Bedrock Newsletter

Friday, August 9th 2013

The first week of August is over, or nearly. We started on the back of last Friday's US Non-Farm Payroll data disappointing- NFP: 162k vs. consensus 185k, prior 188k (revised from 195k) Unemployment rate: 7.4% vs. consensus 7.5%, prior 7.6%. Overall it's a softer report. Then Israel-Palestine talks in D.C. came and went. No news as expected.
But we did see some significant data-
The U.S. trade deficit narrowed sharply in June to its lowest level in more than 3-1/2 years as imports reversed the prior month's spike, suggesting an upward revision to second-quarter growth. The Commerce Department said on Tuesday the trade gap fell 22.4 percent to $34.2 billion, the smallest since October 2009. The percentage decline was the largest since February 2009. The main explanation for this decline can be found in Export growth. The US$ ought to rise as demand for it has increased. But it fell. Some say that the improved trade deficit suggests a slowdown in the US economy as basically it has more imports than exports, so the currency should fall. Is this an axiom?
Then we saw Chinese data- Their trade surplus narrowed- Surplus 17.8 vs. expected 27.2bn. July exports up 10% but imports were significantly up (27%). This is a very significant move, possibly suggesting that they are truly moving to consumption?
And to cement this thought, China may be considering its' one child policy. Wow!!! Invest in Procter & Gamble for their diapers and in Nestle for Baby Formula...

Well, equity markets have held well with declining volatility as measured by the VIX. The news must have been OK…

We wonder though about Detroit. Bankrupt but owns $2 billion worth of art- A city of 600'000 people? That is over $3'000 per person… We remember when Chrysler went bankrupt and then sold its building for $500million…

Greece has 28% unemployment, Fisher of the Fed says that France is a huge problem, Spain is hurting, Italy is in its' usual mess, and yet the Euro is rallying (which doesn't help the economy). Egypt can't find its way out of its political quagmire, Tunisia is experiencing some new storms in its long "springtime", Syria is disintegrating, Iraq isn't healing its sectarian troubles and Al Qaeda is said to be regaining strength in Yemen. On the positive side, Iran's new President is making conciliatory noises.

With all this happening and much more not happening, Dr. Doom and Gloom, Marc Faber, has now likened the markets to 1987 and expects a huge fall before year-end. But others think otherwise- The upside on the S&P 500 index in the next six to 12 months could be 1,800 or even 1,900, Thomas Lee, chief U.S. equity strategist at JPMorgan Chase, told CNBC on Thursday. A move to 1,900 would represent a 12 percent increase from current levels.
The Skyscraper Index is a concept put forward in 1999 by Dresdner Kleinwort Wasserstein, which showed that the world's tallest buildings have risen on the eve of economic downturns. Business cycles and skyscraper construction correlate in such a way that investment in skyscrapers peaks when cyclical growth is exhausted and the economy is ready for recession. Unlike earlier instances of similar reasoning ("height is a barometer of boom"), skyscraper projects are viewed in this model as a predictor of economic crisis, not boom. Well, at this moment some very tall buildings are under construction in several centers around the world…

An ancient Greek built a wonderful geometry based on three axioms, of which one has been demonstrated to be false. Euclid postulated that parallel lines never intersect and we all live and work in buildings constructed based on this axiom. Although parallel lines do intersect, we are safe… Wrong perhaps, but immaterial. In Finance, there are many axioms- unprovable beliefs; GDP drives markets, trade balances drive currency values, etc. Or not…
Have a nice week end.

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Currencies

- The Greenback continued falling against major currencies on reduced likelihood that the Fed will start tapering its monetary easing measures, following last week's weaker than expected Employment report. The DXY – the broadly known Dollar Index – fell to as low as 80.97, the lowest level in 8 weeks.
- The USD dropped to a 7 week low against the EUR, with EURUSD rising from 1.3275 to 1.3383 currently. The EUR outperformed on continued signs that Europe's economies are stabilizing and the Euro region as a whole has returned to growth, dampening demand for US assets.
- The CHF modestly gained against the EUR (with EURCHF falling from 1.2342 to 1.2308 currently) as investors took out risk and returned to the safe haven currency. As a result, USDCHF mirrored the movements of EURUSD, falling from 0.9292 to 0.9200 currently.
- USDJPY fell sharply from 99.00 to below 96.00 – the lowest level since mid-June - before slightly correcting to the current levels of 96.70. The pair fell in spite of the BoJ's pledge to expand the monetary base by 60tn Yen.
- The AUD recovered sharply from last week's massacre – rising from 0.8900 to 0.9145 currently. The Aussie briefly fell at the start of the week as the RBA reduced its cash rate by 0.25% to 2.5%, as expected. However, the AUD was quick to recover as the market viewed RBA's follow-up statement as less dovish than expected. Additional support was attributed to Chinese Industrial production figures beating expectations, and raising hopes for a pick-up in Australian exports.
- Cable rose sharply for the week from 1.5300 to current levels of 1.5550. The focus of the week was Wednesday's BoE meeting, where GBPUSD initially collapsed to as low as 1.5210 following the hawkish announcement that the bank will link the outlook for its benchmark interest rate to unemployment and inflation, and will maintain its accommodative policy until the unemployment rate falls to 7%. The pair quickly bounced more than 2 figures as the bank raised its growth projections for 2013 and 2014 (at the respective rates of 1.5% and 2.7%).

Fixed Income

- US treasuries remained relatively flat for the week, offsetting an early selloff caused by increased likelihood that the Fed might start tapering following a better than expected ISM services figures. Treasuries have since recovered as 10yr note auction attracted above average demand. The US 10yr yield remained flat at 2.597%, the 30yr yield fell from 3.685% to 3.647% and the 5yr rose from 1.358% to 1.366%.
- The Spanish 10yr gained for the week, with yields falling from 4.568% to 4.525%. The bonds gained following better than expected European and Chinese economic data, adding evidence that the region is recovering.
- The Italian 10 Year traded in a similar fashion, with yields falling from 4.253% to 4.203%.

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Equities

- Developed equities dropped by 0.39% this week (as of yesterday's close) as measured by the MSCI World index. World equities started the week by a 3-day selloff prompted by talk the US Federal Reserve could soon wind back its stimulus program, before bouncing back on Thursday on signs of resilience in China's slowing economy.
- The EuroStoxx rose from Wednesday to Friday, resuming a five-week rally after a two-day dip as better-than-expected earnings from heavyweight German companies and positive Chinese trade data boosted European shares across the board. As a result, the index rose by 0.3% over the week.
- Meanwhile, the S&P 500 rose on Thursday, snapping a three-day string of losses as positive data from around the world gave investors a reason to buy. Still, US stocks are down for the week (-0.71%), having pulled back from record levels on concerns the Federal Reserve will start to reduce its stimulus efforts this year as the economy recovers.
- The Nikkei collapsed by nearly 6% this week, losing 4% on Wednesday as the yen strengthened amid Fed taper talks and as the Bank of Japan is not expected to unveil any new stimulus measures in the near future.
- In terms of sectors, Consumer Discretionary and Telecom were the main laggards (losing -0.76% and -0.73% respectively), while Materials, Healthcare and Consumer Staples fared better (+0.43, -0.11% and -0.14% respectively).

Emerging Markets

- Emerging Market equities lost 0.93% for the week, as of yesterday's close, as measured by the MSCI EM index. Asian stocks lost the most (-1.56%) followed by EM European shares (-0.95%) while Latin America was the only region to be positive (+0.55%).
- The Shanghai Composite rose by 0.99% this week, responding with little enthusiasm to China's better-than-expected July trade numbers on Thursday, suggesting investors are wary of reading too much into one month of strong data after steady signs of slowing growth this year. China's exports rose 5.1% in July from the same month a year earlier, while imports rose 10.9%.
- Meanwhile, the Bovespa started the week on a negative tone falling by over 2% as speculation mounted that the US Federal Reserve will soon reduce its stimulus program. However, the index strongly bounced back on Thursday after a report showed China's imports increased more than forecast, sparking speculation that the economy is improving in Brazil's top trading partner. As a result, the index rose by 0.99% for the week.

Commodities

- Commodities dropped by 2.12% over the week, as measured by the S&P GSCI Total Return index. Performances were mixed across the board with Energy losing the most (-3.12%) followed by Agriculture (-0.20%), while Industrial Metals rallied by 2% and Precious Metals were about flat (+0.13).

- Gold lost some ground this week (-0.20%) and is currently trading around $1’309.30 per troy ounce. Bullion started the week on a negative trend as doubts over when the Federal Reserve will begin scaling back monetary stimulus kept pressure on the metal, before strongly rebounding on Thursday as the dollar dropped for a fifth straight session.
- Meanwhile, Oil tumbled by close to 3% and is currently trading around $103.90 a barrel. Crude Oil fell for a fifth-consecutive session on Thursday, as traders looked past record-high Chinese oil imports to focus on the potential scaling back of the US Federal Reserve's stimulus measures. Crude also settled down after the Energy Information Administration announced that stockpiles of crude fell by 1.3 million barrels last week.
