinese demand to pick up later this year.

---

**Commodities**

- Commodities rallied 1.41% for the week as measured by the S&P GSCI broad commodity index. This week, commodities rose across the board.
- Industrial metals were the best performers of the week, up by 2.40% followed by Energy (+1.74%). The least performing were Brent Crude (+0.54%) and Agriculture (+0.62%).
- Gold rose 0.75% this week, currently trading around $1’655 an ounce. Gold rose as Central bank have expanded their bullion reserves and Fed chairman said he is willing to do more, if needed, to spur the economy.
- Crude Oil rose this week (1.09%), currently trading at $104.20 a barrel. Oil rose to a three week high as US home sales gained more than expected, causing a decrease in the dollar.
- 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.

---