Friday, November 15th 2013

The cold weather is upon us all, warmed only by the words of Janet Yellen which have helped the equity markets rise to new (again) highs. We were pleased when she became a candidate to lead the Fed and delighted that she has assumed the Chairmanship even before being confirmed…

Monday traders and strategists said that the market rally is likely to continue through December for a deceptively simple reason: Stocks have rallied significantly all year, and those gains are likely to beget further gains. In other words, since most fund managers have returned less than the market, there will be a temptation to buy into the end of the year to try to capture some last-minute gains - or at least make it look like they have owned the winners all year. Year-end melt-up, here we come…
Tuesday, new records on DJIA and S&P 500, VIX remains low- no fear is visible, 10yr notes steady at about 2.70%.
Wednesday morning gave us China's 3rd plenary meeting which lacked details and substantive policy announcements; Asian stocks lower, and then U.S. stocks rose, with the Standard & Poor's 500 Index climbing to another record level, as retailers led gains amid optimism over the holiday shopping season. Emerging-market stocks extended the longest slump in seven years whilst Treasuries advanced and oil rebounded from a five-month low. Janet Yellen, nominated to be the next chairman of the Federal Reserve, said the economy and labor market are performing "far short of their potential" and must improve before the central bank can begin reducing monetary stimulus. "We have made good progress, but we have farther to go to regain the ground lost in the crisis and the recession," she said. So, no "Tapering" in the immediate Yellen future…
Thursday, Janet Yellen said she is committed to promoting a strong economic recovery and will ensure monetary stimulus isn't removed too soon. "I consider it imperative that we do what we can to promote a very strong recovery," she said.
Yellen is so dovish, perhaps she will INCREASE monthly Fed purchasing to $100Bn from the current $85Bn… maybe a surprise "reverse-taper"?
With this as the backdrop, we are faced with a Win/Win situation- stimulus to continue if things don't get MUCH better, and if they do get so much better, pure economics will drive markets higher yet… Equities have support here, no matter what… Bonds on the other hand, go nowhere either way…

The big problem we are all facing is double- 24.1% is Euro zone youth unemployment with Spain, Italy and Greece over 40%... We need big GDP growth to heal and the second problem that arises from the lack of growth is deflationary pressures. If people don't work and earn, they do not spend, prices fall to generate volumes. Will interest rates rise? Hardly likely…
We are also facing a dilemma- Central banks have been keeping interest rates low to spur financing and growth- but perhaps they are missing the point: the demographics are changing- the young, who are building their lives don't qualify as borrowers (unemployed) so the low rates don't really help them, corporations are cash rich so don't borrow either whilst the growing retired community has lost purchasing power with low or near zero returns on their portfolios, thus don't have the revenues from which to spend. So why not try higher rates to spur demand from where the capital lies?

Maybe Janet Yellen should remember that a person who wants to lead the orchestra must turn their back on the crowd. Have a fine weekend ☺

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Currencies

- EURUSD has recovered somewhat from the lows that we saw last week. The pair started the week at 1.3360 and has gradually moved to as high as 1.35 yesterday morning. In light of the absence of any large amounts of data, the news flows have all pointed towards waiting patiently for what the Chairman-Elect (not a real title!) would have to say yesterday. The Honorable Janet Yellen spoke with gravitas, a sense of respectful admonition on the future management of the Federal Reserve. More than all of this, she continued the dovish tone that the FOMC minutes have displayed for the past few years. We are slightly lower this morning at 1.3455, but we are a long way from the highs of above 1.38… Has the USD bull market started prior to Christmas?

- EURCHF traded higher through the week from 1.2310 to 1.2350. USDCHF moved from 0.9240 to 0.9120 but has stabilized this morning at a little over 0.9180. The USD in general has been relatively static this week and a feeling of walking on air is surrounding the markets. If the Dollar puts in a good base at these levels, we believe that the CHF should continue to weaken.

- USDJPY started the week at 99.00 but breached the 100 figure this morning for the first time in a few months reaching as high as 100.43. Along with the Nikkei Index which moved above 15,000, a first since May, this weakening of the Yen is very much welcomed in Japan. We feel that in all likelihood this JPY downtrend should continue from here, and even gain traction.

- AUD started the week at 0.9385 and has traded down in light of the mild strengthening of the USD. As the Chinese third plenary finished and there was no clear consensus, the stability in the AUD seems to be wavering. Without decisive direction it looks like the AUD is set to weaken. With rate cuts priced in and a structurally weak economy, there is not the most wonderful outlook in the land of Kangaroos and Koala bears.

- Carney clearly read our letter last week and answered our question of, how do you cut rates in the UK that are at 0%? His response… you raise them. Yes, exactly what economics 101 suggests… let us just remove our tongue from our cheek. A 0.1% reduction in unemployment and 50K jobs created over the expectation do not a healthy economy make! Nevertheless, the Pound strengthened from 1.5885 to trade back to 1.61 yesterday evening. We cannot conceal our thoughts that unless there are concrete structural improvements in the debt levels and the creation of economic stability, then the Pound has a long way to fall. Perhaps Carney is trying to lead the orchestra, but with only a string quartet in front of him…

- USDBRL had a bumpy week but seems to be where it started the week. The Real moved from 2.3050 to 2.35 and back again.

Fixed Income

- The US 10Yr started the week at 2.75% and eventually peaked at 2.79%, only to slide to 2.69% on the Yellen news that she will remain dovish and keep the rates low. Again the rates are within the boundaries of 2.5% and 3.0%. Nothing really is happening and there is a lot of smoke leading to oscillations but no real change in sentiment. We believe eventually rates will rise and probably ahead of the final Fed announcement signally either a Tapering or a real rate increase.

- The yield on the German Bund has slipped out of its sombre range to move into a lower range of yields! The Bund traded as high as high as 1.8% but traded down to 1.70% post Yellen's televised first performance. The German economy has been supported by keeping real wages low, the German economy may be booming and the German corporates may well have deep coffers, but unfortunately Mr and Mrs Schmidt have not really benefitted from the economic recovery.

- Spanish yields seemed to follow the direction and speed of the German Bund, as seems to be their want of late moving from 4.12% on Monday to as low as 4.04% this morning. Spain is maintaining its yields at very low levels, being supported by low Central Bank borrowing and a slow recovery domestically. The real issue they have is that their employment levels are so high that when interest rates rise, any debt left in the private sector may well wipe out the remaining discretionary spending left in their pockets. Spain is happily content to be at these levels but we do not see a long term future for rates to remain this low… However, that is for another day…. Mañana Mañana.
- Italy followed suit for the Spanish yields and moved from 4.16% to 4.06% this morning. As the periphery of EU seems to be tending to parity with each other, we believe that when rates turn the spread explosion that will take place will see a rebalancing effect to the economies. Italy shall be amongst those that suffer. There has been no wage rebalance and certainly no domestic demand to increase their tax collection. However, Berlusconi may come back in a new suit and with a new face… Miracles may happen!
- We thought that we should mention Greek debt. Two years ago Greek 10 year debt was trading at 25% yields. By Christmas the yield had exploded to nearly 35% and by the point of the write downs the yield was 45%. We are now at 8.45%, the same levels at early 2010. Has Greece really improved its economy enough to justify these levels? With unemployment running at 40% we have serious doubts as to the viability of debt even at 8%. Perhaps they will simply write down their debt again, but we are fearful of complacency and this is exactly what seems to abound at the moment.

Equities

- Developed equities gained 1.03% for the week – as of yesterday's close – as measured by the MSCI World index. Equities gained on the back of strong Chinese Macro data, as well as supportive comments by the Fed on continued economic stimulus.
- The EuroStoxx index gained 0.44% for the week. European stocks gained following strong Chinese data and the new Fed nominee Janet Yellen backed stimulus. In terms of data, Eurozone growth rose 0.1% in Q3, with a significant slowdown in the German and French readings (+0.3% and -0.1% respectively).
- The S&P 500 gained 1.07% for the week, as of yesterday's close. US stocks gained – extending records for benchmark indices – as the Fed's Yellen said the central bank should take care not to withdraw stimulus too early, as the economy is still operating below its potential.
- The Nikkei surged for the week by as much as 7.66% (the biggest weekly jump since December 2009). Aside from supportive news from the US and China, Japanese shares rallied as the Yen weakened and Japan's Q3 GDP beat expectations (+0.5% vs. +0.4% expected for the quarter).
- In terms of sectors, Consumer Discretionary and Healthcare rose the most (1.74% and 1.48% respectively), while Utilities and Energy rose less (+0.43% and 0.49% respectively).

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Emerging Markets

- Emerging Market equities dropped 0.35% for the week – as of yesterday's close – as measured by the MSCI EM index. EM Asian and EM European shares lost 1.10% and 0.10% respectively, while EM Latin American shares gained 1.92%.
- The Shanghai Composite gained 1.41% for the week. Chinese stocks gained for the week as Industrial production increased more than expected (10.3% vs. 10.0% expected), and amid speculation that the government will unveil detailed changes in economic policy as soon as next week.
- The Bovespa gained 2.30% for the week, as of yesterday's close. Aside from supportive news from the US and China, Brazilian shares gained as corporate earnings beat expectations which attracted investor appetite due to cheap valuations in the country.

Commodities

- Commodities gained 0.89% for the week, as measured by the S&P GSCI Total Return index. Energy was the best performing sector, rising 1.56% for the week, while Industrial Metals and Agricultures lost 2.03% and 0.45% respectively.
- Gold lost 0.37% for the week and is currently trading around $1'284 per troy ounce. The metal sold off at the start of the week on the back of a stronger Dollar. However, the metal has since recouped much of its losses on the back of the Fed's support of continued stimulus and on high seasonal buying.
- Crude oil lost 0.91% for the week and is currently trading at $93.74 a barrel. Crude futures fell to a 5 month low on Tuesday following news the US stockpiles climbed for an 8th week, countering speculation that the Fed will maintain economic stimulus.
