Bedrock Newsletter

Friday, August 23th 2013

Summer holidays are winding down with August. The high temperatures are fuelling a new conflict at the tip of the Iberian peninsula- England and Spain are back at each other's Gibraltar throats… Where will this go? Back to the future? Egypt is falling deeper into mayhem, some side or another in Syria now using chemicals- will this hoist Obama on his own verbal petard? He did place his "red-line" at chemicals last year… And to top it all off, India's Rupee is in a free fall. But then, Angela Merkel is leading in the German polls and markets like stability. And yet, Monday gave us the fourth consecutive down day in the US. Go figure.

Wednesday we saw the Fed minutes; Federal Reserve officials were "broadly comfortable" with Chairman Ben Bernanke's plan to start reducing bond buying later this year if the economy improves, with a few saying tapering might be needed soon. Markets slipped (traders can't read?) on fears of Fed tapering? "Almost all committee members agreed that a change in the purchase program was not yet appropriate," and a few said "it might soon be time to slow somewhat the pace of purchases as outlined in that plan," according to the record of the Federal Open Market Committee's July 30-31 gathering release.
The DJIA falls back to July 3rd level, erasing all July's gains and we saw the VIX back to that day in July's level. Metals of all sorts down, the US$ up a point against the Euro at 1.335 from 1.345
So far this month, U.S. bond mutual funds and ETFs have seen outflows of $19.7 billion, more than the $14.8 billion of outflows in July. August's outflow is already the fourth-highest on record, TrimTabs said, adding that since the start of June bond funds have lost $103.5 billion or 2.7 percent of total assets. The sell-off in bonds pushed yields on the U.S. 10-year to 2.8656 percent on Monday morning, the highest since July 2011.

And now for the good news- The global economy showed signs of improvement on Thursday with factory output improving in two of the world's largest economies. Eurozone flash composite purchasing managers index (PMI) rose to 51.7 in August, from 50.5 last month, beating estimates. It was the best reading since June 2011. In China, HSBC's preliminary reading of PMI data crossed the key 50-level, which signals expansion, for the first time in four months.

On Thursday the NASDAQ systems broke down. Over 3 hours without a trade. Pandemonium was limited to financial commentators on CNBC and Bloomberg TV- Predicting the End-of-the-World-as we know it… But the markets themselves shrugged it off as if it were no-more than a half-day off. The DJIA rose as the mess continued in the virtual next-door as did the S&P 500. Only bonds fell with the 10 year Treasury Note trading to yield 2.93%

Then we saw that while the government is expected to say next week that the unemployment picture continues its gradual improvement, one indicator shows this jobs market is the worst in a year and a half. Widely followed pollster, Gallup, puts the nation's unemployment rate at an ugly 8.6 percent in August, a startling jump from the 7.8 percent the organization recorded for July. When counting the underemployed, the rate zooms to 17.7 percent, off its 2013 high of 18.2 percent. The government puts the jobless figure at 7.4 percent, and 14 percent when including the underemployed and those who have quit looking. Do you trust statistics? If Gallup is to be believed, Tapering is beyond the horizon…

Is Taper synonymous with an apple? "An apple a day keeps the Doctor away it is said… If you throw it hard enough" (Churchill)

Enjoy the end of your Summer.

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Currencies

- EURUSD is completely unchanged on the week at 1.3345 – we feel like a broken record using the same words! On Tuesday, however, the move was upwards for the EUR. Stops and technical trading saw the EUR reach 1.3452. In the absence of people, computers will test the limits! Well that was short lived and with the Fed wording seemingly slightly hawkish with Tapering becoming the new buzz word, we saw the USD pull back from its lows. The DXY bottoming at 80.75 and reaching as high as 81.79 yesterday and the EUR back to where it started the week.
- EURCHF was unchanged on the week at 1.2345. The pair briefly moved to as low as 1.2285 on Tuesday with the safe haven currencies being the favoured resting place for cash. USDCHF had a similar move although with the strength in EURUSD the down move on Tuesday was more pronounced, causing the pair to trade back to 0.9147. We have since moved higher to 0.9250 and the pair looks to have found a bottom for now.
- USDJPY strengthened throughout the week from 97.00 on Tuesday to as high as 99.15 this morning. The pair had little Japanese news flow this week and the main driver in low liquidity was the general USD bid tone that emerged throughout the week. EURJPY also rallied on the week moving from as low as 129.29 on Tuesday to as high as 132.34 this morning.
- AUD had a poor trading week and saw the Aussie drop throughout the week from 0.92 to 0.8932 and would appear to be settling at the moment around 0.9000. Unfortunately, it looks like Stanley Drückenmiller (George Soros' trader who broke the bank of England in 1992) was very right and the weakness of the AUD continues.
- The Pound is unchanged on the week. The summer doldrums really do come true in August. Currently it is 1.5610, briefly having been as high as 1.5718 only to settle back lower. With better than expected GDP figures this morning the pound took a little spring in its step, but we are not sure how long that will last…
- EM currencies in general had a tough week… A VERY tough week. The BRL moved from 2.38 to as weak as 2.4550 yesterday. The weakness in the Real is in fact causing the central bank to bring in a $60Bn currency fund to defend the Real… The ZAR moved from 10.05 to 10.44 at the highs. And the Turkish Lira briefly touched 2.00 to the USD!
- But the big story on the wires was the INR, having moved from 61.79 where it closed last week to collapse to 65.56 on Thursday. To put that number in context… INR has NEVER been that weak, in fact this year alone the USD has gained 18% against the Indian Rupee.

Fixed Income

- US Treasury yields followed the song by MPeople, "Moving on up… time to break free. Nothing can stop me!". The yields moved from 2.81% to peak at 2.93% for the 10 year and the 30 year moved from 3.84% to 3.94% (although we are back at 3.86% now) on the back of the release of the Fed minutes which gave more credence for tapering to start sooner rather than later.
- The German 10-year Bund yields moved lower over the first few days of the week from 1.92% to 1.84% on European worries... only to soar to 1.96% today. Yields are moving up and there does not seem to be too much in the way of them for now.

- Spanish debt seemed to compress again versus the German Bunds, with the yield now at 4.48% there seems to be a very big buyer of Spain at the moment keeping a lid on the yields… There are only two people that have deep enough pockets, The IMF and the ECB… either way this is NOT sustainable and the yields must rise at some point.
- The Italian 10 Year has been sold off again this week, with the yields peaking yesterday at 4.42%. The ten year is in fact trading almost at the same levels as Spanish debt.

Equities

- Developed equities dropped 0.73% for the week (as of yesterday's close) as measured by the MSCI World index. Shares lost on the back of Fed stimulus worries, overshadowing positive macro data globally.
- The EuroStoxx shed 1.96% for the week. European stocks sold off at the start of the week amid speculation that the minutes of the Fed's meeting will provide further details on the timing of the scale back of its monthly bond purchases. Stocks recouped some losses on Thursday following news that German manufacturing exceeded expectations – indicating further improvements for the European economy.
- The S&P oscillated between gains and losses in anticipation for the Fed's meeting. Stocks fell following the meeting as the Fed provided little clarity on when they might start paring back on stimulus measures, with a continued divide amongst the officials on timing of the tapering. Equities rebounded on Thursday on the back of positive US and global data – helping the gauge end the week flat.
- Japanese equities had a volatile week, with the Nikkei dropping more than 2.5% on Tuesday on strengthening of the Yen and on concerns that Asian-Pacific economies are slowing. Stocks pared their weekly losses on Friday's session following positive US and EU data – indicating that the recoveries are improving.
- In terms of sectors, Telecoms and financials were the main laggards (losing 1.54% and 1.40% respectively), while Healthcare and Info-Tech fared better (+0.35% and 0.00% respectively).

Emerging Markets

- Emerging Market equities lost 3.74% for the week, as of yesterday's close, as measured by the MSCI EM index. Latin American and Asian stocks lost the most (-4.35% and -3.98% respectively), while EM European shares lost less severely (-1.67%).
- The Shanghai Composite lost 0.53% for the week. Chinese shares fell to a 2 week low as Fed concerns overshadowed better than expected Chinese manufacturing report (50.1 vs. 48.2 exp.).
- The Bovespa lost 0.28% for the week, as of yesterday's close. The gauge lost more than 2% on Tuesday due to concerns that capital outflows will accelerate amid prospects for reduced US stimulus. However, losses were recovered on Thursday following better than expected Chinese manufacturing data, coupled with a weak Real, which helped lift exporters.

Commodities

- Commodities declined by 1.02% over the week, as measured by the S&P GSCI Total Return index. Industrial Metals dropped the most, losing 2.11%, followed by Agriculture (-1.25%), Energy (-0.91%) and Precious Metals (-0.17%).
- Gold was about flat, swinging between gains and losses as investors weighed expectations the US Fed will reduce stimulus against more physical demand. Bullion moved in narrow range on Thursday and Friday after strong US jobs and manufacturing data stoked lingering concerns about an imminent pull-back in the Federal Reserve's stimulus measures. Also, taper talks pushed the dollar and US Treasury yields higher, preventing any rise on Gold this week.
- Meanwhile, Oil tumbled by 2.15% and is currently trading around $105.10 a barrel. Crude-oil futures fell for a third consecutive day on Wednesday after the minutes from the Federal Reserve's latest policy meeting heightened concerns that less economic stimulus could hit demand for the fuel. Anxiety over the Fed minutes outweighed even a positive US oil-inventory report. However, oil prices bounced back on Thursday and Friday as jobless claims fell and after unexpectedly strong manufacturing data out of the Euro zone and China eased concerns over the global economic outlook.