Friday, April 29th 2011

Ben Bernanke gave a historic news conference. He did appear posed, knowledgeable and told us things that we all knew before- The economy in the US is revived, growing but not fast enough to significantly reduce unemployment and therefore QEII will run its course and rates will not rise for some time to come. Is this "transparency" truly better than the incomprehensible statements of Paul Volker and Alan Greenspan? To hear yet again, clearly that a strong US Dollar is what the USA and the World truly need as the greenback continues to slide to new all-time lows on a daily basis?
Are Dollar denominated commodities (Gold and Oil for example) rising or is it the decline of the Dollar? Gold in Swiss Francs whilst trading down today, it is at the level it was roughly one year ago. In US$ though, it is up today and 30% above where it was one year ago. Inflation hedging is the reason for the commodities rising is what we hear and read. Well, history proved Gold to be a poor hedge against inflation as whenever real inflation came into play, interest rates were increased and the "cost of carry" for gold rose, making its price fall. Contrarian thinking could lead us to think that as Gold is rising in US Dollars, there probably will be little if any inflation therein.
In reality, equities have always been the better inflation hedge. The DAX has risen by 20% over the past year whilst the broad &P 500 has gained 13% and for comparison, Oil has gained 35% in this past year (since May 2010).
Corporate earnings for Q1 have been generally ahead of expectations and outlooks broadly improved. Yes, equities look more promising the more we consider them as an investment venue; Interest rates will remain low, inflation subdued and global growth running steady at a fair rate. At year-end we had expected a reasonable equity market for 2011, projecting an S&P 500 index to reach 1'350, a level crossed yesterday. Where to next? Perhaps 1'500 (another 10%) as we enter an election year? Clearly, the US will not resolve its budgetary issues into an election, so yes, the US$ will remain under pressure and the Fed may be tempted to venture into a (so far denied) QEIII to resolve the unemployment problems. In truth, Bernanke said that QEII will not truly end in June as they will be reinvesting coupons and maturing papers, i.e., increasing the absolute outstanding Fed balance sheet… QEII+ or QE-Light for now… Did we really get better transparency from the Fed?

There is an old traders' adage that says "Sell in May and go away". It didn't work in 2009 but worked for 2010. So clearly a correction could be around the corner, but we would venture that it is likely to rise again after... Perhaps we will be spared these journalistic scaremongering when May 2012 will come around?

And yes, it is the Royal Wedding weekend. No doubt the event of the week, London at a standstill, we are informed more about the dress of the Royal Bride than about the developments in Libya, Syria or Japan. Come to think of it, what *is* happening in these places?

Enjoy the week end.

Currencies

- The US Dollar took a sharp beating against all currencies this week following the Fed's decision to hold the course on QEII. It slid the most against the EUR and the GBP, 2 currencies that in our view do not deserve such a high reading.... the EUR shot up to 1.4860, a level not seen since December 2009. The GBP went up to 1.6745, a level also not seen since December 2009.
- The Swiss Franc rose to new all time high at 0.8670 before dropping a bit to 0.8750 now. Against the EUR, the Swiss Franc continues to hold firm, at levels below 1.3000.
- The JPY was the only currency that did not rise against the USD as the rating agency S&P changed its outlook on Japan to negative following the earthquake reconstruction budget. The JPY weakened on the news to 82.60 but has since rebounded to 81.50 in sympathy with the broad US Dollar move.
- The USD CNY pair also dropped to a 17 year low to stand below 6.50. This move in our eyes is the clearest and has still a long way to go. The pace of revaluation in China is also starting to accelerate.
- The broad USD move looks to be overstretched and extended, so a rebound of some sorts should be occurring soon. In any case, the JPY is set to be the weakest currency going forward as Japan will be the last country to increase interest rates.

Fixed Income

- US Treasuries' prices rose again this week following the Fed's decision not to alter monetary policy at this stage. Treasury yields on the 10 Yr Note dropped to 3.30% as the Fed said that any inflation would be transitory and that growth was cooling down a bit.
- Yields on 2 year treasuries also went down to 0.62%.
- Although the Federal Reserve affirmed keeping interest rates low and will reinvest securities proceeds into Treasuries, the market senses a shifting mindset toward tightening around November, with a first rate hike in Q1 2012. As the Fed shifts, so will the markets, with participants expecting U.S. bond yields to increase gradually as the year progresses.
- In Europe, the saga of the European peripheral countries continues, with Greek Yields surging to 16%!! What is very astonishing at this stage is that both the EUR and equity markets seem unfazed by this looming crisis...
- Concerning Portugal, European Union leaders are likely to agree on bailout terms for Portugal by mid May, Euro group President Jean-Claude Juncker said Thursday. Let's see if this is going to really happen....
- We continue to remain constructive on higher yielding fixed income securities as these will continue to see inflows. On high quality corporate and government bonds, we remain underweight as we find little value and a lot of risk going forward.

Equities

- Global stock markets were positive this week. The MSCI World as of yesterday's close is up 1.8% for the week and up over 8% since the beginning of the year.
- US stocks rose by 2.3% over the last week, sending the S&P 500 Index to the highest level since June 2008, as better-than-estimated corporate earnings tempered investors' concern over slowing economic growth.
- Far East stocks were hit by China's interest rate hike and the Yuan strengthening while Japan recovered from last week losses, up 1.7%
- Among developed markets, Europe performed strongly last week up 2.55% with Germany, Spain and Italy leading the gains, up 3.1%, 3% and 3.8% respectively.
- All MSCI Sectors Index were positive last week, Energy and Materials being the worst performing sectors while Healthcare, Telecom and Utility were the best performing ones. For the month, Consumer staples and Healthcare outperform every other sectors but year-to-date, Energy is still the highest performing sector while Utility 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 underperformed developed markets this week, with the MSCI EM Index down -0.4% versus 1.8% for the MSCI World. Two weeks ago, the MSCI EM was close to catching up its developed counterpart for the year-to-date, but is now quite far from it.
- Asian stocks fell broadly last week after China's Yuan strengthened beyond 6.5 per dollar for the first time since 1993, supported by speculation the central bank will allow appreciation to help tame the fastest inflation in more than two years. The Hang Seng lost -0.75% while the Shanghai Composite was down -3.3% over the week.
- The Indian BSE Sensex and the Kospi Index were both negative while the Taiwan Taiex Index was slightly positive.
- Latin America was up overall this week with Chile, Argentina and Mexico in positive territory while the Brazilian Bovespa was down -0.75%. Brazil lost -4.25% this month on concern about the strengthening Real and mounting inflation that could lead policymakers to tighten monetary policy more than investors originally thought.
- Russia and Eastern Europe did poorly this week. However, Russia remains one of the world's best performing markets for the year up 13.9%, along with Bulgaria (21.8%), Serbia (14%) and Hungary (13.3%).
- We remain positive overall on EM equities and believe these should show strong performances on better growth prospects.

Commodities

- Commodities were about flat this week with the GSCI broad commodity index down by -0.15%.
- Oil kept rising this week up over 1%, at $113 a barrel. This, on the back of a lower USD and on continued tensions and conflicts in the Middle East.
- Agriculture and Industrial Metals were the worst performing sectors this week, down -4.2% and -2.2% respectively while Precious Metals was the best performing sector, with gold up by over 1.7% for the week.
- Gold hit a new price record yesterday at $1536 an ounce and is poised for its biggest monthly advance since November 2009 as a weakening dollar and accelerating inflation prompted investors to buy precious metals as a store of value.
- Silver rise has become parabolic and “bubbly”. We all know how it ends... the question is when and from which level. We certainly are getting more nervous in view of these price movements.