Bedrock Newsletter

Friday, September 6th 2013

Into September which historically is the worst month for stocks (September markets have history against them, with the Dow down 60 percent of the time since 1950), and this year, the calendar is a minefield for the markets. From the Federal Reserve's mid-month meeting to German elections, Japanese tax changes, and U.S. budget debates; there's been a long list of potential catalysts for pain. The list of worries for markets this September just keeps getting longer: Add to that the sell-off in emerging markets which, as the Fed signals a move to normalize rates, has resulted in a jump in interest rates for emerging economies and has driven the Indian rupee to all-time lows. The looming possibility of a U.S. strike on Syria is the latest worry and is to be determined by the U.S. Congress when it returns Sept. 9.

The trade deficit in the U.S. widened in July from an almost four-year low as imports rebounded and exports cooled. The gap increased 13.3 percent to $39.1 billion from $34.5 billion in June that was the smallest since October 2009, the Commerce Department reported this week. The median forecast in a Bloomberg survey of 72 economists called for a $38.6 billion deficit. Americans bought record auto imports and more fuel. A pickup in domestic consumer and business demand will probably prompt U.S. companies to sustain purchases from trading partners in the third quarter. At the same time, slower global growth may weigh on exports as markets from China to Europe struggle to gain momentum. The trade shortfall excluding petroleum grew to $20.4 billion in July from $17.1 billion. This in itself is a clear indicator that the American stock markets have been correct in predicting economic growth. FX markets have taken somewhat of a back seat to movements in core rates over the past twenty-hours. In the late NY session the US10yr broke the 3% level for the first time since mid-2011. This was on the back of very strong US services ISM – fastest pace of expansion since 2005. Understandably this price action has garnered a good deal of overnight press-coverage. However, it is not only the long-end which is in focus. The US short end has also dramatically re-priced over the last week or so – 2yr yields have rocketed from 40bp at the start of the week to 53bp now. 10yr yields are currently just shy of the 3% level at ~2.998%.

The U.S. dollar looks set to shake off its summer lull as the factors for a renewed rise appear to be firmly in place. Upbeat economic data, rising Treasury yields and Federal Reserve tapering expectations have boosted sentiment on the greenback, which hit a six-week high around 100.20 yen last Friday, and held close to a seven-week peak hit against the euro on Thursday following dovish comments from the European Central Bank. Well, all this is subject to today’s Non-Farm Payroll data from the US, where we expect a 200K figure and a steady 7.40% unemployment rate. Any serious deviation will rattle the directions- Much better and interest rates will rise further and the US$ will continue its ascent, much below and the opposite will occur. Your guess is as good as ours, but we will know together very soon…

This week we got the “big news” of Microsoft (MSFT) buying Nokia’s mobile-phone production. Two losers make a winner? Or is this a great deal? Trying to compete with AAPL and GOOG? Well, MSFT fell some, Nokia rose over 30%. Then we had Vodafone divesting of Verizon for many billions. The phone business is being changed… What’s next?

On the Syrian front- nothing new. Obama in his corner with little to no support, the G20 meeting in St.Petersbourg is in a stalemate with Putin vehemently against any military action. We are of two minds here, as to which vision is the right one- In July, Sky News reported rebel claims that they have sarin chemical weapons and delivery systems. Assertions that rebels have no chemical weapons are denied by the rebels themselves. The Syrian government has said the rebels have gas. Both sides have delivery systems. The rebels have even showed Sky News some of their capabilities. Has any media service bothered to investigate if the rebels used gas on August 21? Clearly, it isn’t a shut and closed case here. Oil continues its slow grind-up, gold is off though as the US$ rises.

For your weekend, consider this thought: Yesterday's the past, tomorrow's the future, but today is a gift. That's why it's called the present. For your worries about the world and money, remember what Abraham Lincoln said- “The best thing about the future is that it comes one day at a time”…

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Currencies

- EURUSD moved lower for the week, dropping from 1.3212 at the start of the week to 1.3124 currently. The USD rallied to a 7-week high as better than expected manufacturing data, coupled with an ok ADP report, caused the case for the start of tapering to seem very strong. All eyes will be on today's Nonfarm payrolls report for further signals. In addition, the EUR got slammed on Thursday as Draghi's speech was more dovish than expected, saying that he's not enthusiastic about the return to growth and has lowered the region's growth forecast for 2014.

- The CHF weakened for the week as investors dumped the safe haven currency as sentiment towards riskier assets increased following positive macro data in Europe and the US. In addition, some weakness was attributed to the SNB reaffirming their commitment to the Franc cap as long as conditions warrant and have warned of the property market overheating. EURCHF and USDCHF rose from 1.2307 and 0.9313 respectively at the start of the week to 1.2394 and 0.9444 currently.

- USDJPY gained for the week, with the pair rising from 98.40 at the start of the week to 99.60 currently. Monday saw the majority of the weekly move as positive manufacturing data from China and Europe, as well as speculation that the threat of military actions against Syria might ease, damped demand for haven currencies. The pair reached as high as 100.23 before consolidating to current levels as US treasuries halted their sharp weekly decline, causing a USD selloff.

- AUD gained for the week – rising from 0.8935 at the start of the week to 0.9140 currently against the USD. The Aussie gained following strong Chinese PMI data as well as Australia's GDP figures coming in better than expected. The RBA kept its official cash rate at 2.5% and stated that housing and share prices are benefitting from record low cash rate whilst they are still supporting the prospects of a weaker AUD to help rebalance the economy.

- Cable gained for the week with GBP rising from 1.5525 at the start of the week to as high as 1.5667 on Thursday following very positive Manufacturing, Construction and Services data, indicating that the UK economic outlook is improving. GBPUSD has since consolidated to the current levels of 1.5587 on the back of USD strength following positive US data.

- The Rupee received much attention as the Indian currency jumped as the new Central bank governor eased restrictions on overseas borrowing and said that containing inflation is his top priority. USDINR rose from 66.10 to as high 68.58 prior to the announcement and has since fallen to the current levels of 65.47.

Fixed Income

- US Treasuries resumed their selloff this week with 10yr yields rising from 2.783% at the start of the week to above 3% on Thursday following better than expected US data causing the prospects for Fed tapering seem increasingly likely. Yields have since consolidated to the current levels of 2.977% as investor speculation grew that yields at 3% might be sufficient to compensate for the Fed cutting its bond purchases this month.

- Spanish bonds are set to end the week relatively flat (4.549% currently on the 10yr). Bonds gained at the start of the week following positive European data, but have since fallen on the back of dovish comment by the ECB.

- The Italian 10 Year fell for the week with yields rising from 4.40% at the start of the week to 4.518% currently. Italian bonds underperformed as Italian services output shrank more than expected, raising speculation that the country might need to endure additional reforms on worries that the country is not benefitting from the recovery as in the rest of Europe.

Equities

- Developed equities rose by 1.69% this week (as of yesterday's close) as measured by the MSCI World index. Global equity markets rose as investors took in stride a potential limited American military strike against Syria and data from around the globe suggested a growing world economy.
- The EuroStoxx rose by 1.96% as European Central Bank President Mario Draghi reiterated that interest rates will stay at a record low for an extended period, after the 17-nation euro area returned to growth in the second quarter while the Federal Reserve said it saw a modest to moderate US economic recovery.
- The S&P advanced by 1.35%, staging the longest rally since July, after a private report said US service industries expanded at the fastest pace in eight years, while Labor Department data showed the number of workers claiming jobless benefits slid more than economists predicted.
- Meanwhile, the Nikkei surged by 3.52% for the week, as a weaker Yen stimulated export-oriented stocks. Also, fresh signs of a pickup in global manufacturing activity and a delay in potential US military action against Syria helped boost risk appetite.
- In terms of sectors, Industrials and Financials posted the biggest gains (advancing by 2.31% and 2.27% respectively), while Utility and Consumer Staples lagged (-0.08% and +0.34% respectively).

Emerging Markets

- Emerging Market equities rose by 1.95% for the week, as of yesterday's close, as measured by the MSCI EM index. Latin American and EM Asian stocks rose the most (+2.92% and +1.89% respectively), while EM European shares lagged (+0.86%).
- The Shanghai Composite gained 1.95% as airlines, banks and shipping companies rallied on speculation Shanghai's Free-Trade Zone will lure more business into the nation's commercial hub. Shanghai's Free-Trade Zone, which was approved by the State Council on August 22 and may open as early as the end of this month, is part of Premier Li Keqiang's drive to shift the economy toward services and sustain long-term growth.
- The Bovespa rallied by as much as 4.69%, as of yesterday's close after encouraging data from China and the US boosted shares of mining companies. Also, data on Tuesday showed China's services sector grew steadily in August as domestic demand picked up. China is Brazil's biggest trading partner and a key destination for Brazil's commodities exports such as iron ore, soy and petroleum.

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Commodities

- Commodities were about flat this week, as measured by the S&P GSCI Total Return index. Agriculture and Precious Metals lost the most (-1.52% and -1.58% respectively) followed by Industrial Metals (-0.62%) while Energy was the only sector to be positive (+0.38%).
- Meanwhile, Gold lost about 2% for the week and is currently trading around $1'370 per troy ounce, as prices were pressured by uncertainties about the timing of a US military strike on Syria and expectations for reduced stimulus in the US.
- Oil rose by 0.93% for the week and is currently trading at $108.70 a barrel. Oil prices rose as the increased likelihood of a US military strike on Syria raised concerns over supplies in the Middle East and as data showed a sizable decline in last week's US crude inventories.

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