

# Bedrock Newsletter

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Friday, April 17<sup>th</sup> 2014

It is Friday ahead of a long Easter weekend- we chose to bring send our Newsletter a day earlier rather than not at all.

The week has been quite troublesome as equity markets seem to be confused and frightening- from a down day to an up day, talk of a 20% correction to talk of the beginnings of a new upwards leg in the bull market. Hard to choose a camp... the bonds have risen in price (yields down) some, currencies in a frenzy in a tight range. In short, a nervous market with no significant changes.

Let's look at the significant economic information available to us:

Quietly, under investor's radar, the US has cut its budget deficit by \$1 trillion since its peak in 2009 when it reached 8% of GDP, the CBO now projects it to fall to 2.8% (the US would now qualify to join the EU); that is down 32% from last year! In this season of rebirth and renewal (spring, Easter and Pessach), China growing at 7.4% (is this the "hard landing" that some had expected?) and with economic growth added to the dinner table, we may indeed find Goldilocks at our side!

The second significant undertow can be seen in the US longer-term energy independence. This, if indeed realized, will not only help US competitiveness, it will clearly redress some fundamental imbalances from the huge US trade deficit, and therefore may help the US\$ rise to its due levels.

The third major current can be found in Europe- whilst things are not quite rosy yet, we can see signs of the end of what had been the imminent collapse of the EU and of the Euro. Greece and Portugal are clearly back from the brink with successful Government bond issues. The Euro is clearly well bid...

With these observations of "normalization" and the fact that the elephant in the room, i.e., the Fed, is actually behaving in proper economic form- see Yellen's comments only yesterday to the Economic Club of New York "The larger the shortfall of employment or inflation from their respective objectives, and the slower the projected progress toward those objectives, the longer the current target range for the federal funds rate is likely to be maintained,". At 6.7 percent for March, she said the unemployment rate was more than a percentage point higher than policy makers' estimate for full employment of 5.2 to 5.6 percent. "This shortfall remains significant, and in our baseline outlook, it will take more than two years to close,". So here too, we can see Goldilocks smiling at the low interest rate outlook.

All these bits combine to make a delicious porridge ☺

Where are the clouds?

Clearly the Ukraine is seriously overcast and could experience heavy storms which could cause flooding and other problems in our own courts. Well, Gold falling below \$1'300 yesterday, it tells us that whilst we should be carrying an umbrella, there is no need to open it quite yet.

Then there is the Euro-US\$ tug of war- Both sides want their currency to weaken, to import some inflation- A tug of war is shaping up in the euro-dollar with jawboning by European policymakers putting downside pressure on the pair and the recent decline in U.S. yields providing upside support – In our view though, both forces are significant enough to keep the euro-dollar locked in a \$1.36 to \$1.40 trading range for the foreseeable future. Stability, yes; for now. When and which way will the range break?

Then we are in the midst of Q1 earnings. So far, some beats, some misses. As the markets entered these data with much apprehension and high starting-levels, we may experience some significant volatility- tighten your seat belts... but do remember that there are 3 more quarters ahead in 2014...

We go into this long Easter break in suspense... and as Oscar Wilde once quipped- "this suspense is terrible. I hope it will last."

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**Core View:** The world's economies are mending from the fallout of the "Great Recession". The economics are settling back into a reasonable growth pattern and stability is expected to continue. Volatility as a measure of risk is low in bonds, FX and equities.

- **Fixed Income** - The Fixed Income world is still struggling with low yields and still struggling with low inflation. With the extreme example of Japan showing exactly what is possible when stagnation occurs. With the ECB's talk of further easing it is likely that Europe will embark on large scale easing in the not too distant future, a la BOE and FOMC – especially in light of the commentary from Draghi about the worrying strength of the EUR. No need to worry in the short term about rising rates, then... but do keep an eye on the horizon as it will eventually show signs of rising rates.
- **Equities** – After the dust settles on the showdown at the OK(etski)-corale in the Black Sea the markets are more or less unchanged. With low PE ratios around the globe and earnings (mostly) coming in positive, we feel that the corporate world is still floating. Consumption around the global is still expanding which should mean a positive environment for cashflow growth... so at low PEs and positive cash flow growth, equities would seem like a sensible choice for the year ahead.
- **Alternatives** - In a normalising world, with new-found financial stability and a clearing horizon, economics are returning to base text-book relative values allowing clever investors to take views and positions. We expect this active management allocation to maintain if not exceed its recent results- similar to equity returns but with low correlation to any sector, with about 10% per annum, but lower volatility than equities.
- **Currencies** - The market still has very low realized volatility and the Euro is still very strong versus the USD. We maintain belief in the fundamental strength of the US\$ and would not bet against it at this time.

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## Weekly Highlights:

- Generally the only news on the headlines was muted and surrounded the possible (lack of) news relating to Kiev and Moscow's debate over their summer retreat in the Black Sea. The USD moved higher on possible fractious news only to slip back to 79.60 where it started the week. The EUR is slightly higher at 1.3860, GBP rallied on better employment to be at 1.6830 this morning.
- The US bond market rallied slightly on the fear of possible Russian military movements in the Ukraine. Yields briefly dropped from 2.66% to 2.59% but we are back to 2.63% for now and remain stable. With Draghi's commentary on further easing the periphery has squeezed tighter to the Bund and the Spanish and Italian 10 years are about 3.08%. If further easing does occur then the Bund will likely see lower yields and the spread will likely narrow... but how narrow and how low can it go?
- Global equities that seemed resilient in light of last week's dire performance with US exchanges have seen a 2% rally across the majority of indices. The Nasdaq has recovered to the levels it started last week. The futures have shrugged off the less weak than expected results from Google and IBM, with the futures remaining steady.

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## MARKET INDICES PERFORMANCE

16/04/2014

INDEX NAME	CCY	Last Price	PRICE CHANGE IN % (unless indicated)							P/E	
			1D	5D	MTD	1M	3M	6M	1Y		YTD
<b>EQUITY MARKET INDICES - BY REGION</b>											
MSCI WORLD	USD	1,664.85	1.10	0.53	-0.54	0.66	0.45	4.93	17.19	0.23	15.13
MSCI WORLD LOCAL	-	1,182.27	1.16	-0.54	-0.72	1.48	-0.55	5.70	15.09	-0.19	-
MSCI AC WORLD	USD	409.38	1.01	0.27	-0.40	1.23	0.73	4.03	15.13	0.20	14.35
MSCI EM	USD	1,002.50	0.26	-1.88	0.79	6.28	3.11	-3.04	0.14	-0.02	10.00
S&P 500 INDEX	USD	1,862.31	1.05	-0.53	-0.54	0.19	1.28	7.45	19.99	0.75	15.88
DOW JONES INDUS. AVG	USD	16,424.85	1.00	-0.08	-0.20	1.09	-0.20	6.85	12.36	-0.92	14.86
NASDAQ COMPOSITE INDEX	USD	4,086.23	1.29	-2.33	-2.69	-4.53	-2.65	5.77	27.51	-2.16	18.13
RUSSELL 2000 INDEX	USD	1,131.77	1.10	-2.43	-3.52	-4.75	-3.14	2.68	24.81	-2.74	18.71
EURO STOXX 50	EUR	3,133.95	-0.17	-0.80	-0.87	2.78	-0.64	4.10	22.73	0.80	13.51
CAC 40 INDEX	EUR	4,405.13	-0.01	-0.19	0.31	3.12	1.79	3.90	22.39	2.54	13.90
DAX INDEX	EUR	9,267.71	-0.22	-1.66	-2.70	1.27	-4.57	5.51	23.92	-2.66	13.02
FTSE 100 INDEX	GBP	6,570.99	-0.20	-1.07	-0.41	0.04	-3.78	-0.08	5.23	-2.64	-
SWISS MARKET INDEX	CHF	8,314.05	-0.10	-1.27	-1.05	1.87	-1.94	3.51	10.36	1.35	15.94
NIKKEI 225	JPY	14,417.53	0.00	0.82	-2.77	0.98	-8.37	-1.16	7.73	-11.50	16.18
HANG SENG INDEX	HKD	22,703.29	0.03	-2.09	2.49	5.72	-1.86	-1.70	5.26	-2.59	10.46
SHANGHAI SE COMPOSITE	CNY	2,068.89	-0.30	-1.86	3.23	3.72	4.99	-4.10	-4.33	-0.81	8.03
S&P BSE SENSEX INDEX	INR	22,454.24	0.79	-1.09	0.30	2.95	6.00	9.99	19.88	6.06	14.29
RUSSIAN RTS INDEX \$	USD	1,166.56	1.06	-3.86	-4.86	4.86	-16.42	-21.80	-12.15	-19.14	4.49
BRAZIL IBOVESPA INDEX	BRL	51,200.56	1.48	0.03	1.56	13.48	4.10	-7.51	-3.18	-0.60	10.10
<b>EQUITY MARKET INDICES - BY SECTOR</b>											
MSCI ENERGY	USD	287.15	1.08	2.40	2.98	6.08	6.25	7.82	21.47	4.20	13.82
MSCI MATERIALS	USD	243.95	1.10	-0.18	0.40	1.67	1.37	4.10	14.65	1.65	15.44
MSCI INDUSTRIALS	USD	199.58	1.50	0.35	-0.55	0.88	-0.95	6.13	21.74	-1.18	15.81
MSCI CONS DISCRETIONARY	USD	174.59	1.49	0.20	-1.50	-2.05	-2.65	1.84	20.16	-3.94	15.83
MSCI CONS STAPLES	USD	192.97	0.70	0.70	1.33	3.41	3.54	4.59	6.91	1.31	17.88
MSCI HEALTH CARE	USD	175.38	0.75	0.08	-2.94	-2.99	-0.39	7.80	17.77	2.05	16.66
MSCI FINANCIALS	USD	100.98	1.03	0.02	-1.00	0.64	-1.27	1.40	15.09	-0.89	13.00
MSCI INFO TECH	USD	123.03	1.08	0.83	-1.58	-0.88	-0.28	9.81	24.60	-0.11	15.80
MSCI TELECOMS	USD	70.16	1.45	0.27	-1.04	0.91	-1.87	0.44	13.38	-2.54	14.70
MSCI UTILITY	USD	120.11	1.03	1.53	1.30	2.61	9.69	7.39	9.44	9.31	15.76
MSCI WORLD REAL ESTATE	USD	181.30	0.70	0.77	2.18	3.27	2.95	-1.56	-5.73	3.61	22.88
<b>HEDGE FUND INDICES</b>											
HFRX GLOBAL HEDGE FUND	USD	1,223.37	-0.08	-0.69	-1.27	-0.89	-0.62	1.60	3.54	-0.17	-
HFRX EQUAL WEIGHTED	USD	1,204.20	0.00	-0.52	-0.84	-0.37	0.21	1.89	4.04	0.60	-
HFRX GLOBAL EUR	EUR	1,133.69	-0.15	-0.74	-1.20	-0.83	-0.36	1.58	2.83	-0.18	-

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<b>FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)</b>										
US 3 MONTH	USD	0.03	0.00	-16.78	-16.78	-44.52	-16.78	-37.68	-50.10	-61.61
US 2 YEAR	USD	0.36	-1.12	3.36	-13.24	1.20	-2.24	16.95	80.65	-4.47
US 10 YEAR	USD	2.63	0.24	-0.49	-3.08	-2.14	-6.56	1.74	55.42	-13.00
<b>FIXED INCOME INDICES - BY TYPE OF ISSUER</b>										
GLOBAL AGG TR HEDGED	USD	453.68	-0.03	0.32	0.59	0.57	1.83	2.82	1.34	2.64
US GOVERNMENT TR	USD	2,015.50	-0.06	0.22	0.49	0.19	1.21	1.16	-1.32	1.81
US CORPORATE TR	USD	2,504.47	-0.01	0.52	1.05	1.26	2.89	4.64	1.12	4.02
US HIGH YIELD TR	USD	1,834.83	0.02	0.06	0.34	0.93	2.34	5.68	7.19	3.33
EU GOVERNMENT TR	EUR	221.96	0.01	0.61	0.74	1.13	3.29	5.51	5.04	4.37
EU CORPORATE TR	USD	233.13	-0.06	0.41	0.55	0.63	2.10	3.93	4.30	2.90
EU HIGH YIELD TR	EUR	263.21	-0.02	0.10	0.52	0.97	2.72	6.24	11.03	3.64
JACI GLOBAL	USD	260.16	-0.10	-0.91	-1.26	-1.02	1.33	5.84	13.35	2.68
GLOBAL EM TR (HEDGED)	USD	315.92	-0.06	0.07	0.84	2.22	2.63	3.91	0.09	3.56
S&P/LSTA U.S. LEV LOAN	USD	98.20	-0.02	-0.16	-0.20	-0.21	-0.71	0.68	-0.26	-0.04
<b>COMMODITY INDICES - BY TYPE OF ISSUER</b>										
GSCI INDEX TOTAL RETURN	USD	5,062.89	0.18	0.91	1.84	2.60	8.11	2.92	10.68	4.83
GSCI ENERGY TR	USD	1,159.25	0.19	1.01	2.44	3.22	7.54	2.17	14.59	2.94
GSCI INDUSTRIAL METALS TR	USD	1,331.52	1.24	1.17	2.92	5.07	-2.54	-2.88	-6.57	-2.58
GSCI PRECIOUS METALS TR	USD	1,636.87	0.31	-0.24	1.28	-5.83	4.14	0.23	-7.90	7.46
GSCI AGRICULTURE TR	USD	702.74	-0.51	0.60	-0.05	2.08	16.77	7.63	0.56	15.85
GENERIC 1ST 'CL' FUTURE	USD	104.18	0.40	0.75	2.56	6.80	11.24	2.90	18.82	6.63
GOLD SPOT \$/OZ	USD	1,298.22	-0.33	-1.57	1.11	-5.04	3.52	-1.68	-5.69	7.68
<b>CURRENCIES</b>										
DOLLAR INDEX SPOT	USD	79.67	-0.17	0.36	-0.54	0.36	-1.91	0.03	-3.65	-0.46
Euro Spot	EUR	1.38	0.17	-0.34	0.51	-0.60	2.20	1.20	6.19	0.70
Japanese Yen Spot	JPY	102.00	0.23	-0.46	1.21	-0.23	2.27	-4.01	-3.80	3.25
British Pound Spot	GBP	1.68	0.19	0.26	1.00	1.15	2.47	4.11	10.44	1.64
Brazilian Real Spot	BRL	2.24	-0.48	-2.51	1.27	4.71	5.26	-2.81	-11.42	5.29
China Renminbi Spot	CNY	6.22	0.04	-0.11	-0.04	-0.67	-2.73	-1.96	-0.75	-2.65
Singapore Dollar Spot	SGD	1.25	0.04	-0.01	0.58	1.14	2.07	-0.85	-1.12	1.02
Norwegian Krone Spot	NOK	5.97	0.06	-0.67	0.31	-0.30	3.11	-0.63	-2.85	1.71
<b>VOLATILITY / LIQUIDITY INDICES</b>										
CBOE SPX VOLATILITY INDX	USD	14.18	-9.16	2.60	2.16	-9.34	13.99	5.19	-14.11	3.35
USD SWAP SPREAD SEMI 2YR	USD	15.19	2.98	11.20	20.65	10.47	10.47	13.70	6.90	44.67
TED SPREAD	USD	0.00	3.37	2.74	1.17	7.25	-1.65	-8.04	-10.53	-86.18

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