Friday, September 14th 2012

After last week's "Super Mario strikes again", this week it is "Helicopter Ben Strike III"! The week started with markets enjoying the post ECB and Draghi's effects, holding last week's gains. Then on Wednesday, the German Constitutional Court finally announced their decision concerning the ratification of the ESM and it was positive. That was another major hurdle/uncertainty which was removed.

Then on Thursday, Helicopter Ben delivered even more than the market had expected or hoped for. Not only did the Fed announce a new, open ended, program of Mortgage Backed Securities purchases (40 Bio USD per Month), but they also tied it explicitly to the improvement of the Labor market, saying: "If the outlook for the labor market does not improve substantially, the Committee will continue its purchases of agency mortgage-backed securities, undertake additional asset purchases, and employ its other policy tools as appropriate until such improvement is achieved in a context of price stability".

Waoo! This means that there are no definitive size or time limits on QE3 - prompting some to call it QE-Infinity!! Moreover, the FED also extended its low rate guidance from the end of 2014 to mid-2015.

The market reaction was immediate. Stock indices rallied sharply (1.5% on average), with commodity prices rallying quite substantially also (Gold, Oil, Silver and Grains). The surprise came from the Bond Market where long term yields actually rose, instead of dropping as conventional wisdom would suggest. In our view, this means that the Market sees this latest action by the Fed as reflationary and thus the steepening of the curve.

This is not really what the Fed was waiting for! But amid all the noise surrounding the Fed's Communiqué and Bernanke's press conference, nobody picked up on what Bernanke actually said, which we thought was quite worth repeating here. He said that the Fed buys treasuries, collects the interest income, and then gives back the interest collected to the US Treasury! Who wouldn't dream to be a borrower like the US??? They lend to the FED, and get back through the back door what they have paid! Essentially, they are borrowing at Zero! This is free financing, unlimited in size and in time...

What we said last week is even truer this week: Too bad we can't invest with the Fed or the ECB!

On these grounds, the Euro, which was trading at 1.20 to the US$ in late July, has regained the 1.30 level (a big 8% move, but of course, this was one of the most crowded one-sided trades; so no real surprise here...), precious metals exploded to the upside with Gold rallying 100$ and Silver jumping by nearly 10% in a week! WTI Oil is close to the $100 mark again and some equity indices are at multi month highs (in the case of European indices) while others are at multi year highs (US Indices).

But amid this rosy (market) picture, we would still like to sound a note of caution. All the expected positive news (ECB and Fed, German Constitutional Court, more stimulus from China) are out. So now there is only room for negative news flow, be it economic (nothing is fixed…) or geopolitical (we saw this week that the Arab Spring is turning into an Arab nightmare for the US, and tensions in the Middle East due to Syria and Iran remain extremely high).

Have a nice, sunny and thoughtful week end!

Bedrock Newsletter

Currencies

- Last week was Super Mario, this week it is Helicopter Ben and his $40Bn Bernanke-Bazooka. QE(III) or Operation Twist 2 or Scary Movie 98… We have seen this movie before! If in doubt give the economy a hand-out. EURUSD soared on the news that the US shall be extending the Asset Purchase Plan by yet another almost incomprehensible amount. Starting the week at 1.2800, we are currently at the highs of the week and back at the levels of early May, printing 1.3100. Although the US Money Multiplier is working better than in Europe this is a blunt instrument and won't sort out the fundamental issues. EUR lower is our view and once the mist clears and we see what is left in Europe, perhaps the markets will trade at fair value again.
- With the EUR here to stay (in its current form for now), EURCHF has traded higher again. The pair printing a high of 1.2178 this morning and looking set to trade well on the back of the OMT and the QE3 news, having started the week at 1.2090. This means that the 1:1 relationship between EURUSD and USDCHF has broken down a little, taking the sting out of the USDCHF slippage. However the USD did suffer again with the FOMC decision and weakened from 0.9450 to the lows of 0.9315. The SNB re-iterated their stance on the Floor at 1.20 and said they would not tolerate a strong CHF in light of the risks to the Swiss Economy. There is no threat of inflation on the horizon and the very high risk to stability that the Real Estate Market poses were their headline comments. We think it is safe to say you can buy EURs against the CHF!
- Unfortunately any positives for the BOJ from Draghi last week slowly unwound to see the USDJPY pair move from 78.20 to as low as 77.20 on Bernanke's speech. We are off the lows now trading above 77.95 but the JPY has yet to weaken materially and it would appear the trend of the stronger Yen remains intact for now.
- AUDUSD bounced well with the general Risk-On sentiment in the markets this week. From the lows on Tuesday of 1.0325, to the post Bernanke highs of 1.0590. With good housing data and housing starts positive again and consumer confidence rising, the AUD has caught a decent Bid and continues to rise. As soon as the brakes are put on the AUD will drop again, but make hay whilst the sun shines!
- GBPUSD soared again with the Risk-On sentiment moving from just under 1.60 to 1.62 over the week. As we have mentioned before the GBP should not be so high, but in this case the trend is a USD one, so when the focus is not so tightly on the USD, the GBP will likely revert lower.
- USDBRL is trading back in its pattern of 2.05 and 2.01, the USD weakness continued in the EM pairing as well and saw the USDBRL move from 2.0425 to 2.02. EURTRY also had a good week moving from 2.30 to 2.34 on the EUR positive and Risk On sentiment.

Fixed Income

- Treasuries fell again this week, pushing yields up the most in more than a month. Starting the week with high expectations for The Bernanke to deliver a whopping QE3 – and he didn't disappoint. Short term rates were marginally down from 0.24% to 0.23%, versus the 10s that moved from 1.65% (smashing through 1.84 on Bernanke's speech) and currently trading about 1.7850% and the 30s that moved from 2.82% to touch 3% on the FOMC news and trading thereabouts as we type… NOT what they were expecting which probably indicates that the markets view it as reflationary tactics.

- In Europe, The OMT has been declared a success less than 1 week after having been touted (not even implement!) by Mario Draghi. The Spanish 10 year is back below the 6% barrier and safely trading at 5.63%. With no concrete evidence of the implemented strategy and no one actually asking for a bailout it seems likely that these low levels will not be maintained unless they ask for help.
- The Italians are also happier this week than last week, for their borrowing rates have dropped again from 5.15% to 4.99%. Even the Portuguese rates dropped from 8.4% to 8.08%.
- This week the outstanding performer was the Convertible Bond space moving a massive 2.15% this week. The nearest contenders were the EUR HY at +1.52% and US HY at 1.18%. Only the US Government dropped this week by -0.28%. EU HY this year is nearly reaching 20% with Global EM debt the closest with +13.75%

Equities

- Developed equities were little changed ahead of the FOMC meeting, but surged significantly after the Federal Reserve announced an aggressive plan to stimulate the economy, encouraging investors to dive back into the market. As a result the MSCI World rose by 1.33% as of yesterday's close.
- European stocks rallied to a 14-month high early on Friday, led by growth-oriented stocks, after the launch of the Fed's new monetary easing program in its latest attempt to drive growth in the world's largest economy. As a result, the EuroStoxx 50 rose by 2.36% over the week.
- The announcement of the stimulus plan naturally sparked a rally on US Equities, after the Fed said it would pump $40 billion into the US economy each month until it saw a sustained upturn in the sluggish economy and weak jobs market. The central bank also extended a plan to keep short-term interest rates at record lows – close to zero – through mid-2015 and said it's ready to take other steps to boost the economy even after it strengthens.
- Meanwhile, Japanese stocks stroke a 3-week high as Fed euphoria boosted risk appetite and lifted battered cyclical stocks. As a result, the Nikkei surged by 3.24% over the week
- In terms of sectors, high beta sectors such as Financials, Energy and Materials posted the strongest gains (+2.20%, 2.13% and 2.04% respectively), while Consumer Staples and Healthcare stocks rose the least (+0.09% and +0.64% respectively).

Emerging Markets

- Emerging Markets rose by 1.36% for the week (as of yesterday's close), as measured by the MSCI EM – in line with its developed counterpart. Latin America posted solid gains (+2.97%), followed by Asia (+1.41%) and EM Europe (+0.86%).
- The Shanghai Composite oscillated between positive and negative sessions this week, ending slightly negative for the week (-0.18%). Chinese stocks fell ahead of the Federal Reserve's announcement on Thursday as a lot of investors thought massive stimulus measures would threaten the nation's sustainable growth.
- Meanwhile, the Bovespa soared by 6.24% over the week. Brazilian shares posted hefty gains on robust domestic retail sales data and Federal Reserve plan for more monetary easing in the US, Brazil's largest commercial counterpart.

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- 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 rose by 1.53% this week as of yesterday's close, as measured by the S&P GSCI broad commodity index. Industrial and Precious Metals as well as Energy rose strongly this week (+2.30%, +2.02% and +2% respectively), while Agriculture was negative (-0.70%).
- Agricultural commodities fell this week as trading was dominated by technical selling, as traders took advantage of high crop prices to engage in some profit-taking before Wednesday's USDA supply and demand report. Additionally, traders continue to be concerned with lagging demand for US corn, as high prices have drastically reduced recent corn export sales.
- Gold rose by 2.67% over the week - now trading around $1'772 per troy ounce. The yellow metal hit a six-month high on Friday, extending the previous session's 2% gain, after the Federal Reserve disclosed its economic stimulus program that could add to the risk of inflation and strengthen bullion's appeal.
- Crude Oil surged by 3.31% this week - currently trading at $99.75 per barrel - following strong gains in global equity markets, after Fed's QE3 announcement. Also, rising tensions in the Middle East stirring supply fears supported oil prices further.
