Bedrock Newsletter

Friday, October 18th 2013

Another week passed under the American government's shenanigans. The manufactured "crisis" that came with the debt ceiling fight and unwarranted threats of a debt default has now passed, just as it has passed each time the debt ceiling was up for renewal since 1917. Yes, you read that right. The law establishing a debt ceiling was passed in 1917 and Congress has never failed to raise it. Despite all the noise, the fact remains that the fiscal deficit has made steady and dramatic improvement since 2009. Rather than being dysfunctional, divided government is delivering stable spending and a falling deficit.
This said, we bring you an interesting perspective on the whole budget, deficit and debt ceiling issue; The US has an annual Tax revenue of $2.17 trillion, a budget of $3.82 trillion, thus causing an increase in debt of $1.65 trillion. Current National debt is at $38.5 trillion and the recent budget cuts amount to $38.5 billion. Bringing these scary figures down to personal levels, we remove 8 zeros from each number and get a household budget- Family income of $21'700, annual expenses of $38'200 causing an increase in credit-card debt of $16'500, outstanding debt of $142'710 and budget cuts so far of $38.50. Does not look good, does it?

So here is another way to look at the Debt Ceiling- One day you come home from work and find that there has been a sewer backup in your street… And your home has sewage all the way up to your ceilings. What do you think you should do? Raise the ceilings or remove the mess? ☺

On Monday the Russell 2000 hit a record high. China's foreign-exchange reserves rose last quarter by the most in more than two years, a sign the government's efforts to protect growth attracted money. Reserves were a record $3.66 trillion at the end of September, up from $3.5 trillion in June.
On Tuesday Fitch Ratings put the US government's "AAA" credit rating on 'rating watch negative' saying that the standstill on the U.S. debt ceiling negotiations risks undermining the effectiveness of the country's government and political institutions. Wednesday Stocks closed at session highs with the Dow up 200 points and the S&P within 1 percent of hitting its record, after Senate leaders announced a long-awaited compromise to raise the debt ceiling and put an end to the government shutdown.
After Wednesday's short euphoria on "The Can" being kicked down the freeway to January, Thursday morning "the deal" euphoria fizzles... IBM earnings disappoint, GS revenues are soft, Google beats top and bottom, up 5% after hours... whilst overall the S&P earnings grow, it is below estimates... Then we saw China's gross domestic product (GDP) rise 7.8 percent yoy in the third quarter, up from 7.5 percent in Q2. Where are the fears of a Chinese slowdown of just few months ago? Jobless claims came in worse than expected at 358K vs. 330K The dollar fell the most in a month versus the euro and most other currencies, the Philly Fed report at 19.8 down from 22.3 didn't hurt the rally. The yield on ten year Treasury Notes falls to below 2.60%, US$ falls more, Thursday the S&P 500 closed at a new record. Gold and silver up strongly…
All is good then in the land of opportunities… at least to January when the circus comes back to DC… Or maybe sooner, as Puerto Rico has become for the U.S. commonwealth what Greece is to the EU? The island has come to the headlines with more than $70 billion in debt, falling in value as concerns about its solvency are gnawing at investor confidence…
As we said before, if it isn't one thing it is always something… We remind you that the best performing economy in Europe was Belgium, the country without an operating government for over 450 days- perhaps this can help understand the rise in US equity markets through the freezing of US government? Anarchism has its merits, or so it seems…

Let us go to our weekend with a hope for yet lower interest rates and a higher stock market for the rest of this year, starting today.
Apparently there is nothing that cannot happen today (Mark Twain).

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Currencies

- The Dollar was once again at center stage, with the greenback oscillating between gains and losses in reaction to increasing optimism towards the deadline for raising the debt ceiling. On Wednesday, the senate leaders agreed on a deal to reopen the government and raise the ceiling - sending the USD higher across the board (with the DXY index rising to as high as 80.75). The Dollar strength was however short lived as the currency plunged on Thursday as investor focus turned to the likely damages caused by the disruption and the probable postponement of tapering – sending the DXY index to current levels of 79.62.
- EURUSD traded in the range of 1.3475 – 1.3600 prior to the deal, and has since shot up to as high as 1.3692. Internally, Eurozone industrial production figures beat expectation which have also contributed to the EUR strength.
- EURCHF is set to end the week where it started (1.2345), with the pair rising to 1.2375 on market optimism, and printing as low as 1.2311 following the debt ceiling announcement. USDCHF as a result mirrored EURUSD's movements, rising to 0.9178 before selling off to current levels of 0.9024.
- With no news this week from Japan, USDJPY responded as well to the developments in the US. The pair gradually rose to 99.01 at the first half of the week before shedding more than a figure (97.85 currently) on the USD selloff.
- The AUD gained more than 2 figures during the week – gradually rising from 0.9422 at the start of the week to 0.9650 currently. The RBA had suggested at the beginning of the week that the bank is increasingly comfortable with current interest rate settings and therefore see no urgency to cut rates. However with the Aussie rising to a four month high, pressure is increasing for additional cuts to combat further gains.
- The GBP rallied against the USD for the week - rising from 1.5950 at the start of the week to 1.6196 currently. Aside from the USD weakness, GBP saw strength on the back of better than expected retail sales figures - which rose to a 5 year high – providing supportive growth prospects for the UK economy.
- USDBRL traded in tandem with the other major currency pairs – rising to as high as 2.1940 early in the week before falling to current levels of 2.1523 currently. Forecasters are falling in line with the view that Brazil will keep the pace of interest rate increases after the central bank said inflation remained a threat to economic growth.

Fixed Income

- US treasuries rose sharply for the week. Rates on 10yr treasuries rose early in the week (to as high as 2.756%) on increasing speculation of a default which also caused the least demand for bills at the weekly auction since 2009. Post the debt deal announcement, US 10 year yields dropped to the lowest level in two months (2.546% currently!) amid market attention shifting to the implications of the government shutdown on economic growth which will convince the Fed to keep purchasing bonds into next year.

- Spanish bonds gained early in the week – with yields dropping to 4.242% - as Eurozone industrial figures beat expectations and the country sold bills at the lowest yield since April 2010. Yet the bonds were soon to give up the gains as US growth concerns triggered profit taking, and by so sending yields up to 4.320%.

- Italian bonds outperformed their Spanish counterparts – posting a weekly gain. Yields dropped from 4.295% at the start of the week to 4.199% currently.

Equities

- Developed equities rallied by 1.88% this week (as of yesterday's close) as measured by the MSCI World index. World shares were bolstered by the US Senate agreement on a plan to raise the debt ceiling and reopen the federal government.
- European stock markets broke a six-day winning streak on Thursday, after US lawmakers agreed to end the government shutdown and raise the debt ceiling, but failed to come up with a longer-term solution for the country's finances. The EuroStoxx is set to end the week up 1.40%.
- The S&P 500 rose by 1.76%, as the US Congress announced on Wednesday they approved a deal to end a partial government shutdown and pull the world's biggest economy back from the brink of a historic debt default. However, the deal will finance the government only until January 15 and raise the borrowing limit until February 7, sparking concerns that Congress is just kicking the can down the road.
- Meanwhile, the Nikkei rose by 1.09% hitting a three-week high and extending gains into a seventh day on Thursday as sentiment was buoyed after the US Congress approved a last-minute deal to end its fiscal standoff and avoid a damaging default on government debt.
- In terms of sectors, Telecom and Financials rose the most (+3.27% and +2.60% respectively), while Industrials and Information Technology lagged (+0.55% and +0.82% respectively).

Emerging Markets

- Emerging Market equities rose by 1.05% – as of yesterday's close – as measured by the MSCI EM index. Latin American and EM European shares posted the strongest gains (+1.80% and +1% respectively) while Asian stocks lagged (+0.54%).
- The Shanghai Composite dropped by 1.54% for the week. China's stocks fell to the lowest level this month as companies linked to Shanghai's free-trade zone extended losses on concern valuations were excessive. The benchmark has rebounded 12% from its four-year low on June 27, boosted by speculation the free-trade zone will attract foreign companies and allow for financial liberalization.
- Meanwhile, the Bovespa surged by 4.16% (as of yesterday's close), after the US Senate crafted an agreement to end the government shutdown and raise the debt ceiling. Brazilian stocks have gained ground in recent weeks on bets the worst of an economic slowdown has passed, helping stocks climb back from a recent slump.

Commodities

- Commodities dropped by 0.55% for the week, as measured by the S&P GSCI Total Return index, mainly driven down by Energy (-1.03%) and Industrial Metals in a lesser extent, while Precious Metals rallied by 4.18%.

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- Gold surged by 3.90% and is currently trading around $1’321 per troy ounce, supported by dollar weakness and belief that a temporary deal to avoid historic US debt default might also prompt the Federal Reserve to hold back from reducing its additional monetary stimulus.
- Meanwhile, crude oil lost 1% and is currently trading at $101 a barrel. Crude prices sharply fell on Thursday after a US debt deal failed to assure markets that uncertainty in the world's top oil consumer is over. Crude also fell amid rising oil inventories and signs of weaker near-term demand in the US.
