Bedrock Newsletter

Friday, March 8th 2013

We are closing yet another interesting week… It made us think of Henri Ford's observation, "When everything seems to stand up against you, remind yourself that planes take off *against* the wind. Not with it."
Monday the Dow closed up, second highest daily close ever! This close broke the chain of down Mondays of 2013... The market rallied to within 0.25% from the all-time high, the S&P closed at 2.5% from its high... Oil falling added fuel to the trading.
Tuesday the DJIA closed at a record closing high, joined by both the S&P and NASDAQ showing big gains... We note that in support of this continuing rally the corporate earnings for 2012 were at a record high, suggesting that record prices are reasonable!
On Wednesday the Fed published the "Beige Book" showing data that supported a mild recovery. The DJIA added yet a new record close and oil dropped a little more, further supporting the equity price rise.
We saw also the Euro-zone CPI at 1.8%, running below the ECB target of 2.00%; Mario Draghi in his press conference did say that whilst the EuroZone was not doing very well, he had reason to expect a Q3 revival of the Euro economies. The Euro ran back up and investors were reassured that the world isn't breaking up.
With all this swell of investor optimism we can understand how the Italian political mess fell off the headlines. Clearly the issues of governance are not resolved, but when the rest seems to be doing ok, it is really nothing but background noise, much like the infamous US sequester which came, is here and is clearly of little importance; the ADP employment report was better than expected, showing some life in the private sector hiring.
We seem to ignore troubling information whereby companies are increasing dividends and buying back stocks. Why are they not reinvesting their stockpiles of cash? Do they see something we don't?

Thursday gave us new highs yet again! We closed ahead of the feared publication of the Fed's "Stress Test" on the major banks. Well, the results may ignite another up-leg today- 17 of 18 banks passed, one didn't... The test checked if bank capital would hold-up to the minimum 5% requirement under extreme market events, worse than 2008. Citibank shined as the best under stress, Goldman was amongst the worst but passed nonetheless.

But the growth outlook was dimmed somewhat by another report on Thursday showing a widening in the trade deficit in January as imports rebounded. Initial claims for state unemployment benefits fell 7,000 to a seasonally adjusted 340,000, declining for a second straight week, the Labor Department said, confounding economists' expectations for a rise to 355,000. In a separate report, the Commerce Department said the trade gap rose to $44.45 billion in January from a shortfall of $38.14 billion in December. Well, we are not surprised here! We have often stated that as the US economy takes up strength, imports rise as exports stagnate. This widening of the trade deficit is indirect confirmation that the US economy is indeed on a growth path, modest perhaps, but growing nonetheless! This may well place downward pressure on the Green Back though…

We also note that the VIX, the measure of equity markets' volatility is back down to 13 or so, close to its historical lows, having spiked just days ago to above 18. Difficult world for money managers… Even amid declining stock market correlation, active index managers are still having a tough time staying competitive. Just 37 percent are faring better than the basic indexes they compete against, according to data from JPMorgan Chase, while 63 percent are missing. A mere 7 percent are topping benchmarks by more than 2.5 percentage points. Maybe the sunshine is truly back?

Bedrock Newsletter

Currencies

- EURUSD spent the majority of the week floundering either side of 1.30. With little in the way of news flows the EUR weakened on the data as GDP contracted for the Eurozone. But Draghi's speech on Thursday bolstered the EUR as he saw a recovery in the not-too-distant future, saying that the ECB would not cut rates further unless the state of the Eurozone economies worsened. With the words leaving his mouth, EUR rallied from 1.2980 to 1.3120. He needs to be careful that his words don't stave off any further growth prospects before they actually come-to-pass.
- EURCHF reversed course from last week and has crept up higher all week, moving from 1.2240 to 1.2360. The USDCHF moved in line with EURUSD movements and at one point was as high as 0.9490, although we have settled into a lower level it would seem for the weekend at 0.9440. As we mentioned last week, the SNB's target of weakening the currency seems to be playing out in the markets and we believe it will continue to do so.
- After last week's monumental swings in JPY, this week saw a full reversal and a resumption of the weakening JPY. Starting the week at the lows of 93.00, the USD has rallied and moved up to as high as 95.90 this morning. It looks like last week's very brief strength in the JPY may have been the setback we were expecting and the sliding JPY is back to the forefront of the trading mentality. EURJPY has been more clear-cut, moving from 122.00 prior to Draghi's speech then surging up to 125.50 by this morning. The BOJ will look very favourably on both moves and will do nothing to hinder the downward pressure that their rhetoric brings.
- AUD started the week on a poor footing having slipped to 1.0110. With Chinese housing data and a positive mood in the markets the AUD has rallied back to as high as 1.03 on Wednesday. We are currently trading at 1.0260 and expect the RBA to hold a steady ship for the moment, choosing not to interfere and instead leave the markets to decide the level of the AUD. We are in a breathing space for now and we believe that the AUD will weaken prior to a further rate cut in the distant future.
- The Pound continues its wild ride… as Willy Wonka once said, "it goes up and down, where it goes, nobody knows…". Well, he worked with chocolate and when the heat turns up, that melts… so too does the Pound. When the BOE states loud and clear that it favours, wants and in fact needs a materially weaker currency… Stop, look and listen. Take heed as the Pound may have weakened nearly 10% this year alone, but we do not feel that the central bank believes that is sufficient. Maybe a short term bounce is due, but we hold out little hope of any sustainable strength and await a further slide in Cable.
- Time to mention the ZAR. Having reached 9.19 this week, the Rand is now at a low not seen since March 2009. The USD has surged by 10% this year against the Rand and the trend looks to be well established. The USDBRL however, is moving more freely now and we have seen the pair continue to slip down to 1.9560, on a less dovish tone from the Central Bank.

Fixed Income

- With Risk taking centre stage this week, the 10Y reversed course from last week and moved from 1.83% to 2.01%. The 30Y mirrored the move seeing the bond price slide and the yields move from 3.04% to 3.22%. Perhaps this short term dip was driven by the expiry of the futures contract where the overriding view was short, causing a short term spike in the price as the future contracts were rolled out for another 3 months.

- The German 10-year Bund moved in a very similar fashion to the US Treasuries, seeing the yield move steadily up from 1.40% to 1.51%. The reversal of “buy the core and sell periphery” has been reversed and the peripherals like Portugal saw their yields falling this week from 6.4% to 5.9% on the 10 year government debt.
- Spanish 10 Year yields opened the week at 5.10%, where they closed last week, sneaking lower each day to be trading at 4.83% this morning. As all negative news has been swept under the carpet for now this short term trend of buying the Spanish debt will likely continue for the next week or two. Unfortunately, straws don’t make much noise when you drop them… It is when the camel topples over that the crash occurs!
- The Italian 10 Year debt looked to be in a bad way on Monday with yields remaining at 4.90%, but as we mentioned last week… enter stage left the Protagonist, Mr Bersani. Italy should go back to the polls and Bersani is seemingly on track to get a majority and hence take over from Mr Monti. The yields reacted favourably throughout the week and eventually we are at 4.55% this morning. The brief interlude between politics saw Mr Berlusconi given a year’s imprisonment from the courts, to which he smiled (we think it was a smile as his face does not move now) and walked to his car and left for dinner and drinks with friends… we highly doubt he shall ever spend a day in jail but it does make for good TV.
- The star performer for the last week has been the Global Convertibles with +0.81%, making up much of what was lost last week. The weakest performers on the week were the US Corporates at -0.52% and US Government bonds at -0.40%.

Equities

- Developed equities rose by 1.65% for the week – as of yesterday’s close – as measured by the MSCI World index, as stocks around the world rallied on investor euphoria after the Dow and some key indices broke multi-year highs, helped by bets central banks around the world will keep interest rates low to spur a global economic recovery.
- The EuroStoxx index jumped by 3.60% over the week as European shares edged higher as positive US figures bolstered sentiment while unprecedented central bank monetary policy support kept equities at multi-year highs. In general, investors believe that the broader upward trend for European equity markets remains intact, given expectations of a gradual recovery in the global economy and plans by central banks to keep supporting markets.
- In the US, the S&P rose by 1.53% (as of yesterday’s close), up for its fifth consecutive day. US equities mostly edged higher as jobless claims data pointed to a pick-up in the labor markets, sparking the positive tone and boosting confidence for the US government's payroll report due for today. Continued support from the Federal Reserve and equity valuations that are considered attractive compared with other asset classes have also pushed shares higher; while some continue to call for a pullback from recent levels, as long as the landscape does not change the positive momentum could stay intact.
- Meanwhile, Japanese shares surged by 5.84%, gaining for a third consecutive week after a 3.78% rise during February. The Nikkei closed above 12’000 on Thursday for the first time in 4-1/2 years, with risk appetite supported by record highs on Wall Street and the prospect of Japan soon adopting aggressively reflationary monetary policy. The index rose by over 43% since November!
- In terms of sectors, Consumer discretionary, Information Technology and Telecoms were the best performing sectors (+2.03%, +2.04 and +2.47% respectively) while Energy and Materials lagged (+1.21% and +0.67% respectively).

Bedrock Newsletter

Emerging Markets

- Emerging Market equities gained 0.45% for the week (as of yesterday’s close) as measured by the MSCI EM Index. Latin America and EM Europe rose strongly over the week (+2.11% and +1.62% respectively) while Asia lagged (-0.24%).
- The Shanghai Composite dropped 1.73% for the week. Chinese shares experienced a sharp sell-off on Monday sparked by fresh tightening measures for the property market in China. Then, after a two day rebound, China's shares ended lower on Thursday and Friday on concerns about a share glut amid talk that the securities regulator was close to allowing IPOs to resume. As a result, heavyweight banks led the market decline on profit-taking.
- The Bovespa jumped by 3.45% for the week (as of yesterday’s close), rising the most since July, led by a rally in Petrobras after the heavyweight unexpectedly raised diesel prices by 5%. Brazilian shares were also supported by inflation that unexpectedly slowed in February, easing concern that rising prices may hurt the economic recovery.

Commodities

- Commodities rose by 0.57% during the week, as measured by the S&P GSCI TR Index. Agriculture and Industrial Metals lagged (-0.80% and +0.18% respectively), while Energy and Precious Metals fared better (+1.01% and +0.31% respectively).
- Agriculture dropped this week as wheat futures plummeted to an eight-month low, pressured by wet weather for US crops and continued concerns about weak export demand for the grain. Corn prices also tumbled this week on similar concerns, marking corn's biggest percentage decline in more than five months.
- Gold slightly rose by 0.20% for the week and is currently trading around $1’580 per troy ounce, holding in a narrow range for four sessions as traders were awaiting the outcome of central bank meetings and key US data. Gold edged lower on Thursday as signs of a strengthening US economy encouraged investors to take riskier bets, but signs that central banks will stick to easy money policies continued to put a floor under prices.
- Oil oscillated between gains and losses this week before jumping by 1.25% on Thursday – currently trading around $91.60 a barrel – on hopes that signs of an improving employment outlook will translate into stronger oil demand, outweighing the impact of a stronger dollar and larger than expected US oil stockpiles.