Friday, December 21th 2012

This is our last Newsletter for 2012! If you are reading this, rejoice!, the Mayan prophecy for the end-of-the-world today was false! Or was it just inaccurate? Will we be falling off the Fiscal Cliff in ten days? And then, if we do “fall off”, how bad will it be? Probably not an end for our otherwise quite pleasant World…

On Tuesday this week we enjoyed a rally in the Euro to 1.323, Oil and equities all up as gold melted 2% to $1’668 as bonds fell, reaching 1.82% on the US ten year Treasury Note.
It was a pleasant week since, but then last night Boehner’s “Plan B” was withdrawn, the Fiscal Cliff coming back with a bang- a resolution may be further away than thought (hoped-for) as clearly even the Republicans amongst themselves can’t agree on the issues at hand! Whilst we remain optimistic that a solution will be attained, we recall Groucho Marx’s words “All people are born alike - except Republicans and Democrats.”

Equity markets after the US close are all trading down heavily as are US futures. The Dollar itself perversely is rising into the political debacle and Gold regains a stronger Dollar. The markets are thin on this Friday and movements might be exaggerated due to poor liquidity. We do expect the markets to jump up-and-down through these festive days, probably to conclude more or less at current levels. More of the same which we have experienced throughout 2012;

- *We started the year with a 1.87% yield on the US Ten Year Note, trading today at 1.76%, having ranged from 1.38 to 2.38%*
- *The 10 year German Bund started the year at 1.90% to reach today 1.76%, ranging from 1.16 to 2.06%*
- *Greek 10 year debt entered 2012 yielding 34.97% to trade today at 11.65%, the year’s low!*
- *The DJIA closed 2011 at about 12’200 reaching yesterday 13’300 (+9%)*
- *The Euro closed 2011 at $ 1.295 and is now at 1.322*
- *Gold started the year at $1’564 and is closing at $1’650 (+5.5%) having traded in a range of $200 from highs to lows.*
- *WTI oil came from $99.06 to reach $89 for Christmas, having traded through $110 in early March and a low of $78 at the end of June.*
- *The Chinese Yuan has continued its slow appreciation, coming from 6.2943 to the Dollar to trade now at 6.228 or a 1% increase.*
- *The VIX, the measure of volatility or risk has drifted down during the year, starting at 23.40 to 17.60 having visited 26.70 in late June and a low of 13.40 in mid-August.*

Yes, the year was difficult, markets moving all over the place to finish roughly where we started, except equities which clearly have risen in nearly all markets.
Where to next? Some CitiFX Technicals Team outlooks for 2013- These are technical chartists and their views do not necessarily reflect Citigroup or Bedrock views:

- *U.S. 10 year yields will have one final push down towards 1%-1.2% at which point they could bounce up like a “beach ball let go underwater”.*
- *EURUSD will fall towards 1.20 in Q1 2013 and possibly even 1.10-15 with parity a real possibility in 2 years. And also expect a rally on the USD Index this year of about 15%*

which suggests that this move will be predominately driven by EURUSD (57.6% of the USD-Index).

- *CitiFX expects Gold to move to $2,055 -$2,060 in the first quarter of 2013 and ultimately a rally towards $2,400 in 2013.*
- *Crude Oil (Brent) should rally to the 2011/2012 highs around $125 and possibly move to all-time highs in 2013.*
- *The DJIA will drop over 20% towards the 10,000-10,500 area.*

These are chart-derived views, presented to you to provoke thoughts. Whilst we would not argue with the outlook for the bond market, we have to think carefully about the views on the Euro which may benefit from a resolution of the credit issues of its weaker members. We have no tools with which to argue the bullish views on gold except to attenuate their exuberance with a close look at the recent fall from grace and even Jim Rogers' recent bearish outlook on the yellow metal of which he had been a fervent supporter. On oil, we remain positive on its outlook, Brent or WTI, as even as the US is adding to its capacities, usage of the black stuff is rising around the globe as emerging markets are increasing standards of living. As to the DJIA dropping 20%, it seems hard to conceive with P/E ratios being below historical levels with interest rates or carry-costs at historic lows. Other prophets, fundamental analysts in particular, expect the S&P 500 to generate $100-$105 in earnings for 2013 which with an earnings multiple of 15X suggests a level of 1'575 (+9% from here) and others, expecting an increase in multiples see even higher numbers. What to believe? As Thomas Sowell said "it takes considerable knowledge just to realize the extent of your own ignorance"…

We do not believe in prophesies as the future is not ours to predict- just as the Mayans got it wrong (you are still reading, are you not?), we prefer to discuss views and establish a range of outcomes and add a grain of probabilities to the possibilities. We remain optimistic. Just as all past recessions share the fact that they ended, so will this one. Just as all political debacles get resolved, so will the US Fiscal Cliff, so will the European Union's peripheries' issues. In time, if not in 2013, our universe of investments will regain a fundamental footing. As such, we like to sustain our positive outlook for global equities, remain cautious on interest rates and then, hope for a less strenuous 2013. We know you share our hope that the Syrian massacres will cease and that a solution be found, we know you want the North Koreans and Iranians to find reason and step back from their nuclear ambitions, we know that you hope together with us for all the hungry to find food and the homeless to find shelter. "You have to dream before your dreams can come true" Abdul Kalam.

Have wonderful festivities and a great next year! We will return in January, Mayans not withstanding…

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Currencies

- EURUSD seemed to trace the Eu-ro-phoria of the equity markets, rallying very aggressively from 1.3160 to as high as 1.3308 on Wednesday only to stumble and fall back to 1.32. With weaker than expected US GDP and lower personal consumption the USD dipped briefly on Thursday, however, it has recovered into the Christmas weekend. Having started the year at 1.2970, we are currently at 1.32, having reached as high as 1.3460 and as low as 1.2060.
- EURCHF moved in line with general EUR strength or weakness. Moving between 1.208 to as high as 1.21 with general market euphoria only to slip back to 1.2065 this morning. USDCHF is almost unchanged on the week at 0.9150, having slipped from as high as 0.9180 to 0.9080. On the year the USDCHF has lost a little ground slipping from 0.9380 to 0.9150 now having been as high as 0.9960 and as low as 0.8955.
- The Yen was range bound even though the Japanese PM designate Abe had a 20 minute meeting with the BOJ... He did manage to garner another 10 Trillion Yen though. The pair oscillated between 83.80 and 84.60, we seem to be holding steady at 84.10. Moving from 76.90 at the beginning of the year to 84.10 today, having been as low as 76.00 and as high as 84.60 this week!
- AUD seemed to ignore general positive market sentiments and just slipped from 1.0560 to 1.0410 where we are at the moment. The lack of Chinese data meant that there was nothing positive to inflate the currency unnecessarily. We started the year at 1.02 and are currently up a little at 1.0410, having been as low as 0.97 and 1.0810.
- Cable had a positive week, moving steadily from 1.6160 up to a high on Wednesday of 1.6310. We have slipped a little into the weekend and are currently holding at 1.6250. The pound had quite a wild ride this year starting at 1.5560 immediately slipping to 1.5235 (the low of the year) only to rally to 1.63 in April and back to 1.53 by the end of May, to finish the year at the highs of 1.63 again.
- CNY had a very quiet week, remaining practically unchanged at 6.2350. The once in a decade change of rulers seems to have had little to no impact on the currency but we do remain at the highs for the CNY, trading to 6.2340 this morning. The general direction for USDCNY for the year was of course downwards with a mid-year rally. The USD moved from 6.30 to as high as 6.3965 in July to finish at the lows for the year trading down to 6.21 and now at 6.23.
- The BRL is unchanged on the week so far at 2.08 having been as high as 2.10 and as low 2.0550. Having moved from 1.8680 at the start of the year we moved to as low as 1.6890 only to rally straight to 2.10, from where the central bank has managed it through the year in a trading band from 2.00 to 2.10.

Fixed Income

- This week saw short term rates on the 2-year open at 0.23% but spike to 0.28% on expectations that there was an agreement for the Fiscal Cliff… however seems to be unchanged now that the plan B has been thrown out. Treasury yields on the 10-year moved from 1.72% to as high as 1.84% on Wednesday night only to drop after the Boehner news to where we are today at 1.76%. The 30-year traded in a similar fashion moving from 2.88% up to 3.03% only to print lower as we are writing at 2.94%.

- The German 10-year Bund sold off this week seeing the yield move from 1.37% to as high as 1.46% only to move back to 1.39% as we write.
- Spanish yields moved down as the market seems to further support the Spanish debt in the lead up to the Christmas period. The buying saw the yields tumble from 5.45% to as low as 5.20% almost back to the lows of the year at 4.85% having been as high in the atmosphere as 7.75% amid the "cajas" crisis!
- We are sure that Berlusconi would like to attribute the good bond performance this week to his speeches, however, the market has generally bought up the weakness in the Italian bonds seeing the yield drop from 4.60% to as low as 4.35% on Wednesday only to slip a little to 4.47% as we write. With the Media-Mogul back in the political limelight again everyone seems to have forgotten that he was to be jailed for 4 years! The 10 Year bonds are now at their lowest yields since October 2010, having been as high as 7.17% at the start of the year.
- This week European High Yields were the best performers at +1.14% followed closely by Global Convertible at +0.71% and the largest losers were the US Government at -0.30%, the Fiscal Cliff is now in view, front and centre. Year to date the star outperformer has been European High yield at +26.96%, outperforming its nearest rival by over 11%.

Equities

- Equities rallied for the week with the MSCI World index rallying 2%, as of yesterday's close. Risk sentiment improved this week as Japan's LDP party won a landslide victory, increasing prospects of a weaker Yen to support the economy. In addition, fiscal cliff talks seemed to take a positive turn, only to collapse on Thursday evening, leading to increased pessimism over the likelihood of a deal, causing overnight equity benchmarks to drop around 1%. The MSCI World is set to end the year up 14.5%.
- European stocks rose 0.53% for the week on optimism over "fiscal cliff" talks, as well as better than expected German IFO business climate. The Eurostoxx 50 gauge is set to end the year up 14%.
- US shares rallied 2% for the week up until Thursday's close, yet S&P 500 futures are implying a drop of 1.35% for Friday's trading session (after momentarily dropping as much as 3.4% on very thin volume) as house speaker John Boehner gave in to pressure by the republicans, and scrapped his plan to raise rates for taxpayers earning more than $1 million, and by so do, dampening the outlook for the talks which will only resume after Christmas. Economic figures were mixed for the week, with Manufacturing and Mortgage Application figures coming short of expectations, while Q3 GDP figures were revised up to 3.1% from 2.8%. The S&P is set to end the year up 14.8%.
- Japanese stocks rallied as much as 4.35%, up to Wednesday to a 9 month high, following the victory of the LDP party, causing Japanese exporters to gain due to prospects of implementation of policies which will further weaken the Yen. The gauge has since lost 1.7% on profit taking and fiscal cliff talks collapsing. The Nikkei is set to end 2012 up 17.6%.
- In terms of sectors, Financial, Info Tech and Consumer discretionary stocks led the gains (+3.32%, +2.66% and 2.66% respectively), while Telecoms and Consumer Staples lagged (0.00% and +0.12% respectively).

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Emerging Markets

- Emerging Market equities rose by 1.00% for the week, as of yesterday's close. In terms of regions, Latin America and EM Europe were the best performers (+2.29% and +1.85% respectively), while EM Asia was flat. With the performance of the MSCI EM up 14.9% YTD.
- The Shanghai Composite rose 0.12% for the week. It has been a quiet week in China with movements caused solely by headwinds from the US. The gauge is set to end 2012 down 2.1%.
- The Brazilian Bovespa rallied as much as 2.8%, as of yesterday's close. Brazilian shares gained on the back of positive outlook from the US, causing a rally in Oil prices, and by so supporting Brazilian oil producers. Internally, the finance minister announced an extension of IPI tax cuts for automobiles, furniture and other goods through June, attempting to spur growth in the country. The Bovespa is set to end 2012 up 8%.

Commodities

- Commodities rose by 1% this week, as of yesterday's close, as measured by the S&P GSCI broad commodity index. This week saw a sharp drop on Agriculture (-3.24%) and Precious Metals (-3.73%) as well as a retreat on Industrial Metals (-2.81%) while Energy rallied by 2.70%.
- Agriculture slid this week as Corn suffered an important reversal, after forecast that US farmers will plant over 99 million acres of Corn next spring. Soybeans were also under big pressure after reports of ample rainfall in Brazil, where crops are expected to be huge in the southern Hemisphere growing season.
- Gold dropped by 2.79% over the week, falling from a high at $1'703.35 per troy ounce reached on Tuesday – all the way to $1'649 currently, hitting its lowest in nearly four months, weighed by year-end investor selling. Gold prices are set for their biggest quarterly drop since the third quarter of 2008, with the announcement of a fresh round of usually bullion-friendly US monetary easing last month resulting in only temporary gains.
- Oil rose strongly over the week amid report of shrinking US crude supplies, and after government data showed a jump in demand for diesel and heating oil. Also, some good news overseas offset concerns about political wrangling in Washington. Oil futures rose by 2.90% for the week and are currently trading at $89.20 per barrel.