Bedrock Newsletter

Friday, September 27th 2013

A week has gone by after the Fed's surprise no-Tapering move. And things are back to square one in terms of equity markets. The initial upwards reaction quickly petered out, after market participants realized that if the Fed does not taper, well, it must mean that things are not so great after all! In fact, reality quickly sank in and other (major) issues came in the forefront. The US has two issues looming: federal spending authority must be extended by September 30 to avoid a partial government shutdown, and the debt limit must be raised by late October to ensure the Treasury can continue to pay its obligations. We dare not think of a repeat of the dreadful events of august 2011 where politicians pushed the US to the brink just because of political wrangling and posturing. As is often said, history does not repeat itself but often it rhythms.... so beware of the next few days and weeks as we can suddenly see unpleasant market events as a reaction to those events.

In Europe, the week started with the welcome re-election of Angela Merkel at the helm of Europe's biggest economy. We will see how she will conduct the European debt problems that are still unresolved and getting worse, not better.
In France, public debt kept climbing, reaching 93.4% of the gross domestic product at the end of the second quarter, data showed on Friday. We just do not see how France will not, sooner or later, be attacked by the market. The Government is trying desperately to increase revenues, thereby angering every day another layer of the population. Business leaders were angered by a new levy of 1% on gross profits for companies with revenues above €50m, estimated to raise €2.5bn next year, which comes on top of the standard corporate tax rate of 33% and a number of other taxes and social charges.

After the August angst concerning the Middle East, September proved to be the month of "détente". Iran's new President gave a conciliatory speech at the UN General Assembly and interviews to the US TV channels. He also met with French President Hollande. And yesterday, for the first time since the 1979 revolution, a meeting between US Secretary of State and the Iranian Minister of Foreign Affairs took place. Maybe reconciliation, although not immediate, could be seen in the future? This would of course have major implications for Oil and Geopolitical events

After last week's pledge from Bernanke that short term interest rates will remain at a low level for a long time, Long Term rates declined, and the 10 Year Treasury Note stabilized at around 2.65% from a peak of 3%. This must have been good news for the Fed as they feared the consequences of higher long term rates. However, it must be a question of when and not if the rates will start going back up. We have seen last week that even the market does not believe in QE infinity and that for the good of the economy and the markets, this massive liquidity has to be withdrawn at a certain point in time. This Money printing cannot go on for ever without major (negative) consequences.
For the moment, the market as a whole appears stable. Equity markets retreated from their record highs, but not much. Long Term interest rates seem to have stabilized in a more comfortable range for all market Participants and Central Banks. The US Dollar, although lower against the European Currencies, remains firm against the Emerging Market currencies as well as against the Commodity Currencies. Gold seems to have found a new floor at around 1'300$ an ounce and may well rise again as we do not see short term interest rates rising in any part of the World. Add to that the Euro-Zone debt problems and a looming new LTRO program coupled with the powerful monetary easing going on in the US and in Japan, and it should be a fertile ground for higher Gold prices.

We head into this week end hoping for an agreement (that will eventually come anyway!) between Obama and Boehner, but remain mindful of politicians and their ability to do always the most unexpected and counterproductive things!

Enjoy the unusually mild late September weather and have a relaxing week end.

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Currencies

- EURUSD moved gently lower through the week on the fact that no one talked this week! The Fed's Bullard re-iterated to the markets that although the stimulus was being continued, and not reduced, that this did not mean that they would not reduce the monthly purchase schemes in October (or at another suitable time in the future!). This moderation of the market's reaction last week saw the USD regain a little of the lost ground is sustained post FED announcement. EURUSD moved from 1.3550 to as low as 1.3460 by Wednesday although we are now back to the 1.35 figure.
- EURCHF dropped from 1.2290 to 1.2265. As EURUSD is driving higher it would appear that perhaps not the entire market is comfortable with the current economic situation, seeing large demand for the CHF. USDCHF moved lower on the week seeing a move from 0.9134 down to 0.9080. With Syria out of the headlines for now and the debt ceiling issue rising fast on the horizon with the FED announcement out of the way, we wait with a wry smile for the next US FED policy and the next Government rhetoric that will cause the next market move... without paying the blindest bit of attention to the data.
- USDJPY had a strong start to the week maintaining the highs of 99.40 for a very short while. As the week progressed the pair slid lower on little data and a retracement of the moves from last week to see the pair trading at about 98.60 as we head towards the weekend.
- AUD had a strong start to the week seeing the pair climb from 0.9360 to 0.9460, only to tumble back to 0.9320 by this morning. There does not really seem to be a light at the end of the tunnel that will see the AUD back above parity any time soon. We fear that the Aussie is on a downward trend still and would not hold positions in it.
- Sometimes a change is as good as a rest… sometimes it would seem the markets believe it is better! Carney and the BOE seem to have forced the market to make an about-turn on the Pound. The pound has nearly regained all of the loss that it sustained YTD. The Pound rallied from 1.60 to as high as 1.6132 overnight. We opened the year at 1.6245, so perhaps the market has that figure in its sights. For now we really do not understand why the economics of the country are not equating to a lower GBP, so we choose to stay on the sidelines from a view point, awaiting the final puzzle piece to explain why it is not weaker.
- The EM currencies had a tougher week than previously and saw both BRL and ZAR sliding quite dramatically – from 2.19 to 2.25 and from 9.83 to 10.16 respectively. INR shrugged off the EM troubles and although peaking on Tuesday at 62.90 moved to trade at 61.80 by this morning.

Fixed Income

- As the waters calmed after last weeks FED announcement the treasuries have continued to be bought gradually throughout the week. The yields on the 10 Yr notes moved from 2.75% to 2.65% this morning. The overall range of the yields seems to be trading between 2.50% to 3.00% for now and we don't really expect that to change until the landscape changes in the magic land of money-printing-Nirvana, also known as the United States of America. If in doubt, print your way out!
- After the German elections there is no majority but Merkel is still on top. The Bunds followed the US Treasuries and the yields traded well from 1.98% to as low 1.81% yesterday morning. With little to shake the current news-free environment we believe we should see some sideways trading until the next data point comes out to shake the landscape again.

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- Spanish and Italian debt would now appear to be trading almost pari passu, with both 10 year bonds trading in a similar fashion all week. Spain moved from 4.28% to hit 4.24% only to be finishing the week at about 4.36%... Italy moved from 4.28% to as low as 4.20% but is coming to the end of the week at about 4.36%... With Berlusconi's supporters in the government threating to stop the political juggernaut by withdrawing support, we could be about to witness a rather fantastical come-back by the Italian Bunga-Bunga Party leader. Something tells us that the Italian 10 year might be in for a tough time ahead!

Equities

- Developed equities lost 0.42% this week (as of yesterday's close) as measured by the MSCI World index. Equities lost on the back of market attention shifting to US debt concerns which are likely to increase volatility in the equity market for the weeks to come.
- The EuroStoxx is set to end the week relatively flat (-0.14%). European shares lost ground early in the week on the back of worries that Angela Merkel will struggle to form a coalition after Sunday's election. In addition, PMI Manufacturing readings came in lower than expected across the board, yet PMI Services readings have indicated an improvement. Stocks were quick to rebound as German confidence data came in the highest since mid-2012. Shares have since not seen any sharp movement, with all eyes set on the US debt ceiling discussions.
- The S&P 500 lost 0.66% for the week, as of yesterday's close. US shares gave back the post-FOMC gains as market attention switched from the Fed's tapering expectations to the uncertainty over US budget discussions, with a likely government shutdown in sight. In terms of data, Consumer Confidence dropped, housing and Jobless data saw continued improvements and GDP remained unchanged at 2.5%.
- The Nikkei remained flat for the week (+0.11%). Japanese shares saw weakness until mid-week, as the Yen strengthened due to the uncertainty in the US and Europe and Japanese Machine Tool orders fell. However, equities have since recouped their weekly losses as the Yen weakened on speculation the Japanese government will cut the corporate tax rate.
- In terms of sectors, Healthcare and Consumer Staples posted the largest losses (-1.22% and 1.21% respectively), while Telecoms and IT shares gained 1.63% and 0.27% respectively.

Emerging Markets

- Emerging Market equities fell 1% – as of yesterday's close – as measured by the MSCI EM index. EM European shares were the worst performers (-1.40%) followed by EM Asian and Latin American stocks (-1.04% and -0.76% respectively).
- The Shanghai Composite dropped 1.45% for the week. Chinese equities rallied at the start of the week as Chinese Manufacturing data came in with the strongest reading in 6 months. Chinese shares have since reversed and posted weekly losses as profit taking in Free-Trade companies – which are set to benefit from the government's plan for the shanghai free-trade zone - was triggered as valuations were viewed as excessive following the sharp rally over the last few months.

- The Bovespa lost 0.60% for the week, as of yesterday's close. Brazilian shares gained at the start of the week as China posted strong manufacturing data, supporting the prospects for Brazilian producers. The gauge has since given back the gains following a selloff in Energy stocks on prospects of improved US-Iran relations. Additional losses were attributed to US budget worries, as well as a selloff in Chinese equities.

Commodities

- Commodities dropped 0.25% for the week, as measured by the S&P GSCI Total Return index. Energy and Precious metals were the worst performers (falling 0.83% and 0.64% respectively), while Agriculture and Industrial metals gained 1.63% and 0.27% respectively.
- Gold lost 0.27% for the week and is currently trading around $1'322 per troy ounce. Gold saw some gains mid-week as US budget concerns caused a selloff in the Dollar. However, the metal gave back the gains following positive US data.
- Crude oil dropped 2.15% for the week and is currently trading at $103.00 a barrel. Crude prices dropped on eased Syria concerns, as well as improved prospects for US-Iran relations. In addition, data showed US inventories unexpectedly rising while demand slipped.
