Bedrock Newsletter

Friday, March 22nd 2013

Another week… and this one wasn't boring! We remember a saying by William James who said "The art of being wise is the art of knowing what to overlook." Well, whilst Cyprus represents 0.2% of the EU's GDP, we will not overlook it and its turmoil!
The Context: With massively overextended banks and a stumbling economy, Cyprus is in desperate need of external funding. Like other struggling euro zone members, it turned to its European partners and the International Monetary Fund for help.
After months of negotiation, a 10 billion euro ($13 billion) bailout package was announced. It spreads the burden sharing in an unprecedented manner by including a de facto haircut on all bank deposits (de jure, depositors receive an equity claim).
The news that the euro zone wants bank depositors in Cyprus to contribute towards a bailout is surprising even given the ongoing European debt crisis, Jim O'Neill, chairman of Goldman Sachs Asset Management, told CNBC on Monday. "I'm still trying to get my head around [it],". He added that Cyprus won't be able to "put the Genie back in the bottle" despite whether or not the depositor hair-cut gets approval.
Then the Russians holler "theft" as some 20% of Cypriot bank deposits are held by Russian nationals. They forgot already the 1998 de-facto confiscation of the Russian GKOs (T. Bills equivalent which were taxed at 100% with what were primarily non-Russian holders). The big issue here isn't the few billions being taken but the concept of secured ownership being put into question. Security and trust are put into doubt. And this extends way beyond this tiny island in the Mediterranean…

On Monday the Euro fell and stock markets were taxed by investor fears. By Tuesday the VIX had risen by 30%, quantifying for doubters the return of fears. Wednesday Ben Bernanke kept rates steady, reassuring talk. He said Cyprus has little effect on US and sees nothing to worry about for current equity Levels. On Thursday we experienced a generalized equities' sell-off of more than 1% across the globe, US$ rising, Gold rising and talk of contagion back in the headlines. To top our anguish, Oracle [ORCL] released disappointing results, below expectations on all measures. ORCL lost over 9%...

Against this troublesome backdrop, on March 18 Bloomberg issued this report -- The two biggest U.S. equity bears in 2012 see the Standard & Poor's 500 Index rising more than 12 percent this year to at least 1,600, as strong economic data point to higher corporate earnings. Goldman Sachs Group Inc.'s chief U.S. equity strategist, David Kostin, raised his target today for the benchmark stocks gauge by 3.2 percent to 1,625 from 1,575. Adam Parker of Morgan Stanley boosted his 2013 estimate by 12 percent to 1,600 from 1,434. They join strategists at Deutsche Bank AG, Credit Suisse Group AG and Jefferies Group LLC in increasing their targets for U.S stocks in the last week. "The 2013 U.S. equity market story is becoming one of improving business activity accompanied by increased CEO confidence," Kostin wrote in a report. "Recent economic data has been strong as employment growth, ISM surveys and retail sales have all posted positive surprises. The 'sequester' has begun, and the federal government is still functioning." Kostin, the New York-based chief U.S. equity strategist at Goldman, lifted his estimate for combined earnings by companies in the S&P 500 this year by $1 to $108 a share. Goldman expects U.S. economic growth to reach 3 percent in the first quarter and 2 percent in the second three months of the year.--

After such a long and big rally? The Economist of March 16th put this in some perspective- The US markets are basically back to their peaks of 2007. But that isn't the entire picture! Brazil is still 20% below, Japan at 35%, Russia and the Eurozone at 40% and China is still 60% behind!

We leave you for the first weekend of spring with a thought from Abraham Maslow "If you only have a hammer, you tend to see every problem as a nail."

Currencies

- EURUSD awoke on Monday to Cypriot Bank's remaining closed, asset grab headlines and Russian threats; all of the headlines caused the EUR to open nearly 170 points lower than it had closed on Friday, crumbling from 1.3070 to 1.2900. We are currently trading at 1.29 at the end of the week with movements up on news that the parliament of Cyprus had rejected the deposit tax, down on the news that Russia would not step in to bail out the banks and then just wobbliness when no action had been taken and no one has a clue what is going to happen. Cyprus is so small, so why does anyone care? Unfortunately the Germans will use Cyprus as a test case, and therefore, a template for other periphery country bailouts and if an asset grab of bank deposits is the solution rather than passing it to the equity holders and bondholders, this will cause another run on the banks a la 1930's. No monetary union has ever failed without a run-on-the-bank… They better get it right then!
- EURCHF weakened on the EUR negative news about the Cypriot bailout and the various formats it might possibly take. The weakness across Euroland has hit all crosses and the CHF safe haven status is back in play. USDCHF should have rallied on the EUR news but instead this has remained almost unchanged on the week revolving around 0.9450 in a 25 point range. As the fear is back, the CHF has rallied and for now remains bid.
- The JPY soared Monday seeing both USDJPY and EURJPY collapse, moving from 95.40 on Friday close to 93.50 on the open and 124.50 to 121.00 respectively. EURJPY throughout the week slowly made back the losses and peaked on Wednesday at 124.50 only to slump back to 121.60 this morning. Even the USD has weakened from last week trading at 94.40 this morning. As we have stated before, we believe that the JPY will continue to devalue, but that this will not happen in a straight line, and perhaps with the fear returning we will see a short period of Yen strength again… we watch this space.
- AUD moved up to as high as 1.0460 this week, after briefly pausing on Monday morning dropping to as low as 1.0333. With a snap leadership election, Julia Gillard remains at the helm. The leading indicators rose and the RBA is now very unlikely to cut at the next meeting and as such the AUD has found a bid on shorts being taken out of the market.
- After last week's tremendous rally on Cable, the British Pound was stoical in the face of the Cypriot news and opened exactly where it closed last week. With a bit of British "Stiff-Upper-Lip", the pound rallied again after King was defeated in expanding the stimulus plans and moved higher again with positive Retail Sales figures seeing the pound move up to as high as 1.52 on the news. We are settling in to the 1.5200 level as we write and expect the consolidation phase to last a little longer before the pound materially weakens further.

Fixed Income

- With fear taking centre stage the yields on the US 10Y dropped 10 points from 2.00% to 1.90% on the open on Monday. The movements in the US treasuries mapped to the ebb and flow of the news flows from Cyprus – a country that has a GDP less than 6 months earnings of Apple at $25Bn! The 30Y mirrored the move seeing the bond yields moving from 3.21% on Friday to 3.11% on the open on Monday. For both 10's and 30's we appear to be at the lows of the week for the yields and until there is clarity on the Cypriot bailout plans, we believe the yields will remain suppressed.

- The German 10-year Bund moved in a similar fashion to the US Treasuries seeing the yields drop heavily from 1.45% on Friday close, to open at 1.41% and briefly dropping to 1.35% on Monday morning. The Cypriot bailout applied pressure, finishing at the lows below 1.34%.
- The Spanish 10 year is moving again… Cyprus is setting the template for a disaster in Spain is deposits are the “tax bailout” that shall be enacted. The camel is now walking on a tightrope, balancing straws as they pile up and with yields peaking at 5.08% on Monday we fear that if a poor solution is forced on Cyprus that the repercussions will be swift and aggressive…
- The Italian 10 Year yield skyrocketed on Monday, shooting to 4.81%. However, the Italian debt markets seemed to have shrugged off the Cypriot news and are back near the lows of the week at 4.57%.
- As you would expect, high grade paper and bonds have been the favoured investments this week as fear grips the market until a solution is found. Both EU and US Government bonds performing with about +0.45% with the Global EM bonds taking the hit this week at -0.34%.

Equities

- Developed equities slid by 1.23% over the week (as of yesterday’s close), on fears of a potential banking collapse in Cyprus and signs the economic downturn in Europe is deepening after weak Euro zone data.
- The EuroStoxx index lost close to 2% for the week, as European shares fell after Germany – the region's leading economy – showed signs of fatigue and French businesses turned in their worst performance in four years. France, the Euro zone's second-biggest economy, likely fell into a recession. European equities continue to dip as we write this, on growing worries over Cyprus' bailout problems.
- The S&P 500 dropped 0.95% for the week, as of yesterday’s close. Several upbeat US economic reports on housing, future economic activity and business conditions in the mid-Atlantic region failed to lift investor sentiment amidst European woes and Cyprus uncertainty.
- Meanwhile, the Nikkei broke its upward move this week, losing as much as 1.71%. Japanese equities reached a fresh 4-1/2 year high on Thursday as financials and exporters gained on the news of the US Federal Reserve's pledge to maintain stimulus and hopes of more monetary easing by the Bank of Japan's new leadership. However, the Nikkei was hit hard on Friday (losing 2.35%) on Cyprus bailout worries and a stronger Yen.
- In terms of sectors, Materials and Financials were the worst performers for the week (-2.66% and -2.35% respectively), while Consumer Staples and Utilities were the only sectors to be positive (+0.12% and +0.42% respectively).

Emerging Markets

- Emerging Market equities fell 1.90%, as of yesterday’s close, as measured by the MSCI EM index. The worst performing region was EM Europe (-3.13%), followed by Asia (-1.84%), while Latin America fared slightly better (-1.63%).
- The Shanghai Composite jumped by 2.19% this week, bolstered by economic optimism after some strong manufacturing data. The benchmark started the week by dropping substantially on Monday on the back of bad news out of Europe, but strongly rebounded for four consecutive days until Friday, lifted by a few Chinese energy heavyweights.

- The Bovespa lost as much as 2.27% for the week (as of yesterday's close) as Cia Energetica de Minas Gerais – which slid by over 10% during the week – led a plunge by electric power companies on concern the Brazilian utility regulator's rates review may curb industry profits.

Commodities

- Commodities fell for the week, with the S&P GSCI TR Index falling 1.22%. Energy and Industrial metals both lost as much as 1.76%, while precious metals and Agriculture gained 1.31% and 0.49% respectively.
- Gold gained 1.30% for the week – poised for the longest weekly rally in six months – and is currently trading around $1'613 per troy ounce. Investors resorted to the traditional safe heaven as Cyprus's bailout deal shocked the market. However, investors have been reported to exit their holdings in gold ETFs at a faster rate, as a rebounding economy dims the appeal for bullion. We remain steadfast in our belief that Gold will continue to rally as competitive devaluations remain the rule and that the printing presses continue to roll.
- Oil dropped 1.5% for the week, and is currently trading at $92.50 a barrel. Crude traded in a choppy fashion during the week as sharp declines – caused by the Cypriot president failing to gain approval for a levy on depositors – overshadowed a fall in inventories and reports that the Fed will keep up its efforts to spur the economy.

Disclaimer

This document is for information purposes only and has been prepared by Bedrock SA, representing the opinions and investment views of Bedrock SA as applied in its investment advisory and management activities. It is a private publication intended for private circulation only. It does not constitute a company survey, a financial research, an offer, a solicitation or a personal recommendation to buy or sell specific products or securities. Bedrock SA disclaims all liability for any losses or damages of any kind relating to such information, which may be changed at any time without notice. The risks inherent in certain investments, particularly derivative products, may not be suitable for all investors. The contents of this publication may have been used for transactions by Bedrock SA prior to their communication. Distribution or dissemination of this document and/or the sale of certain products mention herein are subject to restrictions. Copyright 2013 All rights reserved. Approved for circulation in the UK to professional clients only by Bedrock Asset Management (UK) Ltd which is authorized and regulated by the Financial Services Authority. This presentation is being made to you solely for your information and must not be copied, reproduced, further distributed to any other person or published, in whole or in part for any purpose.
© 2013 Bedrock S.A. 4, ch. Des Vergers, 1208 Geneva, Switzerland, T: +41 (0)22 592 5455 F: +41 (0)22 592 5459, www.bedrockgroup.ch