Friday, December 6th 2013

First week of the last month is over! We have had choppy and declining equity markets driven by economic data and the resulting resurgence of “tapering” fears. For some perspective here, we note that since 2007 the S&P 500 index has not had a negative month of December!
We note with apprehension the arrival of a new era- The era of the commercial drone! Amazon, the e-retailer (AMZN) disclosed that it is working on drone deliveries... 30 minutes after ordering… And maybe, just maybe said delivery drone will photograph your driveway and then Amazon can e-mail to you proposals on lawnmowers and new cars to consider… We are not sure we are ready to embrace this Amazonian future…

Goldman Sachs' chief U.S. strategist, in an appearance Monday on CNBC, downplayed fears of a bubble in equities and the effect an expected drawdown of the Federal Reserve's economic stimulus program would have on the financial markets. Forecasting next year's economic picture, David Kostin told CNBC that the S&P 500 could hit 1,900 by the end of 2014 and the economy will continue to improve, but investors should be prepared for a 10 percent correction during the same time frame. Then on Tuesday Pacific Investment Management Co.’s Bill Gross, manager of the world’s biggest bond fund, said the unprecedented cash added to the financial system by central banks is raising the risk of a slide in global asset prices. Then he repeated his call that interest rates would remain low for at least two more years. Gross said global economies and their "artificially priced" markets are "increasingly at risk." But he compared their eventual unwinding to the shape of an eagle's wings as opposed to a "T" shape. In short, deleveraging will likely occur gradually not suddenly.

On Wednesday we learned that Private sector job creation surged in November, with ADP reporting 215,000 new jobs in a number that could put some heat on the Federal Reserve to begin reducing its monthly stimulus. In fact, ADP sharply revised its October number up to 184,000 from an initially reported 130,000. Then, the Commerce Department said the trade gap fell 5.4 percent to $40.6 billion. September's shortfall on the trade balance was revised to $43.0 billion from the previously reported $41.8 billion. The three-month moving average of the trade deficit, which irons out month-to-month volatility, inched up to $40.9 billion in the three months to October from $40.2 billion in the prior period. Perhaps this is evidence that the US economy is indeed improving? And perhaps the improving economy will cause the deficit to widen further and add downwards pressure on the US Dollar? It sure looks like it as we see the Euro rise to almost 1.37. But then, Economic conditions remained status quo from early October through mid-November, leaving the Federal Reserve in a policy quandary, according to the central bank's most recent Beige Book report.

Thursday the European Central Bank President Mario Draghi re-affirmed that interest rates will stay low for the foreseeable future, after officials cut their inflation forecast for next year. “We may experience a prolonged period of low inflation,” Draghi said at a news conference in Frankfurt today, echoing language he used last month after the ECB unexpectedly cut interest rates. Draghi reiterated his commitment to keeping borrowing costs low “for an extended period of time” as policy makers continue their deliberations over whether they have done enough to prevent deflation and support the region’s recovery, or whether they need to embrace measures such as a negative deposit rate.
Blackstone Group said the stock market rally that helped firms exit investments may last two more years, as long as the Federal Reserve provides support. Equity markets aren’t overvalued when measured by the prices buyout firms are paying for companies! Equity values may continue to experience compound annual growth of 8 percent to 10 percent for another two years.
Many wise investors are mouthing rather bullish views on equities. Bond specialists are expecting only gradual interest rates rises from a slow or “tapered” Tapering… And yet, the yield on the benchmark 10 year Treasury Note hit 2.87% Gold continued its slide off 27% for the year. And the US Dollar is now down 5% for the year. The VIX however is at 15 or so, as close as imaginable to its level at the start of the year.
As we close on year end we charge the batteries of our Crystal Ball and recall Winston Churchill’s words - It is always wise to look ahead, but difficult to look further than you can see.

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Currencies

- EURUSD had a volatile week, following mixed data from the US and Europe. The pair initially rose at the start of the week (from 1.3590 to 1.365), as EU manufacturing broadly beat expectations, with an overall modest expansion thanks to a pickup in Italian and German manufacturing, while manufacturing in France and Spain contracted. The pair quickly reversed their gains (trading as low as 1.3530) following news of acceleration in US manufacturing. EURUSD have since traded in a choppy fashion as a rise in the USD due to better than expected ADP figures (where employers added 215K more workers) was offset by a drop in Non-manufacturing activity. Finally, EUR rose sharply on Thursday (to as high as 1.3675) as ECB's Draghi indicated that further monetary easing measures aren't imminent, and did not seem overly concerned by the recent strength of the European currency.
- EURCHF lost for the week - the pair gradually falling from 1.2310 at the start of the week to 1.2240 currently – as a lack of risk taking due to the prospects of tapering, sent investors back to the safe haven currency. Similarly, USDCHF fell for the week from 0.9060 to 0.8955 currently. However, we do not see this as a lasting move.
- USDJPY gave back some of its recent gains, falling from 102.45 at the start of the week to 102.20 currently. The pair saw additional gains early in the week (to as high as 103.35) on speculation that the BoJ might expand its economic stimulus even further. The pair has since sold off to as low as 101.70 as a weakness in riskier assets sent investors back into the safe haven currency. Finally, the Yen sold off to current levels on the back of news that Japan's government investment fund will start cutting domestic debt holdings right away.
- The Aussie sold off for the week, falling from 0.9125 to 0.9060 currently. AUDUSD initially rose early in the week, as the RBA maintained its monetary policy unchanged – sending the pair to as high as 0.9168. The AUD has since sold off sharply (to as low as 0.8999) on the back of news that the Australian economy grew at a sluggish pace in Q3.
- Cable is set to end the week where is started (1.6370 area), yet following a choppy trading week. The GBP rose sharply at the start of the week (as high as 1.6440), as manufacturing and construction data beat expectations. The pair has recovered to current levels on Dollar strength, following better than expected US GDP and employment reports.

Fixed Income

- The US 10Yr yields rose sharply for the week, rising from 2.75% at the start of the week to 2.86% currently. Treasuries sold off to the lowest level since September as a combination of positive US data reports added to concerns that the Fed will start scaling back its asset purchases.
- The Japanese JGBs fell sharply as well – with 10yr yields falling from 0.61% at the start of the week to 0.663% currently – with majority of the selloff seen on Friday following news that the Japanese pension investment fund (the world biggest retirement fund) will need to cut local debt holdings as the advisory panel recommended the wealth manager should seek higher returns.
- Spanish yields rose sharply this week, from 4.12% at the start of the week to 4.23% currently. Spanish bonds were little changed for majority of the week but have sold off on Thursday as the ECB upgraded its forecast for Euro zone growth, and Draghi signalled no further interest rate cuts.

- Italy bonds mirrored the movements of their Spanish counterparts, with yields rising from 4.055% at the start of the week to 4.241% currently.

Equities

- Developed equities lost 1.81% for the week – as of yesterday's close – as measured by the MSCI World index. World stocks slid due to fears that the Federal Reserve will scale back its stimulus as the US economy recovers.
- The EuroStoxx tumbled by 3.88%, hitting seven-week lows, as investors fretted about the risk of deflation in the euro zone while healthy U.S. economic data raised expectations the Federal Reserve could start reducing its stimulus.
- The S&P 500 lost 1.15%, declining for a fifth day on Thursday and sending the benchmark to a two-week low, after improving economic data boosted bets the Federal Reserve will curb its monthly bond purchases sooner than estimated.
- Meanwhile, the Nikkei slid by 2.31%, hitting a one-month low on Friday morning after a sharp drop on Wall Street dented risk appetite, keeping investors on the defensive ahead of the crucial US jobs report later in the day. Still, the benchmark jumped by about 47% this year, gunning for its best yearly performance since 1972 helped by the Japanese government's massive fiscal and monetary stimulus to revive the economy.
- In terms of sectors, Financials and Materials stocks were the worst performers (-2.72% and -2.47% respectively), while Information Technology and Energy fared better (-0.27% and -1.13% respectively).

Emerging Markets

- Emerging Market equities lost 1.95% for the week – as of yesterday's close – as measured by the MSCI EM index. EM European and Latin American shares collapsed by 3.75% and 3.45% respectively, while EM Asian shares lost 0.94%.
- The Shanghai Composite gained 0.75% for the week, as China's government moved to end a 14-month ban on initial public offerings and allow the sale of preferred shares, sparking a rally in financial stocks as investors bet the measures will boost fees for brokerages and ease banks' funding.
- Meanwhile, the Bovespa tumbled by 3.23%, following weaker than expected third-quarter economic growth data. Also, Brazilian equities dropped as Petrobras tumbled by about 8% this week, after posting its worst one-day loss in nearly five years on Monday, losing 9.2% following the company's decision last Friday not to implement a transparent fuel pricing model that the market had widely expected it to adopt.

Commodities

- Commodities rose by 1.62% for the week, as measured by the S&P GSCI Total Return index. Energy was the best performing sector (+2.52%) followed by Industrial Metals (+0.24%), while Precious Metals and Agriculture were in negative territory (-1.58% and -0.88% respectively).

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- Gold lost 1.75% this week, and is currently trading around $1’230 per troy ounce. Prices fell by as much as 2% on Thursday after data showed the US economy grew faster than initially estimated in the third quarter. The metal has been under pressure as markets believe a recovering economy could prompt the Fed to slow the pace of its USD 85 billion in monthly bond purchases – that boosted bullion's appeal as a hedge against inflation – from this month.
- Meanwhile, crude oil surged by 4.9% and is currently trading around $97.25 a barrel – bolstered by signs of an improving US economy. The prospect for a pick-up in the world's biggest oil consumer came along with the news that TransCanada would begin the southern portion of the pipeline to the Gulf Coast that could relieve a supply bottleneck, and that the OPEC agreed to maintain its production target at 30 million barrels a day. In addition, the announcement last week by the API that crude stockpiles shrank by 12.4 million barrels also supported crude prices.
