Friday, May 4th 2012

Another week is ending and again under a fluttering European banner. Clearly, the French “Bleu Blanc Rouge” is in the forefront: The Presidential finals this Sunday with the Socialist Hollande in the lead. Interestingly, the normally left-wing French press gave Hollande as the winner of the Wednesday debate whilst the English and German interpretation was diagonally opposed. The markets seemed to support the Anglo-Saxon interpretation as European equities advanced some since the said debate. We are a little bewildered as we note that the only Socialist governments in the EU are Spain, Portugal and Greece… The latter may change this weekend though, as they are holding their own elections (no obvious leader here, but no-one outside of Greece seems to care). Winston Churchill once said that Socialists are like Christopher Columbus- When they leave port they don’t know where they are heading and then, when they get there, they don’t know where they are…
The only market manifestation of the inherent risks from the French elections could be observed in the German Bund which rallied to its lowest ever yield at 1.61% on Wednesday. We wonder if a socialist France will not be the trigger for a German exit from the Euro?

In the US, Romney is the only GOP candidate still standing as his opponents have dropped out. US markets in the face of mediocre economic data reached a 4 year high with the DJIA matching (intraday) its December 2007 highs. Earnings flow remains positive and even outlooks are not bad. Employment isn’t progressing as Obama’s campaign would like with job creation running below requirements. Later today we will get the official April data and we will need an amazingly strong surprise to produce the next leg upwards. Otherwise, only bonds will generate positive returns.
And we also celebrated the first anniversary of Bin Laden’s death. Time flies… and then Facebook gave us some more information on its upcoming IPO. Whiffs of 1999 emanate… expected to price at 99 times earnings… A social-networking bubble? Will Facebook reach a number of users greater than the world’s population?
Another strange corporate event could be seen in Delta Airlines acquiring a New Jersey based oil refinery. OK, they received a subsidy to help, but it is strange. Will the next move be by Exxon buying GM to assure the continued production of large V8 motors and ever larger SUVs? Carl Icahn, the renowned corporate raider, quipped that as we are developing artificial intelligence, he’d rather base his investments seeking natural stupidity…
We take a step back and look at the world with a little more distance than the moment by moment bits of data. We see that equity markets are rising gently and bond markets holding steady. Arguably, we should not consider the latter as indicators of economic interest, as they are managed by LTRO and QEs. Gold is fluctuating in a narrow band as are the major currencies. From a distance, nothing or very little is happening. Are we in the eye of a very large hurricane? It has been quite some time since 2008, so you may think it is time the crisis be done and finished. Well, let’s not forget that the Dark Ages did last 300 years…
We continue to preach caution as we can’t identify the impetus for a clear route forward. We remain optimistic as this way we can keep our smile. Have a lovely weekend.

Bedrock Newsletter

Currencies

- After strengthening into last weekend, EURUSD has weakened throughout the week from 1.3280 to 1.3130. Strong US ISM manufacturing data on Tuesday saw the USD pop up 80 pips. Followed on Wednesday by German employment figures coming in weaker than expected and the EUR dropped another 80 pips. The ECB kept rates low with no dovish tone allowing a little respite for the EUR; however with the French elections this weekend, could this be the start of the EUR downturn the market has been waiting for?
- On that note, we believe it is worthwhile buying some EUR put Options against the USD as volatility has come down a lot in the past few weeks, and on the basis that the big economic and debt clouds gathering on the Euro Zone different countries are gathering strength...
- USDCHF again mirrored EURUSD and traded up from 0.9070 where we finished last week to a high of 0.9170 before drifting a little lower post Draghi comments, settling at 0.9150. If we do see further European weakness then this pair could indeed be heading back to the last highs (0.93-0.94), or perhaps parity.
- The Yen had some larger than normal moves this week bouncing 50 pips on Tuesday following the USD positive ISM data. We feel that the pair has found a solid support about 80.00; this could also see the start of the JPY weakening that the BOJ is so desperate to see.
- As discussed last week, the AUD could not hold the highs and post the RBA surprise announcement to cut rates by 0.50% instead of 0.25%, the cash target now sits at 3.75%. The Aussie has slipped over 200 pips from 1.0470 to 1.0250. If the central bank, who has access to a raft of data to which we are not privy, decides to cut rates by double the expected amount we should take note – the Aussie should weaken.
- Cable is taking a breather after two weeks of trading each day to a higher high; GBP has sold off a little from 1.6260 to 1.6180. This is a mixture of profit taking and general USD strength. In light of the economic weakness in the UK, the GBP should turn lower, but the relative play on EURGBP seems to be keeping GBP elevated for now.
- In the general USD bull mode some of the EM currency slipped as expected. USDBRL slipped to a high of 1.9280.

Fixed Income

- US Treasury yields had a wild ride this week with very little to show for it at the end; ISM causing a stir only to see any weakness in price to be bought into. As a result, the US 30-year dropped 1 Bps to 3.11%, 10-year remains steady at 1.92% and the 2-year yields remained the same at 0.258%.
- On the European front, after last week's ratings cut for Spain the debt stabilised a little just below the 6% mark. Managing to only raise just over 2Bn on short term paper, we see storm clouds growing apace for the country with a 25% unemployment rate.
- With the French elections this week and post "The Debate" the OATs have caught a bid and moved from above 3% to a low of 2.87%. Unfortunately, if Hollande is successful, as all of the polls seem to indicate, we are not sure how long there will be support for French debt, 4% will be the new 3%!
- With Greece issues being raised again and noises that they will have to leave the Euro zone a tone of risk off is creeping back into the markets. The Greeks have not managed to stabilise

the domestic growth slide and with the ability to weaken their currency, the call for them to leave shall only get stronger.

- Italy had some respite this week seeing their funding costs drop back to below 5.5%. Both Italy and Spain are still struggling to reduce their deficits and debts while also trying to stimulate stagnant growth. The Austerity measures are not sitting well in either country, will there be local uprisings, only time will tell.
- Higher yielding securities reigned supreme this week with Emerging Market credit. EM produced 1% as well as US and EU High Yield rising by 0.86% and 1.08% respectively. US Corporates and Sovereigns lagged (0.51% and 0.13% respectively) with EU Corporates and sovereigns coming in at 0.50% each. On a year-to-date basis, European High Yield saw an increase of 12.66% so far and remains the top performing fixed income sector.

Equities

- Developed equity markets slid this week, with the MSCI losing 1.10% as of yesterday's close. The fall in major stock indices was mostly led by Euro zone's worsening economic outlook.
- European equities slumped this week, with the EuroStoxx 50 losing over 3%, in reaction to recession news out of Spain following the announcement that gross domestic product had shrunk for a second consecutive quarter. Then, the obvious prospect of a socialist French government and an increasing level of European Government debt also weighed on sentiment.
- US stocks lost some ground this week, with the S&P 500 dropping by 0.84% on Euro zone's negative headlines, although ISM announced the fastest growth in US manufacturing in 10 months. This news however gave a short-lived lift to US and European Stocks on Tuesday. Manufacturing has been a standout through the recovery, and added steam to US markets in April despite a recession in Europe and slower growth in China.
- Also, US shares were little changed on Thursday despite weekly data on jobless claims sharply falling after three weeks of increases, as investors traded cautiously a day ahead of the non-farm payrolls report.
- Meanwhile, the Nikkei lost 1.48% as a stronger yen hurt the shares of exporters on Tuesday, and as renewed worries about Europe's finances continued to cloud prospects for a global economic recovery.
- In terms of sectors, Materials, Info Tech and Financials stocks were the main laggards this week (-2.23%, -1.64% and -1.63% respectively), while Consumer Staples and Healthcare fared better (+0.03% and -0.17% respectively). Corporate earnings so far seem to outperform the most among Technology 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 rose this week, advancing by 0.47% as measured by the MSCI EM Index, mainly driven up by Asian marketplaces.
- The worst performing region was Emerging Europe, down by 2.16% as measured by the corresponding MSCI index, followed by Latin America (-1.18%) and Asia (+1.51%) as the region surged in holiday-thinned trading.
- Closed on Monday and Tuesday, the Shanghai Composite jumped by 1.88% during the week, after non-manufacturing industries grew at a slower pace, prompting hopes that new easing measures will take place. The benchmark gauge has gained 11% so far this year, after falling a combined 33% in the previous two years, on speculation the central bank will ease monetary policy to boost economic growth.
- The Brazilian Bovespa rose by 0.67% for the week as data showing that manufacturing picked up in China boosted the outlook for growth in Brazil’s top trading partner. Petrobras contributed the most to the gauge’s advance after Valor Economico reported that the state-run oil producer may participate in a $2.6 billion project to build a terminal in the city of Marica in the state of Rio de Janeiro. OGX Petroleo and Gas Participacoes also rose after its controller, the billionaire Eike Batista, said he’s considering the sale of another stake in his EBX Group.

Commodities

- Commodities slumped by 1.86% this week as measured by the S&P GSCI broad commodity index. As usual, performance varied quite a lot across sectors.
- Energy lost the most this week, down by 2.25% followed by Precious Metals (-1.90%), while Agriculture (-1.06%) and Industrial Metals (-1.30%) fared better.
- Gold fell by about 1.77% this week – currently trading around $1’630 an ounce – having dropped for three out of the last five weeks, prompting shorter-term speculators and longer term investors to curtail their holdings of the metal both in the futures market and in exchange traded funds. Gold prices fell 1% on Thursday after data showing a slide in US weekly jobless claims last week boosted expectations that Friday's non-farm payrolls report will beat forecasts, offsetting speculation that the Federal Reserve would take fresh measures to shore up the economic recovery.
- Meanwhile, Crude Oil slid by -2.26% – currently trading at $102.55 a barrel. Oil fell on worsening economic outlook and news of rising US crude oil stockpiles. Oil market participants keep a close eye on employment data for signs on oil and fuel demand. High unemployment in the US – the world's biggest oil consumer – has been a major factor behind the slump in demand for gasoline because it means fewer motorists travelling to work or taking vacations.
- 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.

Bedrock Newsletter

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