NEWSLETTER Bedrock

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Time Magazine, *the other weekly publication*, named Vladimir Putin as Man of The Year. Indeed, Vlad has done much for Russia and the Russians whilst doing little to frighten us all in the West. Do note that Time Magazine's award is not considered to be honorific!
In all modesty, we at Bedrock beg to differ with their choice of greatness. We rather name Jean Claude Trichet as Bedrock's Man of The Year! Although this award will no doubt pass unnoticed by most of the world excepting our limited mailing list, we trust that many of you will back our choice…
Our Man Of The Year saved the financial markets from the liquidity crunch. Yes it was he with an unabashed 500 billion Euro infusion of liquidity ahead of the Christmas holiday and this in comparison to the paltry, homeopathic $20Bn by the Benman.
Unlike the Fed, the ECB took the bull by the horns: A liquidity problem? Why compromise inflation fighting mandate and lower rates into rising PPI & CPI data? Add money, hold rates. AMEN!
Result you ask? Immediate collapse of inter-bank spreads, money moved between banks accelerated further by the ECB's promise to supply as much liquidity as needed. Fears of a collapse of the financial market were alleviated, the visible symptom being a nice pre-Christmas equity rally.
Our Man Of The Year did much for the ECB's credibility, for its trustworthiness and appearance of financial wisdom and acumen. It also calmed global markets; it added to the viability of the Euro and, last but not least, helped us at Bedrock improve your portfolio returns!

Let's have a serious look at the US elections' circus, from an investment and risk control point of view. We need to establish an understanding of process and develop a view as to the eventual outcome so that we may better project 2008 for our portfolios.
Here is what will happen;
The Democrats will do their Dog and Pony show and will present the American people with a Candidate. Hilary? Barak? Maybe a new face? The markets will react, sometimes up, sometimes down, and then, perhaps Barak Obama will tell the world that he had chosen his newfound sponsor, Oprah Winfrey to be his running mate! How will you know the truth of their standings? Look at pharmaceutical stocks… The better the Democrats do, the further down these may slip.
The Republicans will entertain us on the other rink. Giuliani, whenever he will look good, defense and pharmaceutical stocks will rally. Will he be nominated? Maybe, maybe not. There are a couple others there- the Mormon and the Evangelist…
Then, the day will come when one of these Democrats will be facing one of these Republicans.
We at Bedrock find that this is where the real problem starts: We can't think of any of these leading Party choices as "electable" country-wide. Will this be the moment for say Michael Bloomberg to announce his independent candidacy?
What turmoil! Markets will go up and down. Analysts will project various future scenarios. We at Bedrock look through the noise and point out the one certitude of these elections: NO MORE George W. Bush. Now let's think again- is this good for a portfolio or bad?

Flash: **A new risk has just emerged on our next-year-radar: Yesterday Benazir Bhutto was assassinated. Could this lead Pakistan into lawlessness? Might it become a rogue state? Before waving this away, remember that they quarrel a lot with India and that they have nukes…**

Last week we promised you a peek into our Crystal Ball together with our prognostic for 2008. Well, with freshly recharged ECB-supplied batteries, here goes;

ECB gains in importance & credibility, sustaining the Euro's exchange rates, possibly avoiding a rate rise as the strength of the currency alone will keep Euro-inflation at bay.

The Fed will lower interest rates a couple of times in 2008, reducing the odds for a rebound of the US Dollar.

Yield curves will probably steepen in the US and remain flat elsewhere in the G7 currencies.

Recession? Probably not. An economic slow down? Possibly, mainly affecting the US and the UK, a "light"

version of same in Europe but overall, World GDP to grow at 5% to 6% range.

Who will be President? Does the answer really affect our portfolios? Let us stay with just no more G.W. Bush.

Equity markets? Strong!!! They are priced for bad news, recession, inflation and rising rates into financial meltdown. Some of these risk perceptions will be removed into the New Year and off to the races!

Emerging markets will likely continue to pull ahead in both global GDP share and resulting market performances,

Commodities will pursue their upwards run, especially agricultural products and energy. Our algorithm is simple: More people, many of whom are getting wealthier; More consumption of foodstuff and obviously, more energy. This demand situation is aggravated by governments using food to make oil substitutes, so prices of both commodities might rise even faster.

In summary, we expect volatility to continue at fairly high levels. This, if true, implies fairly high expected-returns from being in the markets.
So, as we all like high returns, let us remain invested! We all dislike volatility in itself, so let us increase our allocations to Hedge Funds and reduce accordingly the long-equity component! This way, we remain in the markets, but "clip" volatility at the cost of some upside potential.
Our portfolio allocations have been revised slightly into 2008;

Increase Commodities (ex energy)
Maintain Energy
Increase Hedge Funds
Reduce direct Long Equity exposures (replace with "semi-directional" Hedge Funds)
We stay away from all forms of fixed income excepting cash.

Happy New Year and many Happy Returns to all!

Do remember though that all these ramblings are visions extracted from a Crystal Ball!

Currencies

- The US Dollar seems to have lost recovery ☹ Oil rushed up, political assassination in Pakistan and not so good eco-news States-side. We believed it unwise to be a seller of the greenback at the 1.44 level, and cannot find firm footing to change our outlook in these very light year-end markets these levels. We are now trading around 1.47 Euro and 112.60 JPY.
- We believe the Pound will weaken further in the coming months, having broken through the $2.00/GBP, now trading 1.99 to the US$
- The Japanese Yen is "soft". As usual, it continues to perplex and disappoint us.
- "Commodity currencies" have stabilized and even gained a little. The Canadian Dollar broke through the parity firmly to trade at 0.975 against its US counterpart.
- The Chinese Yuan, with a local increase in interest rates, is clearly poised to continue gaining on the US$ and the rest of the world.

Fixed Income

- Yields of the US 10 Yr Note ended the week unchanged while yields of 10 Yr JGB's and 10 Yr German Bunds fell slightly.
- The US yield curve has become very positive on Treasuries, with 2 year yields almost a full percentage point below the ten years'. Should we read this as the market telling us "NO RECESSION coming"?
- We remain wary on fixed income instruments in general. With Central Banks continuously pumping liquidity into the markets, holding or even lowering interest rates into poor inflation data, we are concerned.
- Again, we believe that Bonds are being mispriced because of technical liquidity issues! Chasing yields whilst ignoring true credit-worthiness brought about the current dislocation, are we now chasing credit worthiness whilst ignoring economics?

Equities

- **Again, quite volatile equity markets, in thin holiday volumes. Let's not try and extrapolate here!**
- **We had expected a small year-end rally. What did we get? A waste of time. Some markets up a little, others down a little. We still have today's close and some position squaring on Monday. Pretend say the year is over, ok?**

Emerging Markets

- **Emerging Markets were as listless as the main indices. Do note that many Emerging Markets' ETF's went Ex Dividends this week, resulting in significant price action (example the China Fund went Ex $12.12/share on the 25th)**
- **We continue to like these markets as they have much upside imbedded in them, and should continue to enjoy a significant allocation in every portfolio.**

Commodities

- **Oil prices exploded upwards crossing into the $97+ territory! Supply concerns, heightened political risks culminating in the assassination of Mrs. Bhutto seemed to have rattled this market. Hold on to your black gold!**
- **Gold rallied to $834 on the fall-back of the US Dollar, the rise in oil and the re-emergence of political risk.**
- **Commodities continue to represent a very attractive investment and should be a core part of any investment portfolio. We believe that a broad diversification into energy, agriculture, mining, and water is warranted. We believe that agricultural commodities are only at the beginning of their bull run and one should add exposure anytime there is weakness in the sector.**

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