Friday, March 21st 2014

It is Friday and we need a quiet weekend to recover- We saw the effective annexation of the Crimean peninsula by Russia followed by cries of indignation from the Ukraine, the EU and the USA. Talk of sanctions against Russia has hit our screens and eardrums- escalating daily! The US has targeted individual Russians close to Putin, barring some 20 people from entry to the US and has frozen the assets of a dozen or so… The Russian retaliated and will not issue entry visas to John McCain; will this force the US Senate to accept the annexation? Who knows… But these conflicts could escalate seriously, affecting gas supplies, German exports to Russia etc. Our world is so inter-linked now- Treasuries held in custody at the Fed by foreign central banks dropped by $104 billion to $2.86 trillion in the week ending March 12, as of December, Russia held $138.6 billion of Treasuries. Will the Russians sell or just transfer custody to protect their holdings? As yields are not rising, then the latter makes more sense…

On Tuesday we heard Putin in a speech at the Kremlin - “Don’t believe those who scare you with Russia, who yell that Crimea will be followed by other regions, Crimea is our historic legacy. It should be part of a strong and stable sovereignty, which today can only be Russian.” Putin's speech made it clear that he wants the West to recognize Russian interests in Ukraine. For the West, it all boils down to a tough dilemma over compromising with Moscow to avert military conflict or taking a hard-line stance and risking a Russian invasion of Ukraine. Putin has sent clear signals he could take extreme measures if he doesn't get his way on keeping Ukraine out of NATO and ensuring that Ukraine remains in Russia's political and economic orbit.

Monday data-flow showed us that the Euro-zone inflation dropped on low energy prices, below expectations and running at 0.7% year on year. The strong Euro may be helping here- but remember that the ECB targets 2% inflation, so they likely would want a lower currency. Monday also showed us U.S. manufacturing output rebounded more than expected in February and recorded its largest increase in six months, in the latest sign that economic activity is gaining momentum after being dampened by severe weather.

Then, Janet Yellen spoke on Wednesday. At its first meeting under her new Chairmanship, the Federal Reserve agreed to dial down its stimulus package another notch, and changed its view on when interest rates will rise. Despite a seemingly dovish tone, markets recoiled at remarks from Yellen, who said interest rate increases likely would start six months after the monthly bond-buying program ends. If the program winds down in the fall, that would put a rate hike in the spring of 2015. The Fed dropped the 6.5% unemployment target and tapers another $10bn to $55B. In other words, as the Fed winds down quantitative easing, it will be ramping up something we call "qualitative teasing." The Fed is not moving the goal-posts; it is adjusting policy appropriately to address the issues that their counterparts in Congress and the White House are too timid to handle. Arguably, what the Fed has really said was that the US economy is getting better and is on a clear path to normal health. The markets gave us a huge storm in a tea-cup! As Janet was speaking, the DJIA fell over 200 points only to recover about 100 of these by the close, and this loss being recovered the next day… In what Goldman Sachs Group Inc. Chief Economist Jan Hatzius called a “hawkish shift in the dots,” the forecasts show more officials predict the rate will rise at least to 1% at the end of 2015 and 2.25% percent by the end of the following year, higher than previously forecast.

On Wednesday Goldman Sachs cut its growth forecast for China, noting the world's second largest economy faces a "bumpy road ahead." The bank lowered its 2014 forecast to 7.3 percent from 7.6 percent late Wednesday. It also cut its 2015 outlook to 7.6 percent from 7.8 percent. The Chinese widened the trading band for the Yuan and it has slipped somewhat against the US$- now at 6.23 down from 6.05 at year-end, about 3% decline.

We see through the data a rather clear message- the world’s economy is stabilized and we should return to the pre-2008 ways of measuring value and portfolio diversification. We do remain concerned with the political situation- recalling Lewis Carroll’s words of Alice “But I don't want to go among mad people,” “Oh, you can't help that,” said the cat. “We're all mad here.”

Currencies

- EURUSD was marking time, holding its breath and desperate to let it out – all hanging on the words of Chair Janet Yellen. "Janet from the block" "kept it real" and delivered the speech the markets were initially uncomfortable with, but sent the USD flying across the board. EURUSD tumbled from 1.3925 to hit 1.3810 on her words. The slide continued on Thursday and saw the pair drop to 1.3750. We feel that a short term top has been formed now. The USD will likely see strength for a while as the FED takes central stage and not the ECB.
- USDCHF followed the inverse of the EURUSD movements and soared from 0.8740 to peak at 0.8870 yesterday afternoon. The USD has given back a little this morning and it is now trading at 0.8825. We are not back to the 0.90 level that seemed to act as the magnetic draw for several weeks, but it may not take very long for that to be reached.
- USDJPY flew higher on Janet's words and shot from 101.40 in the morning to finish the day at the highs of 102.68. The pair has moved a little lower this morning to 102.10. We look for massive currency moves to come when the next wave of central bank stimulus is implemented.
- The Aussie started the week at 0.9020 and had reached 0.9120 prior to Yellen speaking, which sent the pair back to 0.9000 by the next morning. However, the AUD has recouped some of the losses and seems to be holding ground at about 0.9080 at the moment.
- Cable moved lower on Monday with Yellen's announcement, seeing the pair drop from 1.6550 (where is started the week) to 1.6510 by the end of the day. The Pound has seen a little more weakness but nothing really sustained and the pair is at 1.6500 this morning. In light of the rally from 1.50, we are still near the highs and the Pound seems settled and quite unruffled by the data points for now. Perhaps a little short term weakness ahead, but for now it seems stable.
- The RUB had a mixed week after the Crimean/Ukrainian elections unanimously voted to move Crimea under Russian rule (whether legally or not is not the point here). Initially the RUB strengthened from 36.65 to 35.88 but we have seen weakness again today and the pair has moved to 36.40. The UAH has moved lower and lower throughout the week, moving from 9.40 to 10.46 this morning… It started the year at about 8.20!

Fixed Income

- The US 10Yr yield surged higher on Wednesday moving from 2.66% to peak at 2.78%. The bonds have strengthened this morning a little to trade to 2.76%, but really this is just in the middle of the 2.5% to 3% band that we have been following, so we count it as a short term move and no ground shaking development quite yet for the long term.
- The German Bund took the German acceptance for the ESM Fund in its stride and remained unchanged at 1.56%. The US chat from Yellen was the catalyst for the move this week, seeing the Bund open Thursday morning at 1.63% and peaking at 1.66%. Subsequently we have traded back to 1.635%.
- Spanish yields are unchanged on the week at 3.34% and had been as low as 3.30% prior to Yellen speaking and briefly reached 3.38%. They seem relatively unperturbed by her words for now!

- Italy's 10Yr yields is completely unchanged on the week at 3.41% but had reached as low as 3.36% on Wednesday ahead of the FED.
- The UK 10 year opened the week at 2.66%, weakening slightly to 2.69% ahead of the FED meeting. Thursday morning saw the Gilts open at 2.76% and remain at the same level for now… Maybe Mark Carney's accent sounding a little American had some influence!

Equities

- Developed equities gained 0.80% for the week – as of yesterday's close – as measured by the MSCI World index. Global shares gained following better than expected economic data, and amid prospects that the Ukrainian crisis will be contained.
- The EuroStoxx rallied 3.24% for the week, recuperating all of last week's losses. European stocks gained as investors viewed the sanctions imposed by the West on Russia as less severe than expected, and following Putin's speech, have considered the Ukrainian crisis as contained. In addition, some gains were attributed to global risk taking following strong US data.
- The S&P 500 gained 1.67% for the week, as of yesterday's close. US shares gained early in the week as US Factory data showed the largest increase in six months. On Wednesday, the Fed announced a reduction of an additional $10bn in asset purchases, as expected. However, shares lost ground as Yellen hinted at an earlier interest rate hike than expected. Wall Street bounced back on Thursday on strong Business outlook and employment data.
- The Nikkei lost 0.73% for the week, as of yesterday's close – with Tokyo shut today for a public holiday. Japanese shares posted sharp losses on Thursday's session as the prospect of the US raising interest rates sparked a global equity selloff.
- In terms of sectors, Utility and Consumer Staple stocks were the best performers (1.05% and 0.38% respectively), while Financials and Materials lost 1.20% and 1.16% respectively.

Emerging Markets

- Emerging Market equities gained 0.32% for the week – as of yesterday's close – as measured by the MSCI EM index. EM Latin American shares gained the most (4.82%) followed by EM Europe (0.45%), while EM Asian stocks lost 1.26%.
- The Shanghai Composite gained 2.16% for the week. Chinese stocks gained as the Chinese government outlined urbanization plans worth 1 trillion Yuan. Shares sold off at the middle of the week on rising concerns of corporate credit defaults; however they were soon to correct amid speculation that the government is loosening funding restrictions for property developers and banks to support growth.
- The Bovespa rose by as much as 5.14% for the week, as of yesterday's close. Brazilian shares gained on prospects that president Dilma Rousseff will not be re-elected in October elections. Such speculation supported equity prices of state run companies, as the current administration is viewed to have been too involved in the affairs of the businesses, and harming the profitability of companies such as Petrobras by ordering fuel subsidies.

Bedrock Newsletter

Commodities

- Commodities fell 0.70% for the week, as measured by the S&P GSCI Total Return index. Precious Metals lost the most (-3.65%), followed by Energy (-0.83%) and Industrial Metals (-0.73%) while Agriculture was the only sector to be positive (+0.16%).
- Gold slumped by 3.20% for the week, and is currently trading around $1’338 per troy ounce. Bullion is on track for its biggest weekly fall since September as the dollar firmed after the US Federal Reserve hinted at an interest rate hike in the first half of 2015.
- Meanwhile, crude oil was about flat – currently trading around $99 a barrel. WTI swung between gains and losses over the week, as the supporting effects of gains on Wall Street and concerns over violence in Crimea were offset by news that the Federal Reserve could raise interest rates as soon as next year, bolstering the dollar.
