Friday, August 2nd 2013

We are closing what has been an interesting week. We closed the month of July with good returns from equities, slight declines in bonds and abatement in volatilities- The VIX falling below 13 and the FX markets calming down, trading in narrowing bands.
On Tuesday the NASDAQ closed at a 13 year high... Awaiting the FOMC meeting and the US GDP figure for Q2... But we saw that US Tax receipts are up, so the economy must be picking-up... Euro zone unemployment was announced at an all-time high of 12.20% and then, the world of Potash was shaken as Uralkali, the world's largest potash producer, upended the $20 billion-a-year industry by abandoning limits on production that underpinned prices and halting cooperation with Belarus that controlled supplies from the former Soviet Union. The decision sent shares of potash producers plunging as much as 27 percent from Israel to Germany to Canada. Another nail in the coffin of inflation as food production costs may be reduced?

The earnings scorecard shows nearly 300 companies on the S&P 500 reporting, with 66% topping Wall Street expectations. However, just four of the index's 10 sectors are seeing earnings growth, with financials boasting a whopping 24.7% increase and materials showing an ugly 11.7% loss. Of the six positive sectors, industrials are barely above water and healthcare is tracking at less than a 2 percent increase, according to S&P Capital IQ. German unemployment dropped for a second month in July, adding to signs the recovery in Europe's largest economy is gathering pace and potentially buoying support for the government before September elections.
Thursday gave us data on China's manufacturing sector which managed to stay in expansionary phase in July, according to official government data, defying forecasts of a contraction. More fuel to the equities… And then The Federal Reserve said persistently low inflation could hamper the economic expansion and pledged to keep buying $85 billion in bonds every month.
U.S. economic growth unexpectedly accelerated in the second quarter, laying a firmer foundation for the rest of the year that could bring the Federal Reserve a step closer to cutting back its monetary stimulus. Gross domestic product grew at a 1.7 percent annual rate, the Commerce Department said on Wednesday, stepping up from the first-quarter's downwardly revised 1.1 percent expansion pace. The recovery from the worst U.S. recession in the post-World War II era has been stronger than previously estimated. It's also been more uneven. The world's largest economy grew at a 2.3 percent annualized rate from the end of economic slump in mid-2009 through last year, compared with the 2.1 percent pace previously reported, revised figures from the Commerce Department showed today in Washington. The update also recast gross domestic product to include spending on things such as entertainment and research and development, adding $526 billion to the value of goods and services produced in 2012.

The Economist's Big Mac Index shows near-parity between the Euro and the US$ - $4.56 for a Big Mac in the USA and $4.56 in the Euro zone… Perhaps the volatility in the FX markets will abate now? It feels that way and the question that arises is where will the volatility pop-up next? We had anticipated FX volatility and now believe that it is truly abating and observe that bonds seem to have settled in a narrow range around the 2.60% for the 10 year US Notes. Should we now fear the VIX? Equities at all-time highs in the US, the usually illiquid month of August might indeed become volatile… Maybe... We must keep our discipline in our asset allocation...
Thursday was the start of August, and it commenced with a bang!!! Big up through records... Gold down a little, US$ up some, oil up 3% but THE "story" is in equities. Facebook trades through its IPO ($38)...

An issue to consider in our risk assessment is the news this week that Iran may achieve the "critical capability" to process low-enriched uranium into material for a nuclear weapon without detection by international inspectors by mid-2014, according to a report by a research group. That and the ongoing Syrian killings, revival of the Iraqi sectarian killings, Egypt's challenges of revolution… the World has not found its peace, even if the global economy seems to be stabilizing. A thought for your weekend- John Paul Getty had a formula for making money- "Get up early, work hard, strike oil..."

Bedrock Newsletter

Currencies

- The USD was the focus of the week, where all eyes were set on Wednesday's conclusive announcement of the 2 day FOMC meeting. The USD modestly gained against the EUR for the first part of the week, with the pair gradually falling from 1.3280 to 1.3220 ahead of the announcement. The dollar shed more than a figure against the EUR (with the pair rising to as high as 1.3340) as the Fed maintained its dovish stance, confirming that they will continue easing until the labor market has improved substantially. The pair was soon to reverse its gains as Thursday's Jobless claims beat expectations, and the ECB announced that they expect interest rates to remain low for an extended period – sending EURUSD below 1.32 before stabilizing at the current level of 1.3220.
- The CHF dropped against both the EUR and the USD as investors dumped the safe haven currency following the supportive remarks from the Fed and the ECB. EURCHF rose from 1.2327 to as high as 1.2385 currently. USDCHF rose from 0.9280 to 0.9380 currently. We expect USDCHF to maintain its uptrend towards parity, as US unemployment data is likely to improve, and in turn increase the probability of tapering by the Fed.
- USDJPY gained close to 2 figures as it was trading below $98.00 for the majority of the week, in anticipation of FOMC announcement. Post the announcement and publication of strong US data, the pair gradually rose to as high as $99.80.
- The AUD broke down, falling from 0.9250 at the start of the week to 0.8900 currently. Aside from USD strength, the Australian government boosted its budget deficit forecast for the current year, increasing expectations that the RBA will cut rates by an additional 0.25% at next week's meeting. We expect the AUD to continue its downtrend until there are signs of a pickup of the country's exports and Housing numbers.
- Cable fell for the week, dropping from 1.5400 at the start of the week to 1.5140 currently. The GBP fell ahead of Thursday's BoE meeting, which left the monetary stimulus targets in place without any change.

Fixed Income

- US treasuries sold off for the week on speculation of a start of the Fed's tapering. The US 10yr rose from 2.562% to as high as 2.688% prior to the fed's announcement. Treasuries recouped almost all of the gains following the dovish announcement, only the resume the downtrend after the strong US data – sending the 10yr yields to as high as 2.730%. The 30yr and the 5yr mimicked the moves with yields rising from 3.620% to 3.777% and 1.363% to 1.498% respectively.
- The Spanish 10yr traded in a choppy fashion, selling-off at the start of the week (with yields rising from 4.616% to 4.675%) ahead of the Fed and ECB meetings. The bonds recouped their losses as Draghi signalled that the worst is over for the region, and reiterated that rates will remain low for the foreseeable future.
- The Italian 10 Year matched the movement of their Spanish counterparts – Oscillating between 4.460% to 4.320% - yet posted modest weekly gains (4.368% currently), on the back of strong Italian PMI Manufacturing data.

Bedrock Newsletter

Equities

- Developed equities rose by 0.57% for the week (as of yesterday's close) as measured by the MSCI World index, on better economic data and as global central banks committed to maintain accommodative monetary stances.
- The EuroStoxx rallied by 1.39% this week, jumping by 1.46% on Thursday after European Central Bank President Mario Draghi reiterated that rates will remain at their present level or lower for an "extended" period.
- Meanwhile, the S&P 500 rose by 0.90%, hitting a record all-time high on Thursday's close – topping 1'700! – on the back of strong data on factory growth and as the Fed said they would keep monetary stimulus in place. US economic growth unexpectedly accelerated in the second quarter and private sector hiring was higher than forecast in July.
- The Nikkei surged by 2.38% for the week on a firmer dollar, upbeat earnings results from heavyweight such as Sony & Softbank and a strong lead from Wall Street. Japanese stocks were also bolstered by dovish statements from the Fed and the ECB.
- In terms of sectors, Information Technology, Industrials and Consumer Staples led the gains (rising by 1.39%, 1.02% and 1.01% respectively), while Materials and Energy lagged (-0.41% and -0.06% respectively).

Emerging Markets

- Emerging Market equities lost 0.77% for the week, as of yesterday's close, as measured by the MSCI EM index. Asian stocks lost the most (-1.26%), while EM European and Latin American shares slid by 0.30% and 0.38% respectively.
- The Shanghai Composite rose by 0.92% this week, as most Chinese stocks advanced after manufacturing unexpectedly strengthened and the government said it will boost spending in urban infrastructure to maintain economic growth. The index was also supported as property companies rose amid growing speculation that the government may relax curbs on the industry to prevent economic growth to slow.
- Meanwhile, the Bovespa lost 0.57% - dragged down by heavyweights Petrobras and Cemig. Brazilian stocks fell until Wednesday as foreign investors backed away from blue-chip shares in Brazil ahead of a highly anticipated monetary policy statement by the US Federal Reserve. The index then jumped by 1.88% on Thursday, bolstered by dovish statements from Fed's President Ben Bernanke. The BRL also slipped to a low of 2.30 versus the USD, a level not seen since March 2009.

Commodities

- Commodities rose by 1.56% over the week, as measured by the S&P GSCI Total Return index. Performance was mixed across the board with Energy and Industrial Metals rising by 2.17% and 1.36% respectively, while Precious Metals and Agriculture lost 0.80% and 0.39% respectively.

Bedrock Newsletter

- Gold declined by 3.33% this week and is currently trading around $1’290 per troy ounce. The metal fell for a sixth consecutive day on Friday, in the longest run of losses since May, heading for the first weekly decline in a month as US economic data backed the case for less stimulus. Gold traders were bearish for the first time in six weeks as accelerating US economic growth and weaker sales of physical bullion curbed demand for the metal.
- Meanwhile, Oil rallied by 3% and is currently trading around $107.85 a barrel, supported by upbeat economic data from the US, Europe and China suggesting stronger demand going forward. Also, traders preferred to focus on positive US economic data rather than an EIA report showing that crude stockpiles had risen against expectations.
