Bedrock Newsletter

Friday, February 14th 2014

Today we send our Valentine's flowers to Janet Yellen and wish her a long and sweet relationship with all of us!

Global stocks have been turbulent, with U.S. and Japanese equities dropping to multi-month lows earlier in the week as soft U.S. economic data compounded worries about emerging markets. The global markets sell-off since the start of the year may have sent investors scurrying for cover, but it's getting a yawn from analysts who are sticking with their 2014 calls. For their part, emerging markets have seen a brutal sell-off this year after sharp falls in the value of the Argentine Peso, Turkish Lira, South African Rand and Brazilian Real triggered panic selling across the asset class. Analysts largely blamed the turbulence on the Federal Reserve's tapering measures, the first hint of which last year sent risk assets worldwide sprawling. "Although we didn't anticipate the big moves witnessed in equities and bonds so far, we think it would be a mistake at this juncture to change our stance," Dugan of Coutts bank said. "We see periods of weakness as an opportunity to add exposure to equity markets, not a reason to sell into the panic." Credit Suisse said the market has gotten overly concerned about an economic slowdown in developed markets after data from the U.S., including the ISM new orders and December non-farm payrolls, came in weaker than expected. The bank believes poor weather in the U.S. accounted for much of the slowdown.

Then on Tuesday, our Valentine laureate Janet, whilst delivering her first public remarks as Fed chairman, said financial market turmoil doesn't pose a major risk to the outlook for the U.S. economy and repeated the Fed's statement that asset purchases aren't on a "pre-set course". She spoke days after a government report showed that the jobless rate unexpectedly declined almost reaching the Fed's threshold for considering an increase in the benchmark interest rate, even as payrolls growth was weaker than forecast. Yellen said the unemployment rate alone isn't an adequate gauge of labor-market health. The central bank has said it will keep buying bonds until the outlook for the labor market has "improved substantially." The markets loved the speech and rallied strongly. Janet's reassuring words were further supported by an announcement by Republicans that they would put the debt ceiling to a vote with no conditions triggering a powerful rally that drove the S&P 500 through key technical levels to 1,819, a gain of 1 percent! Perhaps the fact that Janet Yellen didn't say anything to spook the market… In fact, she did quite the opposite in reiterating that the Fed is going to remain extremely accommodative.

"If you're short, you've got a problem," said Dennis Gartman. Gartman became neutral on stocks a couple of weeks ago but said that now he can't help but be long. There are many reasons the stock market could advance double-digits again in 2014 and in years to come, according to JPMorgan chief U.S. Equity strategist- "This could be only the middle innings of what could be one of the longest bull markets in history, there is a lot of firepower to fuel this rally. There is a lot of cash on the sidelines, consumers have de-levered." His year-end target for the S&P 500 index is 2,075, in line with our own predictions for 2014 as stated at the close of 2013.

Gold and oil rallied through $1'300 and $100 respectively. Gold has unusual demand reactions- It appears to attract more buyers as its price rises, enough so to make Milton Keynes tremble in his grave… Go figure. Another classic anomaly is observed in some investor reasoning that gold purchases hedge against inflation, forgetting that when inflation does kick-in, central banks raise interest rates slapping the metal down… Inflation is reflected in currency values – the Economist's Big Mac index shows that the EUR and USD are priced correctly (Euro area 4.96 and US at 4.62. Whilst Japan at 2.97 is cheap and Switzerland at 7.14 is expensive! But Brazil – even AFTER the Real fall to 2.4 is still overvalued at 5.25!).

A thought for your weekend- Central banks around the world are trying to bring back some inflation. In case you wondered why, Milton Friedman explained that "Inflation is taxation without legislation"… Say no more… Even the Republicans are not objecting here…

Bedrock Newsletter

Currencies

- EURUSD was static until the European Industrial data on Wednesday was revised lower for the previous data point and lower than expected this month as well. For a short while the USD rallied seeing EURUSD drop from 1.3640 to 1.3560. However as the USD lost its footing after Yellen spoke about the economy in front of Congress. As we come towards the end of the week EURUSD has moved up to 1.37, despite reduced Industrial production but with GDP for France and Germany on the (very slight) increase.
- The USDCHF pair took a bit of a tumble from the 0.90 figure that has been creating magnetism at this level for the last few weeks. USDCHF has moved lower from 0.8980 to trade down to 0.8900 by this morning – although we have regained a little ground from there
- USDJPY has weakened from 102.30 to 101.80 over the last couple of days. The market seems to be taking stock at this point and although it jumps higher whenever the pair goes below 101.00, the equity market has just halted its rebound for now and we feel it may pause to catch its breath. We still see the pair going high, but are willing to watch how it develops over the next few weeks.
- After last week's positive economic news with its first trade surplus in a long time we note that this week saw the employment data miss and miss quite badly. The unemployment rate actually increased and the participation rate slowed again for an 8th consecutive month. The AUD opened the week at 0.8960, rose to as high as 0.9060, collapsed to 0.8930 on the employment data and we are now back at 0.9015. Again, we reiterate… although we will refrain from outright negativity we do not favour the AUD currency as we see the upside as a very limited trade with huge downside problems that will realize very quickly if and when they come out in the data points. We would not own the AUD.
- Cable has outperformed yet again, rising from 1.6400 to 1.67 this morning. The British pound may well be getting a boost from the fact that Scotland is possibly being forced to go back to a bartering system and giving up its monopoly version of the British Pound that they call the Scottish Pound. Mr Salmond would like to keep the Pound but wants to be an independent country… let's see if the Scottish people want to separate in September, because until then, this is all political blustering! The Pound continues to strengthen.
- This week was relatively subdued in EM FX (in comparison to the last few weeks at least!). Except for the Russian Ruble that saw it drop very heavily and the USD rally, moving from 34.75 to 35.40 this morning. Perhaps the Sochi games have not quite been enough to support the RUB…

Fixed Income

- The US 10Yr yield is higher on the week at 2.74%. However, as the equity markets were severely boosted the bond yields have risen from as low as 2.66% at the beginning of the week. As the equities have shaken off the initial fear driven drop from last week, the yields have slowly moved higher to see bonds weaker since Monday – despite their strength for the start of the week.
- The German Bund moved from 1.66% to be 1.68% as we write. However, they reached as high as 1.72% as equity markets everywhere rallied on the dovish tone of Yellen.

- Spanish yields rose this week from 3.58% to as high as 3.67% yesterday morning. The spread has remained at about 194 Bps over the bund and the trend seems to be at or around this level for now.
- Italy's 10Yr yields moved in a similar fashion to that of Spain, but with a dramatic move from 3.66% to 3.79% on Wednesday and Thursday. We are lower on the yields today at 3.72% with a spread over the Bund of 204Bps – which has narrowed from a high of 220 a couple of weeks ago.
- The UK 10 year has recovered after Mr Carney's words of "sort-of" wisdom last week. The yields dropped slowly and steadily from 2.72% to 2.80% as the GBP rose and the equity markets gently inclined as well.

Equities

- Developed equities rallied by 1.95% over the week – as of yesterday's close – as measured by the MSCI World index. Global shares posted their longest winning streak in five months as they rose for a seventh straight day on Thursday, boosted by upbeat trade data from China and a US House deal extending the federal borrowing authority.
- The EuroStoxx surged by 2.10%, boosted by better-than-expected Chinese export data and corporate results. European stocks are set to rise today, climbing for the seventh time in eight sessions, as data showing slightly better-than-expected economic growth in Germany and France helped fuelling expectations of a rebound in corporate profits in Europe this year.
- The S&P 500 rose by 1.83% for the week, as of yesterday's close. US stocks rose for a fifth day out of six sessions, bolstered by comments from Federal Reserve Chairman Janet Yellen, encouraging bets the economy is strong enough to weather further stimulus cuts.
- Meanwhile, the Nikkei dropped by 1.03% – down over 12% so far this year. The index dropped by over 3.3% on Thursday and Friday, hit by a stronger Yen and as investors locked in recent gains accumulated over the past three sessions.
- In terms of sectors, Materials and Healthcare stocks were the best performers (+2.88% and +2.84% respectively), while Energy and Industrials stocks lagged (+1.48% and +1.14% respectively).

Emerging Markets

- Emerging Market equities rose by 0.91% for the week – as of yesterday's close – as measured by the MSCI EM index. Asian shares rose the most (+1.26%), followed by EM European and Latin American shares (+0.14% and -0.06% respectively).
- China's stocks surged by 3.49% – their biggest weekly advance in five months – as Chinese trade data showed solid demand with exports rising in January, easing fears that the world's second-largest economy is mired in a worsening slowdown.
- Meanwhile, the Bovespa dropped by 0.54%, as state-run Banco do Brasil posted weak fourth-quarter earnings and investors fretted about lackluster retail-sales data in Brazil, adding to concern that growth is faltering in Latin America's largest economy.

Bedrock Newsletter

Commodities

- Commodities rose by 0.52% over the week, as measured by the S&P GSCI Total Return index. Precious Metals rallied by 2.86%, while Agriculture, Energy and Industrial Metals rose more cautiously (+1.01%, +0.34% and +0.11% respectively).
- Gold jumped by 3.40% for the week, and is currently trading around $1’310 per troy ounce. Gold prices rose above the $1’300 level on Thursday for the first time in over three months, gaining almost 1% after disappointing US retail sales data weighed on the dollar and increased bullion's appeal as a currency hedge.
- Meanwhile, crude oil was about flat and is currently trading around $99.85 a barrel. Oil futures swung between small gains and losses this week, as Fed’s encouraging comments and a weaker dollar were mitigated by higher US crude oil inventories.
