Friday, April 5th 2013

Easter and Pessach are behind us and spring is upon us as we embark on Q2… We had a *great year* in Q1 and Tuesday continued the trend with equities roaring to new "new highs" as gold and other commodities falter. Talk has shifted from Gold 2'000 to "End of the Gold Era". Let's not forget that Gold is a very heavy metal… Cyprus is off the first page as the crisis seems to have been resolved with what is in effect a large tax on depositors.

Japan's new central bank governor embarks on a huge QE project, firing a huge rally in local equities and a corresponding decline in the JPY. The old saying that all boats rise as the tide comes in is being confirmed- Central Banks are pouring so much water into the oceans, the water level is indeed rising! Analyst articles are repeating "correction coming"... One day, they no doubt will be right! But then, by being cautious trying to avoid a 10% "correction" many have missed a 25% rally!
North Korea has taken crazy pills… Are they serious in threatening nuclear attacks on the USA?
Wednesday is down!!! On weak ADP employment, US sending defense systems to Guam and a warning from the US Defense Secretary on North Korean risks!
Gold slides further, oil down, Dollar down... Clearly, some investors give some thought to the Korean noises!
Thursday ECB holds rates @ 0.75%, Euro gets slapped to $1.273. Equities down in Europe and down on US open. But later in the day, the Euro rebounds strongly to 1.295 on nothing in particular and US stocks turned to close up! Gold stabilized.
Take a double-digit percentage gain and throw in a high level of investor crisis-fatigue, and you get a seemingly endless stream of bullish stock chatter. But stalking the market is the danger that something could go wrong- something no one is talking about now but will be once they get blindsided. We see three Black Swans circling in our pond…
1. Too much risk is what took down the market in 2008, and too much risk could do so again. Carol M. Schleif, chief investment officer at Wells Fargo division Abbot Downing, said in a report. "For the millions of bond fund investors late to the party, the notion that one can lose money (and quite a lot of it) in bond funds may become as harsh a reality as 2001–02 was to technology investors."
2. Reports have surfaced that the Obama administration is taking a hair-of-the-dog-that-bit-you approach to the housing renaissance and directing banks to lend to riskier borrowers.
3. Much of the stock market gains have been predicated on unconventional stimulus policies from the Federal Reserve, as well as on an economy that is progressing on the road to recovery. With momentum based on, at most, par growth ahead, even the Fed's money-creation machines may not be able to keep the market's searing pace on course.

At the same time, we note that fears of a rush for the exits from the U.S. bond market have been greatly exaggerated. Even as the fixed-income sector grapples with a rare negative start to the year, many of the biggest and widely followed bond firms are still attracting new cash to their flagship funds. The Federal Reserve's massive bond-buying program, $85 billion a month of U.S. Treasury debt and residential mortgage bonds, has driven bond prices higher and pinned their yields. The Fed's program to suppress interest rates has triggered a massive yield hunt among investors. That has translated into strong demand for investment-grade corporate debt and high-yield bonds.

But then, to get a perspective on truly important matters, let's look elsewhere into the weekend- April 3 (Bloomberg) -- The European Organization for Nuclear Research said it has data that could signal the presence of dark matter, an elusive unseen target that physicists believe makes up as much as a quarter of the universe. "Dark matter is one of the most important mysteries of physics today," CERN said.

Bedrock Newsletter

Currencies

- EURUSD traded in line with which ever Euro Technocrat opened his mouth, starting the week at 1.2800 and grinding up to 1.2860 and back down again. With little real news in the market (rates are no longer interesting, it is what Draghi, et al, say that counts), the EUR was thrust into action on the ECB president's speech seeing it drop heavily to 1.2746 on a negative outlook. Only to rebound 2 figures by the end of the day to 1.2950 on the fact that he said the Cypriot bailout (or rather bail-IN) was not a template and was badly managed. Ignoring the politicking, we see that the majority of Eurozone countries have seen contracting economies and the data continues to underwhelm. We have little doubt that this temporary EUR positive respite shall surprise to the downside again… so we shall BUY the rumour and SELL the fact. We look for the EUR to weaken, and weaken materially against most currencies.
- EURCHF is unchanged on the weak, but when the EUR negative comments abound the CHF safe haven status rears its head and the pair drops, seeing moves to as low as 1.2130. USDCHF started the week at 0.95 on fears that the Cypriot bailout would damage the banking infrastructure within the Euro-Zone. With a "wait-and-see" mentality during the week the pair drifted between 0.9460 and 0.9520. With Draghi speaking the pair dropped from 0.9520 to 0.9380 and we have given back some of that loss to trade at 0.9430 as we write.
- Little did we know how prescient our words would be - Short term JPY strength followed by sustained weakness! With the USDJPY staying strictly in a 50 point channel all of last week around 94.40, what a difference a long weekend makes. On words alone the JPY strengthened on Monday of this week, seeing the USDJPY move from 94.40 to 92.57. With the BOJ meeting on early Thursday morning, the world awoke to unprecedented monetary easing. USDJPY skyrocketed from 92.80 to a high of 97.19 back to levels last seen in mid-2009. The fundamental cornerstone of whatever they implement is the mass printing of Yen. They have doubled the bond buying program and are hoping that by increasing the monetary base that the economy will reflate… they just need to make sure that the banks lend that extra money out to the Japanese and don't shore up their balance sheets instead!
- AUD moved up to as high as 1.0497 this week, after pausing for thought post weaker data causing a drop to as low as 1.0385 post Draghi's speech. The AUD is being held afloat by relative strength in China and the positive news flows from the Asian region, we are simply not able to believe that the domestic economy, that seems to be floundering, can support such a high level in its currency. Perhaps the search for yield maintains its outperformance, eventually the economics will speak for themselves and the AUD will have to weaken.
- We are still in the consolidation phase of the British Pound weakening. Completely unchanged on the week at 1.5200… This is not to say that they were no moves, quite the contrary in fact! With poor PMI manufacturing data, poor PMI Construction and a drop in money supply the Pound dropped from 1.5240 to 1.5050 only to see all of the loss retraced with a mixture of the BOE speech and the Draghi-effect on the USD. The Pound does not quite feel ready to continue its downtrend… but that does not mean it won't happen! We look to see material weakening to 1.42 in the coming months.

Fixed Income

- With Cyprus still centre stage the yields on the US 10Y dropped another 10 points from 1.88% to 1.78% over the week. The movements in the US treasuries mapped to the ebb and flow of the news flows from Cyprus. The 30Y mirrored the move seeing the bond yields moving from 3.14% to 2.98%. Both 10's and 30's appear to be at the lows of the week for the yields.

- Japanese yields this week alone saw the equivalent of more than one year's yield movement within one trading day, not once… but twice! The yields moved from 0.60% at the beginning of the week to as low as 0.32% on the open on Friday after the Japanese Central Bank opened up the cash flood gates, flooding the market with cash and increasing their bond buying program. By the evening of the Japanese trading day those same yields had soared back to a high of 0.65%. Moves that are completely unprecedented on the Japanese slow moving market. We'll risk putting the thought out there… is this the turning point in Japanese bonds, shock-horror could they be about to sell off and see yields rise?!?
- The German 10-year Bund continued its move lower in yields, even if the periphery is being bought, so too is the Bund, suggesting that without any spread compression the fear has remained at the same if not at a higher level. The yields moved from a high of 1.31% to as low as 1.2350%
- The Spanish 10 year last week peaked at 5.15%, a high of recent weeks. This week opened slightly stronger with the yields at 5.07% but as the comments were passed by Draghi that Cyprus would not be the template (words seem to mean more than action at the moment), the Spanish yields subsided and dropped to 4.85% by the end of the week.
- The Italian 10 Year yield finished last week at 4.79% after fears that the Cypriot bail-in might end up being replicated in Spain and other countries in need of help with the knock on effects that this might have on the Italian auctions. With the fear subsiding that Cyprus was not the template the yields on Italian debt dropped, finishing the week in the region of 4.48%.
- As you would expect, high grade paper and global aggregate have been the favoured investments this week as worries took centre stage. Global Aggregate performed well with +0.41% and US Corporates following close behind with +0.40%, the only negative performer for the week was Global Convertibles who were -0.08%.

Equities

- Developed equities slid 0.85% for the week (as of yesterday's close), on the back of worse than expected US economic figures and the ECB warning of a deeper recession in the Eurozone.
- The EuroStoxx index remained flat for the week (+0.02%). European shares rallied more than 2% on Tuesday – the first trading day after the Easter break - catching up on optimism in global equity markets coming in to the month of April. Stocks gave back their gains at the latter part of the week as key economic figures from the US fell short of expectations. In addition, ECB president Mario Draghi said the Eurozone was at risk of a deeper recession, and warned that monetary policy cannot compensate for lack of government action. The benchmark concluded the month of March down 0.36% and is down 0.46% for Q1.
- The S&P 500 fell 0.59% for the week, as of yesterday's close. US shares lost as reports showed a slowdown in manufacturing activity, as well as a rise in Jobless claims and fewer than expected jobs were added in March. All eyes are on today's NFP report to conclude the employment picture for March. US equities regained some ground following supportive remarks by Fed officials for the continuation of asset purchases to support the economic recovery. The S&P has ended the month of March up 3.6% and is up 10% for Q1.
- The Nikkei endured large swings during the week, falling as much as 3.2% by mid-week, only to reverse its losses and swing to a weekly gain of 3.5%, breaching the 13'000 mark for the first time since 2008 during Friday's trading session. Japanese equities initially sold off as the Tankan survey (sentiment of the country's largest manufacturers) missed estimates and the Yen strengthened ahead of Japan's policy meeting. During the meeting, the BoJ announced a bold new measure to massively expand the money supply though asset purchases to stoke

inflation and get the economy out of its two-decade stagnation. The Nikkei rose as much as 7.25% during March and concluded Q1 up 19.25%!!

- In terms of sectors, Materials and Energy stocks were the worst performers for the week (-2.70% and -2.08% respectively), while Healthcare and Telecom stocks gained (0.72% and 0.54% respectively).

Emerging Markets

- Emerging Market equities fell 1.75%, as of yesterday's close, as measured by the MSCI EM index. The worst performing region was EM Europe (-2.49%), followed by Latin America (-2.16%), while Asia fared better (-1.36%).
- The Shanghai Composite dropped 0.50% for the week up until Wednesday (markets were shut on Thursday and Friday due to Ching Ming festival). Chinese shares fell as PMI Manufacturing figures came in weaker than expected. Stock futures dropped further at the latter part of the week on news of a new strain of bird flu hitting the country, overshadowing reports of better than expected non-manufacturing PMI figures. The benchmark has ended the month of March down 5.45% and down 1.5% for Q1.
- The Bovespa posted an additional week of losses, falling 3% as of yesterday's close. Brazilian shares lost as economists revised upwards their 2014 inflation targets - sending consumer stocks lower – following reports of a fall in PMI manufacturing figures. In addition, industrial production figures came in weaker than expected (-2.5% vs. -2.0% exp.), and the worsening crisis in Europe raised concerns for commodity demand. The gauge posted additional losses at the latter part of the week following Citigroup's downwards revision of the benchmark, citing anaemic economic growth and faster inflation. The gauge concluded March down 1.87% and down 7.55% for Q1.

Commodities

- Commodities sharply fell this week, with the S&P GSCI TR Index losing 3.36%. Most commodity sectors dropped by over 3%, with Energy and Agriculture leading the downfall – falling by 3.75% and 3.37% respectively, while Industrial Metals fared better, losing only 1.43%.
- Agriculture slid this week, pulled down by hefty losses on Corn during the week (over 9.5%) as traders continued to fret over last week's data showing bigger-than-expected stocks of the commodity.
- Gold tumbled by over 3.10% for the week, currently trading around $1'550 per troy ounce. The yellow metal even hit a 10-month low around $1'541 an ounce early on Thursday as the dollar strengthened ahead of a statement by European Central Bank chief Mario Draghi, after the bank left rates on hold as expected at its latest policy meeting.
- Oil collapsed by 4.29% over the week, and is currently trading at $93 a barrel. Following a steep 2.82% drop on Wednesday, crude oil futures came under continued pressure on Thursday (losing a further 1.26%) after news that US crude oil stocks climbed to their highest end-March level since 1931 and new worries about economic recovery in the world's biggest oil consumer, as US weekly jobless claims rose by more than expected.

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