Bedrock Newsletter

Friday, August 31st 2012

August is coming to an end, and what a relief for some of us that it has been so calm. For the first time since 2007 it has allowed those in the northern hemisphere to enjoy some summer calm. Not that this means anything for the weeks and months ahead of course, with all the usual fears and concerns persisting. The various topics such as the US election, US fiscal cliff, the vast array of Middle Eastern issues, global food prices, the Euro Area of course, various issues in some Growth Economies and large emerging economies, and of course, China. The latter now enjoys a GDP of about $7.3 Trillion, roughly half of the American GDP. The big question overhanging markets is what will be its growth-rate into the future? Some are concerned with a hard landing; others expect a significant slowing of their growth-rate. Sir Martin, Chairman of WPP sees their China business (advertising) growing @ 15% and when asked about a "Hard Landing" he says he rather sees a "no landing"... indeed, if China will grow at a 3% differential to the US, they will overtake America's GDP in 20 years… Perhaps the worry here is overstated…

In America, the Federal Reserve published on Wednesday its Beige Book. There were positives data and some negatives, overall though, a little more positive than negative. To confirm this, the US Q2 GDP was revised up to +1.70% from 1.50%. We reached the Jackson Hole weekend meeting- Ben Bernanke will give his speech today and set the markets on a track. Will he announce QE3 or will he use language which affirms the FOMC's commitment to their second mandate of employment and indicate that he will use his arsenal of weapons if and when needed? The data driving the Fed gives us reason to expect the latter, possibly disappointing the markets, whilst indirectly suggesting a back-stop at somewhat lower levels than those we reached recently.

Mario Draghi, the Chairman of the ECB isn't coming to the event. He most certainly already read Bernanke's text and figured that he has other matters to attend. Another reason to assume this Jackson Hole Meet to come and go as yet another non-event.

We hear that Super-Mario's next challenge is to implement an EU plan to have the ECB become the ultimate regulator of European banks- the ECB will grant licenses and be the regulator, much like the Fed. Maybe order is coming into the Euro-mess? Well, today, ahead of Bernanke's speech the Euro is rising strongly, European equities are recuperating yesterday's losses and the US futures are rising nicely…

Recently Brazil embarked on a $66Bn stimulus program and this week, their Central Bank cut interest rates by 0.50% to an historic low of 7.50% No, we are not quite out of the global economic mess, but many are doing things to redress the ship.

We also witnessed hurricane Isaac troubling the Republican Convention, taking air-time away from politics, replacing images of a convention center with flash-backs of hurricane Katrina, building-up tension as Isaac approaches New Orleans. Well, it did go to New Orleans, seven years after Katrina. As we write, it is expected to have caused $2.5Bn of damages from heavy rains and flooding. But the levies have held and this damage is much lower than feared. Katrina was quantified above $45Bn…

Do we believe in the remedies to the crisis? From Brazil force-feeding the economy, ECB taking control of the banking sector in Europe and the Fed leading the US, we recall Bernard Shaw's words which said that it is a fact that a believer is happier than a non-believer, adding that this is like a drunk which seems happier than a sober person… Be merry and believe into the last weekend of summer 2012!

Bedrock Newsletter

Currencies

- EURUSD is currently trading at 1.2510, the same level it has commenced the week. The pair traded in a tight range for the week (1.2465 – 1.2570), testing the lower bound just shortly on Tuesday due to global growth fears. The pair recovered the losses and reached the week's highs as German consumer climate beat expectations and Euro zone M3 money supply posted its best numbers in 3 years. The EUR erased its weekly gains on Thursday as Spain refrained from bidding for a sovereign bailout until there will be more clarity on the aid conditions.

- USDCHF, as usual, inversely mimicked the EURUSD movements, ranging 0.9550 - 0.9620 for the week. EURCHF maintained the level of 1.2010 for an additional week, where SNB president Thomas Jordan emphasised this week that the franc's ceiling is "absolutely necessary", and is expected to be maintained for the near future. However, Jordan further commented that the ceiling will not be for eternity due to the potential losses on Euro holdings.

- Global growth fears and Japan's government cutting its economic outlook drove investors to safety causing the Yen to maintain an elevated level (78.47-78.85) against the USD up until Thursday. On Friday USDJPY made further losses (78.40) as Japanese industrial production fell 1.2% in July compared to the preceding month.

- AUDUSD gradually weakened for the week from 1.0426 to a low of 1.0280 on Friday's overnight session, and is now trading at 1.0315, set to conclude August down 1.8%. The so called Aussi declined for the week as China reported declining industrial profits. Domestically, new home sales dropped for the first time in 4 months and home building permits fell the most in a decade.

- GBPUSD is set to end the week relatively flat, currently trading at 1.5825 after ranging 1.5755 – 1.5865 for the week. The major domestic economic news for the week were reported on Friday where Home prices were reported to have increased 1.3% in August (+0.1% expected), easing concerns that the recession is worsening. Cable is set for a monthly gain of 1%.

- BRL weakened for the week, causing USDBRL to rise from 2.0270 at the beginning of the week to as high as 2.0550 on Thursday. President Alexandre Tombini reduced the target lending rate by half a percent to 7.5%, stating there is room for additional adjustments. In addition, Finance minister stated that Brazil's government will keep taking action to weaken the currency to help local manufactures in 2013, where he has set a growth target of 4.5%.

Fixed Income

- US Treasuries gained for the week with anticipation to Bernanke's speech on Friday, where investors are seeking further hints on further quantitative easing. US 10 year yields fell 5bps to a 3 week low of 1.639, the 5 year down 4bps to 0.667% and the 2 year lost 1bp to 0.26%.

- In Europe, peripheral EU government bonds sold off on the back of fears that the ECB will fail to contain the region's debt crisis, and Murcia became the third Spanish region to say it will need emergency loans. Spanish 10 year yield rose 27bps to 6.657% and Italian 10 year yield gained 9bps to 5.807%, in spite of Italian borrowing cost dropping on a 5 and 10 year bond auction on Thursday where Italy raised a combined €7.29bn, near the maximum auction target at a respective rate of 4.73% and 5.82%.

- The ECB is set to meet on September 4th where it is expected to provide some guidance on plans for a bond buying program.

Bedrock Newsletter

- This week, US corporate and US sovereigns were the best performers, rising 0.27% and 0.23% respectively. EU sovereigns were the only losers, down 0.02% for the week.

Equities

- Developed equity markets slid this week, with the MSCI World retreating by 1.07%, as of yesterday's close. The mood was cautious in financial markets due to the high stakes surrounding the Fed chairman's speech as well as a meeting of the European Central Bank next Thursday that is expected to take pressure off highly indebted countries. The sentiment was negative overall, mainly as economic uncertainty in Europe is perceived as rising as growth prospects worsen and unemployment rate hit record (11.3% according to latest figures).
- The EuroStoxx 50 lost 1.20% for the week hitting a four-week low. European stocks dipped until today, losing ground for the fourth session in a row, as expectations of further stimulus from the US Federal Reserve faded ahead of a key speech from Chairman Ben Bernanke. Earlier in the week, European Commission's euro-zone economic-sentiment indicator fell to the lowest level since late 2009.
- The S&P 500 dropped this week, losing 0.83% as of yesterday's close. US stocks fell on Thursday after several days of muted trading as investors took a defensive posture before US Fed's Ben Bernanke's much-awaited speech today. Also, concerns over Europe weighed on sentiment as well as jobless claims data indicating muted US employment activity.
- Meanwhile, the Nikkei dropped about 2.54%, falling to a four-week closing low on Friday, on a stronger Yen and as resources-related shares remained under pressure on concern over slowing China growth.
- In terms of sectors, Materials, Industrials and Energy were the worst performers of the week (-2.85%, -1.59% and -1.50% respectively), while Consumer Staples and Healthcare fared better (-0.32% and -0.51% respectively).
- We believe that America, Europe and China will continue to provide market friendly measures and stimulus, which in turn will continue to underpin Equities. We also favour EM equities as China's market is at very depressed levels. In Brazil, as the Central Bank cut rates to a record low of 7.5%, we also expect the equity market there to have a nice tailwind.

Emerging Markets

- Emerging Markets slid by 2.18% for the week (as of yesterday's close) - as measured by the MSCI EM - pressured by global growth worries and uncertainty over central bank action. EM Europe and Latin America were the worst performing regions (-3.26% and -2.70% respectively) while EM Asia fared better (-1.77%).
- Chinese shares fell this week, after globally declining earnings showed the impact of the nation's declining growth. As a result, the Shanghai Composite lost over 2.13% for the week. Signs that China's economic slowdown is deepening dragged the Shanghai Composite down about 2.4% in August, a fourth straight month of declines and the longest losing streak since August 2004.
- The Brazilian Bovespa dropped by 2% this week, as of yesterday's close. Despite the widely expected key interest rate cut by the Brazilian central bank on Wednesday from 8% to 7.5%, euro zone fears once again grabbed the market's attention.

- We remain constructive on Emerging Markets in the medium/long term as most investors keep being attracted by these countries' growth and their relative sovereign-stability.

Commodities

- Commodities dropped by 0.53% this week as of yesterday's close, as measured by the S&P GSCI broad commodity index. Industrial Metals were the most negative sector (-1.70%), while Energy and Precious Metals both lost 0.93%.
- Agricultural commodities were the only positive segment, rising by 1.15% this week as of yesterday's close, still supported by the damages to US crops caused by the sustained drought.
- Gold lost 0.72%% this week (now trading around $1'660 per troy ounce). Gold prices turned lower as a wave of heavy selling in US equities and other markets triggered profit-taking in bullion a day before a hotly awaited speech by Federal Reserve's Ben Bernanke. Bullion, seen as a hedge against inflation as a result of rampant cash-printing, is heading for an almost 3% gain this month, its third straight month of gains.
- Crude Oil closed the week slightly negative (-0.13%) and is currently trading at $95 per barrel. Oil prices took their cues from the stock market and a rising US dollar on Thursday, as traders' focus turned from oil production outages due to Hurricane Isaac and toward the broader economy.
