Bedrock Newsletter

Friday, April 12th 2013

We closed last week with a disappointing Non-Farm Payroll report out of the US- Only 88 thousand new jobs were created against 190 thousand expected. The US Dollar fell as did equity markets on this data which might be indicating that future GDP growth may be slowing. Ouch… Then the Trade Deficit of the US narrowed a little; at first sight, this in itself may be positive, but then, as GDP grows the trade deficit usually and normally expands… A cloud in our blue skies? Optimists pointed at the lower unemployment rate in the US, now at 7.6%. Others analyzed the same data differently- the reason, they claim, that the rate of unemployment is dropping is simply because the number of people either working or seeking employment has declined- an algebraic result of little meaning they say! In fact, the number of people in the so-called work force is at a 35 year low! Ah, statistics, they say whatever one wants to read…

Well, by Wednesday the markets forgot Friday's disturbances… The S&P 500 broke its all-time intra-day highs. Thursday builds new highs, in all indices, again... Gold stabilized at 1560 after having fallen hard and fast… We noted this week that a Swiss bank is selling gold in the form of a chocolate bar, each square being one gram. Retail interest appears to be high, amongst Euro based customers. Is this the end or the restart of the gold rush, 2013?

Thursday gave us some new concerns- China announcing an $884 million trade deficit for March and Cyprus told their benefactors that the "financial problem" they have is larger than previously thought. Now estimated at Euros 23 billion vs. 18Bn. George Soros suggested that Germany should leave the Euro. Then, the world's biggest bond fund manager Bill Gross has had a change of heart on Treasuries, raising allocations to U.S. government bonds, as the fund seeks to pre-empt an increase in buying from Japanese investors. PIMCO increased its allocation to Treasuries to 33 percent in March from 28 percent the previous month, the firm's website showed on Tuesday. The fund also decreased its exposure to mortgage bonds from 36 to 33 percent. Let's take this with a pinch of salt as PIMCO has had several reversals of view over the recent past. Whilst holding on to significant fixed-income positions, we remain defensive with relatively short durations and higher yielding credits.

A curious tidbit of information came our way- Germans are one of the poorest groups in Europe even poorer than those in the troubled peripheral nations of Greece, Spain and Italy, according to the surprising findings of a joint survey by various divisions within the European Central Bank. The Household Finance and Consumption Survey (HFCS) looked at household wealth in some key euro area countries. According to the report, "the composition of net wealth is primarily driven by real assets", of which the main component is owner-occupied housing wealth. Net wealth according to the findings is substantially higher in Cyprus at 671,000 euros compared to a rather paltry 195,000 euros for Germans. Spain punches higher than Germany too with net wealth at 291,000 euros and Italy at 275,000 euros.

Somehow the fears of last week, about North Korea, have faded into our equity rally; Syria's ongoing political melt-down and deaths are hidden in the back pages and even the breakdown of the nuclear talks with Iran are hidden behind investment exuberance. But we must remain vigilant- A "crescent of chaos" emerging from the Middle East and North Africa (MENA) region and tensions with Iran could lead to a dramatic turnaround in the price of oil, according to Nomura's analysis. Brent crude, which fell to an eight-month low last week on weak U.S. jobs data, is set to climb following Iran's presidential election in June, the firm said in research published on Tuesday. Brent crude, which has spent the vast majority of the last two years range-bound between $105 and $120 per barrel, surged close to a two-year high when civil unrest broke out in Libya two years ago, but Iran now poses the biggest threat according to senior political analyst Alastair Newton.

A smile for the weekend can be gained from the proposal to Kick-start EU economies by cancelling Euro500 bills. The theory suggests that this would force holders to spend them...

Currencies

- EURUSD had positive performance throughout the week on little to no data flow. With the FOMC minutes having accidentally been released early to some staffers in the congress, they were subsequently released to the public early, causing a small USD rally. The EUR started at 1.2990 and has moved to as high as 1.3138 yesterday only to settle back this morning to 1.3080. As we said last week, the data is poor and getting weaker. With the Chinese having the first trade deficit in recent memory, Germany's Industrial Production weakening and wholesale prices dropping, we do not see where the support for the EUR will come from going forward. The main driver for all crosses is the JPY and the subsequent flows and rhetoric coming from the BOJ. Once the dust settles the EUR will likely be unmasked in its full glory and the 1.20 figure will be in its sights.
- EURCHF moved up from 1.2130 to as high as 1.2210. In light of the absence of worry or fear the safe haven status of the CHF has been mildly brushed aside. We feel that this is unwise and that in the not so distant future the SNB may need to defend the 1.20 floor they have so successfully maintained. USDCHF moved exactly inverse to EURUSD and fell from 0.9340 to 0.9280 but is now almost back to where it started the week at 0.9325.
- …And the beat goes on! The BOJ drum has been beating time to push the JPY lower again reaching 99.95 on Wednesday, having moved up from 97.60 on Monday morning. EURJPY moved from 126.80 to 131.00, these unprecedented moves in the EURJPY seem to have happen too fast and too soon causing the EURUSD cross to swing positive when the fundamentals do not support such a move. We believe a large correction will occur in EURJPY. We have now reached levels that were last seen in 2009… April 2009. In every year the Japanese financial new year starts in April. In every year for the last 5 years the JPY has strengthen on companies repatriating their foreign income into Yen… The real question is whether we will see the same business flow and whether that is even able to counter (in the short term) the massive printing presses of the BOJ. Perhaps we will see a short term strengthening in the JPY (not likely we believe) but the direction of Kuroda is clear, steadfast and thoroughly ingrained in the market mindset. The JPY will weaken, let the currency war begin! (or rather continue…)
- AUD moved up again this week, moving from 1.0350 to as high as 1.0590. This move is in spite of very poor employment figures, a weakening domestic economy and Chinese data that was the first piece of outwardly negative data for the market. The search for yield and the lack of any fear in the market this week combined with blind euphoria has all of our warning alarms going off. We watch and wait, but cautiously awaiting the trigger to turn the sentiment.
- The Iron Lady passes; a lady that tried to keep the British out of the ERM… We guess George Soros was glad she stepped down prior to that decision; otherwise he would have not been able to bet so heavily against it! However, this week saw the GBP strengthen again on the general Euphoria and then some non-negative (that does not mean positive in this case!) manufacturing data with a GDP expansion estimate of 0.1%. We do not feel that Cable will necessarily reverse these loses any time soon, but when the turn occurs unfortunately we do not see much to slow the rapid descent of the pound. We look for low 1.40's in the not too distant future.
- Both BRL and ZAR had a positive week, seeing the BRL reach 1.9680 yesterday and the ZAR moving from 9.10 to 8.87, only to see it weaken this morning to 8.95.

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Fixed Income

- With US equities' rallying like the world is blooming with fluffy pink rabbits, the US 10Y paper moved from 1.70% to as high as 1.81% on the week. Clearly with fear no longer at the forefront of the markets view, Treasuries sold off and Risk was the appetite for the week. The 30 year saw much the same move, with the bonds dropping and the yield surging up from 2.87% to 3.01%. The 2 year however is at levels not seen a in a long time and although moving from 0.26% to 0.21% over a month may not seem like much, the last time we saw 2 year yields at this level was late July last year after the equity markets had corrected… yet we are now 25% higher in equities, this does not bode well…
- Japanese yields rose again this week as the BOJ laid forth more plans to stimulate the economy out of its 20 year slumber! Yields moved from a low on the week of 0.45% to a high of 0.64%, the equivalent of the US 10 year moving to above 2% on the week. These are huge moves, the equivalent of annual moves that are taking place in a matter of days. If you don't believe the landscape is changing then look at the JGBs… it is real and it is happening. Do not get in the way.
- The German 10-year Bund moved off the price-highs at the start of the week to see the yield glide higher as the euphoria was maintained, moving from 1.2180% to 1.3330%. With some sense of European issues and Cyprus requesting further assistance we believe that the Bund will stay bid and the real risk is not that the yields go to 1%, it is what happens when people no longer have the will to take 1% for 10 years… that worries us… A LOT.
- The Spanish 10 year remained well received in the market with the yields moving from 4.87% to as low as 4.61%. With Cyprus headlines all but side-lined for now, we are nervous that when the tide turns the Spanish are going to be swimming without their trunks…
- The Italian 10 Year yield finished last week at 4.38%, much lower than we expected, but this week has seen the Italian bond auctions print at their lowest for a very long time. Reaching as low as 4.26% on Monday we are in fact almost unchanged now on the week at 4.37%.
- The best performer this week as Global EM bonds with a positive contribution of +0.89% closely followed by EU HY at +0.80%. US Government was a poor performer at -0.09%.

Equities

- Developed equities rose sharply this week and are set for second best week of 2013, with the MSCI World gaining 3.08% (as of yesterday's close), as stocks around the World were buoyed by Japan's radical monetary easing plan and signs of a growing recovery in China
- The EuroStoxx index surged by 3.42% over the week, after European shares experienced their biggest daily rise in three months on Wednesday (+2.56%), supported by continued central bank stimulus. However, European stocks struggled to return to all time highs, limited by weak growth and political turmoil surrounding Cyprus' bailout.
- The S&P 500 rose by 2.58% for the week, as of yesterday's close. US stocks sharply advanced on Wednesday (+1.22%) taking the index to new highs, pushed by an upbeat sentiment after the dovish tone of the FOMC minutes and better-than-expected Chinese imports. US stocks rose for a fourth straight day on Thursday, sending the S&P 500 to new closing highs as positive data on the labor market and an encouraging retail outlook eased recent concerns about economic growth.

- The Nikkei surged by 5.08% this week, rising to its highest level in over four years on Thursday as the central bank's unprecedented stimulus measures continued to attract buyers for reflationary stocks like banks and real estate firms, while the Yen strongly weakened – approaching the 100/US$ mark.
- This week, nearly all sectors rose by over 2.5%, with Financials, Industrials and Consumer Discretionary leading the gains (+3.64%, +3.43% and +3.32% respectively), while Consumer Staples rose a bit more cautiously (+2.37%).

Emerging Markets

- Emerging Market equities rose by 2.09%, as of yesterday's close, as measured by the MSCI EM index. The best performing region was EM Europe (+2.75%) followed by Latin America (+2.60%), while Asia rose by only 1.50%.
- The Shanghai Composite dropped 0.86% for the week, despite signs of economic improvement. China's stocks fell on Monday after a two-day holiday amid concern a bird flu outbreak and property market curbs will hurt the nation's economic recovery. The index then rose on Tuesday and Wednesday on an unexpected trade deficit in March, before falling again on Thursday and Friday as commodity producers led declines amid lower material prices, overshadowing gains for banks after new loans and money supply data exceeded analysts' forecasts.
- The Bovespa advanced by over 2% until Wednesday after a report showed Brazil's inflation slowed more than forecast in March, easing concern that rising prices will hurt the recovery in Latin America's largest economy. However, the index gave back most of its gains on Thursday, as a report showing retail sales unexpectedly dropped in February rekindled concern that Brazil's economic upturn will falter. As a result, the Bovespa rose by 0.64% for the week.

Commodities

- Commodities rose for the week, with the S&P GSCI TR Index gaining 0.49%. The biggest contributors were Industrial Metals and Agriculture (rising 1.87% and 1.33% respectively), while precious metals lost 0.37%.
- Gold fell 1.47% for the week, and is currently trading at $1'558 per troy ounce. The metal was little changed during most of the week, but fell the most in five months on Wednesday on rumours that Cyprus plans to sell the excess of its gold reserves to raise money.
- Oil posted modest gains – rising 0.32% for the week – and is currently trading at $93.00 a barrel. Oil rallied sharply at the first half of the week on USD weakness as well as the US boosting its 2013 price forecast (additional 2.2% for the year). Crude reversed its gains at the later part of the week following the International Energy Agency trimming its forecast for global demand, predicting the weakest demand in Europe in almost 3 decades. As a result, the Brent-WTI spread has narrowed to $10.8, the narrowest in 14 months.

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