Bedrock Newsletter

Friday, February 22nd 2013

February is fast winding down. Last week we were honored by the presence and participation of Jim O'Neil, Chairman of Goldman Sachs Asset Management, in our Investment Committee. We were pleasantly surprised by his above-consensus world growth forecasts, with which we concur- We were pleased to hear that he too favors investments in Equities for the medium term; agreeing with us that returns therein should be higher than Fixed Income over the next periods. He supports our view that a small portfolio allocation to gold is warranted for protection against further debasing of currencies.

The head of the International Monetary Fund (IMF) Christine Lagarde strongly dismissed concerns over a so-called currency war on the sidelines of the Group of 20 nations (G-20) meeting of finance ministers and central bankers in Moscow. "There's been lots of talk of currency wars, and we have not seen any such a thing as a currency war. We've heard currency worries, not currency wars," said Lagarde. "We've not seen confrontation but deliberation, dialogue, discussions and clearly this G-20 meeting has been extremely helpful and productive."

Tuesday the equity markets rose. Watching CNBC, we noted that they are showing how far the DJIA (120pts) and S&P 500 (30 pts) are from their highs. No mention of the NASDAQ though, which isn't even half-way up to its previous highs of 12 years ago.
At the same time as equities were "melting-up", Gold was melting down. Dow transports hit another all-time high as the DOW financials went through 2007 highs. All this on Tuesday! Too good to be true? Wednesday was a bad day for equities, and for oil, and for Gold on the back of the release of the Fed minutes. The U.S. Federal Reserve's signal that it may not continue its bond buying program is a game changer for global equity markets, Dennis Gartman, editor of "The Gartman Letter" told CNBC on Thursday. "I was very bullish on stocks, until yesterday, "Suddenly the game has changed. … We're in for a leg lower, and this is from someone who was publicly very bullish on stocks because of the monetary authorities." Wednesday's sell-off in the US spilled into Asia, then a horrible Thursday in Europe, with European stocks having a bad week, now flat for the year! The US opened down further on Thursday, the VIX soared as Gold and Oil slipped... As if there was a doubt… it is the Fed that is driving the markets!

Stan Drukenmiller (Soros' partner in the raid by the Quantum Fund on the Sterling, way back when) on Thursday's CNBC is angry with the Fed and Congress. The Fed supporting the bond market masks the risks of the US deficits, keeping the markets at bay which then permits Congress to keep its ostrich-head in the sand. Without a market punishment, Congress has no incentive to take action. Stan explained that the attention on the "sequestration" risks to strike on March 1st is demagogy as the issue at hand of about $80Bn is an insignificant 0.25% of GDP. The Street's worry is that a reduction in Government spending will reduce GDP… Stan reminded us that when the US emerged from WWII it was running a deficit of 43% of GDP, experiencing a huge growth thereafter as the said deficit was trimmed to 13%. Indeed, the 0.25% is just noise. Well, we are Friday now and have seen 430 of the S&P 500 companies reporting; 70% of which have come ahead of expectations. Have the recent falls in the indices been just "technical corrections" ahead of a further rise?

Then, if you had a concern for rising rates, do give a thought to the Fed's huge book of long dated bonds. Then think how the value of this book will be affected should they let rates rise...

We leave you into another cold weekend with a thought offered to us by Mark Twain "Get your facts first, then you can distort them as you please."

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Currencies

- EURUSD held the lows of last week post Eurozone GDP contraction for the first part of the week, remaining at 1.3340. With a brief flurry to as high as 1.3430 ahead of the FOMC minutes release on Wednesday evening, causing the USD to finally take hold. The EUR then sunk to 1.3160 by the end of Thursday. The data flow for the moment seems to be USD positive and we believe that this trend should extend towards 1.29 over the coming weeks, as we approach the US Sequester. Any EUR positive data will likely be sold into as the short EUR trade continues to unfold.
- The CHF weakened against the USD this week, moving in a similar pattern to EURUSD, eventually rallying to 0.9330. EURCHF could not escape the EUR weakness and slipped slightly from 1.2340 to 1.2280. The CHF seems to slowly be devaluing in line with the SNB's targets; we would not bet against any Central Bank and believe both the EUR and the USD will strengthen over the coming weeks against the CHF.
- We are closing the week where we started for the JPY. No matter what piece of news moves it by 50 points, it would appear to have stalled at the 93.50 level. The EURJPY was not immune to the EUR weakness either and slumped from 125.75 to a low of 122.25 only to rebound a little this morning to 123.50. The consolidation phase is likely to last a few weeks and we see a little strength for the Yen on the horizon still. The G20 (after spending more of the taxpayer's money) unanimously agreed that outright currency manipulation is bad and naughty, but if the currency moves as a result of "market-pressures" then this is, of course, fine… uh-huh?!
- AUD saw a lot of weakness at the beginning of the week slipping from 1.0360 to 1.0220. The slide was mostly driven by USD strength rather than specific data driven weakness in the AUD. This was proved further by the huge 80 point jump in the AUD with the better than expected Chinese housing figures released this morning, and the less dovish testimony by RBA's Governor Stevens. The AUD moved in a straight line from 1.0240 to 1.0310. We see lower lows with each passing week and although trading the AUD can be painful, the direction does seem to be downwards for the most part.
- We have seen a further weakness in the GBP this week. Carney's words and the BOE minutes showing 3 voting members wishing for an increase in the stimulus package caused a 100 point instant slide on Wednesday. This coupled with the US FOMC minutes later in the evening saw another 100 points knocked off Cable. Having started the week at the heady heights of 1.55, we made it to as low as 1.5130, but rebounded a little to 1.53 this morning… We are afraid that even these levels would seem sensible to sell at and look for even further weakness in the Pound to come.

Fixed Income

- With the US shut on Monday, the bonds really only started trading on Tuesday. On the 4 day trading week the yields appear to be relatively unchanged at 2% on the 10Y. Prior to the Fed minutes the yields touched as high as 2.05% but eventually slid to 1.96%, only to move back to 2%. The 30Y moved with the same pattern from 3.17% to 3.24%, sliding to 3.14% and finishing back at 3.17% at the moment.
- The German 10-year Bund started the week at 1.64% (having slid into the weekend after our last letter to a yield of 1.66%). However, post the FOMC notes the Bunds were bought up very heavily moving from 1.68% to 1.58%.

- Spanish 10 Year yields were almost unchanged on the week at 5.20%, but with fairly wild (if normal now!) swings in the yield from 5.18% to 5.28% then to as low as 5.14%. As a trader this is the kind of volatility you would enjoy, as investors this is something to avoid. With such uncertainty about how the Spanish financing will play out, with the coffers of the banks being slowly bled to death and with the Eurozone foundations being shaken, we look through our non-rose-tinted binoculars and await the bailout for Spain. That being said we are at the same funding level as the 1st of January, the first week of December and the last week in October (almost)… so if you ignore fluctuations, they have maintained these levels for about 5 months… the straws are building on the camel's back again!
- The price of Italian 10 Year debt has slid this week, losing most of the gains from last week pushing the yields back up from 4.37% to 4.5%. With the Berlusconi-show back in town and the polls in a black-out period prior to the elections we wait with baited breath… who knows… he might even make Pope! But for the bonds, we see the yields possibly contracting a little but then moving upwards in a much larger move, we would not own Italian debt.
- This week the strongest performer was EU HY at +0.35% and the weakest was the global convertibles at -0.30% (not surprising given the equity performance).

Equities

- Developed equities fell for the week, with the MSCI World Index falling 1.05%, as of yesterday's close. Shares lost on the back of renewed growth concerns from Europe, as well as sudden worries that the Fed might slow its asset purchase program.
- The EuroStoxx lost 0.48% for the week. European stocks started the week on a strong foot on the back of a strong overnight trading session in Japan, where the relative lack of criticism of Japan by the G20 ministers was well perceived. In addition, German Investor confidence figures climbed to the highest level since April 2010. Shares dropped sharply at the latter part of the week on US Fed's concerns and German and French PMI manufacturing figures indicating a sharper contraction than expected, dampening the outlook for the region.
- In the US, equities fell 1.15% as of yesterday's close, as measured by the S&P 500. The gauge hit a new 5 year high on Tuesday on positive news from Europe. On Wednesday US stocks turned sharply negative as minutes from the Fed's last meeting showed debate over further stimulus action, with some saying an earlier end to purchases might be needed due to concerns over the costs and risks of the Central bank's expanding balance sheet. On Thursday shares extended losses as Jobless claims and Manufacturing figures came in worse than expected.
- Japanese shares gained for the week, with the Nikkei up 1.89%. Japanese equities outperformed as the G20 nations refrained from censuring the nation's policies that have been used to weaken the Yen. In addition, shares were supported on speculation that the succeeding BOJ governor will accommodate policies to support growth, in line with the policies of the new government.
- In terms of sectors, Materials and Info-Tech stocks were the worst performers (-3.48% and -1.66% respectively) on the back of weak corporate earnings reports, while Consumer Staples stocks gained 0.71% on an increase in M&A activity.

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Emerging Markets

- Emerging Market equities lost 1.25% as of yesterday's close, as measured by the MSCI EM Index. Most losses were attributed to Latin American and EM European shares (-2.46% and -1.60% respectively), while EM Asia fared better (-0.62%).
- The Shanghai Composite plummeted for the week, losing as much as 4.87%. Shares lost throughout the week on weak retail sales during the Lunar New Year, and amid speculation that the government might impose stricter restrictions on second home purchases to rein in rising home prices. The benchmark – being high beta in its nature - lost as much as 3% on Thursday on worries of negative economic developments in the West which might impact the recovery of the world's second biggest economy.
- The Bovespa lost as much as 3% for the week, as of yesterday's close, contributing to a year-to-date loss of 7.9%. Brazilian shares lost as the Central bank's weekly survey showed Brazil's GDP expanding less than expected (+3.65% vs. +3.8%) next year. In addition, financial stocks lost amid speculation that the Central bank delaying benchmark borrowing costs increases, will keep them from raising their own rates to improve profits.

Commodities

- Commodities dropped 2.76% for the week, as measured by the S&P GSCI TR Index. Industrial Metals and Energy lost the most (-4.65% and -3.08% respectively), while Agriculture fared better (-0.59%).
- Gold lost 1.85% for the week and is currently trading at $1'580.3 per troy ounce. The metal was little changed early in the week, only to fall 2.5% on Wednesday on speculative selling and weak industrial demand, pushing the price below the key technical level of $1'600. Gold has since regained some ground on short-covering due to weak economic data. We believe Gold should find a floor soon and start to move up again due to the massive liquidity injection by all the major Central Banks.
- Oil lost as much as 3.83% for the week, and is currently trading at $93.00 a barrel. Oil took a big hit on Wednesday and Thursday trading sessions on speculation that a large commodity fund is selling positions, on news of an increase in stockpiles and on global growth fears.
