Bedrock Newsletter

Friday, October 26th 2012

Today is the last Friday of the fearful month of October. Last Friday was the 25th anniversary of “Black Monday”, when equities fell by 25% or so in a day… To celebrate, last Friday was a big down-day (on tech earnings disappointments?), Monday down some more, only to close flat on the day. A shaky omen for the week…

Monday had the third Presidential Debate. Foreign Affairs was the official topic and much like the second debate, no clear “winner” emerged. Except that Romney appears to have improved his odds as per opinion polls. Perhaps not because of the debate though.

Tuesday caused the Euro to slip vs. the USD... Triggering another big market drop, or were more disappointing earnings the cause? Face Book surprised everyone with a strong beat on both revenues and earnings, rising a huge 20% or so. Maybe there is value in its huge user base after all?

Then the Fed announced that it maintains its interest rates’ targets unchanged and reiterated its intent to maintain low rates into 2015. In addition, the Fed assured the world that it will continue buying securities at the already announced $40bn per month, until such time that employment data improves. Well, that is what the FOMC says, but we all know that Chairman Ben Bernanke’s term expires in early 2014. And then, we recall that Romney said that if elected, firing Bernanke will be one of his first acts. Maybe the rising probability of his election is rattling the markets? Do we really need the implicit uncertainty of a new Chairman? Should we re-asses the Fed’s promises of low rates forever (or thereabouts!)?

By Tuesday, 25% of the US companies reported, 60% of which beating market expectations. Where is the rally? Probably buried under generally cautious outlooks from the reporting companies, compounded by the newly realized imbedded risks in a Romney win…

The looming US “Fiscal Cliff” has caused a group of corporate leaders to take action, demanding in unison of Congress to act. If Congress fails to reach a deficit reduction deal by the end of the year, it will automatically trigger big spending cuts and tax increases in 2013. This so-called "fiscal cliff" would hit the still-recovering U.S. economy hard. An indirect side effect might well be a rise in the US$, further slowing the economy by slowing exports. The automatic spending cuts could be viewed as a sign of fiscal discipline that would benefit the currency. Remember Japan’s economic woes that caused the Yen to rise for the last 25 years?

Amid a lackluster earning season that has featured many companies missing sales expectations, cash balances have swelled 14 percent and are on track toward $1.5 trillion for the Standard & Poor's 500, according to JPMorgan (Apple alone has approx.120 Bn USD).

These are historic highs. There is little chance that corporations will start spending and investing this huge cash hoard before some serious decisions on future tax rate, budget deficits and other related political matters are clarified. Employment? It can’t rise whilst corporations keep tightening their belts. Uncertainty is a significant “handbrake” on economic activities.

Last night, even Apple disappointed investors! For the first time in quite a while, it wasn’t a blow-out report. Were their sales slow because of competition or was it caused by supply problems? If it truly was the latter, we can expect the next report to be stupendous… And do remember the huge weight of AAPL in the indices…

We are optimists by nature, but here we have a problem in keeping with our natural outlook- We observe world leaders in general and Congress in particular trying to figure-out taxation issues. We recall Albert Einstein’s observation “The hardest thing to understand in the world is the income tax…” Well, if he can’t understand, how could “they” fix it?
Have a good weekend. Next week might be tiring…

Currencies

- EURUSD had a relatively quiet week, in essence stuck between 1.3075 and 1.2950. With rumours of Greece receiving funding from the Troika, then not. With Spain agreeing a bailout package, then not. Even the FOMC was a complete non-event equivalent to the FOMC stating"never mind us… pretend we are not here". Generally a week of very little action and a lot of wait-and-see mentality. The EUR is at the lows of the week currently at 1.2925.
- EURCHF is back to trading a range which seems to be tighter than last week between 1.21 and 1.2110. We need the EURUSD pair to break significantly up before the EURCHF pair sees any further movement out of the range to the upside. The USDCHF pair inversely tracked the EUR and moved from 0.9260 to 0.9360, where we are currently trading.
- The Yen weakness continues this week, seeing the USD move from 79.30 to as high at 80.40 this morning. The rumours yesterday evening of another 10 Trillion Yen (125 Bn USD) asset purchase scheme will probably be confirmed next week, and will probably do the same as the last stimulus packages… very little. However the USDJPY pair has dropped this morning and is now trading at 79.95.
- AUD looks to be exactly where it started the week at 1.0320, having been as low as 1.0240 and as high as 1.0395. Very little news this week and the negative momentum in the markets should have seen the high yield currency weaken. But for now the AUD seems resilient in light of the low yield environment.
- Cable had an interesting week, weakening prior to the GDP figures from 1.60 to as low as 1.5925 only to rally up to 1.6150 after the GDP figures showed (at least on paper) that the economy technically was out of recession. How much of this is due to the Olympics is hard to tell, but with retail sales below what was hoped for, the UK needs to have a bumper Christmas sales period to bolster the GDP.
- CNY continued its appreciation in the cash markets moving from 6.2570 to 6.2340. The BOC rhetoric continues and the CNY strengthened again this week. Slowly but surely the currency is heading to where the US would like to see it. However, on the close of the Chinese market (or EU morning) we have seen a marked move up in the USD and as such is now printing at 6.25 again.
- The BRL this week was even more range bound than normal stuck between 2.03 and 2.0240. We look set to open at the lower end of the range this morning but no doubt remaining within a small range.

Fixed Income

- This week saw short term rates on the 2-year almost unmoved at 0.30% with slight fluctuations to as low as 0.2850% on Wednesday and as high as 0.3125% on Thursday evening. Treasury yields on the 10-year moved from 1.76% to as high as 1.85% on Thursday only to drop after the Jobless Claims which came in better than expected and is now trading at 1.78%. The 30-year traded in a similar fashion moving from 2.93% right up to 3.01% only to print lower as we are writing at 2.92%. Generally the long end 30-year got bought better than the 10-year after the data.
- The German 10-year Bund seems to have been the star performer in the European markets this week relative to its other country counterparts, seeing the yields drop from 1.60% to as low as 1.51% as we write.

- Spanish unemployment has “officially” breached 25%, this number seems to under-estimate the real figure but all we can say is that this is the highest figure we have on record in the last 16 years. The GDP shrank again and for the 3rd quarter would appear to have dropped by 1.7%. The markets are making their feelings known, pushing the 10-year yield from 5.35% to 5.7%. If the bailout terms are acceptable to all sides then the OMT should be able to buy Spanish debt in the secondary market which should ease some of the worries about market access. The question is WHEN, not IF, contrary to what Premier Rajoy keeps saying!
- Contagion of the Spanish debt problem seems to have crept over into the Italian bond market. The 10-year bonds have lost ground this week seeing a move from 4.76% at the beginning of the week to 4.91% as we write. Although the Spain/Italy spread has widened, both countries are now paying more for their debt than last week. Spreads over German Bunds have widened as well.
- A relatively quiet week this week in terms of news. This week European Corporates were the only positive performers at +0.12% and the largest loser were the convertibles at -1.23%, with a general trend that the EU Corporates and Governments outperformed their US peers.

Equities

- Equity markets fell for the week, with the MSCI World down 1.48% (as of yesterday’s close). Risk sentiment was hurt as reported corporate earnings worldwide remained weak, prompting worries over a global slowdown.
- European stocks lost almost all of their monthly gains, with the EuroStoxx 50 dropping as much as 3.10%. Disappointing corporate earnings, as well as reports of an accelerating rate of contraction in European manufacturing, caused European shares to reach new multi-week lows.
- US shares lost 1.41% for the week, as of yesterday’s close, as measured by the S&P 500. A worsening picture of global corporate earnings and worse than expected MBA mortgage applications over-shadowed reports of much better than expected durable goods (+9.9% for September). All eyes are on today’s US Q3 GDP figures which are expected at a rate of +1.8% (1.3% previously).
- Japanese stocks outperformed their developed peers, with the Nikkei down 0.77% for the week. Outperformance arose this week with the weakening of the Yen due to increasing hopes of monetary easing by the BOJ, following earlier reports that Japan’s exports fell 10.3% from a year earlier. Japan’s dispute with China has started taking its toll with a clear drop in demand for Japanese products from China, causing Japanese firms to turn to India as the next best alternative.
- In terms of sectors, Energy and Telecoms stocks were the worst performers (-2.77% and -2.19% respectively), Consumer Staples and Information Technology stocks fared better (-0.74% and -0.93% respectively).

Emerging Markets

- Emerging Markets fell 0.69% this week (as of yesterday’s close), as measured by the MSCI EM, where EM Europe and EM Latin America were the worst contributors to the gauge (-2.21% and -1.00% respectively), while EM Asia fared better (-0.41%).

- The Shanghai Composite fell as much as -2.92% for the week. Chinese stocks fell on the back of corporate earning concerns, overshadowing earlier optimism caused by an improvement in Chinese PMI (49.1 vs. 47.9 for SEP).
- The Brazilian Bovespa fell 1.84% for the week (as of yesterday’s close). Corporate earnings were the centre of attention this week, with Brazil’s mining giant Vale reporting disappointing earnings on Wednesday. However, guidance provided was on the positive side, with the company expecting a pickup in global economic activity, causing a pickup in the Bovespa on Thursday.

Commodities

- Commodities slumped by 2.83% this week as of yesterday’s close, as measured by the S&P GSCI broad commodity index. Energy and Industrial Metals led the losses (-3.47% and -2.69% respectively), while Precious Metals and Agriculture fared better (-0.56% and -1.16% respectively).
- Agricultural commodities lost some ground this week, on tepid US export sales and mounting concerns about weak demand. This summer’s drought – the worst in half a century – drove prices to historic highs until recently but there are growing signs demand is waning as end-users back away from the market due to poor profits.
- Meanwhile, Gold dropped by 1.42% and is now trading around $1’704 per troy ounce. Gold is heading for its third week of decline as the US dollar firmed and equities plunged, while persistent fears about the health of the global economy also dragged. Bullion has fallen around 5% since hitting an 11-month high above $1’795 an ounce in early October, after the excitement ignited by the US Federal Reserve's latest monetary easing programme died down.
- Crude Oil tumbled by 4.09% this week, currently trading around $85.15 a barrel. Crude fell for a seventh straight session on Wednesday, hitting 12-week lows after a sharp build in US oil stockpiles. On Thursday, crude oil settled slightly higher following a mixed session that was rocked by upbeat economic reports contrasted with a sharp increase in supplies. Crude is again sharply falling today, on the back of a stronger greenback and global shares decline.

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