

Bedrock Friday February 5th Newsletter

We are ending yet another absolutely bewildering week! Correlations and reason of the past broke down and we feel at a loss in our efforts to comprehend the markets' messages. Some say that these are winds of recession blowing our way. Others say that all this is nothing but noise around readjusting to the change in Fed posture. In a 1966 Newsweek article, the eminent economist Paul Samuelson famously quipped that the stock market had predicted nine of the past five recessions. It's a remark that is often repeated to deride the powers of the stock market to predict the economy. Samuelson's quip was spot on. There have been 13 bear markets in the post-war era. These 13 bear markets have led to recessions seven times within about 12 months. So instead of Samuelson's 9 of 5 (think about it like shooting 55%), it's really 13 of 7 (53%). Pretty impressive for a quip! As we shake, rattle and roll with these markets, let's not forget that there is a lot of volatility in financial markets but the underlying economy is much steadier. Lew Alexander, U.S. chief economist at Nomura said that decades of economic research show that you cannot explain movements in the economy from stocks.

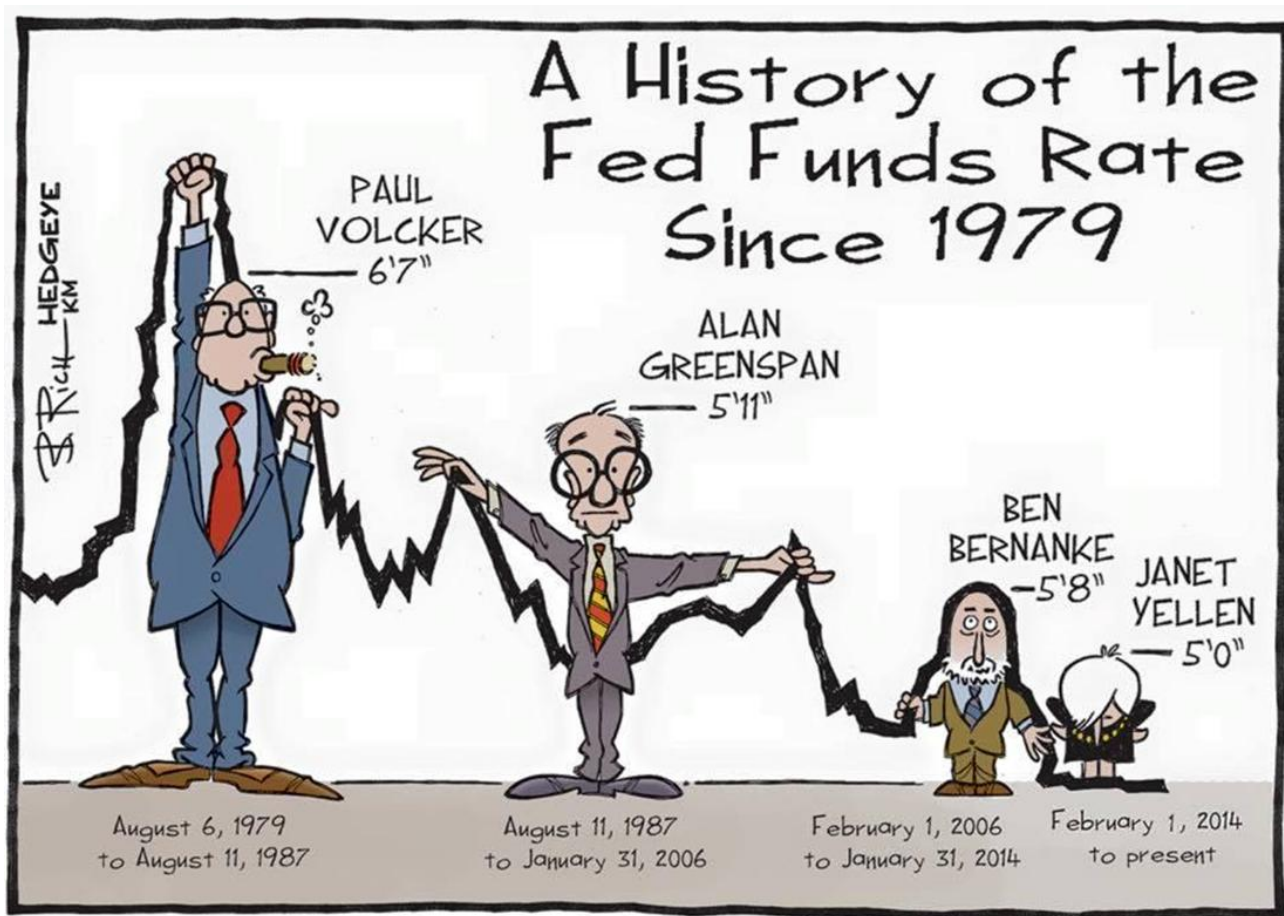
Theories aside, something is clearly driving this huge volatility. Most believe that the engine for this can be found in the erratically falling price of oil. Amazingly, against 'normal logic', each uptick in oil causes a jump in equity prices and vice versa when oil prices tick down. Every few minutes we get flash messages from one guru or another explaining the moves and predicting the next one. We choose to stand down from joining this crowd or even read them. We do have a view on oil however, based on two observations- The first being that when Bedrock was established back in 2004, the world consumed 80 million barrels of oil per day. Today, we burn over 105 million barrels per day. How can anyone say that demand is down? We also know for a fact that the total amount of oil in our planet is smaller today than it was back in 2004, as no new dinosaurs died in this interval during which about 350'000 million barrels were burned (12 years at say 80MM per day). Clearly, exploration and production technology improve and we extract more from existing and new wells, but we are not creating new oil. The second and broader observation is that money talks and b-s walks; this is applicable to much we observe, and specifically, we note that the Oracle of Omaha, Warren Buffet, has just added \$1 billion to Berkshire's bet on Phillips 66 (an oil company) to reach \$5.9Bn. He might be wrong, but betting with him statistically improves your odds. We can't call a bottom here, but can be reasonably confident that oil has probably found a base around here. Our macro vision would suggest that once this is set, the way forward is higher...

From this and the "new reasoning" on cause and effect between oil prices and equity prices, we sense that the next leg for equities in general is up! Maybe...

The other big market move was the sudden reversal in the US Dollar strength- It has fallen broadly since Tuesday- About 3.5% against the Euro! Why, you may ask. Clearly, more sellers than buyers is the answer and then, we wonder WHY more sellers showed up since Tuesday... One possible explanation can be found in the poorly economic data that came out States-side, reducing the probability of imminent further Fed action to raise rates. Much of the US\$ rally up until Tuesday was driven by the expectations for rising US interest rates against the backdrop of everyone else dropping theirs- "Carry is King". Well, the data and certain Fed Governors dovish talk have combined to reduce the perceived probability of the already-priced rate rises, so less carry expected and positions are closed. The yield on the US 10 year note having fallen back to 1.85% or so confirming the perception of lower rates for longer. Less than two months after the Fed enacted its first rate hike in more than nine years, market talk already has turned to whether the central bank's future may not be more hikes, but rather negative rates. Intensifying recession fears, volatile financial markets and moves toward negative rates by other central banks have triggered speculation over whether the Fed may have to reverse course on its tightening policy. Negative rates in the U.S. would be a highly unusual move. However, several high-ranking Fed officials, including Chair Janet Yellen, Vice Chair Stanley Fischer and New York Fed President Bill Dudley all have indicated the move would be something they would have to examine should financial conditions tighten and threats to economic growth increase. Improbable you say? Well, it seems to be fashionable these days... The CME's FedWatch tool, showed markets assigning no higher than a 28% chance of a hike at any meeting this year, and just a 31% chance of a hike at 2017's first meeting. In reality, the sudden fall in the US\$ is tantamount to an easing!

We all have seen the past and we are intrigued by what may lay ahead. Morgan Stanley's chief U.S. equity strategist, Adam Parker, told CNBC's "Fast Money Halftime Report" on Monday that recession fears are mostly overblown. "I think the market is down too much," he said. Bank of America, using its contrarian indicator, put the S&P at 2'200 for year-end, as does JP Morgan and RBC at 2'225. We are at 1'915 now... Looks good... Add to the brew the thought that Donald Trump has been nominated for the Nobel Peace Prize and you could believe in anything! Another titbit to make you question reality- McDonald's salad was found to have more calories than a Big Mac! Where is our world going to?

The next page will give you an idea ...



...And inspite of the fact that Janet isn't likely to join the Harlem Globetrotters anytime soon, Goldman Sachs Group Inc. and Pacific Investment Management Co. say bonds are poised to fall (rates to rise!) and traders aren't prepared for how far the Federal Reserve will raise interest rates.

Market Weekly Highlights:

- The Dollar has softened over the past week; with the USD Index (DXY) trading at 96.60 down from 98.8 last week. The US\$ is now trading at about \$1.12 against the EUR and at 0.99 against the Swiss Franc. The Pound is now at 1.452 after reaching 1.4668 yesterday. In spite of this decline we maintain our belief in the fundamental relative strength of the US\$ with a risk of some further short term declines - this view is driven by the outlook for interest rates to hold or rise further in the US and hold or decline elsewhere. The Japanese Yen has risen some, trading at 116.93. Gold has gained ground this week and is now at \$1'160. We note that WTI Oil has held around \$32 for the week and is now trading slightly lower at \$31.48/Bbl. Whilst Brent has gained 5% to \$34/Bbl., a significant rise. Remarkably, Brent is now back to trading at a small premium to WTI. With WTI having touched a low of \$26.19/Bbl. three weeks ago, perhaps we have seen the near term bottom?!
The Chinese Yuan seems to have stabilized, now at 6.57 – flat for the week but a fall of 3.5% since early December vs. the US\$. The Russian Ruble now at 77.44 per USD had a flat week. The Brazilian Real has gained some ground now trading at 3.89, a big gain of 6.5% vs. the USD for the week.
- The risk off sentiment of this week pushed lower the yield in US with the US 10Yr Treasury yield trading at 1.84% after hitting below 1.80% on Wednesday. The German 10Yr Bund yield dropped as well this week to below 0.26% on Wednesday from 0.33% where it started this week. While the Spanish 10Yr yield moved higher at 1.658% from last week's 1.48%. The Italian 10Yr yield followed the same pattern but at a lower amplitude moving from 1.40% to 1.50% during the week. In the UK, the Gilts' yields had resisted the move down and are trading around 1.549%. The Swiss 10Yr yield is at -0.276%.
- The first week of February was another volatile week across all equity markets. The S&P500 is -1.28% for the week, although looking to open at a meager positive 0.05% on the open today. The Dow Jones is down 0.30% for the week and NASDAQ at -2.26% with both markets looking to open positive today. The DAX is trading -4.30% for the week, the CAC40 is -3.70%, with the SMI at -4.0%, the UK FTSE trading -2.9% and the EuroStoxx50 at -4.25%. In Asia, the Nikkei has closed the week at -3.99%, whilst the Shanghai composite and the Hang Seng Index had divergent results for the week closing respectively at +0.95% and -2.0%.

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Highlighted items are interesting data points for the week

MARKET INDICES PERFORMANCE

04/02/2016

INDEX NAME	CCY	Last Price	PRICE CHANGE IN % (unless indicated)									P/E
			1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y	
EQUITY MARKET INDICES - BY REGION												
S&P 500 INDEX	USD	1915.45	0.17	1.17	-1.28	-5.02	-8.79	-8.78	-8.29	-7.13	26.74	15.44
DOW JONES INDUS. AVG	USD	16416.58	0.51	2.16	-0.30	-4.32	-8.10	-8.41	-5.79	-8.21	17.43	14.87
NASDAQ COMPOSITE INDEX	USD	4509.559	0.16	0.06	-2.26	-7.81	-12.06	-12.26	-9.94	-5.36	42.19	16.68
RUSSELL 2000 INDEX	USD	1014.789	0.45	1.15	-1.99	-8.61	-14.77	-17.61	-10.66	-16.04	11.73	15.12
EURO STOXX 50	EUR	2905.3	0.32	-4.21	-4.21	-8.22	-15.39	-20.67	-10.73	-14.44	10.02	12.75
EURO STOXX 600	EUR	328.76	-0.18	-3.73	-3.73	-8.18	-13.00	-18.42	-9.92	-11.54	15.39	14.39
CAC 40 INDEX	EUR	4228.53	0.04	-3.66	-3.66	-8.22	-14.55	-18.11	-8.23	-9.52	15.18	13.49
DAX INDEX	EUR	9393.36	-0.44	-4.12	-4.12	-8.88	-13.71	-19.26	-12.55	-13.85	22.57	11.67
FTSE 100 INDEX	GBP	5898.76	1.11	-2.60	-2.60	-3.45	-6.90	-12.25	-5.08	-13.70	-5.99	15.30
SWISS MARKET INDEX	CHF	8003.4	-1.48	-3.70	-3.70	-7.92	-10.88	-15.90	-9.14	-9.23	8.20	15.66
NIKKEI 225	JPY	17044.99	-0.85	-3.99	-3.99	-8.46	-12.01	-18.41	-11.63	-3.91	52.26	16.22
HANG SENG INDEX	HKD	19183.09	1.05	-2.01	-2.01	-8.97	-16.32	-21.32	-11.98	-22.12	-16.68	9.69
SHANGHAI SE COMPOSITE	CNY	2781.023	1.53	0.95	0.95	-15.94	-21.55	-25.20	-21.92	-11.89	13.58	11.00
S&P BSE SENSEX INDEX	INR	24338.43	0.48	-1.38	-1.38	-4.12	-6.76	-13.10	-6.09	-14.99	24.75	17.17
RUSSIAN RTS INDEX \$	USD	738.82	6.01	-3.07	-3.07	-4.02	-17.65	-14.39	-4.57	-10.20	-65.24	5.93
BRAZIL IBOVESPA INDEX	BRL	40821.73	3.11	5.67	1.03	-3.77	-15.04	-18.82	-5.83	-17.09	-31.33	9.30
MSCI WORLD	USD	1548.86	0.54	-0.85	-0.85	-5.02	-9.46	-12.13	-6.85	-10.34	10.23	14.96
MSCI WORLD HEDGED	USD	667.647	0.20	0.42	-1.96	-5.50	-8.39	-11.05	-7.21	-6.63	27.13	-
MSCI WORLD LOCAL	-	1183.509	0.18	0.35	-2.00	-5.65	-8.80	-11.89	-7.37	-8.46	20.08	-
MSCI AC WORLD	USD	371.99	0.72	-0.81	-0.81	-4.90	-9.95	-12.82	-6.85	-11.89	4.79	14.47
MSCI EM	USD	739.55	2.48	-0.38	-0.38	-3.76	-14.42	-17.09	-6.87	-24.71	-30.73	11.07
MSCI AC ASIA x JAPAN	USD	455.75	1.72	-1.28	-1.28	-5.84	-14.02	-16.26	-8.84	-21.79	-17.53	11.28
MSCI EM LATIN AMERICA	USD	1784.13	3.88	7.07	2.30	0.49	-13.90	-20.40	-2.50	-32.75	-54.68	12.65
MSCI EM Eur, ME & Africa	USD	203.05	4.67	0.87	0.87	-0.77	-17.11	-21.40	-3.41	-28.42	-43.54	10.13
EQUITY MARKET INDICES - BY SECTOR												
MSCI ENERGY	USD	172.01	1.62	-0.63	-0.63	-3.10	-16.12	-15.63	-3.56	-28.22	-32.23	22.32
MSCI MATERIALS	USD	172.7	3.42	4.12	4.12	-4.12	-11.99	-18.23	-6.48	-25.27	-28.62	16.49
MSCI INDUSTRIALS	USD	181.33	1.56	0.54	0.54	-3.64	-7.64	-9.27	-5.46	-9.82	11.33	15.21
MSCI CONS DISCRETIONARY	USD	177.97	-0.34	-1.73	-1.73	-5.57	-11.18	-12.07	-8.08	-8.39	27.17	14.98
MSCI CONS STAPLES	USD	208.24	-0.82	-0.90	-0.90	0.54	-1.08	-2.95	-1.04	0.28	21.45	20.40
MSCI HEALTH CARE	USD	191.04	-0.68	-1.32	-1.32	-7.67	-8.89	-16.46	-9.12	-7.54	38.58	15.35
MSCI FINANCIALS	USD	85.67	1.53	-1.99	-1.99	-9.52	-13.73	-18.93	-11.70	-15.15	-1.13	11.29
MSCI INFO TECH	USD	135.47	0.26	-1.73	-1.73	-5.44	-10.08	-6.64	-7.45	-3.62	36.08	15.82
MSCI TELECOMS	USD	68.66	0.23	1.09	1.09	2.23	0.01	-4.60	1.07	-3.19	16.47	15.28
MSCI UTILITY	USD	115.47	0.18	1.93	1.93	4.20	1.16	-0.90	3.40	-7.17	13.28	15.26
MSCI WORLD REAL ESTATE	USD	181.39	0.44	0.27	0.27	-4.02	-5.74	-8.34	-4.45	-12.24	2.04	23.01
HEDGE FUND INDICES												
HFRX GLOBAL HEDGE FUND	USD	1136.14	-0.24	-0.14	-0.48	-3.23	-5.53	-7.97	-3.23	-6.75	-3.20	-
HFRX EQUAL WEIGHTED	USD	1146.75	-0.21	-0.18	-0.37	-2.22	-4.18	-5.43	-2.22	-3.73	0.25	-
HFRX GLOBAL EUR	EUR	1039.08	-0.23	-0.17	-0.49	-3.36	-5.81	-8.40	-3.36	-7.53	-4.73	-
MARKET INDICES PERFORMANCE												
04/02/2016												
INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y	
FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)												
US 3 MONTH	USD	0.2899	0.00	-0.02	-0.02	0.09	0.25	0.22	0.13	0.28	-	-
US 2 YEAR	USD	0.7062	0.01	-0.07	-0.07	-0.31	-0.12	-0.02	-0.34	0.19	-	-
US 10 YEAR	USD	1.8426	0.00	-0.08	-0.08	-0.39	-0.39	-0.43	-0.43	0.02	-	-
FIXED INCOME INDICES - BY TYPE OF ISSUER												
												Yield to Worst
GLOBAL AGG TR HEDGED	USD	488.12	-0.03	0.57	0.14	1.43	1.70	2.03	1.61	1.17	10.91	1.54
US GOVERNMENT TR	USD	2146.94	0.09	0.40	0.40	2.36	2.43	2.74	2.49	1.53	6.54	1.54
US CORPORATE TR	USD	2578.91	0.09	0.00	0.00	0.29	-0.23	0.30	0.36	-2.59	6.59	3.63
US HIGH YIELD TR	USD	1511.45	0.11	-0.80	-0.80	-2.39	-7.02	-8.38	-2.40	-8.02	1.47	9.39
EU GOVERNMENT TR	EUR	246.8736	-0.21	-0.13	-0.13	1.31	1.83	3.07	1.72	1.09	19.51	0.52
EU CORPORATE TR	USD	246.18	-0.14	0.14	-0.21	0.29	0.43	0.37	0.46	-0.62	12.55	1.42
EU HIGH YIELD TR	EUR	266.5	-0.10	-0.30	-0.62	-1.79	-3.69	-3.25	-1.82	-2.17	15.73	5.63
BARCLAYS GLOBAL CONVERT.	USD	202.94	0.31	0.28	-0.67	-4.01	-7.22	-9.32	-4.66	-6.83	10.55	-
GLOBAL EM TR (HEDGED)	USD	324.7056	0.26	0.50	0.14	0.20	-1.87	-1.35	0.13	0.49	3.96	5.68
S&P/LSTA U.S. LEV LOAN	USD	87.18725	-0.01	0.00	0.05	-1.07	-3.49	-7.25	-0.60	-8.99	-10.49	6.73
COMMODITY INDICES - BY TYPE OF ISSUER												
GSCI INDEX TOTAL RETURN	USD	2010.788	-0.54	-0.86	-2.31	-6.76	-22.22	-26.06	-7.36	-33.82	-60.50	-
GSCI ENERGY TR	USD	317.79	-1.00	-2.78	-4.95	-13.64	-34.43	-38.74	-13.71	-46.11	-71.80	-
GSCI INDUSTRIAL METALS TR	USD	961.853	0.86	3.28	2.35	3.17	-3.53	-8.96	0.74	-20.93	-41.01	-
GSCI PRECIOUS METALS TR	USD	1415.674	1.35	3.78	3.75	7.81	3.91	5.58	9.01	-9.60	-35.09	-
GSCI AGRICULTURE TR	USD	441.8056	-0.89	0.06	-0.88	0.07	-6.69	-5.21	-1.84	-13.35	-41.59	-
GENERIC 1ST 'CL' FUTURE	USD	31.72	-1.07	-6.66	-6.66	-16.92	-36.71	-38.45	-19.21	-48.48	-69.77	-
GOLD SPOT \$/OZ	USD	1155.6	-0.02	3.33	3.33	7.21	4.67	6.49	8.86	-8.85	-30.94	-
CURRENCIES												
DOLLAR INDEX SPOT	USD	96.47401	0.17	-2.98	-2.98	-2.79	-1.33	-1.35	-2.02	3.28	21.57	-
Euro Spot	EUR	1.1209	-0.11	3.38	3.38	4.18	2.88	2.67	3.08	-2.44	-17.57	-
Japanese Yen Spot	JPY	116.78	-0.05	3.68	3.68	1.90	4.20	6.57	2.89	0.59	-19.86	-
British Pound Spot	GBP	1.4589	-0.35	2.06	2.06	-0.93	-4.41	-6.83	-1.34	-5.15	-7.16	-
Swiss Franc Spot	CHF	0.9933	-0.03	2.97	2.97	1.52	0.17	-1.46	0.86	-7.29	-8.58	-
Brazilian Real Spot	BRL	3.8902	0.15	4.61	2.80	3.85	-2.32	-10.78	1.81	-29.52	-48.71	-
China Renminbi Spot	CNY	6.5695	0.00	0.10	0.10	-0.82	-3.40	-5.48	-1.16	-4.82	-5.15	-
Singapore Dollar Spot	SGD	1.3974	-0.16	1.78	1.78	1.86	0.52	-1.11	1.35	-3.92	-11.63	-
Norwegian Krone Spot	NOK	8.5037	-0.11	1.95	1.95	4.66	0.47	-3.02	3.88	-11.73	-35.67	-
VOLATILITY / LIQUIDITY INDICES												
CBOE SPX VOLATILITY INDX	USD	21.84	0.88	-2.59	8.12	12.93	45.12	74.58	19.93	29.61	59.18	-
USD SWAP SPREAD SEMI 2YR		8.25	-	18.18	18.18	-34.56	0.00	-68.69	-35.44	-69.17	-56.17	-
TED SPREAD		33.02	-	13.86	9.23	-26.46	9.66	46.89	-26.62	32.08	37.76	-

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All data is compiled from Bloomberg

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