Friday, May 6th 2011

Wow!!! Commodities got a nasty spanking all week, culminating in a nasty crash on Thursday. The year-long commodities "Trade du jour" was dismembered in a brief moment. Ben Bernanke may have been right in saying that the inflationary concerns due to commodity prices were exaggerated as they were likely transitory. As is our inclination, let's step back a little and take a look at what happened: Silver which had been rising by the minute since some months now collapsed in a few days, only to find its level of March 15th… Oil, in tandem, "collapsed" back to where it had risen with much fanfare in mid February. Certainly, some late-comers to the domain got big bruises… But then, isn't a fall in commodities' prices good for the economy? Until two days ago we were all bombarded with nasty analysis all predicting economic slowdown from the "oil tax", so why did equities fall into this oil reversal?
Maybe we just had a slow and long build-up into rising commodities, these being notoriously thin markets, when the run for the doors happens, the fall in a day of a month's worth of rises is normal, n'est ce pas?
We take on the inflation fears which we had been sceptical of for a very long time. We believe that the impact from commodities on inflation is relatively low given their part in GDP. Labor costs are contained in most developed countries; capacity utilization is also far from bottlenecking so the real, usual causes for price increases are contained. The Bank of England and the ECB held their interest rates steady and none of the big Central Banks seem concerned with the subject. In truth, the market isn't listening to CNBC- the US yield curve is lower than it was at year-end. At all points- 2 year, 5 year, 10 year and even the 30 year bond yields are all below the year-end levels! What inflation?

Adam Smith postulated that "All money is a matter of belief". Well, we still believe that inflation isn't nipping at our heels, that commodities remain important necessities and are likely to have supply/demand imbalances into the future whereby demand growth outstrips supply capacities. Probably in the likes of oil, copper and foodstuffs. What and whom to believe? Yesterday morning Jim Rogers touted oil as the most undervalued asset around, then in our early evening Jim Cramer on CNBC postulated that oil (as it was falling) was substantially overvalued.
The US Dollar which has been melting away steadily rebounded strongly yesterday. Was the said decline simply the offset effect of the Commodities rise? Let's not forget that every purchase (investment or speculation) of a commodity is in effect a sale of Dollars… We buy Oil for $100, as we sell Oil, we are actually buying Dollars. Perhaps yesterday's commodity wash-out will set the floor on the Dollar's decline?

Oh yes, with all these commodity upheavals we almost forgot that the US Navy Seals killed Osama Bin Laden…

Smile into your weekend, now safer for all and cheaper for all…

Currencies

- The Dollar strengthened against most of its major counterparts during the week even as claims for unemployment benefits jumped and productivity of US workers slowed in the first quarter. The Dollar Index touched 72.69 on Wednesday, the lowest since 2008. It then started rebounding smartly on Thursday, when everything else either collapsed or sank.
- After a rise to a 17-month high against the Dollar on monetary tightening speculation, the Euro weakened to 1.4525 versus the Greenback after the European Central Bank signalled it will wait until after June to raise interest rates. The European currency weakened against 14 of its 16 major peers. It had started the morning on Thursday at a 2 year high at 1.4920, and then lost 4 big figures to stand at 1.4520 in the evening, the largest one day drop since October 2008.
- The Yen strengthened to below $80 on demand for safer assets, even falling at 79.60 during the week for the first time since central banks intervened to weaken the currency in March. Japan's currency climbed versus all of its 16 most-traded peers and reached the strongest level in six weeks against the Greenback as falling commodities and stocks prompted investors to unwind bets in higher-yielding assets financed with yen. This move is non sense and we should see a weaker JPY soon.
- As a consequence of the commodity rout, currencies of commodity exporters including Australia, Norway, Canada and Brazil plunged. Norway's krone fell over 4% to $5.4755 to become the worst performer among the 16 major currencies while the Real also fell over 3% to $1.6220.
- The Pound fell to 1.6385 versus the Dollar after the Bank of England kept its benchmark rate at a record low. Signs the recovery is losing momentum kept a majority of policy makers focused on stimulating growth during the Government's fiscal squeeze.
- After hitting an all time high record this week at 0.8550 versus the Greenback, the Swiss Franc lost some ground to 0.8725 currently. Against the EUR, the Swiss Franc continues to appreciate, at levels well below 1.3000, to stand at 1.2650.

Fixed Income

- Government debt prices kept rising this week following Fed's decision to maintain its record stimulus when it ends purchases of Government securities two weeks ago.
- Treasury 30-year bonds gained for a sixth day (as yields lost 13 bps), the longest winning streak since December 2008, as a plunge in commodities and a rise in weekly jobless claims eased concern inflation is accelerating. The 10-year note yield also fell 13 bps to 3.17%, after touching its lowest level in eight weeks. Treasuries yields fell 2 bps to 0.58% while 6-month bill rates traded at 0.06% after touching a record low at 0.05%.
- The premium investors demand to hold Treasuries instead of 10-year inflation-protected debt dropped to the lowest in a month as the Fed purchased $1.9 billion in Treasuries maturing from August 2028 to February 2041.
- The difference between yields on 10-year notes and TIPS, a gauge of expectations for consumer prices over the life of the debt, decreased to 2.5 percentage points, the narrowest since April 4. It widened to 2.67 percentage points on April 11, the most in three years.

- In Europe, the saga of the European peripheral countries continues, with Greek Yields standing around 15.4% after having surged to 16% last week.
- Details about the bailout package for Portugal emerged on Thursday with an aid totalling 78 Bio. The deal was reached after Portugal committed to a new fiscal program. Portugal's economy is now expected to shrink by 2% in 2011.
- 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 broadly fell this week as commodities plunged and a jump in US jobless-benefit claims fuelled concern that the recovery of the world's largest economy may falter. The MSCI World as of yesterday's close is down -2.4% for the week and up close to 6% since the beginning of the year.
- US stocks tumbled, sending the S&P 500 Index down for a fourth straight day, as shares of energy and raw material companies slumped following the biggest plunge in commodities in almost two years.
- In Europe, stocks fell as the banking sector earnings disappointed. The Euro Stoxx slid -3.2% with every European market place in negative territory.
- All MSCI Sectors Index were negative, Energy and Materials being the worst performing sectors while Healthcare and Consumer Staples were the only ones to be slightly positive. However, Energy remains one of the highest performing sectors for the year along with Healthcare, Telecom and Industrials while Materials and Utility are the worst performing ones.

Emerging Markets

- Emerging markets equities underperformed developed markets this week, with the MSCI EM Index down -3.5% versus -2.4% for the MSCI World. Three 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.
- China's stocks experienced their biggest loss in two months with the Shanghai Composite down by -1.65% while the Hang Seng lost close to -2.4%.
- The Indian BSE Sensex was one of the worst performers among EM countries this week down over -4% as the Reserve Bank of India lifted its repurchase rate by 50 bps to 7.25% on May 3 to cool inflation. The reaction was global funds cutting their exposure to Indian equities.
- In South Korea, the Kospi Index was down -2% over the week while the Taiwan Taiex Index was the only Asian market to be about flat. Year-to-date, the Kospi is still one of the best Asian countries. Within Asian frontier markets, we can note a spectacular performance in the Mongolia's MSE Top 20 Index which is up over 37% for 2011 so far.
- Latin America was down last week with Brazil, Chile, Argentina and Mexico in negative territory. Brazil lost over -4% this month still 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 with the Russian RTS Index losing over 7%. However, a lot of Eastern Europe countries remain among the world's best performing markets for the year, including Bulgaria (22%), Serbia (14%) and Hungary (10%).
- We continue to favour EM over DM, on better growth fundamentals and ongoing capital inflows. EM will continue to experience rising inflation and tightening, but we think that the market is already priced for that.

Commodities

- Commodities were sharply down this week with the GSCI Index down by close to 10%. Commodities dropped the most in almost two years, paring this year's gains to about 8%, on speculation that economic growth will slow as central banks seek to cool inflation by raising borrowing costs.
- Crude Oil fell over 15% this week experiencing yesterday its worst daily drop ever!! The Oil price fell after an Energy Department report showed US stockpiles rose more than expected. This five-day drop will be the longest losing streak in almost eight weeks mainly on US slowdown fears as gasoline demand dropped.
- Energy and Precious Metals were the worst performing sectors this week, down -11.6% and -9.1% respectively while Industrial Metals and Agriculture also lost about 6% each.
- Gold hit a new record last Friday at $1575 an ounce before falling over 7% this week to $1475 currently as a stronger Dollar amplified negative sentiment toward precious metals.
- After a parabolic ascension until last week, Silver nearly rose to its record price of $50 an ounce before collapsing. As we predicted in our previous newsletter, the correction finally happened and Silver futures slid over 30% in less than a week. It is funny to see the Chart of Silver being so much like the chart of the NASDAQ when it topped at 5'000...
- We believe that for the moment, it is better to lighten up in commodities as we believe that the decline that stared this week is not over and that we will see lower prices ahead.
