Bedrock Newsletter

Friday, February 1st 2013

January drew to a close yesterday. Already 1 month came and went. In terms of market action, it was good. Actually it was the best January month since 1997 for the S&P 500 index, and the best January since 1994 for the Dow Jones, quite an achievement!
Will it last? Well, we are probably due for a market reaction very soon, but if history is any guide, 2013 should be a good year for equities after such a strong January.
Actually, with all the support from Central Banks around the world, it is even surprising that we are not higher (yet)! This week, we had more strong hints from the Bank of Japan, the Swiss National bank and the US Fed that monetary stimulus would either continue in full swing or even increase... Even Canada surprised us last week with their very dovish statement!

But despite these very powerful tail winds, we see strong head winds in terms of actual economic numbers in Europe (even if numbers came in less bad lately): a too strong EUR, bad comments from the S&P rating agency citing very strong risks in China and strong risks in Australia and Brazil, a shockingly weaker than expected US GDP 4th quarter number that came in at -0.1% instead of a 1.1% expected, a persistently weak economy in the UK and in Japan.

Add on top of that a very big risk of big instability in the Middle East with Egypt near a total collapse according to an Egyptian government official, the civil war in Syria becoming more deadly and gruesome every day that goes by. Israel this week intervened around the Lebanese Syrian border in order to stop the delivery of arms to Iran's protégé, Hezbollah.
These renewed tensions in the Middle East have had an effect on the price of Oil, which rose to nearly 98$ a barrel for WTI and 118$ for Brent. This cannot be good news for the economy...

As you will have gathered by now, our desire to hold risky assets due to the very reflationary policies of the central banks around the world are balanced with all these concerns we have.
In terms of asset allocation, we have continued to reduce the duration of our fixed income portfolios as the yield for longer maturities do not pay for the risk anymore in our view.
We held on to our equities but bought some protection as we think that markets could be in for a rough patch soon. We also hold to our Gold and Oil positions.

One more thing to take note: even if the USD went down against the EUR, and against the CHF by proxy, the USD actually went up against the GBP, the AUD, the CAD, the SGD and emerging market currencies save for the BRL. This is now contrary to the past, where any move up in equities or risky assets was accompanied by a drop in the USD against all currencies and against Gold. This is not happening now and we view this as a potential negative sign for equity markets...

In summary, it may be good to be a bit more defensive in February.
We leave you with these thoughts and wish you a pleasant and restful week end.

Bedrock Newsletter

Currencies

- EURUSD has confounded most market traders this week and continued higher into the upper atmosphere. Whilst trading sideways for the first half of the week at 1.3450 it has moved dramatically higher to 1.3585 as of yesterday evening. The short positions have been squeezed and normally when they have all exited the market, it is then that the market finally gives up and the direction changes. We wait for the market to run out of air and fear that when the market turns that Risk in general will be offered throughout the market…
- The CHF has been bought up a little from its lows against both the EUR and the USD. EURCHF has moved fairly steadily from 1.25 to as low 1.2350, with the USDCHF moving from 0.93 to 0.91. The SNB freight train will be very happy to see the EURCHF maintaining the move higher. Perhaps this slight slowing in the depreciation could be the SNB reducing their foreign reserves to regain some dry powder? Only time will tell when the reserve data is released later on. For now we view the direction as weaker for the CHF, this is just a little station pause before the large move continues!
- Act 2 of the Japanese Drama! We continue to see the JPY weaken, moving erratically from 90.40 to 91.40. The Japanese authorities seem to be towing the party line now and falling in lock-step with Team-Abe's inflation-target-talk. The need for massive depreciation of the JPY is the cornerstone of their toolbox to achieve their target and quickly. We have heard a few people saying the fall in the JPY can't last… well to this, we say; please do not try to catch a falling knife. The movement is in one direction and it shall continue with the odd pause along the way.
- AUD attempted to make some new lows for the year. In fact it tried twice, reaching as low as 1.0380 on the second attempt. The economic situation for the country is horrendous, the central bank has indicated they may need to cut rates and yet it has not faltered. For now the search for yield seems to outweigh the economic sense behind the trade and so the high yielding AUD remains elevated. We await its decline.
- This has been a week of mixed emotions for Cable. The British economic data has weighed very heavily and the political talk of whether the UK will exit the EU has supported large scale worry and skepticism. The Pound moved to as low as 1.5675 on Monday only to reverse course and trade right back to almost 1.59. Unfortunately we feel the move is temporary and the economics will continue to see the British Pound slide back.
- The ZAR is trading wildly at the moment and saw the USD rocket to as high as 9.15 from 8.94 in one day. This move has completely reversed and the pair moved back to 8.94 last night. BUT the big move is the BRL… finally the USDBRL is moving out of the range. Not necessarily the direction we expected, but this week we saw it move from 2.04 to as low as 1.98. We again view this as short term as a risk-on mood pervades the street… make hay whilst the sun shines though… just make sure you have an umbrella at hand for the change!

Fixed Income

- Treasuries fell for the week, with the 10 year yield rising from 1.95% to above 2% for the first time since April, as retail sales figures beat expectation and amid concerns that the Fed might slow bond purchases. On Wednesday the Fed restated its commitment to asset purchases to spur economic growth, causing the 10 year to dip from 2.03% to below the 2% level (1.99% currently).

- The German 10-year Bunds fell for an additional week, with yields rising from 1.64% to 1.71% on Monday following a German auction which sold 12 month bills at a positive yield for the first time in seven months. Yields rose further to 1.727% following a negative surprise for US GDP figures. Bunds gained ground on Thursday on reports of a fall in German retail sales, causing yields to fall to 1.68%.
- The Italian 10 Year gradually lost ground during week. The initial sell off started on Monday as consumer confidence fell to the lowest level in 15 years (!!) causing yields to rise from 4.13% to above 4.20%. On Wednesday the bonds fell further (yields rose from 4.20% to 4.40%) as demand declined at an auction of 10 year bonds, as investor appetite seems to have fallen at the current borrowing cost. The bonds have since recovered some of their losses with current yields at 4.29%.
- Spanish bonds traded in line with their Italian counterparts, with yields ranging 5.15% - 5.30%.
- Bonds have fallen across the board (besides convertibles which have risen 0.57% for the week), with the worst performers being EM bonds and EU high yields (-1.02% and -0.92% respectively).

Equities

- Developed equities ended flat for the week as measured by the MSCI World index (as of yesterday's close) due to investors' caution on whether the strength of the global recovery justifies the sharp rally so far this year, amid mixed earnings and economic data. The MSCI World rose by 5% during January.
- The EuroStoxx fell by 0.91% this week, as European stock markets slumped on Thursday amid fears over a shrinking US economy and a flood of company earnings news, with Madrid hit hard by poor results from banking giant Santander. But having benefited from a broad shift in investment flows towards riskier assets, the index remains near two-year highs and has notched up a near 3% rise in January.
- US stocks dropped by 0.32% over the week, as US jobless claims topped forecasts on Thursday, adding to concern about the economy a day after the government said GDP unexpectedly shrank last quarter. The S&P 500 has climbed about 5.3% over the month and had its best January since 1997.
- The Nikkei surged by 2.42% over the week, posting its best January in 15 years as gains in the banking sector and a weaker Yen lifted sentiment, offsetting gloomy earnings from some heavyweight companies. Japanese shares reached a 33-month high on Thursday and posted a 7.15% gain this month, after rallying 22.9% in 2012.
- In terms of sectors, Telecom and Utility led the gains (+1.49% and +0.42% respectively), while Consumer Discretionary and Industrials lagged (-0.62% and -0.51% respectively).

Emerging Markets

- Emerging Market equities were flat this week, as measured by the MSCI EM. As usual, performance varied a lot across regions. Asian shares rose by 0.37% buoyed by China, while Latin America was about flat and EM Europe dropped by -1.63%.
- For the month of January, the MSCI EM Index underperformed the MSCI World , with a weak +1.3% gain.

- The Shanghai Composite surged by 5.57% over the week, rising for five consecutive days and hitting a new 8-month high. The rally in China was supported by a positive earnings outlook for firms there, as well as the recent data showing positive economic momentum.
- Meanwhile, the Brazilian Bovespa dropped by 2.30% for the week (as of yesterday's close), extending its first monthly decline since October, on concern that government intervention will hurt earnings of state-controlled companies including Petrobras.

Commodities

- Commodities rose 1.68% for the week with Energy and Agriculture leading the gains (+1.87% and +1.75% respectively). Precious metals lagged and have fallen 0.68%.
- Agriculture gained as the worst drought since the 1930's persists, cutting prospects for crop yields, sending corn futures to seven-week high and soybean futures to a six-week high.
- Gold rose 0.42% for the week and is currently trading at $1'665.6 per troy ounce. The metal was little changed early in the week but has spiked $15 on Wednesday following disappointing reports of US Q4 GDP figures, causing a USD selloff. Gold gave back some of its gains on Thursday on reports that Americans' incomes surged in December.
- Oil gained as much as 1.5%, and is currently trading at $97.30 a barrel. Oil gained early in the week as US durable goods jumped, and OPEC announced that crude prices are unlikely to drop this year. Oil made further gains as Israeli jets striked Syrian trucks carrying missiles, increasing tensions in the area.
