Bedrock Newsletter

Friday, October 12th 2012

October and Q4 are upon us. Yesterday China and Japan announced that they are entering high-level discussions about the contentious small islands… clearly diffusing the tensions of the recent past. An immediate reaction is seen in the Yuan which is now at an all-time high against the US$ at 6.266!

As one flash-point is being hosed-down with words, another is flaring up- We are observing a worrisome escalation in hostilities between Turkey and Syria, bombs and other projectiles crossing their borders. Whilst this may divert our sights from the ongoing internal massacres in Syria, we are concerned that the escalation could ignite a bigger conflict between the Shia and Sunni across the region. On Tuesday Israel announced they will run early elections, possibly a Netanyahu ploy to gain support for his hawkish stand vis a vis. Iran and the Hamas in Gaza. The latter benefitting from the nervousness around and fired large volleys of missiles into Israel. Another bid of escalation was seen in a drone flying into Israeli airspace, possibly operated by Hezbollah out of Lebanon. Oil prices are creeping up again, with WTI trading again above $92/Bbl. We maintain our long exposure to oil and hope that we lose money on it…

With these political issues in the background we remain focused on the mundane; Q3 earning season opened with a pleasant surprise from Alcoa, beating expectations on all counts and subsequently losing 3% of its value. Others have also shown better than expected numbers, but then again, the expectations had been (yet again) ratcheted down into perceptions of a global slowdown. So far, ahead of Friday's trading we are seeing generally flat equity markets for the week.

Oh yes, let's not forget last night's Vice Presidential debate- Vice President Biden vs. Romney's avatar… Since the debate between the candidates, Romney's odds have been improving whilst still trailing Obama. The markets seem to like the idea…

Let's not lose sight of the fact that we are another week closer to the Fiscal Cliff… And we see absolutely no political attentions being paid to the looming, potentially disastrous problem. A certain Simpson said in an interview that "the US is the healthiest horse in the glue factory…"

One cuddly ray of data came out this week- U.S. debt has shrunk to a six-year low relative to the size of the economy as homeowners, cities and companies cut borrowing, undermining rating companies' downgrading of the nation's credit rating. Total indebtedness including that of federal and state governments and consumers has fallen to 3.29 times gross domestic product, the least since 2006, from a peak of 3.59 four years ago, according to data compiled by Bloomberg. Private- sector borrowing is down by $4 trillion to $40.2 trillion. Perhaps US debt is not quite as toxic as some fear mongers have been saying?

The Real Estate market in the US seems to have stabilized, possibly just bouncing along the bottom. We see that a substantial proportion of sales are of the so-called "Short-Sale" type- this is where a home is sold for an amount lower than the debt attached. Well, this might become a problem come January, as a part of the said "Fiscal Cliff" includes special tax waver- Debt forgiveness is essentially revenue. A short sale generates a gain to the borrower which normally would be taxed as income.

A Republican thought into the weekend- One cannot multiply wealth by dividing it…

Currencies

- Monday saw the official inauguration of the ESM, followed by the reassuring tones of Mr Juncker confirming to the citizens of the Euro area that the bureaucrats are now tirelessly watching over their interests… reassuring isn't it?! Spain still has not requested the bailout the market is waiting for, and this saw the EUR slip from 1.3030 to as low as 1.2820 by the end of Wednesday. The Germans have stated that they do not believe Spain needs a bailout… and we did not think the German's had a sense of humour! Eventually on Thursday morning the markets were greeted by a downgrade for Spain from one of the agencies (how much does this even mean anymore?!) and the EUR bounced and we are currently at the 1.2940 level. What if the German's are right, the markets have priced a bailout… does the EUR go up?

- EURCHF saw little change, but gave back a few points from last week's positive performance as we see the pair currently at 1.2090 having been as high as 1.2115. As a result, the USDCHF pair resumed its usual mirroring of EURUSD, gradually rallying back to the previous week's high of 0.9435 from as low as 0.9280 on Monday to slip a little on the Spanish downgrade to 0.9340 currently.

- The Yen strengthened for the week against both the USD and the EUR after statements that the JGB shall only ever be issued in JPY and that no further heed was paid to the expectation of the BOJ foreign bond buying program. USDJPY moved from 78.70 to as low as 78.00 on Thursday only to rally all the way back to 78.60 after better than expected Industrial data in Japan. EURJPY followed a similar pattern dropping from 102.50 to as low as 100.25 only to rally back to 107.70, where we are now.

- On little to no news and a slight bid tone in the commodity sector the AUD has rallied from the lows on Monday of 1.0149 to print 1.0294 on Thursday. We are currently just off the highs at 1.0270, perhaps in the short term we have seen the lows if the equity rally and risk on sentiment resumes, however structurally, all is not well in the Aussie two speed economy and we feel that new lows shall be set in the coming months.

- The GBPUSD was attacked politically on Monday after the British Prime Minister did not vote for the transaction tax and also stated that the free movement of labour from within the EU into the UK is likely to be reviewed as he feels they are taking domestic UK jobs from UK citizens. As a result Cable slipped from 1.6140 to as low as 1.5978, breaching the 1.60 figure for the first time in over a month.

- CNY jumped to its highest levels of the last 19 years (the only years that matter as the currency trading system was only entered in 1994)! The Chinese let the Yuan appreciate to its highest levels in an apparent political gesture to the US ahead of the election. The USD weakened against the CNY from a mid-week high of 6.30 to the new record low of 6.2627 today.

- The BRL slipped against the USD from 2.0300 to 2.0425 on further confirmation that the Brazilian economy is slowing. This said, inflation came in higher than expected on Monday and was followed by stronger than expected sales but the economic activity index month on month was weaker than expected. Add to the mix the COPOM rate cut by 0.25% from 7.5% to 7.25% and the uncertainty in the market explains the weakening BRL, as desired by the Brazilian Government.

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Fixed Income

- With the US Treasuries closed on Monday we only had a four day trading week. Short term rates were almost completely unmoved from 0.258% to finish the week at 0.2620%. Treasury yields fell with 10-year and 30-year trading as low as 1.67% and 2.85% respectively. On Thursday, Jobless Claims came in at the lowest level since 2008. However the market had already sold off and seemed to dismiss the news, only to be bought back to a much higher level than prior to the data, leaving us at 1.69% on the 10Y and 2.87% on the 30Y.
- With the Spanish rating being downgraded on Wednesday evening we saw the yields peak as high as 5.93% having been as low as 5.61% on Monday. The market seems to have shrugged off the rating change and is back to 5.70% as we type. The lack of clarity on the Spanish bailout will likely leave the bond markets choppy and awaiting a firm decision.
- The Italian bond market was relatively stable all week, seeing the yield spike on Thursday morning with the Spanish downgrade story, but only to see the bonds rally to a yield below 5%! The Italians started the week at 5.10%, rallied as high as 5.17% and are currently trading at 4.99%.
- A relatively quiet week this week. This week European high yields were the best performers (+0.25%), while the convertible bond space was the worst performer (-0.39%).

Equities

- Equity markets dropped this week, with the MSCI World down 1.93% (as of yesterday's close), as worries about the euro zone's crisis strategy, the upcoming US election and slowing global economic growth limited the appeal of riskier assets.
- European stocks strongly slid over the week until Wednesday, as the International Monetary Fund issued a warning about the impact of the euro-zone debt crisis. On Thursday, the Spanish ratings downgrade and lingering concerns over Greece were unable to hinder a strong positive move as investors were hoping that these events may bring Madrid closer to a bailout request. However, European shares are currently falling on poor Q3 earnings view, bringing the Eurostoxx 50 down 2.18% for the week.
- The S&P 500 fell by 1.92% for the week, as of yesterday's close. An unexpectedly strong economic report showing that jobless claims fell to the lowest in four years failed to overcome muted market sentiment about the earnings season, as global growth concerns continue to weigh heavily on investors.
- Japanese stocks tumbled this week, with the Nikkei down -3.71%, the worst weekly fall since May. The index fell for a fourth straight session on Friday on mounting concerns that the upcoming quarterly corporate earnings will be weak after a tame start to the US results season.
- In terms of sectors, Information Technology, Telecom and Consumer Discretionary stocks had the toughest week (-3.25%, -2.97% and -2.55% respectively), while Energy, Financials and Utilities fared better (-0.88%, -1.09% and -1.10% respectively).

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Emerging Markets

- Emerging Markets dropped by 1.31% this week (as of yesterday's close), as measured by the MSCI EM, outperforming its developed counterpart. Emerging market stocks snapped a three-day decline on Thursday as higher commodity prices boosted producers. The best performing region was Latin America (-0.63%), followed by EM Europe (-0.83%) and Asia (-1.75%).
- The Shanghai Composite rose by 0.89% over the week, as a unit of China's sovereign wealth fund vowed to support banking shares, offsetting concern a downgrade of Spain's debt will exacerbate the credit crisis. As a result, investors put money in growth-sensitive sectors on expectations of more governmental support for the Chinese economy.
- The Brazilian Bovespa rose by 1.01% for the week (as of yesterday's close), on higher commodity prices and as claims for US unemployment benefits fell to their lowest level since February 2008, boosting prospects for growth in the world's largest economy and Brazil's first commercial counterpart.

Commodities

- Commodities rose by 1.96% this week as of yesterday's close, as measured by the S&P GSCI broad commodity index which climbed to a three week high. Energy and Agriculture led the gains (2.87% and 1.27% respectively), while Industrial and Precious Metals suffered (-2.65% and -0.69% respectively).
- Agricultural commodities rose this week, as grains prices soared on Thursday after the US Department of Agriculture cut its forecast for global ending stocks to the lowest level in six years.
- Meanwhile, Gold dropped by 0.41% and is now trading around $1'767 per troy ounce. Gold was little changed today after gaining in the previous session when the dollar eased from a one-month high, although it remained on target for its biggest weekly drop in two months. The yellow metal has been fluctuating between $1'760 and $1'780 so far this week, with no fresh catalysts to drive it up from that range, after stimulus measures by central banks pushed prices near $1'800 earlier this month.
- Crude Oil jumped by 2.65% this week, currently trading above $91.70 a barrel, on course for its biggest weekly gain in two months, supported by tension between Turkey and Syria, lower output at North Sea oil fields and upbeat US data.
