Bedrock Newsletter

Friday, March 15th 2013

It is Friday again… We will try to summarize this week in shorthand:

- ***Monday the DJIA closed at a new record high***
- ***Tuesday the DJIA closed at a new record high***
- ***Wednesday the DJIA closed at a new record high (and we got a new Pope!)***
- ***Thursday the DJIA closed at a new record high***
- ***Is Friday likely to see the DJIA to close at a new record high? Will the S&P 500 break its own high?***

The fascinating part is that in this equity rally, bonds have not moved out of a narrow band, Gold stabilized and oil is edging back up to above $93, as analysts were expecting a collapse to $75.

We did note though that the average daily trading volume across all US exchanges is declining slowly- 2013 is running at 6.2Bn down from 6.5Bn in 2012, and that on Thursday the yield on the 30 year Bond was 3.24% at auction. The S&P 500 index is struggling to break its own record, having closed Thursday within 0.25% of the record.

Where to next? At Bedrock we try to read the market and anticipate the headlines- Economic data from the USA is indicating that the economy has regained some footing- employment data last Friday surprised to the up-side, housing has clearly bottomed, Congress and the White House are as far apart as ever and signs of Spring are upon us (except perhaps in North-West France). The equity markets are awakening with record-low volatility. Fear is clearly ebbing and we say that **a further move upward can be powered by a switch from the fear of losing money to the fear of missing opportunity. When attitudes are moderate and allocations are low, it doesn't take much…**

Equity markets may continue this moderate melt-up to further new highs, although the air is getting thinner here and we advise some caution, bond markets may just hold hereabouts, sustained by the ongoing commitment by central banks around the globe. A Goldilocks scenario? Moderate growth, no inflation, historically low interest rates, reasonably priced equities (P/E below long-term averages) and signs of stability in "escape assets" such as Gold, Oil and Real Estate.

Oil prices rising on the back-drop of rising equities suggests to us that the economic data may further surprise on the positive side. The low volatility in equities and bonds further supports our view that the Sun has finally broken the cloud cover! We now take a look at currencies- the maligned Euro is showing some signs of stabilization- Very volatile year-to-date, it is back where it was on January first (1.315 then and 1.307 now). The Yen seems to be rolling off a cliff though… but this is by political design, as by the way, is the case with the British pound. Even the mighty Swissie is losing some of its shine. In China the Yuan has edged slightly upwards since we chose to cut back, but the true risk lies with the seemingly almighty Greenback - If indeed the equities are correctly predicting an economic come-back, why then, the US trade deficit is likely to open further from increased imports and unaffected exports. The trade deficit places pressure on the currency, the offset would be capital flows… however, these have slowed given the low yields on Treasuries with the resulting implicit risks therein. Counter-intuitively then, perhaps the USD could weaken?

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It is time to take some action- Remember that procrastination is the art of keeping up with yesterday!

Currencies

- EURUSD started the week stuck either side of 1.30 again. With the expectation that Italy would have another good issuance, EURUSD rallied to 1.3070. The exuberance was short lived as there was a poor showing for the Italian auction and US retail sales came in very strongly, combining to smash the EUR down to 1.2925. However, with better than expected Jobless data, the EUR turned around and bounced back to 1.3050 and has remained thereabouts since yesterday. Bad data is being ignored; if the EUR has slipped 7 figures on either a lack of data or lukewarm data, how far will the EUR move when the markets panic about the data turning sour?
- EURCHF gave up some of last week's gain and slipped from 1.2360 to 1.2310. The USDCHF moved in line with EURUSD movements and at one point was as high as 0.9560, a 6 month high, although we have settled into a lower level it would seem for the weekend at 0.9440 - just like last week but with a higher high and a higher low… SNB's Jordan will be quietly happy and after keeping rates flat and restating the EURCHF floor, we do not see any other direction than down for the CHF.
- Japan approved Kuroda, Iwata and Nakaso san through the Upper House. This was exactly as the market had predicted and there was little movement on the news. This is not to say that the week has not seen massive movements in the JPY, although it appears that we will finish the week where we started at 96.00. Tuesday saw the high at 96.71 followed by y dip to 95.45 by mid Wednesday. EURJPY was more reserved this week moving from 126.00 to 124.00 and looking like finishing the week at a touch above 125.00.
- AUD moved steadily from 1.02 at the beginning of the week to 1.03 on Thursday morning only to see the jobs growth at a much higher figure than expected (which later was confirmed as a statistical anomaly by the RBA!), the currency moved to 1.0380 immediately. After touching briefly 1.04 the AUD has settled back to 1.0370 and we expect that when equities turn that the AUD will surely follow suit and head lower over the coming weeks.
- Our closing line last week for the Pound: "Maybe a short term bounce is due, but we hold out little hope of any sustainable strength". And so it is with exactly this mantra that we are happy to see Cable bounce and will look to see the turning point where the shorts will re-enter. With little to no movement for the start of the week except a momentary drop to 1.4830 on horrendous Industrial Production; it took two words – "fairly valued" - from the exiting Governor, Mervyn King, to see the GBP fly to 1.5150. An about-face on the BOE stance was released that he thought the Pound was "fairly valued" and the BOE did not want to push the Pound down. A sudden and very much opposite view than that which had been expressed very recently.
- The Rand continued its slump versus the USD and saw it drop to 9.29. The movements are rapid and really one sided at the moment, we expect further depreciation and feel that double digits will be soon around the corner.

Fixed Income

- With little to no breaking news the 10Y looks set to finish the week where it started at 2.04%, having stayed between 2.02% and 2.06% all week. The 30Y mirrored the move seeing the bond price relatively stable with the yields moving from 3.27% to 3.20% but finishing at 3.24%.

- The German 10-year Bund moved in a very similar fashion to the US Treasuries seeing the yields drop only moderately from 1.50% to 1.48%. The week was slow for information and consequently the FI markets have been just as quiet. Perhaps the bailout for Cyprus will set a tone that will cause the next move in the markets, we wait patiently.
- The Spanish 10 year is moving when the rest of the markets are relatively stable! The yield moved from 4.73% to 4.90%. The camel is wobbling, the straws are piling and if the scene is set with a negative tone for the Cypriot bailout then the Spanish access to the open markets will surely be sealed. The possibility of bondholders being forced to bear the loss will not be received well… we await the thud.
- The Italian 10 Year debt wobbled midweek with a poor showing at the auction seeing the yield move from 4.60% to as high as 4.73% by the afternoon. However, the Italian debt markets seemed to have shrugged off the poor reaction and are back near the lows of the week at 4.61%.
- With a quiet week in Fixed Income the best performers were EU and US High Yield with Leveraged Loans at +0.40% on average. The weakest performers on the week were the US Government Bonds at -0.14% and Global EM Hedged at -0.12%.

Equities

- Developed equities rose 0.80% for the week, as of yesterday's close, as measured by the MSCI World index. Shares gained on the back of positive US economic data, as well as optimism from Japan, where recent leadership nominations are raising speculation for further easing.
- The EuroStoxx index rose 0.38% for the week. European shares lost early in the week on the back of Fitch downgrading Italy's credit rating to BBB+ and Eurozone industrial production figures coming in weaker than expected (-0.4% vs. -0.1%). Equities bounced to a 4.5 year high on Thursday as European leaders gathered for a 2 day meeting, and corporations posted upbeat earnings.
- The S&P 500 gained 0.77% for the week, as of yesterday's close. Shares gained on positive macro data, where retail sales beat expectations and Jobless figures dropped to the lowest level in 5 years. All eyes are on today's reports of Manufacturing, Industrial Production and confidence figures.
- The Nikkei continued its upward move, rising by as much as 2.25% for the week. Japanese shares gained as speculation rose that the BoJ will step up monetary easing once the new leadership takes over. Additional gains were made at the latter part of the week – achieving the highest close since September 2008 – as Japan's upper house confirmed Haruhiko Kuroda – an advocate of aggressive monetary easing - as the central bank governor.
- In terms of sectors, Telecoms and Energy were the best performers for the week (+1.20% and +1.10% respectively). Utilities and Consumer discretionary stocks rose the least (+0.20% and 0.58% respectively).

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Emerging Markets

- Emerging Market equities fell 1.72%, as of yesterday's close, as measured by the MSCI EM index. The worst performing region was Asia (-1.95%), followed by Latin America (-1.61%), while EM Europe fared better (-0.36%).
- The Shanghai Composite fell 1.74% for the week. Chinese shares lost ground as the country's Industrial output posted a weak start to the year, and lending and retail sales growth slowed. In addition, policy makers raised concern they will step up efforts to curb real estate prices and inflation, following February's price gains that beat expectations. Shares trimmed some of their weekly losses at the latter part of the week as Xi Jinping – general secretary of the communist party – was elected as president of the People's Republic of China, raising confidence in the country's political and economic developments.
- The Bovespa lost as much as 2.00% for the week, as of yesterday's close. The benchmark lost following worse than expected corporate earnings, and OGX Petroleo posting large losses following UBS and Credit Suisse recommendations to sell the stock. Additional losses were made amid concerns that the Brazilian central bank isn't doing enough to contain surging inflation that threatens Brazil's recovery, causing homebuilder stocks to sink.

Commodities

- Commodities were about flat this week, as measured by the S&P GSCI TR Index. Energy lost 0.34%, while Agriculture, Industrial and Precious Metals fared much better (+1.38%, +0.86% and +0.69% respectively).
- Agriculture rose this week as wheat jumped for a seventh straight day on Friday after a government report showed that export demand for US wheat was stronger than expected last week.
- Gold rose by 0.90% for the week and is currently trading around $1'593 per troy ounce, heading for a second week of gains as investors remained loyal to the yellow metal, counting quantitative easing measures in key economies and lurking risks in the Eurozone among reasons to own bullion – a hedge against rising inflation outlook and economic distress.
- Oil rose by 1.30% last week – currently trading around $93.30 a barrel – on a weaker dollar and as upbeat employment data in the United States buoyed the sentiment and fuelled hopes that demand will improve in the world's biggest oil consuming nation.
