Friday, June 27th 2014

It is summer again and as we all know, seasons come and go. Q2 is closing as we write and earnings' season is about to commence. "Déjà vu, all over again", as said Yogi Berra...
The "shock du jour" came Wednesday when we heard that the U.S. economy contracted at a much steeper pace than previously estimated in the first quarter, but there are indications that growth has since rebounded strongly. The Commerce Department said on Wednesday that Gross Domestic Product fell at a 2.9% annual rate, the economy's worst performance in five years, instead of the 1.0% contraction it had reported last month. The difference between the second and third estimates was the largest on records going back to 1976. Economists had expected growth to be revised to show it contracting at a 1.7% rate; déjà vu… expectations by economists and analysts…

The worsening conflict in Iraq poses a bigger risk to long-term oil prices than traders had anticipated, according to banks from Citigroup Inc. and Bank of America Corp. Brent crude contracts for December 2018 cost $15.26 a barrel less than August 2014; a spread that's widened by 9.9% since the end of May. The IEA believe that violence in Iraq is the biggest risk to new supply this decade. Markets haven't panicked because Shia-dominated southern regions remain unaffected and will be fiercely defended against the ISIL insurgency; Southern Iraq produced more than 85% of the country's 3.1 million barrels a day.

The dollar was poised for declines this quarter against most of its 16 major counterparts. The pound was about 0.2% from its strongest level since 2008. Taiwan's dollar gained as quarterly equity inflows climbed the most since 2009. Three-month implied volatility in dollar-yen reached 5.805% on Tuesday after declining to 5.715%, the lowest level since Bloomberg began compiling the data in December 1995. And then, the greenback will strengthen to 107 yen by Dec. 31, according to a survey of economists by Bloomberg. We say that before selling the JPY though, do refer to Yogi Berra's words above…

And now we give you four Bedrock existential thoughts about investing;

Inflation: Real inflation is derived from energy and food prices. Central Bank actions to try eventually to contain it via rate rises would not change droughts or the fighting in Iraq...

Investing: New highs don't mean you have to sell. New market highs are unnerving, of course, because the next bear market will start at one of them. You just don't know which one. Had you invested in the market at its then all-time high of Oct. 9, 2007, for example, you would have been deeply unhappy. On that day, the S&P 500 hit 1565.15, a level it didn't break again until March 28, 2013. On the other hand, markets generally hit new highs over time, and if you were to sell at each new high, you'd run a decent chance of missing further gains. Had you sold at the market's former all-time high of March 28, 2013, for example, you would have missed a 25% gain. A new high, in and of itself, is probably a bad reason to sell.

Risk: Where some investors see nothing but rolling green fields and placid summer lakes, others see black swans circling high above. Such is the picture painted when comparing the widely followed Chicago Board of Options Exchange Volatility Index - the market's "fear" gauge - and its sister measure, the Skew, aka the "Black Swan Index," which charts… well… lots of fear. (The black swan is a metaphor for a highly unusual occurrence and took on added significance following Nassim Taleb's 2007 book, "The Black Swan"). While the VIX is closing-in on historic lows and has tumbled nearly 20% year-to-date, the Skew has surged in June, rising more than 12% for the month. Taken together, the two measures reflect an interesting dichotomy among investors. One crowd, buying plain-vanilla VIX options, anticipates a smooth ride, while the other is not necessarily anticipating but at least bracing for some really off-the-wall occurrence. Expecting a dunking for the seemingly indestructible stock market in the freezing waters of the said placid summer lake!

Rebalancing: A mantra for portfolio management - Always look forward, and maintain into the future your risk-profile. To do so, you invariably sell-down your winners and add to your losers. Whilst the target of a balanced risk-profile is commendable, the prudent investor is clipping his/her good positions and adding to the bad ones. Another difficult risk/reward dichotomy…
Bedrock considers these four existential thoughts with each portfolio we construct and track. We are called to be architects of the future, not its victims. Vision is the art of seeing what is invisible to others.

<u>Core View</u>: This week saw Q1 GDP at -2.9% QoQ, much weaker than expected – couple this with the tapering from last week and the slightly dovish statement we re-iterate that the data is telling us that things are doing better but not as well as desired. Inflation, whilst rising slightly is NOT an issue at this time and interest rates will NOT be rising anytime soon. US stock markets were stable near their all-time highs and Treasuries a touch stronger after the weaker GDP, with volatility as measured by the VIX dropping to another seven year low of 10.30! This, on the back of the ECB's action reassures us of our view that 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. As a group, most Central Banks are targeting an elusive 2% inflation rate. As the industrialized economies are running with excess labour and industrial capacity (the US is running at under 80% of capacity), the return of inflation appears to be in the distance - short term interest rates are unlikely to rise anytime soon.

Some other and less predictable risks are brewing on the horizon - The Ukrainian elections and Russian-debacle have moved off the front page, it is clearly unresolved and might yet grow to be a serious problem. On the other hand, Iraq appears to be falling apart yet again and threatens oil supplies... with Iran sniffing around the periphery to positions itself as a powerhouse in the region. Clearly, political risks abound and are rising around us;

- **Fixed Income -** As all Central Banks are seeking somewhat higher inflation than they have, it is hardly reasonable that they raise rates! Vigilance is important, short maturities with low duration are and remain appropriate- whilst we are sanguine about short-term rates, we find little incentive in taking term duration risk or higher credit risk as markets have squeezed returns to a point where the risk/reward ratio in bonds is no longer interesting- virtually no upside exists in the sector and expected returns at the 3% level (coupon plus capital gains) are insufficient to offset the underlying risks.

- **Equities –** With P/E ratios around the globe at historically reasonable levels and rising (!) - And earnings are still maintaining fair growth rates (3.5%), we feel secure in owning equities. As the P/E's expand, the inherent value in the indices diminishes… we take note and will focus on watching the sector rotation and seeing whether the momentum stocks regain full traction. We remain positive and recommend exposures to be maintained using global diversified funds, or by allocating some fixed income exposure to convertible bonds- owning the security of fixed income with an exposure to equities.

- **Alternatives -** In a normalizing financial-world, with relative economic stability and a clearing horizon, fundamentals are returning to base text-book relative values allowing traders and investors to take views and positions. We expect this active management allocation to maintain, if not exceed, its historical results - similar to equity returns but with low correlation to any sector with significantly lower volatility than equities. We stick with our view that a well-diversified Fund of Funds is the best investment for now. We reiterate our fundamental views on Alternatives, whereby their role in a portfolio is to attenuate volatility and risks, not as yield enhancement!

- **Currencies -** The market still has a very low volatility relative to the past 5 years. The Euro appears to have regained its footings versus the USD at 1.36+. We maintain belief in the fundamental strength of the US$ and would not bet against it at this time. The ceiling level of $1.40 per EUR is likely to hold firm. Gold appears to have maintained a hold above $1'300 as the Iraq/Syria/Iran debacles play out.

Weekly Highlights:

- The FX markets have been quiet; with a lack of big data the markets remained unfazed and continued bobbing along. Despite the large negative miss from expectations for the Q1 final GDP data, the USD is unchanged on the week although any strength is showed for Monday and Tuesday has been erased. The EUR remains above 1.36, and Cable is still above 1.70. The only pair that has seen a move out of its recent trending pattern is the USDJPY, where the JPY has retraced is recent weakness - despite PM Abe's most recent shot across the bow to boost the economy by cutting corporate tax rates – the USDJPY is now at 101.40. The USD index moved lower this week despite the continuing fears attached to the Iraq situation.
- The US Treasuries, Bunds and Gilts held strong week, despite Central Banks pushing for the long term rates to rise with a poorer USD GDP figure the markets are not ready to sell just yet! The US 10Y dropped to 2.51%, the Bund moved from 1.31% to 1.25% and the UK Gilt is trading at 2.64%. The spreads of the Periphery in Europe to the Bund are steady at the same levels as last week. Italy's 10 year yields slightly stronger on the week moving from 2.96% to 2.85% and Spain moving in a similar fashion from 2.74% to 2.66%.
- Global equities maintained their highs or thereabouts this week. Aside from the short term sell-off due to the poor US data they are marginally weaker, but still within a cat's whisker of the highs. The US saw their major indices drop on average 0.3% on the week and with a very similar move for the Emerging markets, save for Brazil that is down 3.0% on the week. Europe had a tough week with most indices down between 1.3% and 2%! The S&P 500 made new intraday highs of 1,968 and so too the DJIA a new intraday high of 16,978. So… we remain "comfortably" vigilant.

Highlighted items are interesting data points for the week

MARKET INDICES PERFORMANCE

26/06/2014

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	1Y	YTD	
			PRICE CHANGE IN % (unless indicated)								
EQUITY MARKET INDICES - BY REGION											P/E
MSCI WORLD	USD	1,737.27	-0.05	-0.58	1.29	1.73	5.09	5.02	20.98	4.59	15.83
MSCI WORLD LOCAL	-	1,233.85	-0.04	-0.61	1.14	1.88	4.77	4.88	20.34	4.17	-
MSCI AC WORLD	USD	427.22	0.01	-0.49	1.35	1.69	5.33	5.02	20.19	4.57	15.19
MSCI EM	USD	1,046.81	0.48	0.28	1.86	1.35	7.33	4.94	13.85	4.40	11.38
S&P 500 INDEX	USD	1,957.22	-0.12	-0.12	1.75	2.37	5.85	6.29	21.33	5.89	16.54
DOW JONES INDUS. AVG	USD	16,846.13	-0.13	-0.45	0.77	1.02	3.58	2.23	12.12	1.63	15.05
NASDAQ COMPOSITE INDEX	USD	4,379.05	-0.02	0.45	3.22	3.35	5.49	5.35	28.72	4.85	19.09
RUSSELL 2000 INDEX	USD	1,180.71	-0.17	-0.28	4.07	3.37	2.54	1.69	20.49	1.47	19.63
EURO STOXX 50	EUR	3,237.64	0.14	-1.96	-0.21	-0.20	3.32	4.06	23.58	4.14	14.53
CAC 40 INDEX	EUR	4,445.84	0.14	-2.10	-1.63	-1.85	1.52	3.93	18.17	3.49	15.09
DAX INDEX	EUR	9,813.79	0.09	-1.74	-1.30	-1.28	3.84	2.34	22.81	2.74	13.74
FTSE 100 INDEX	GBP	6,746.09	0.16	-1.16	-1.44	-1.44	2.39	-0.07	8.05	-0.04	-
SWISS MARKET INDEX	CHF	8,541.97	0.01	-1.83	-1.53	-1.93	2.57	3.89	11.34	4.13	16.61
NIKKEI 225	JPY	15,095.00	-1.39	-1.66	3.16	3.13	3.23	-6.70	14.24	-7.34	16.91
HANG SENG INDEX	HKD	23,187.42	-0.04	-0.03	0.46	1.06	6.20	-0.24	13.44	-0.51	10.78
SHANGHAI SE COMPOSITE	CNY	2,036.51	-0.11	0.49	-0.13	0.10	-0.49	-3.08	4.44	-3.76	7.95
S&P BSE SENSEX INDEX	INR	25,088.41	0.10	-0.07	3.60	2.20	12.94	18.38	32.91	18.51	16.04
RUSSIAN RTS INDEX $	USD	1,379.88	0.18	1.56	6.49	6.35	16.99	-4.53	9.27	-4.36	5.46
BRAZIL IBOVESPA INDEX	BRL	53,506.75	0.15	-3.07	4.43	2.55	7.77	4.37	12.39	3.88	10.93
EQUITY MARKET INDICES - BY SECTOR											P/E
MSCI ENERGY	USD	309.15	0.10	-0.89	4.45	4.94	12.20	12.50	26.85	12.18	14.81
MSCI MATERIALS	USD	251.12	0.01	-0.38	1.77	1.23	4.94	5.14	21.63	4.64	16.32
MSCI INDUSTRIALS	USD	205.33	-0.04	-1.33	0.34	0.73	3.85	2.15	22.35	1.67	16.40
MSCI CONS DISCRETIONARY	USD	181.27	0.16	0.23	1.13	1.56	3.68	0.37	18.90	-0.27	16.69
MSCI CONS STAPLES	USD	198.06	-0.33	-1.30	-0.56	0.48	5.00	4.21	12.56	3.98	18.54
MSCI HEALTH CARE	USD	188.50	-0.03	0.02	2.28	2.64	5.35	9.87	25.99	9.69	17.69
MSCI FINANCIALS	USD	103.82	-0.20	-1.01	0.59	0.92	3.23	2.39	17.47	1.89	13.44
MSCI INFO TECH	USD	130.38	-0.16	-0.02	1.68	2.10	5.59	6.48	27.35	5.86	16.51
MSCI TELECOMS	USD	72.27	0.31	-0.40	-0.81	0.15	2.82	0.49	18.01	0.39	15.60
MSCI UTILITY	USD	124.32	0.32	0.12	2.16	3.20	5.98	13.67	18.86	13.14	16.26
MSCI WORLD REAL ESTATE	USD	190.39	0.15	-0.09	0.56	0.91	8.81	9.46	9.84	8.81	23.17
HEDGE FUND INDICES											
HFRX GLOBAL HEDGE FUND	USD	1,245.40	0.00	0.03	0.79	1.26	0.78	1.95	5.80	1.62	
HFRX EQUAL WEIGHTED	USD	1,217.90	0.01	0.04	0.61	0.87	0.54	1.91	5.18	1.74	
HFRX GLOBAL EUR	EUR	1,152.76	0.00	0.02	0.76	1.26	0.73	1.82	5.48	1.50	

MARKET INDICES PERFORMANCE

26/06/2014

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	1Y	YTD
			PRICE CHANGE IN % (unless indicated)							
FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)										
US 3 MONTH	USD	0.03	0.00	0.02	-0.01	0.00	-0.01	-0.04	-0.02	-0.04
US 2 YEAR	USD	0.46	-0.01	0.00	0.08	0.11	0.01	0.07	0.11	0.08
US 10 YEAR	USD	2.52	-0.01	-0.09	0.04	0.01	-0.16	-0.48	0.05	-0.51
FIXED INCOME INDICES - BY TYPE OF ISSUER										
GLOBAL AGG TR HEDGED	USD	460.00	0.12	0.41	0.32	0.67	1.98	4.04	5.56	4.07
US GOVERNMENT TR	USD	2,031.10	0.17	0.45	-0.20	0.09	1.21	2.61	2.31	2.60
US CORPORATE TR	USD	2,545.02	0.22	0.75	0.10	0.64	2.60	5.77	8.41	5.70
US HIGH YIELD TR	USD	1,668.51	-0.01	0.07	0.83	1.15	2.53	5.60	12.55	5.46
EU GOVERNMENT TR	EUR	226.86	0.11	0.47	1.06	1.58	3.11	6.66	9.32	6.67
EU CORPORATE TR	USD	237.48	0.04	0.17	0.61	0.87	2.44	4.74	7.68	4.82
EU HIGH YIELD TR	EUR	268.37	-0.04	-0.08	0.89	1.29	2.64	5.82	14.29	5.67
JACI GLOBAL	USD	264.97	0.08	-0.01	0.30	0.96	0.91	5.07	15.17	4.58
GLOBAL EM TR (HEDGED)	USD	327.00	0.07	0.61	0.79	1.57	4.96	7.12	11.51	7.19
S&P/LSTA U.S. LEV LOAN	USD	98.88	0.01	0.04	0.18	0.26	0.48	0.72	1.73	0.65
COMMODITY INDICES - BY TYPE OF ISSUER										
GSCI INDEX TOTAL RETURN	USD	5,148.56	-0.37	-0.58	2.98	1.61	4.45	5.69	11.40	6.61
GSCI ENERGY TR	USD	1,196.58	-0.68	-1.06	3.79	2.48	6.53	5.05	15.13	6.26
GSCI INDUSTRIAL METALS TR	USD	1,376.93	0.37	2.14	1.99	1.39	8.48	1.55	5.20	0.74
GSCI PRECIOUS METALS TR	USD	1,665.91	-0.38	0.47	6.57	2.75	1.69	8.20	7.44	9.36
GSCI AGRICULTURE TR	USD	639.94	0.42	-0.66	-3.55	-5.55	-7.45	5.00	-7.46	5.50
GENERIC 1ST 'CL' FUTURE	USD	105.74	-0.09	-1.02	3.38	1.99	5.36	7.15	9.08	9.26
GOLD SPOT $/OZ	USD	1,317.25	0.05	0.18	5.40	4.14	2.01	8.56	9.71	9.26
CURRENCIES										
DOLLAR INDEX SPOT	USD	80.15	-0.09	-0.28	-0.27	-0.25	0.05	-0.30	-3.32	0.14
Euro Spot	EUR	1.36	0.03	0.12	-0.14	-0.14	-0.90	-0.97	4.43	-0.92
Japanese Yen Spot	JPY	101.43	0.30	0.63	0.34	0.54	0.74	3.69	-3.04	3.83
British Pound Spot	GBP	1.70	0.00	0.08	1.62	1.29	2.50	3.30	11.59	2.84
Brazilian Real Spot	BRL	2.20	0.50	1.40	2.03	1.26	4.83	7.14	-0.46	7.52
China Renminbi Spot	CNY	6.22	0.11	0.12	0.47	0.48	-0.08	-2.39	-1.11	-2.63
Singapore Dollar Spot	SGD	1.25	0.00	-0.02	0.40	0.59	1.21	1.58	1.39	1.10
Norwegian Krone Spot	NOK	6.13	0.05	-0.22	-2.58	-2.90	-2.12	0.24	-1.42	-0.98
VOLATILITY / LIQUIDITY INDICES										
CBOE SPX VOLATILITY INDX	USD	11.63	0.35	9.51	2.02	1.04	-20.45	-6.66	-31.02	-15.23
USD SWAP SPREAD SEMI 2YR		12.75	4.08	-13.91	-7.27	-19.30	9.07	34.21	-15.73	21.43
TED SPREAD		0.00	-2.22	-4.87	5.99	2.08	5.53	12.38	-5.00	-85.75

All data is compiled from Bloomberg

Disclaimer