Bedrock Newsletter

Friday, July 19th 2013

Summer doldrums are upon us- A whole week rolled by with little if any noteworthy events. Syria is still engaged in its auto inflicted self-destruction, Egypt appears to have chosen the Syrian mode of development, the USA is still stuck in its own fiscal quagmire as sequestration 1.1 is about to take hold, Europe is still discussing new deals for Greece and Portugal, France saw its credit rating down-graded by Fitch and just this Thursday the city of Detroit filed for Chapter 9 bankruptcy – The largest US city to go belly-up… And then Moody's reaffirmed the triple "A" rating for the USA.

On Wednesday, U.S. stocks and Treasuries gained as Federal Reserve Chairman Ben S. Bernanke's testimony to Congress eased concern that the central bank was planning to curtail stimulus. The dollar strengthened against the euro and yen while gold retreated.
Thursday we saw IBM beating expectations with its Q2 results, its stock rising 3% on the news, followed by Google missing on all counts as did Microsoft- These stocks were punished by 4% and 6% respectively after hours. This showed a mixed picture in the technology sector, unlike the financials which have been surprising us to the positive side. Goldman made money in fixed-income underwriting whilst Morgan Stanley did well off equities. Then Blackrock showed impressive growth in assets under management and an exceptional increase in its results.
Larry Fink, Blackrock's Chairman, who had turned bullish on equities back in November last year, came on CNBC last night, reiterating his view that equities will continue to give interesting returns. He expressed concern about the bond markets and noted that the expected "rotation" from bonds to equities has yet to commence- for now, there is a rotation with sectors of the fixed-income markets. Larry added that portfolios remain heavily under-invested in equities. Blackrock is less concerned than most with the anticipated Fed "tapering"- their view is that as the Treasury is reducing its issuance given the improvement in the US budgetary balance, the Fed may reduce its purchases- offsetting each other and leaving the markets neutral.

Then we had PIMCO's El-Erian who questioned where the Fed gets its projections because the "new normal" of slow economic growth, high unemployment, and government debt problems is persisting. "We continue to heal," he added. "But we're not at escape velocity." "The Fed wants to taper for two reasons. One, [is] they have a more optimistic view of the economy. That's good. Two, is they're worried about the costs and risks, or collateral damage and the unintended consequences. So there are two things that they're trying to fulfill with one instrument, and that's why the market becomes so volatile."

Last week's Economist showed the Industrial and Commercial Bank of China to be the largest bank in the world when ranked by tier 1 Capital! JPM is second. ICBC is also first when measured by assets at 2.8Trn. If anyone had a doubt as to the growing prominence of China, this data should clear the question…

The recent volatility in gold prices has left not only investors and traders puzzled about what is going on with the precious metal. "Nobody really understands gold prices and I don't pretend to understand them either," Federal Reserve chief Ben Bernanke told the Senate Banking Committee on Thursday in response to a question on why gold prices have been volatile. As traders speculate whether battered gold prices can make a decisive push above the key $1,300 level or are headed for more pain, analysts say there's another key factor for the gold outlook that is being overlooked: strong demand for gold from Asia.

Everything moves and remains where it was- Euro/US$ is unsteady at 1.31 where it was when the month started, the Yen is at 100 to the Dollar as it was, Gold is up $20/Oz, Oil is up 10% for July and equities continue to break new highs in the US and trade up elsewhere.

When we get frustrated with moving every day and finding we didn't go far, we must remember that the Future comes one day at a time…

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Currencies

- The EUR is stronger on the week and the USD is weaker on the week. This is following the bazooka from Ben last week and the Silence from Draghi. The markets were left in no doubt that the candy store will be left open. EUR maintained the highs pushing up from 1.3060 to touch 1.3177, with any downward momentum simply bought into. It looks like the certainty of what the market can buy is back in motion (for now at least!). The broad based Risk On is quite the reverse of what we had been experiencing prior to Ben's speech last week… however; his speech this week was much more of a non-event. Sideways trading will be the trend for now as there is little news on the horizon and the summer doldrums should lead to lower volumes.

- CHF weakness is front and centre. EURCHF has seen a sustained strength staying above 1.2670 for the majority of the week (except for a quick blip below after Bernanke made a non-speech). USDCHF followed suit and moved higher, but with EURUSD showing strength the USD has underperformed the EURCHF pair. Starting at 0.9465 we see it at 0.9440. Perhaps with Moody's reaffirming the Aaa status of the US debt and the fact that it is "stable" will see a change… or perhaps not. The ratings agencies have little to no sway anymore and we suggest that the summer moves will be erratic on low volume with little direction.

- USDJPY is marching to the beat of its own drum. With low volume and the month end option expiries in the equity market we saw some large moves but at the end… a lot of smoke and air. USDJPY started at 99.25, moved up to 100.50 only to oscillate back to 99.80 and back to 100.40… The waters are muddied for the short term but the Japanese are set on one goal and one goal alone… Competitive Japanese exports, or read another way…. Cheap yen.

- AUD recovered from last week's Aussie-bashing moving up from 0.9050 to 0.9150 today. With the Chairman's speech on Wednesday there was a temporary aberration that allowed more AUD selling at 0.9292, but we fear that with poor fundamentals a weakening data set from China and some "interesting" politics the AUD is heading down the mineshaft…

- Cable saw a decent bounce this week on the news that the BOE (for once!) unanimously backed Carney (for the first time). With 9-0 vote in favor of a stable asset purchase program and no dissents the pound soared from 1.5075 to 1.5250. We have held the highs, but we cannot but help the feeling that the Pound is simply being set up for a fall!

Fixed Income

- After briefly touching 2.63% on Monday, Bernanke caused the US 10 year to rally and the yields to drop. The 10 year dropping to as low as 2.46% with the whole curve following suit, even the 2 year yield moved from 0.35% to 0.29% and the 30 year yield sliding from 3.68% to as low as 3.54%. All of the bonds have sold off a little since the speech but are essentially better bid since the start of the week.

- The German 10-year Bund yields slipped this week as the Bund was bought up by the markets. The yield has moved quite steadily from 1.57% to 1.51%.

- The Spanish saw much better demand for their debt this week after Draghi confirmed the situation to be unchanged on a Monetary Policy from at his last speech. The yields in the open market moved from 4.82% to 4.62% this morning. In fact their latest bond issuance was higher than the amount they planned, signalling that the markets will accept this yield for now and continue to pick up pennies in front of the steam roller. We watch for the turning point.

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- The Italian 10 Year was practically unchanged on the week until yesterday where the yield collapsed from 4.5% to 4.36% this morning. We note that Italy will hold a roadshow where it shall be showcasing some of its assets that it shall look to sell off to fund their deficit… we are still not a 100% sure why they simply don't just collect some taxes to cover the deficit?!?

Equities

- Developed equities rose 0.85% for the week, as of yesterday's close, as measured by the MSCI World index. Equities rose following better than expected economic data and corporate earnings, as well as supportive comments from the Fed on the unlikelihood of tapering in the near future.
- The EuroStoxx rallied 1.11% for the week. European shares gained on the back of better than expected economic data in China and the US, as well as supportive comments from the Fed. Internally, Investor sentiment in Germany unexpectedly fell, raising worrying signals for the country's export market.
- The S&P 500 gained 0.54% for the week (a new all-time high), as of yesterday's close. US shares are set to gain for a fourth consecutive week following better than expected Jobless claims and Business outlook (Phill Fed) figures. Much attention was given to Bernanke's speech on Wednesday where he had maintained his dovish stance, stating that the timetable for tapering asset purchases is not on present course.
- The Nikkei rose 0.57% for the week. Japanese shares gained more than 2% up until Thursday as Chinese GBP figures met expectation of 7.5%, the JPY weakened and on the back of optimism over Japanese and US corporate earnings. On Friday the gauge reversed most of its weekly gains, triggered by profit taking ahead of this weekend's election that should see Shinzo Abe gaining control of the upper house of parliament.
- In terms of sectors, Financials and utilities led the gains (rising 1.87% and 1.69% respectively) on the back of better than expected corporate earnings, while Healthcares and Telecoms lagged (-0.06% and +0.18% respectively).

Emerging Markets

- Emerging Markets equities rallied 1.28% for the week, as of yesterday's close, as measured by the MSCI EM index. Latin American and EM European stocks rose the most (+4.09% and +2.69% respectively), while EM Asian shares lagged (+0.26%).
- The Shanghai composite lost as much as 2.3% for the week. The gauge posted gains at the start of the week as Chinese GDP figures met expectations, on better than expected corporate earnings and increased M&A activity. Concerns about the slowing economy were soon to follow as investors find unlikely that the government will introduce stimulus to prop us economic growth in the near future. In addition, reports of a rise in Chinese home prices dimmed prospects for easing of property curbs.
- The Bovespa posted an additional week of strong gains, with the index rising 4.6%, as of yesterday's close. Brazilian shares gained as speculation rose that the Brazilian central bank will slow the pace of interest rate increases. In addition, commodity producers were supported on the back of signs of US economic strength.

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Commodities

- Commodities rose by 1% over the week, as measured by the S&P GSCI Total Return index. Performance was mixed across the board with Industrial Metals and Agriculture losing 1.31% and 0.50% respectively, while Energy and Precious Metals rose by 1.50% and 0.16% respectively.
- Gold rose by a mere 0.20% for the week, and is currently trading around $1’287 per troy ounce. The metal oscillated between gains and losses as investors hoped to get further clarity on the central bank’s plans to taper its bond-buying program. Gold lost 1.25% during Wednesday after the Fed chief said that the proposed timetable for tapering the buys was not set in stone. However, bullion advanced three times this week on signs of increasing physical purchases.
- Meanwhile, Oil rallied by 1.86% and is currently trading around $107.90 a barrel. Crude Oil futures jumped to a 16-month high on further evidence of strong demand from refiners and signs of improving economic conditions in the US. WTI crude has rallied 12% since the start of July, nearly erasing its discount to global prices and recovering – at least for the time being – its status as a global benchmark.
