Friday, September 20th 2013

What a week! This one started on Sunday- Larry Summers withdraws from race to Fed Chairmanship. Monday's trading showed a strong view- Bond yields fall, equity futures rise. We did say the markets would prefer Janet... Now that Larry Summers has pulled his name for consideration to be the next Federal Reserve chairman, President Barack Obama's safest choice is Janet Yellen, but keeping Ben Bernanke may still be a possibility, said Tony Fratto, former White House press secretary in the George W. Bush administration. Well… Ben did give us reason to like him even more than we already did, just three days later…

On Tuesday we read that core and base CPI for august were +0.10% down from 0.20% for July. Clearly, the QE programs have not brought-on the feared inflation, or were they successful in averting deflation? 10 year Note rallies to yield 2.82% The central bank's two key measures that it uses to gauge the success of its dual mandate leave something to be desired as well. Unemployment has fallen to 7.3 percent, but that is in large part the product of a labor force participation rate stuck at a 35-year low. Moreover, the rate remains well above the 6.5% level the Fed has targeted before it will begin raising rates. Inflation, meanwhile, is barely 2%, well below the Fed's 2.5% target and indicative of an economy that is not clear of a deflation spectre. The initial tapering talk triggered a sharp stock market sell-off amid fears that a rate increase would not be far behind, and multiple Fed officials have gone public to insist that is not the case. The economy may be stronger but it's not that strong, at least not in the eyes of the people who make that decision. On Wednesday, Bernanke announced his bombshell- No tapering at this time! Not $10Bn, not $15Bn, no tapering at all- The FOMC announcement was much more dovish than expected. Not only did the Fed postpone tapering, the FOMC also guided toward a slower tightening pace than the market's projections. Bernanke's comments suggest that this was a deliberate attempt to ease financial conditions and reverse some of the recent market-induced tightening. While this is a clear green light for risk taking, the Fed is doing so at the expense of transparency. The guidance on asset purchases is once again incredibly vague, and could contribute to renewed bouts of volatility in the months ahead. In explaining the very low rate forecasts, Bernanke said that the headwinds to recovery - which include a slow recovery in housing, continued fiscal drag and continued effects from the financial crisis - are expected to abate only gradually. In response to a question on when rates will get to 4%, Bernanke said that it will likely take a **few more years after 2016!** As an anecdote, since 1790, the average 10 year Treasury yield has been 5.18% as per CNBC analysts.
Markets had a huge jump on this news! 10yr yield dropped to 2.71%, S&P 500 spikes to all time high, the US Dollar collapses and Gold flies up 5%! On This Fed news, even Thursday's words from Iranian President Hassan Rouhani saying that his country will never develop nuclear weapons and that he has the authority to strike a deal with the West, passed unnoticed, together with John Kerry's shuttling around the Syrian debacle, riots in Egypt and other world news…
The Swiss central bank forecasts growth at 1.8% and unemployment staying at 3.2% for 2014 and decided to hold its ceiling on CHF/Euro at 1.20 European Central Bank President Mario Draghi has repeatedly highlighted the fragility of a euro-area upswing, saying this month that the recovery "is only in its infancy." Industrial output contracted more than economists forecast in July and European car sales slid in August to the least since records started in 1990. So, the Euro Zone and Switzerland will not be doing anything to let or make interest rates rise anytime soon.

US Government shutdown is the next issue to concern us- Whilst a government shutdown is messy and embarrassing, it is potentially nothing like a default. The longest shutdown was 22 days over 1994-95. Social Security checks would be unaffected, health care spending would continue but non-essential government employees would be furloughed, passport offices closed, and national parks shut. So don't plan a trip to Yellowstone in early October! But then, if we get some fiscal relief, it could add to growth… that is bullish equities.

Antoine de Saint-Exupery said "True happiness comes from the joy of deeds well done, the zest of creating things new." Thank you Ben! Live NOW, pay later...

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Currencies

- The Dollar started the week with little change in anticipation to Wednesday's FOMC meeting, where general consensus was that the Fed will commence scaling back asset purchases. The greenback collapsed across the board to a 7 month low as the Fed announced that they will not taper the rate of purchases until there is further confirmation of improvement in the outlook. The broadly used Dollar index (DXY) dropped more than 1% on the news – from 81.10 to 80.10 – and has since remained at depressed levels, although to a lesser extent than after the news.
- EURUSD is set for its biggest weekly gain in 2 months – rising from 1.3355 at the start of the week to 1.3570 post the FOMC announcement, before settling at current levels of 1.3510. All eyes are set on next week's ECB meeting to provide further guidance on any change in monetary policy, more so than to this weekend's German election.
- The CHF gained for the week, with EURCHF falling from 1.2340 at the start of the week to 1.2320 currently, and USDCHF from 0.9235 to 0.9120 currently. The SNB once again reiterated the importance of the cap on the Franc, even though the dangers to the Swiss economy from the European debt crisis recede.
- USDJPY was little changed for the first half of the week – oscillating around 99.00. Following the FOMC announcement the pair sold off to as low as 97.80, before rebounding to current levels of 99.40 as the rally in equities damped demand for safe haven currencies.
- AUD rose sharply for the week – rising from 0.9335 against the greenback at the start of the week to as high as 0.9530 post the FOMC announcement. The pair has since given back some gains – currently trading at 0.9400 – as the RBA vocalized their frustration with the sharp rise of the Aussie, stating difficulties for some industry sectors and the increased likelihood of an additional interest rate cut.
- The Pound rose against the Dollar from 1.5935 at the start of the week to as high as 1.6160 post the FOMC announcement. However, the pair has since dropped to current levels of 1.6010 following news that UK retail sales fell 0.9% in August and US posted strong Jobless and Business outlook figures.
- The EM currencies posted even higher gains against the Dollar, with INR and BRL gaining more than 2% post the announcement.

Fixed Income

- US Treasuries posted the strongest gains since 2011, with initial gains (2.881% to 2.796% on the 10yr) on Monday following the withdrawal of Summers from the Fed race, meaning that the next chairman might be less aggressive in slowing monetary policy. The no taper FOMC announcement sent 10yr yields even lower (as low as 2.67%!) as treasuries have already been pricing-in a cut in purchases. However, yields have since come back up and are currently at 2.76%.
- European bonds benefitted as well from the bond rally with yields on Spanish 10yr dropping to as low as 4.213% post the Fed announcement, but has given back some gains (4.340% currently) even though Thursday saw a successful 6 month auction whereby the country has already covered almost 83% of the planned sales for the year.

- The Italian 10 Year had as well a strong week with yields dropping from 4.531% to 4.299% currently.
- Data shows a 17th consecutive week of outflows from EM bonds funds (but only ~$290m vs. -$1.1bn the prior week). The majority of these outflows were from local currency funds (-$350m vs. -$685m). Hard currency funds actually saw a small inflow – perhaps indicating a turn in sentiment. 2013 outflows stand at $2.6bn versus inflows in 2012 of $39bn.

Equities

- Developed equities rose by 2.57% this week (as of yesterday's close) as measured by the MSCI World index, as global equity markets surged and the dollar tumbled after the US Federal Reserve stunned markets by choosing not to cut back on its asset-buying program for now.
- The EuroStoxx advanced by 2.15% over the week, closely following the rally on global markets, with European shares hovering near 5-year highs on Fed's decision to delay a cut in its monetary easing measures.
- US stocks rallied to record highs (close to 1'730 at the highest on Thursday's early trading), up over 2% after the Federal Reserve surprised markets by deciding against scaling back its stimulus program that has helped fuel Wall Street's rally of more than 20% this year.
- Meanwhile, the Nikkei rose by 2.34%, holding around a two-month high until today, supported by exporters as the yen retreated against the dollar after the US Federal Reserve decided to keep cheap money flowing.
- In terms of sectors, Materials and Industrials rose the most (advancing by +3.49% and +3.35% respectively), while Energy and Telecom lagged (+1.57% and +1.46% respectively).

Emerging Markets

- Emerging Market equities rallied by 3.62% – as of yesterday's close – as measured by the MSCI EM index. EM European stocks surged by 6.92% followed by Latin American and EM Asian stocks (+4.69% and +2.64% respectively).
- The Shanghai Composite dropped by 1.98% over the week. China's stocks fell for a second day on Tuesday, led by material producers and financial companies, after technical indicators signalled shares were overbought. Stocks slightly bounced back on Wednesday's thin trading before the start of Chinese holidays.
- Meanwhile, the Bovespa rose by 2.41%, as of yesterday's close. The index rose by as much as 2.64% on Wednesday following the Fed's decision to keep intact its stimulus measures. BRL also rallied sharply, giving some relief to the Brazil's Central Bank which has been intervening to defend its currency.

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Commodities

- Commodities dropped by 1.04% for the week, as measured by the S&P GSCI Total Return index. Energy and Agriculture were the worst performers (falling by 1.88% and 0.02% respectively), while Precious and Industrial Metals gained 4.97% and 3.26% respectively.
- Gold rallied by 2.4% and is currently trading around $1’358 per troy ounce. Gold rose over 4% on Wednesday after the Federal Reserve surprised investors by announcing it would stick to its bond-buying program. The Fed’s bond purchases have pumped cash into the financial system, raising fears about inflation or dollar weakening, and investors generally view gold as a hedge against either scenario.
- Meanwhile, crude oil dropped by 2% and is currently trading around $106 a barrel, as concerns over a possible supply disruption in the Middle East persisted during the week. Oil prices fell because the deal between America and Russia over getting rid of Syria's chemical weapons is seen as reducing the chance of US military action in Syria, and the possible spread of violence in Middle East. Also, Crude fell sharply on Thursday on headlines about increased Libyan production and easing tensions over Iran.

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