Friday, April 15th 2011

Barak Obama spoke this week. Forcefully explaining how big the US debt really is, how difficult it will be to reduce it. Amazingly, he was applauded for presenting a plan (without details) to reduce the problem over a period which will cover 3 or 4 Presidential elections and across 6 or 8 Congressional re-balancing. Can any politician set today his followers agendas into the future? Let's leave this as an open question, shall we?
Amazingly the IMF has suggested that it might have to assist the USA in its debt quagmire. What could the IMF be thinking? Ask the US to increase its funding of the Fund so the latter may help the US? Perhaps we should not try to understand? The US Dollar continued to fade through both Obama's and the IMF talks…Gold at an all time high of $1'475 may be nailing down the message that all is not well with the Dollar. This said the other measure of the Dollar, oil, is off its recent peaks and equities are wobbling. We have seen some Q1 earnings' reports: Alcoa showed fair if uninspiring results and got slammed. Google had great figures and is bursting the seams of its wallet, and got slammed hard (investing too much in redesigning the world?). Headwinds are still blowing- The turmoil in the Arab world is all but over, Japan has the shakes and is affecting the economics around the globe as it can't deliver components. And yesterday we got the US Producer Price Index, running stronger than expected. Only to be mitigated by record exports leaving US ports. Is a weak Dollar a bad thing for the US? Well, if the CPI will not follow, then it's good…
China gave us some data today. With GDP growing at 9.6% their slowdown clearly isn't dramatic… But their inflation definitively is a problem. This reinforces our view that they must let the Yuan appreciate! Occam's Razor advocates the obvious as the best answer, as inflation is simply a decline in the value of currency. Occam would simply re-value the currency as the obvious anti-inflationary step. But at the end of the day, China, in joining the advanced economies is becoming more like Obama and the IMF… Say no more…

Yes, we have headwinds. We quote Winston Churchill's comment "*Kites rise highest against the wind - not with it*" in support of our optimistic outlook on the global economy and portfolio returns. We remain confident that the best returns will come from equities as bonds will likely suffer from inflation fears. Commodities? Well, if China is indeed growing at almost 10%, they will consume more and we cannot increase production for them at this rate. So prices likely will continue to be under upward-pressures. As these are priced principally in US$, the effects will be attenuated for those operating in a different currency base than the $.

Going into the Passover and Easter holidays we would like to give all you Euro Bears a titbit of data to consider; since its inception, the Euro's compound rate of inflation has been 2%. The ECB has met its mandate!

Happy Holidays to all. Do note that Bedrock will be closed next Friday for Easter, and no newsletter…

Currencies

- The Euro did not move this week versus the US Dollar and lost some ground versus the Japanese Yen. The Euro went from 1.4440 at the beginning of the week to 1.4410 currently versus the US Dollar and from 122.80 to 120.00 currently versus the Yen.
- Europe's currency has rallied 7.5% against the dollar so far this year as inflationary concerns lead to expectations of rate hikes by the ECB.
- The British Pound stood still against the US Dollar and the Euro. The pound strengthened during the end of the week as a report showed U.K. consumer confidence rose in March from a record low, fuelling speculation that the central bank may increase interest rates.
- The Swiss Franc appreciated further against the US Dollar and reached a new record at 0.8920 from 0.9070 last week.
- The Japanese Yen weakened versus most of its major counterparts as appetite for risk improves. The Bank of Japan is unlikely to raise rates anytime soon and is likely to provide liquidity as the country aims to recover from the dramatic earthquake and Tsunami of March.
- After weeks of strong appreciation, the Canadian Dollar depreciated this week against the US Dollar as oil declined. The CAD had reached 0.9555 versus the USD last week and now stands at 0.9650.

Fixed Income

- US Treasuries' prices rose, heading for their first weekly gain in a month on speculation the economy will lose momentum as the government and central bank curtail stimulus. The financial markets seem to have some confidence in the U.S.'s ability to reduce its budget deficit after President Barack Obama vowed to cut $4 trillion over 12 years.
- Yields on 10 and 30 year US Treasuries declined by 12 bps (at 3.43% and 4.49% respectively) this week while yields on shorter term bonds (2 year) declined by 6 bps at 0.71%
- Yields on long term European government bonds also declined this week as the ECB became the first major central bank to raise its benchmark rate.
- Spanish 10-year yields rose 14 bps at 5.41. The difference in yield, or spread, between Spanish 10- year debt and equivalent German securities widened for a fifth day to as much as 207 basis points.
- German two-year notes declined after data showed Euro region inflation accelerated to the most in more than two years.
- Government and corporate bonds outperformed higher yielding securities this week. However total returns on High Yield remains well ahead for the year.
- We remain constructive on higher yielding fixed income securities valuations and as these will continue to see inflows. We remain shy of high quality corporate and government bonds as these will be under pressure from higher inflation expectations and low overall rewards.

Bedrock Newsletter

Equities

- Global stock markets were slightly negative this week. The MSCI World as of yesterday's close is down -0.6% for the week, but up over 5% since the beginning of the year.
- Far East stocks fell broadly after China reported that inflation in the world's second-largest economy increased faster than estimated, increasing speculation that the government will need to do more to contain growth.
- Among developed markets, Japan and Switzerland were the highest performers during last week, up 0.2% and 0.8% respectively. In Switzerland, better-than-estimated results released by a number of large caps helped the SMI to fare better than its European counterparts.
- The S&P 500 was flat for the week while the Dow Jones Industrial Average was marginally positive up 0.12%.
- Nearly all European markets were negative during the week with the Euro Stoxx 50 down -1.9%.
- Energy and Materials were the worst performing sectors this week while Industrials, Financials and Information Technology were also down significantly. Consumer staples and Healthcare were the top performers this week. Year-to-date, Energy is still the highest performing sector while Information Technology is the worst performing one.
- We remain positive on equities overall, as better economic environment, reasonable valuations and strong M&A activity should continue to support equity prices.

Emerging Markets

- Emerging markets equities this week underperformed developed markets, with the MSCI EM Index down -1.50% for the week versus -0.90% for the MSCI World index. However, the EM index is close to catching up its developed counterpart for the year to date, having been far behind only a few weeks ago.
- After having strongly performed last week, Asian stocks performance was mixed this week with the Shanghai Composite and the Kospi index positive, while the Indian BSE Sensex and the Taiwan Taiex index were negative.
- Latin America was the worst performing region among EM last week, with the Brazilian Bovespa showing -4.5%, while Chile and Argentina were down close to -2.5%. Europe EM also did poorly this week.
- Chinese stocks are back in demand, having lagged significantly last year. The Shanghai Index is up 8.6% for the year.
- We remain positive overall on EM equities and believe these should show strong performances on better growth prospects.

Commodities

- Commodities declined this week with the GSCI broad commodity index down by -1.9% for the week.
- Industrial metals and agriculture were down the most this week, with the GSCI Industrial Metals down close to -2.5% while the GSCI Agriculture lost -3.4%.

- Precious Metals was the only positive sector, with gold up by nearly 3% for the week and silver up over 4%, climbing to its highest level since 31 years as inflation in China accelerated more than forecast, underscoring the challenge that central bankers worldwide face in combating rising prices.
- Oil prices declined for the first time in two weeks, with Brent crude oil down -1.2% for the week to $121.9 a barrel currently. Oil prices significantly increased over the past weeks on inflationary concerns and the weaker dollar and ongoing trouble in the Middle East.
- We remain positive on commodities, especially energy and industrial metals on growth prospects and supply and demand pressures.
