Bedrock Newsletter

Friday, October 25th 2013

And so we move away from the political (non)impasse of the government shutdown and move onwards to the "IPO" of Obamacare. The much talked about Obamacare seems to be having a few technical – or should we say technocratical – glitches, much like the IPO of Facebook that we saw all those months ago. The question is, will the political market allow it to drop only to recover, or will the glitches prove too much and we end up seeing another political impasse that will not be surmountable (until a solution is found, of course). We note that Bernankecare (QE), in all its glory, seems to be ignoring any political turmoil and steadily pumping out money to support the World's engine. It would seem that based on a simple comparison of Obamacare and Bernankecare, perhaps Ben should run for President? Well maybe that is a little extreme, but perhaps he could do some seminars for them instead…?

Moving onto the markets, we have entered into earnings season with a rather positive outlook on the numbers so far. A few surprises along the road though, with Caterpillar falling over 6% on weaker earnings – many were expecting the Chinese data improvement to have fed through into orders for the heavy machinery giant, with mining still lagging, it would appears that this expectation was misplaced, for now at least. Although Boeing, even with the issues it has been suffering with the Dreamliner, beat the expectations and jumped up 7%. With a broad-based positive outperformance of analysts' expectations we have seen the rally in equities continue to new highs. Perhaps we should pay less attention to the analysts…

Monday was relatively quiet as the market waited for the new Non Farm Payroll numbers to be issued on a Tuesday – a new schedule for the markets! With a weaker number than expected but the reality that the government had been in shutdown for many days prior to the data release, the numbers were taken with a pinch of salt. The S&P 500 reaching new highs of 1,752, but the DJIA not quite reaching the peak reached in October. With renewed confidence in the markets, a lack of data points to distract and Big Ben at the helm of the printing presses the US Treasury market is relatively unperturbed and remains at a little over 2.5% for the 10Yr and even the very short term paper is back to more or less 0.03%.

After the "surprise" cautious stance taken by the FED at the last meeting resulting in the USD to weaken against most major currencies, it looks like the data that we are now seeing supports their view. As we have said many times, when Bernanke speaks we should listen. We hope that Janet Yellen will continue the good Doctor's work in maintaining a stable marketplace. Looking at the words of Bernanke we should therefore note that he has said that he will slow the pace of investment and possibly in the early months of 2014. Slowing investment of an ever-growing juggernaut, but still re-investing the coupons/dividends is not the same thing as removing stimulus. If you start with $100 and every year you earn 7% with each year re-investing your 7% at the same rate, after 10 years you would almost have doubled your money. If however, you increase your capital by adding in an additional 7% in "injected money" each year, it only takes 6 years to reach the same figure. The point being that even stopping the stimulus, but maintaining the income reinvestment would mean that they continue massive purchasing in the market place to get them to the same place, just at a more tempered pace.

We leave you with this thought about the size of the US debt from the great Irish poet, Oscar Wilde; "Anyone who lives within their means suffers from a lack of imagination."

Currencies

- The Dollar extended its losses for an additional week, to a two year low. The Greenback posted modest gains early in the week – with the DXY rising to 79.82 – ahead of Nonfarm Payrolls report. Upon the NFP release – where only 148K jobs were added vs.180K expected – the Dollar fell across the board, with the DXY reaching as low as 79.04, as the prospects for tapering are being pushed forward into 2014.
- EURUSD was little changed at the start of the week – trading around 1.3675. The pair rose more than a figure to 1.3800 post the employment figures, and have remained at these elevated levels since.
- EURCHF is set to end the week roughly flat (1.2340). The pair sold off to 1.2284 post the NFP report, before recouping the losses. As a result USDCHF weakened together with the broad Dollar selloff – falling from 0.9040 to 0.8940 currently.
- USDJPY gained at the start of the week – with the pair rising to as high as 98.48 - as the Yen sold off following comments by Kuroda that policy easing will go on until inflation reaches 2%. The pair sold off at the latter part of the week on the Dollar weakness, with the pair currently trading at 97.25.
- The AUD sold off for the week as risk appetite faded as speculation rose that China is leaning towards tightening its policy. The Aussie rose to as high as 0.9758 against the USD by mid-week, before falling to current levels of 0.9590.
- Cable had a volatile week, where the pair initially sold off to 1.6120 on Dollar strength, before rising to as high as 1.6255 post the NFP report. The pair has since given back its gains as the BOE said on Wednesday that policy makers were unanimous in rejecting higher interest rates. Finally, the pair was supported on Friday on the back of strong UK GDP data - bringing cable to current levels of 1.6195.

Fixed Income

- US treasuries rose sharply for an additional week. Treasuries posted minor losses at the start of the week – with the 10yr yields rising to as high as 2.617% - in anticipation for Tuesday's NFP report. Following the softer than expected report, Treasuries rallied - with yields falling to as low as 2.469% - as the case for tapering became even less likely for the upcoming months.
- Spanish bonds traded in tandem with the rest of the bond market with yields on the 10yr initially rising to 4.275% before falling to 4.098% as the periphery is expected to benefit from the Central banks' cautious monetary policy.
- Italian bonds traded in line with their Spanish counterparts for the majority of the week – with yields initially rising to 4.202% before falling to 4.081% post the Payrolls announcement. However, the bonds sold off at the latter part of the week (4.209%) as consumer confidence figures came in worse than expected.

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Equities

- Developed equities rose by 0.61% this week – as of yesterday's close – as measured by the MSCI World index. Amid a mixed bag of corporate earnings, global shares' gains stemmed from China's encouraging manufacturing data and expectations that the US Federal Reserve will continue its stimulus measures – hopes which have propped up the equity market and economy for much of the year.
- European stocks lost ground over the week, as a wide range of heavyweight companies reported quarterly sales that missed projections – as a result, the EuroStoxx dropped by 0.30%.
- The S&P 500 rose by 0.43%, boosted by signs of growth in China's manufacturing sector, while rising expectations that the Federal Reserve will keep its stimulus efforts in place for months kept US Treasuries yields near three-month lows.
- Meanwhile, the Nikkei collapsed by 3.25%, slumping by 2.75% on Friday, hit by the yen's strength against the dollar and as fears grew that tight credit conditions in China could put the brakes on the world's second-largest economy. The index also lost close to 2% on Wednesday as disappointing earnings from Caterpillar drove heavy-equipment makers Komatsu and Hitachi Construction Machinery sharply lower.
- In terms of sectors, Industrials and Materials rose the most (+1.73% and +1.65% respectively), while Energy and Financials lagged (-0.30% and -0.25% respectively).

Emerging Markets

- Emerging Market equities dropped by 1.08% – as of yesterday's close – as measured by the MSCI EM index. Latin American and Asian shares lost the most (-1.63% and -1.19% respectively) while EM European stocks were flat.
- The Shanghai Composite slumped by 2.78% for the week, as the PBOC's decision to abstain from injecting liquidity on Tuesday gave rise to concerns over possible monetary tightening in the world's second largest economy, sending money-market rates to three-month highs. It was the second time since last week that the central bank did not inject liquidity as regulators showed signs of concern that loose liquidity may be fuelling another round of risky credit growth.
- Meanwhile, the Bovespa dropped by 0.91% (as of yesterday's close), as concerns that officials would tighten monetary policy in an effort to control inflation, offset encouraging economic data from top trade partner China.

Commodities

- Commodities dropped 2.47% for the week, as measured by the S&P GSCI Total Return index. The main losing sectors were Energy (-3.38%) and Agriculture (-1.09%), while Precious Metals rallied 2.90%.
- Gold rose by 2.04% and is currently trading around $1'343 per troy ounce. Gold rose for an additional weak as the soft Payroll report caused a Dollar selloff as the Fed's tapering prospects were pushed forward.

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- Crude oil lost as much as 3.91% and is currently trading at $97.30 a barrel. Oil sold off sharply as US stockpiles were reported to have risen to a 3 month high, and supplies increased by 5.2MM barrels.

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