Bedrock Newsletter

Friday, February 21st 2014

Just when things started to calm down on the US and European fronts for investors, there's a raft of trouble overseas. Streets are on fire in Ukraine, Libya and Venezuela. Syria continues to explode with war and nuclear talks with Iran are on the brink. In Egypt, militants have warned tourists to leave the country this week... or else. What does that mean for investors? Not a whole lot—yet. "The way it works is only in the bigger picture—if it's energy-related, if it looks as if there's going to be a disruption of supply, then it affects markets," said Quincy Krosby, chief market strategist at Prudential Annuities. "If it looks like it's going to become a credit problem, then it starts to make its way into the U.S. markets. Then it will affect companies or banks that have exposure."
We should be vigilant- this unrest could spread and could have repercussions…

In a note prepared for central bankers and finance ministers from the Group of 20, the IMF said the recovery is still weak and "significant downside risks remain." The Fed released minutes of its January meeting, at which policy makers pushed ahead with stimulus cuts. U.S. housing starts fell 16 percent in January, the Commerce Department said. IMF staff wrote, "A January global growth forecast of 3.7 percent for this year, from 3 percent in 2013, hinges on recent market volatility from Turkey to Brazil being short lived". Rising political tensions from Ukraine to Thailand, China's slowdown and the Federal Reserve's tapering of its stimulus have resulted in falling stocks and currencies in emerging markets. Less than two months into 2014, global investors pulled more money out of emerging-market stock and bond funds than the total amount they retracted last year. Then this week Italy gets yet another new leadership... Markets up and spreads down, the Euro rallies as US$ down.
Tuesday told us that the USA creates 2M new households per annum, yet new home buildings are running at 800K pa... A shortfall of supply which helps explain why half of new householders rent. Ten year yields down at 2.71%
Greater confidence amongst Americans has led to a surge in household debt not seen since the recession began, according to new figures from the Federal Reserve Bank of New York. Mortgages, credit cards, auto loans and student loans together rose $241 billion, or 2.1 percent, to a total of $11.52 trillion between October and December. It is the biggest quarterly rise since 2007. Has the US economic motor truly caught?

We have observed an unusual market phenomenon these past few days- Every morning the US futures have traded down only for the cash market to follow with gains- the latter is populated with both the general investor public and the professionals, whilst the futures are primarily a professional ecosystem. Is the public driving the market and the institutional investor hedging? If it is true, then we may indeed be close to a "top"…
Then the bombshell- Facebook pays 16Bn for WhatsApp, a messaging system with 55 staff. The Facebook acquisition was the fourth major deal this year, with Comcast Corp.'s $45.2 billion purchase of Time Warner Cable Inc., Actavis Plc announced Feb. 18 a $21 billion deal to buy Forest Laboratories Inc. and Suntory Holdings Ltd. agreed in January to pay $16 billion for Beam Inc. M&A is alive and well, corporate balance sheets remain strong. Interesting times- Corporate cash is high, financing costs are low- perhaps this M&A will be the driver of the next bull-leg in equities? Some feel that these deals were expensive, especially the Facebook deal… but then, back in 2000 HP bought Compaq for 23Bn... The market punished Facebook for this excess, just for a short while and then applauded it with a new record high… clearly, the dollar weighted opinion is favorable for the deal. Time will tell…

The trouble with our times is that the future is not what it used to be…

Currencies

- EURUSD is more or less unchanged on the week so far at 1.37. On Tuesday as the USD weakened a little after the President's Day holiday the EUR reached as high as 1.3770 only to come back to 1.37 after both German and French CPI missed the mark with Industrial Production weaker than expected as well. Even in light of the data pointing to poor economic support, the EUR does not seem to lose ground – it might give up some profits, but it does not seem to drop for now.
- The USDCHF slipped from where it finished last week at 0.8930 to reach a low of 0.8860 by Thursday morning. With the weaker than expected data out of the European titans, France and Germany, USDCHF took a bid and moved swiftly to the level we are at as we come towards the end of the week at 0.8906. Again we are trading at or about 0.90 and until there is a rate change or a sentiment change, then we do not see any great movements from this level in the very near term.
- USDJPY awoke on Tuesday to confirmation from the BOJ that it would boost its lending and a raft of rhetoric to confirm it would continue to implement its monetary easing cycle to meet its inflationary target of 2%. The pair started the morning at 101.80 and popped right up to 102.70 after the announcement. As the equity market retreated a little afterwards, so did USDJPY, only to bounce back to 102.60 this morning following the equity rally.
- The Aussie slowly gave up its gains from last week slipping from 0.9080 on Tuesday to hit 0.8940 as wage inflation data caused a drop of 80 pips. The Aussie is now trading at almost exactly 0.90. We again restate, we do not like the AUD and we would not own it. Although there may be some short term respite for the pair as data either softens its pace of negativity or ever so slightly beats the very low expectations, but eventually an economy that is built on commodities that are not being shipped or mined is probably in for a bit of a rough ride – unless the crushers spring to life again!
- Cable is off its highs of the week of 1.6823 and is trading at about 1.6666 as we write. The data was ok this week as retail data came in a touch weaker than expected, but overall the UK seems to be weathering the storm at the moment. A frightening statistic for you, the UK national debt increases by £440Mn a day – that is roughly 160 Billion Pounds a year or another 50% more exports if you need to quantify how much that is in terms of extra revenue that would be needed…
- EM currencies had a mixed week, with the RUB, TRY and the UAH (Ukrainian Hryvnia) slipping on the week. RUB moving from 35.10 to 35.80, the TRY moving from 2.18 to reach 2.22 in yesterday's trading session and the UAH having slipped from 8.40 prior to the riots in Kiev to trade to 9.15 at the peak of the strife in the capital city. BRL seems to have bucked the trend moving from as high as 2.41 on Wednesday to as low as 2.36 midway through yesterday's session.

Fixed Income

- The US 10Yr yield is marginally higher on the week at 2.75%. As President's day took out Monday from the trading calendar we have only seen 4 days of trading, but as the equity markets rallied the bonds have weakened a little. We are still within our prescribed band of 2.5% to 3.0% that we have been stuck within since June last year and probably shall be for the foreseeable future – unless the Fed rhetoric changes or the markets decide otherwise!

- The German Bund is relatively unchanged on the week at 1.68%, but in light of the European troubles in Ukraine and the weaker European equity indices there was some short term strength for the bonds seeing the yields reach a low as 1.63% as the DAX bottomed on Thursday morning.
- Spanish yields are higher, having moved from 3.54% on Monday to trade 3.57% this morning. The spread has dropped to about 188 Bps over the bund and the trend seems to be resuming for a narrowing of the spread over the Bund as we were 194Bps last week. In fact most of the periphery seems to be narrowing (apart from the Ukraine which is exploding outwards and with a downgrade it is heading on a different tack!).
- Italy's 10Yr yields moved from a high of 3.66% on Monday ahead of the change of government to reach 3.54% ahead of the changes and the weakening equity markets. However, the market has subsequently sold off the bonds and the yields are now back to 3.63%. This leaves a spread over the Bund of 192Bps which has narrowed from 202Bps last week as the fear of the change in government has been closed out.
- The UK 10 year has ended the week in similar territory to that which it opened at, 2.79%. The UK yields were affected by the weaker than expected data but as the equity markets have traded positively for the week the yields are now more or less unchanged.

Equities

- Developed equities rallied 0.35% over the week – as of yesterday's close – as measured by the MSCI World index. Equities gained on the back of positive US data and corporate earnings, as well as supportive measures taken by the BoJ to stimulate growth.
- The EuroStoxx is set to end the week flat (-0.09%), though with some volatility seen in the later sessions. European shares saw some selling during the week following weaker than expected Macro data, whereby German Investor confidence (ZEW) fell short of estimates, and the UK recorded an increase in Unemployment rate to 7.2% (however other data showed an improving picture for the labour market). Stocks recouped their losses on positive corporate earnings and better than expected US data.
- The S&P 500 is also set to end the week flat (+0.06% as of yesterday's close). Shares sold off at the start of the week following weaker than expected Manufacturing and Housing data. Stocks saw further weakness following the release of the minutes of the latest Fed meeting which indicated that it will continue tapering unless there is a big surprise. Finally, shares recouped their weekly losses on the back of positive Jobless claims and Manufacturing data (preliminary PMI).
- The Nikkei rose as much as 3.86% for the week, with a lot of volatility. Japanese stocks commenced the week on a strong foot as the BoJ announced that they will double the size of its fund to support economic growth. On Thursday, stocks sold off sharply as the Chinese manufacturing gauge dropped more than expected, but a rebound was seen on Friday's session on positive US data.
- In terms of sectors, Telecom and Energy stocks were the best performers (+1.83% and +1.23% respectively), while consumer Discretionary and Industrials stocks lagged (-0.22% and -0.20% respectively).

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Emerging Markets

- Emerging Market equities lost 0.70% for the week – as of yesterday's close – as measured by the MSCI EM index. EM European and Latin American shares lost the most (-2.06% and -1.78% respectively), while EM Asian shares fared better (-0.18%).
- The Shanghai Composite lost 0.10% for the week. Chinese shares gained at the start of the week as credit growth climbed to a record high. However, stocks were sent lower at the end of the week following Chine's flash PMI hitting a 7 month low of 48.3 (down from 49.5 in January).
- The Bovespa lost 1.90% for the week, as of yesterday's close. Brazilian shares sold off sharply at the start of the week as data from last week indicated that Brazil's economy lost steam in H2 of last year, which caused economists to lower their 2014 and 2015 outlooks. Shares recouped some of the earlier losses as the government came through with a credible plan to bolster its finances with numerous budget cuts as a way to tame inflation.

Commodities

- Commodities rallied by 1.99% over the week, as measured by the S&P GSCI Total Return index. Agriculture and Energy jumped by 3% and 2.09% respectively, while Industrial Metals rose by 0.54% and Precious Metals were about flat.
- Gold rose by 0.20% for the week, and is currently trading around $1'321 per troy ounce. Gold put on hold its rally that started in late December from levels around $1'200, as a firmer dollar and weak manufacturing data from China (the world's top gold consumer) left investors stalled in neutral.
- Meanwhile, crude oil surged by 2.2% and is currently trading around $102.55 a barrel. US oil futures cruised to 4-month highs, as a tightening picture for products refined from crude and improved domestic pipeline infrastructure buoyed the market.