Bedrock Newsletter

Friday, July 12th 2013

The past weekend started with a miracle- a horrible air crash into San Francisco. A Korean 777 Boeing with over 300 persons on board crashed landed and exploded. Amazingly, there were only 2 casualties.
Wednesday, Federal Reserve Chairman Ben S. Bernanke called for maintaining accommodation even as the minutes of policy makers' June meeting showed them debating whether to stop bond buying by the Fed in 2013. "Highly accommodative monetary policy for the foreseeable future is what's needed in the U.S. economy," Bernanke said. The main development is that Chairman Bernanke has clarified the message that the Fed has been trying to communicate all along, which comes down to "tapering is not tightening." The key issue for markets and the economy is not the potential tapering, but the potential tightening. Chairman Bernanke has signalled that the latter is a long way off.
A little chuckle is merited here- A short while ago President Obama said that Bernanke has over-stayed his welcome, the day before the Chairman was to speak. Bernanke spoke and spooked the markets with misinterpreted talk of "tapering". Ben didn't respond to Obama's words. This week Ben explained and markets roared… He must be a student of Moliere who said "A wise man is superior to any insults which can be put upon him, and the best reply to unseemly behaviour is patience and moderation".

Earnings' season opened with Alcoa beating on both top-line and bottom-line. We do expect much of the same to follow, as analysts' expectations have been ratcheted down severely, all talking of a poor Q2. We can hardly be disappointed with the reality to be disclosed shortly… More fuel for the equity markets?

Tuesday Gold bounces together with a powerful rally in the US$, the VIX falls to 14.30, US Bonds stable and European bonds rise even with a downgrade of Italy. Go figure.
Other noises came from John McCain who is trying to revive the Glass-Steagall laws that governed US banking since after the Depression. Back to the future?

Many analysts and investors have held a conviction of a rising US$. Bernanke spoke and the US$ falls hard. Against just about all currencies and Gold (the latter rising rather dramatically since Ben spoke). America is lagging the devaluations of all the world currencies and the Fed clearly sees the benefit to employment (its "other" responsibility) from rising exports driven by a weaker currency. Then we look at oil, which didn't move on the news. Actually, it has been amazingly stable over the past 18 months as all other commodities have been sinking with huge volatilities. Is the investor world expecting continued strength in demand from economic growth? It is possible; The U.S. government posted a budget surplus in June, the latest sign of rapidly improving public finances. Rising tax revenues, public spending cuts and big payments to the Treasury from state-backed mortgage firms helped the government take in $117 billion more last month than it paid out, the U.S. Treasury said on Thursday. Analysts polled by Reuters had expected a smaller surplus of $39.5 billion. June's surplus was the largest for that month on record. The US economy must be improving if tax receipts rise. This is hard data, not a poll… Then, we find that only 27% of Americans own any equities now, vs. 70% or so in 2007... Has the Rally only begun??? Thursday we saw more equity indices breaking records. The most unloved rally ever...

Is it a REAL RALLY? We go to our weekend with Albert Einstein's thought "Reality is merely an illusion, albeit a very persistent one."

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Currencies

- The EUR continued its fall during the early part of the week, reaching 1.2750 to the USD, but then, on Wednesday, when Bernanke reiterated with force that interest rate rises in the US were nowhere near, the USD took a nose dive and the EUR reached 1.3200 in a frantic and panic move. It did not stay there for long and slid back to the 1.3000 level which seems to hold for the moment. We remain however EUR bearish, as the situation in Europe keeps on getting worse and not better, and as the US economy continues to slowly creep up. We believe that the 1.27 level will be revisited, and once broken, will lead to a sharp move lower. Let's not forget last week's Draghi's comments that were clearly the most dovish in a very, very long while…
- The CHF also slid early this week, to reach 0.9760 on the USDCHF pair and 1.2460 on the EURCHF pair. As Bernanke spoke, the USDCHF fell back to the 0.94 level but has since recovered some lost ground to 0.9500. We believe that parity is in sight and that we should test this level in the coming weeks. As for EURCHF, we continue to foresee a range between 1.2350 and 1.2600.
- USDJPY also had a volatile week, starting at around 101.20, and falling back to 98.20 after the Bernanke comments. The JPY should remain weak, and any move around 95 should be sold into. The elections that will be held in the coming week should give more power and strength to Prime Minister Abe to push further his aggressive reflationary agenda.
- The AUD, although also reacting to Bernanke's comments, failed to see much strength. The AUD rebounded from a multi month low of 0.9038 to as high as 0.93 but failed to hold this level and slid back to 0.9160 currently. The problem with the AUD is that economic figures keep on coming in poorly, as witnessed this morning by the weak housing finance approvals. The AUD looks set to continue its downward adjustment for now.
- The Pound, after tumbling to the 1.4810 level against the USD was saved, not by the Queen, but by the mighty Bernanke. The GBPUSD pair rebounded swiftly to the 1.52 level, but as for the other Dollar pairs, could not sustain this level for long. We continue to see a further weakening in the Pound, especially in light of the more dovish comments from the new BOE Governor Carney. We see the 1.48 level being broken and the Pound sliding to the low 1.40s in the coming months.
- The BRL steadied at a low level of 2.27 this week, and did not react to the increase in the Selic rate to 8.5% from 8%. However, we are starting to see some stabilization in the BRL and we do not foresee a major move lower from here anymore.

Fixed Income

- US Treasuries gained for the week as the Fed's Bernanke soothed concerns that policy makers are moving closer to end asset purchases sooner than the market has expected. In addition, Investors saw a buying opportunity on the view that an increase in 10 year yields to the highest in two years has been too rapid. The US 10yr yields fell from 2.750% to 2.542% currently, the US 5yr yields fell from 1.613% to 1.361% and the US 30yr yields from 3.712% to 3.601%.
- The Italian 10 Year is set to end the week roughly where it started (4.453% currently). Italian bonds posted gains at the start of the week on the back of comments from the ECB that key rates are expected to remain at these levels or lower for an extended period. The 10yr later reversed and posted losses following S&P's credit rating cut for the nation, citing a weakening

of the country's economic prospects. On Thursday, Italian borrowing costs dropped at an auction of three-year debt following reassuring remarks of more monetary stimulus by the Fed.

- The Spanish 10 year bonds fell for the week with yields rising from 4.647% to 4.726% currently. Spanish bond sold off on the back of Italy's credit rating cut, sending yields to as high as 4.899% before recovering to present levels. At the start of the week, Spain sold long dated bonds for the first time in 2 years which gathered robust demand as investors put their faith in the ECB's pledge to keep rates at record lows.

Equities

- Developed equities surged by 3.29% this week, as of yesterday's close, as measured by the MSCI World index. Global stocks rose after Chairman Bernanke said the Fed will continue to maintain accommodative monetary policy for the foreseeable future, citing low levels of inflation and the high unemployment rate.
- The EuroStoxx rallied by 3.12% over the week. European stock markets surged by over 2% on Monday, rebounding after a selloff at the end of last week, as the prospect for continued low rates in Europe and a stronger US economy overshadowed fears of less stimulus from the Federal Reserve.
- The S&P 500 jumped by 2.64%, closing at a record high on Thursday – a day after Federal Reserve Chairman Ben Bernanke said the US central bank will keep a loose monetary policy for some time to lower the unemployment rate, backing sustained monetary stimulus.
- Meanwhile, the Nikkei rose by 1.37% - its fourth consecutive weekly upward move - edging up to a seven-week closing high on Friday buoyed by a record finish on Wall Street and the generally upbeat mood on receding concerns about an imminent rollback of the Federal Reserve's stimulus.
- In terms of sectors, Materials and Utilities posted the largest gains (+5.04% and +4.01% respectively), while Telecom and Information Technology performed less than the overall 3%+ general trend (+1.94% and +2.52% respectively).

Emerging Markets

- Emerging Markets equities rallied by 2.76% for the week, as of yesterday's close, as measured by the MSCI EM index. EM European and EM Asian stocks rose the most (+2.77% and +2.87% respectively), while Latin America lagged (+1.79%).
- China's stocks started the week on a negative tone losing 2.4%, before strongly bouncing back on Wednesday (+2.2%) and Thursday (+3.2%) sending the Shanghai Composite to its biggest two-day gain in 18 months, on speculation the government will take measures to bolster economic growth. However, the benchmark retreated today amid concern that official data due Monday may signal a sharp slowdown in GDP growth for the second quarter. As a result, the index rose by 1.6% for the week.
- Meanwhile, the Bovespa surged by 3.13% for the week (as of yesterday's close). Brazilian stocks opened higher on Wednesday following a market holiday in the previous session, led by commodities exporters' shares. The index rose for a second straight day on Thursday, tracking global equity markets after the US Federal Reserve suggested its bond-buying program may be kept in place longer than some investors had expected, easing tapering fears.

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Commodities

- Commodities rallied by 1.52% over the week, as measured by the S&P GSCI Total Return index. Commodities rose across the board with Precious metals, Agriculture and Industrial metals rising 5.65%, 3.83% and 3.18% respectively, on the back of a weaker Dollar, while Energy rose less (+0.98% for the week).
- Gold rallied as much as 4.4% for the week, and is currently trading at $1'276.70 per troy ounce. The metal is on track for the biggest weekly rally in 2 years as the Fed eased concerns of an early end to US monetary stimulus, causing a sharp Dollar selloff.
- Oil rallied 1.43% for the week, and is currently trading at $104.70 a barrel. Crude oil futures rose sharply during the week, following an announcement by the API that stockpiles dropped more than expected - sending front month futures to as high as $107.35! – due to rising refinery operating costs. Futures have since consolidated as the sharp rise to a 15 month high seemed excessive.