Bedrock Newsletter

Friday, June 21st 2013

BEARnanke… If anyone had a doubt as to what was and **is** the true motor of the markets, well, this doubt has been laid to rest…

We started this week with up-markets in both equities and bond prices, some of which possibly attributable to the election of what appears to be a moderate leader in Iran. And we had the G8 discussing taxes and Syria in Dublin. Well, we were reminded that Ahmadinejad was considered "moderate" when elected 8 years ago and the Dublin meetings got nowhere on Syria. Turkey's riots continued as Syria's death-toll increases by the day; Brazil added its own riots to the dinner table but all this remained mute, as the "State-of-The-World" speech by Ben Bernanke was expected for Wednesday…
Tuesday we got the first salvo across the bow with President Obama saying that Bernanke has stayed in his post "longer than he wanted"; adding that he can and should go or words to that extent. Are the President and his administration "Fed-up" with the Fed? A very strong message that there will be a new Chairman coming next year…
Even Boehner joined the Ben-bashing saying that he "destroys markets", and he is from the other side of the aisle...
Wednesday, Ben Bernanke took the podium. Effectively he told us that the economy has stabilized… he was more hawkish than before but reiterated strongly that the Fed will not be reducing its portfolio, reinvesting coupons and capital and that the Fed will continue buying for $85Bn per month. He added that they watch the economy closely and will adjust their purchases up or down as the economy evolves. He did say that risks to the economy are abating. Well, as Ben went into the Q&A session the market reacted to the news (no news?) with a strong sell-off in all assets- The DJIA closed down 200 points, bonds fell and yields rose. Gold accelerated its fall, the VIX raced upwards of 15% to 19+%, the US Dollar surged… The Big Bad BEARnanke took away the porridge... Or did he? We heard Bernanke state clearly that should the recovery falter, the Fed will do WHATEVER IS NEEDED.
A backstop remains, so why did the markets react so badly? Was it the level of dissent at the FOMC? 2 members dissented; it was the most since 2011. Ten year Treasuries rose in yield to 2.27% and gold fell through $1'360. This as the Fed said that their inflation outlook has further moderated and that employment will be slow to come back and that they do not foresee a rise in rates before 2015…
We entered Thursday with apprehension and indeed, a wash-out day followed: All equity indices fell around 3.5% in Europe and then 350 points were shaved of the DJIA that evening. The DOW broke 15'000 and the S&P 500 fell through 1'600, the VIX soared through 20… the 10 year Note fell to yield a 15 month high of 2.43%, Gold fell through 1'290 and even oil shed over 3%.
PIMCO's Bill Gross after the Fed says he sees the 10 year at 2% or less by year-end and he is a buyer here. Then the Eastern Markets stabilized overnight, Europe started Friday in the green, the US Futures are all up and the US$ stabilized. Was this just a storm in the Ben-Porridge?
We can see some reason for PIMCO's outlook, as the surge in the US$ can have a nasty side effect of removing the little inflation remaining in the USA, deflation supports bonds…
Whilst the markets have become jittery, we try to remain calm. We believe that the course of the recent past hasn't changed with the Fed's "show" and we remain vigilant on the risks on our watch list: Iraq's breakup? Iran's future, North Korea, Syria, Social unrest, Deflation.
If you want to gain, you must assume some risk. Remember Joe Lewis? He said *"Everybody wants to go to heaven, but nobody wants to die"*

Currencies

- EURUSD or this week we should really say USDEUR! Bernanke "exposed" himself to the markets in a matter of fact manner; the markets responded. The USD rallied. EUR moved very gently from 1.3350 to 1.3400 until The Bearnanke drove the USD up and simultaneously sunk the EUR from 1.3415 to 1.3260 with one swipe of the microphone. With the dust setting throughout Thursday and this morning, the EUR declined further dropping to as low as 1.3160. Tapering will be the new catchphrase on the newswires for months to come… how much, what will be reduced, when will it be reduced? Looks like Goldilocks' porridge is coming to an end and when the porridge runs out – so the story goes – the Bears come out of the woods. Beware the Bearnanke, he comes bearing a Tape(r) measure… that should signal the resumption of the USD up trend. (Caveat… unless Obama can replace him before then!)
- The CHF is almost unchanged on the week against the EUR at 1.2285. Against the USD, the CHF lost some of the ground it had gained. This move is relatively small though in light of the enormous USD move we have seen - +0.7% for the USDCHF but +1.7% for the DXY. With the fear back in the markets the CHF safe haven status has not completely been forgotten, with the majority of flows hitting the main cross of EURUSD. We are currently at 0.9285 on the USDCHF and it would seem that our recent commentary on lightening up the CHF was not misplaced.
- Last week we mentioned that Kuroda and Abe were politically-handcuffed and were not in a safe-enough place to continue the weakening of the Yen. Who else could continue the Samurai war on their currency…? Step in Big Ben. Who needs enemies when you have friends like Bearnanke on the loose? Looks like the Japanese have found their next Gai-Jin. The Yen's descent has been stimulated, this time from outside of Japan, Gai-Jin sent the JPY down from 95.00 to 98.30, having been as high as 94.00 on Monday. We are settling this morning at just below 97.75. The downtrend in the JPY has resumed, albeit as a result of the USD uptrend!
- We mentioned a few weeks ago that Carney (the soon-to-be Governor of the Bank of England) would be mining is way through the earth to Australia to devalue the Pound. It looks like we have a new Euro-Tunnel agreement with the Aussies digging first! The AUD fell from 0.96 to a low of 0.9165 on the back of USD strength. We believe that this weakness should continue as the dire situation of the economy continues to be pressured by weak commodities. The race to the bottom has not only begun it is furiously intact and the currency wars continue!
- Uh oh! The Calamity appeared this week. With the prior USD weakness the previous driver of the Pound. So too now, in strength, the USD causes the GBP to drop. "all the world's a stage, and all the men and women merely players: they have their exits and their entrances; and one man in his time plays many parts, his acts being seven ages." Well it looks like the Bernanke has been reading Shakespeare and ventured out for his next age… the age of USD strength! It's not about the money, but it is about the price tag. With the weakness in the British economy and the Tapering in the US, this pair could be very much lower in the quickest of flashes. As the price tag for Tapering is USD strength…
- Last week we wrote that all the hallmarks were present for a more volatility for EMs… we did not expect so much so soon. The BRL and ZAR collapsed, moving from 2.18 to 2.28 and 9.95 to 10.32 respectively. The EM currencies have taken a nose dive and without a brake on them, the central banks will allow their exporting nations to continue the slide to maintain or bolster their Domestic economies. As we have said before. It is a messy race to the bottom…

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Fixed Income

- US Treasuries had a tough week with the bonds being sold heavily again, with the 10Yr moving from 2.15% to 2.36% on Wednesday alone. As we said before, the FED got a taste of the market view point on any form of tapering. Like a spoilt child the candy store hinted at closing up a little early and all toys were thrown out of the pram. The US 10 year spiked to as high as 2.47% and has settled back to about 2.40% this morning. Even the shorter term 2 Yr paper moved from 0.26% to 0.32%. It looks like bonds have taken the brunt of the Bearnanke's commentary square on the chin.
- The German 10-year Bund was not immune to the USD surge and the German yields moved rapidly from 1.52% to peak at 1.69%. The Stalwart of Europe has had dust kicked in its face. If the Germans start to feel the pressure, this will only be pushed out to the periphery which could start a mud-throwing fight. The cascade effect from the Motherland could cause problems as funding costs rise and the economies that were just getting off their knees are slapped back down. This is not a pretty picture forming.
- The Spanish 10 year bonds were almost unchanged on the week at 4.54%... oh, until they awoke from their siesta on Thursday morning. The 10 Yr bonds collapsed, the yields spiked to above 4.90% and the short term paper got hit as well sending the yields to a 3 month high of 2.35%. If one speech in the US moves the yields up by 40Bps… can you imagine what will happen when the Tapering ACTUALLY kicks in? We would not be holding periphery paper; you need stomachs stronger than ours to deal with the volatility.
- The Italian 10 Year weakened this week, moving from 4.25% to 4.62% by this morning. We note that Italy has been sold more aggressively than Spain again. We still fear that the periphery may well be treated as one unit in the not too distant future and would not advocate their bonds in any way shape or form.

Equities

- Developed equities tumbled by 2.73% this week, as of yesterday's close, as measured by the MSCI World index. Global stocks sharply sold off on Thursday (-3.46%), depressed by the Fed's plans to eventually stop pumping cheap money into the world's biggest economy, raising concerns about the broad impact on growth.
- The EuroStoxx lost 2.2% over the week, mainly due to yesterday's session hefty fall on the prospect of diminished stimulus from the US Federal Reserve. Central bank stimulus measures had helped push European markets to five-year highs until May despite a shrinking domestic economy and falling earnings expectations, but the threat of withdrawal has knocked the index around 9% since mid-May.
- The S&P 500 dropped by 2.37%, as of yesterday's close. US stocks lost almost 4% between Wednesday and Thursday, sending the Index to its biggest loss since November 2011, after Fed Chairman Ben Bernanke said the central bank may end bond purchases by the middle of next year if the US economy improves in line with Fed projections. The S&P 500's 2.6% decline so far this month threatens to end seven straight monthly gains through May, the longest winning streak since September 2009. The gauge rallied as much as 147% from its bear market low in 2009, fuelled by strong corporate earnings and the Fed's highly accommodative stance.
- Meanwhile, the Nikkei surged by 4.28% - marking the Index's first weekly gain in five weeks - as a weakening Yen offset worries over a liquidity crunch in China and a scaling back of US monetary stimulus.

- In terms of sectors, Materials, Consumer Staples and Utilities posted the largest losses (-4.25%, -3.40% and -3.40% respectively), while Information Technology and Industrials fared better (-1.41% and -2.21% respectively).

Emerging Markets

- Emerging Markets equities tumbled by 4.74% over the week, as of yesterday's close, as measured by the MSCI EM index. Latin American and EM European stocks collapsed this week (-7.40% and -6.95% respectively), while EM Asia fared better losing "only" 3.50%.
- The Shanghai Composite lost 4.11%, posting its steepest weekly loss in four months, amid concerns a cash crunch may curb economic growth and the US Federal Reserve will reduce stimulus. Chinese stocks sharply sold off on Thursday after money-market rates jumped to records as the monetary authority refrained from using open-market operations to address a cash squeeze.
- Meanwhile, the Bovespa lost 2.27% (as of yesterday's close). Brazilian stocks tumbled on Thursday, briefly sliding below 46'000 points for the first time in four years, the day after the US Fed signalled it would end a stimulus program that helped pump money into high-yielding emerging market assets. Data pointing to lower growth in China – the top buyer of Brazil's raw materials exports – also weighed.

Commodities

- Commodities dropped by 2.34% over the week, as measured by the S&P GSCI Total Return index. Precious Metals collapsed (-7.60%), and Energy and Industrial Metals were also quite sharply down (-2.93% and -3.83% respectively), while Agriculture was the only sector to be positive (+1.15%).
- Gold collapsed by 6.7% this week, and is currently trading around $1'297 per troy ounce. Gold fell to a three-year low early on Friday and was in danger of recording its second biggest weekly drop in 30 years after the US Federal Reserve said it would wind down its bullion-friendly stimulus later this year, sparking a 4.9% drop on Thursday. The bullion rebounded today on speculation the slump may spur purchases, but bullion is still set for its worst week since last April. However, we believe that we should finally approach the bottom in Gold prices and hence a rebound should ensue.
- Meanwhile, Oil dropped by 2.2% and is currently trading at $95.60 a barrel. Crude-oil futures dropped sharply on Thursday, posting the biggest one-day drop in 7 months (-2.89%) as the market grappled with a continued Chinese manufacturing slowdown and signals from the Fed that a reduction in monetary stimulus is in sight.

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