Bedrock Newsletter

Friday, March 14th 2014

It is Friday again and we are under sunny skies with a couple of low-hanging storm clouds overhead- Effectively in a pinch between the Ukraine/Crimea/Russia haze and the perceived Chinese economic slowdown. The first visited us with a bang two weeks ago and dissipated only to reappear on our radar-screens whilst the second has been knocking at our doors intermittently for the past several year- Yes, China with its targeted 7.50% GDP growth worries many analysts who fret that the second largest economy might find it difficult to meet its target. We say that even a huge miss, resulting in "only" say 4% growth is still good in the face of a hoped for 1% in Euroland and 2.5% in America…! The Ukrainian matter is harder to evaluate- Arseniy Yatsenyuk, Ukraine's interim prime minister, believes the upcoming referendum in Crimea (in two days' time) will inevitably result in the population rejecting Ukrainian rule, but remained adamant that the country will do all that it can to protect its territorial integrity. "(It) seems to me that this referendum is already pre-ordered and that we can easily predict the outcome," he told CNBC in New York late Thursday. Well, what he means is that the referendum's outcome is clear, but then, the repercussions thereof are quite unclear- How will the West respond, how will Russia repost to such responses and the effects on what really matters, our markets, are seriously impossible to predict. Equity markets reacted yesterday much as they did on February 3rd with a significant drop and bonds rallied as gold rose.

On Tuesday we read that the CIA searched a congressional computer network in a possible criminal violation and breach of the separation of powers between the branches of government. "I have asked for an apology," Senator Dianne Feinstein, a California Democrat, said in a speech on the Senate floor today in Washington. We wonder how come nobody anticipated the Ukraine issue with the ensuing Russian annexation of Crimea? The US president was caught off guard, as were the EU leaders... Was the NSA too busy spying on Merkle and the CIA spying on Congress?

On Thursday, as markets were tumbling, New Zealand's central bank raised its key interest rate, the first developed nation to exit record-low borrowing costs this year, and said it plans to remove stimulus faster than earlier forecast to contain prices. Is this a sign that economic spring is upon the West? Well, not everyone is in tune here- "A bull market left to run without a correction for this long sets up stocks for huge declines" 'Dr. Doom' Marc Faber told CNBC on Thursday. How huge? The editor and publisher of The Gloom, Boom and Doom Report said U.S. stocks could drop 30 to 40 percent, if left without a significant pullback. Well, some other prominent investors think otherwise; Five years into a bull market, Byron Wien doesn't see a top in sight. In fact, the vice chairman of Blackstone Advisory Partners says that there's still plenty of time to buy stocks. Wien says that stocks remain reasonably valued and continued economic growth will boost corporate earnings - "The market isn't overvalued, rather it's reasonably valued". JPMorgan Chase's Tom Lee remains one stubborn bull. On Thursday the investment bank's chief U.S. equity strategist said that he sees growth picking up in the second half of this year because of pent-up demand, and that a "construction boom" appears imminent. Despite a rocky start to 2014, Lee said he doesn't know why we "should be worried about the short-term noise." He also sees tailwinds from lower oil costs and improving weather.
Tuesday the leaders of the Senate Banking Committee announced an agreement on legislation to wind down government-owned mortgage financiers Fannie Mae and Freddie Mac, jump-starting a long-standing debate that could still take years to resolve. Within the next two days these two stocks plunged by almost 40%...
One market observation isn't consistent with the obvious worries here- Very strong Euro and Swiss Franc, weak US$? One would think that Europe is at direct risk of Russian reactions to eventual US sanctions? Another question remains- We hear of many fully invested bears and then of cash rich bulls... Interesting markets...

We will be pondering these questions through the Crimean referendum… It is always wise to look ahead, but difficult to look further than you can see. Winston Churchill

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Currencies

- EURUSD was pretty much unchanged at 1.3880 until the Chinese data on Thursday where we saw the pair move higher to reach 1.3960 midway through the US morning. By the close of the trading day the ground looked very different with EURUSD reaching to as low as 1.3850 by the end of the European day. Now a new day has seen the pair surge back higher again on weaker US consumer confidence figures, the Europeans leaving for the weekend with the EURs worth 1.3920 USD again. Some large swings but really very little has changed!
- The USDCHF really is having a tough time at the moment. The pair has been steadily weakening and the CHF strength has now pushed the pair to 0.8700 this morning having been as high as 0.8805 on Tuesday.
- USDJPY has slipped out of the headlines for the last few weeks with the Japanese current account figures showing that the closing of their power stations has had a large impact on their economy than the words of their central bankers – higher energy prices from their weaker Yen. With the JPY regaining a little ground throughout the week we have dropped to the support levels of the last few weeks at 101.40.
- The Aussie could not hold the highs from last week of 0.9070 and slipped through the sessions to bottom out on Wednesday at 0.8925. with the Chinese data the Aussie regained some ground and moved back higher, briefly touching 0.9100. We would seem to be coming into the weekend around 0.9050.
- Cable moved lower on Monday from 1.6750 to sink to 1.6640 and we have been at or around that level for most of the week – save for a little blip higher on the Chinese story. The Pound seemed to weaken in sympathy to the poor French and German GDP figures on Monday morning and never recovered. Also the Lloyds business sentiment came in negative…
- EM currencies had a mixed week, with the RUB dropping throughout the week. With the uncertainty in the market place the RUB shall probably remain weak until the Ukrainian issues are swept away, once and for all. The RUB slipped to as low as 36.70 this morning.

Fixed Income

- The US 10 year has moved higher and higher throughout the week pushing the yields lower and lower. Having started the week as high as 2.80% we have hit as low as 2.60% this morning. Is this a renewed fear factor in the markets? It certain seems to be reflected in the equity markets as well and as the equities have sold off the bonds have been purchased.
- The German bund has followed the path of the US 10 Year and has strengthened throughout the week moving from a yield of 1.66% on Tuesday to 1.50% this morning. The poor German GDP data on Monday seemed to have very little impact on the Bund and the macro story around the world seems to be playing a much larger role for now.
- The Italian 10 year saw a lot of strength on Monday moving from 3.42% to 3.36%, however that has been short lived and the bonds are trading back at 3.40% this afternoon. The spread over the bund is now slightly wider at 190 Bps today.
- The Spanish 10 years had a reasonable quiet week moving between 3.36% and 3.32%. the spread over the German Bund is relatively steady at about 180 Bps.

- The UK gilts moved from as high as 2.82% on Monday to 2.65% this morning as equity weakness and slightly weaker UK data saw the fear draw the bond buyers out from the woodwork.

Equities

- Developed equities dropped by 1.75% for the week – as of yesterday's close – as measured by the MSCI World index. Global shares declined over anxiety about heightened tensions between Ukraine and Russia as well as slowing growth in China. Concern about China intensified after data showed its economy slowed markedly in the first two months of the year. Growth in investment, retail sales and factory output have all dropped to multi-year lows.
- The EuroStoxx fell by 3.16%, extending a two-week slide, as worries over economic growth in China and tension in Ukraine took their toll on market sentiment. Investors are wary about developments in Ukraine before Sunday's referendum in Crimea, which could bring harsh Western sanctions against Russia.
- The S&P 500 declined by 1.69% amid China slowdown fears and potential Russian expansion despite recent signs of stability in the US economy. Russia's takeover of Crimea, home to its Black Sea Fleet, has sparked the worst crisis with the West since the Cold War as the US and the European Union try to use sanctions to force President Vladimir Putin to retreat.
- Meanwhile, the Nikkei collapsed by as much as 6.20% (!) after weaker-than-expected Chinese output and retail sales data disappointed the market. Also, investors locked in profits after a recent rally to a five-week high, while a stronger yen hit overall sentiment and dragged down exporters.
- In terms of sectors, Materials and Industrials stocks were the worst performers (-2.45% and -2.50% respectively), while Utility and Consumer Staples fared much better (+0.95% and -1.28% respectively).

Emerging Markets

- Emerging Market equities dropped by 2.43% for the week – as of yesterday's close – as measured by the MSCI EM index. EM European shares lost the most (-4.56%) followed by Latin America (-2.32%) and Asia (-2.25%).
- The Shanghai Composite slumped by 2.60%, suffering a hefty loss of nearly 3% on Monday as investors switched to "risk-off" mode following disappointing Chinese export data over the weekend. China's exports tumbled 18.1% while imports rose 10.1% from a year earlier, producing a trade deficit of $23 billion for the month of February, data released on Saturday showed.
- The Bovespa slid by 1.73% following global markets, amid worries about China's growth prospects and the country's recent disappointing economic data, directly raising concerns for Brazil's export market.

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Commodities

- Commodities fell 1.94% for the week, as measured by the S&P GSCI Total Return index. Industrial Metals and Energy lost the most (-3.34% and -2.69% respectively), while Precious Metals gained as much as 2.40%.
- Gold rose 2.24% for the week, and is currently trading around $1’370 per troy ounce. Gold reached the highest level in six months as tension escalated in the Ukraine, and amid concerns that China’s growth is faltering.
- Meanwhile, crude oil fell as much as 4.12% and is currently trading around $98.30 a barrel. WTI is heading for the biggest weekly decline in two months as investors weighed the outlook for fuel demand due to the slowdown in Chinese growth, and on news that US stockpiles rose.
