Friday, June 17th 2011

This week has been under the sign of Greece. Words from the not-so-distant past are coming back into our language- namely "Contagion". Whilst watching the Greeks demonstrate, we are told that poor reception for Spanish bonds shows us that the "firewall" to the bigger problematic economies may have some cracks. Indeed, the Greek issue in itself, whilst horrible for the Hellenic people, is too small to break the system. But Spain is much, much bigger. As we hear of the nomination of the Minister of Defence to the Ministry of Finance (!?) we also can see that the yield on Spanish bonds is now higher than that country's potential growth rate, i.e., unsustainable… Contagion indeed! Let's hope that Angela Merkel and the headless IMF will find a way to kick these problems far enough to give time for a new generation of leaders to find a permanent solution. And perhaps they could send a note to Bill Gross of PIMCO asking him to stop telling us the truth about the US real debt burden? (He said it was higher than Greece's in terms of GDP). Scary thought, as we know that the IMF could not possibly bail-out the USA…

Well, back to our mundane day-to-day troubles… A bad week for equities combined with a nasty return of volatility. Bonds rallied… Oil fell… The Dollar found some warm air and gained some lost ground. We saw a flurry of IPO's and announcements of others to come. Some rose strongly on issue, others tanked. Some say that Facebook will come soon, valued at $100Bn… For us, 100Bn is so big a figure that we can barely comprehend it. How could we possibly opine on its value? We will not.

Albert Einstein was right! Everything is relative! Just 5 short months ago as Oil *rose* to $95.00 per barrel it seemed expensive and debates raged as to the impact on the revival of the global economy. This week, the same Oil *fell* back down to and through $95.00 and debates rage now if this is predicts a reversal of the economic trends…
Oh yes, OPEC had a meeting about this. They failed to agree on anything. Maybe this means that some (many?) members will feel free to exceed their quotas? Or just admit that they have been doing so since ever? Is that market expecting a rise in supply? Maybe… we still believe that the gap between needs and possible supply will be widening into the future. We stay long energy.

The same Albert is credited with saying "As our circle of knowledge expands, so does the circumference of darkness surrounding it".
We wonder what he would have thought of our financial markets? They are contracting as capital is being destroyed and volumes are light. Is the circumference of darkness closing-in on us? We think not. We remain positive on the global expansion and a better future ahead, albeit one different from the recent pasts. We will adapt.

Have a wonderfully warm weekend!

Currencies

- Currency markets were shaken this week as the Greek sovereign debt crisis worsened sharply. The events over the last few days have been quite dramatic, with scenes in the street similar to what has been happening in certain parts of the Middle East (with much less violence), the Greek government on the verge of breakdown, significant uncertainty surrounding the actions, if any, of the EU and IMF, and consequently increasing concerns over potential contagion effects.
- The Euro as a result dropped sharply versus all of its major counterparts. It fell from a high for the week of almost 1.45 versus the US Dollar to 1.4150 currently. It reached an all time low versus the Swiss Franc at 1.1950 but has recovered a little and is trading around 1.21.
- The Greek situation has eased somewhat as the Greek government reshuffled its government, named a new finance minister, and as it now seems likely that it will receive the EU and IMF aid as planned. However, the issue is far from being resolved, and markets will be on the edge for signs of contagion. As such, it is likely that currency markets will remain volatile and the Euro under pressure.
- The US Dollar benefited from the turmoil in Europe and also from some better economic data, including better than expected jobless claims and higher housing starts. The Dollar Index, which measures the Greenback versus a basket of major currencies, advanced from 74.8 at the begging of the week to 75.65 currently.
- The Japanese Yen and the Swiss Franc especially remain extremely strong. The Swiss Franc reached an all time high against the Euro this week and remains near its all time high versus the US Dollar.
- With appetite for risk lower, higher yielding currencies such as the Aussie and New Zealand Dollars dropped versus the US Dollar this week.

Fixed Income

- US Treasuries are headed for a fifth weekly gain as speculation European leaders will fail to contain the Greek debt crisis boosted demand for the safest securities.
- The yield on the 10 year benchmark security dropped 4bps this week to 2.93% currently, close to its low for the year. Yields on 2 year US treasuries dropped by 2bps to .383%...
- German bonds were the largest beneficiary in Europe of the turmoil, with yields on 10 year bunds dropping by 3bps to 2.93% this week. Conversely, bonds of periphery European countries got hammered. Indeed, the Spanish 10-year yield rose to 5.647% and the Portuguese yield climbed to 11.271%, also euro-era records
- Not surprisingly, the cost of insuring Greek government bonds against default soared to another new record Thursday as a growing government crisis cast doubt on the country's ability to continue qualifying for international aid. Greece’s case was not helped by comments from Alan Greenspan, who said that a default by Greece was almost certain.
- Credit markets were also soft this week, and again higher yielding securities underperformed higher quality securities.

Equities

- Equity markets seem headed for another weekly loss, with the MSCI World index down -1.16% as of yesterday's close, as the Greece crisis roiled financial markets. This week's action brings most bourses in the red for the year to date…
- European stocks declined, with the Stoxx Europe 600 Index heading for its longest weekly losing streak in more than three years, as concerns escalate that Greece will default on its sovereign debt. The index is down -1.25% for the week as we write this.
- European financials led the declines, as these stand to suffer the most should the Greek debt crisis spread across the euro zone.
- The Nikkei 225 dropped by -1.7% this week amid concerns the euro crisis will derail the global recovery and the government will scale back spending on disaster reconstruction.
- American stocks are also down, but by much less. The S&P 500 is down only -0.26% as of yesterday's close. The Dow Jones Industrial is actually marginally up on the week, given the appeal of blue chip stocks in times of high uncertainty. US equity markets were also given a small boost in slightly better than expected unemployment and housing data.
- The VIX index, which measures the volatility of the S&P 500 and which can be considered as a "fear indicator", jumped by 20%.
- In terms of sectors, cyclical sectors were the worst performers. Financials dropped because of credit concerns while energy and materials dropped given concerns over the global recovery and weaker commodity prices.
- The best performing sectors were healthcare and consumer staples, given their defensive nature.
- Despite the higher market volatility, this week saw its fair share of IPOs, with Prada and Samsonite both listing on the Hong Kong market this week, and Pandora, an unprofitable internet music company, sold shares on the NYSE. However, these IPOs lacked some of the sizzle of recent debuts, and may lead to some re-considering their plans to go public…

Emerging Markets

- Emerging Market equities declined this week by more than their developed counterparts. The MSCI EM is down by -1.9% as of yesterday for the week, versus -1.16% for the MSCI World index.
- Chinese markets were down by 2% on concern the central bank will take more steps to cool inflation, slowing growth in the world's second-largest economy. Exporters led the declines following concerns over the impact of the Greece crisis on global growth.
- The Brazil Bovespa Index is down by 4% for the week, bringing losses for the year to around -10%. Lower commodity prices and concerns over policy put pressure on Brazilian stocks. Russian equity markets were also impacted by the fall in energy prices.
- Meanwhile, China's finance ministry failed to draw enough bids for a bond sale for a second time this year as the central bank steps up efforts to rein in inflation…

Commodities

- Commodities declined, with the S&P GSCI broad index down -3.8% for the week. However, there were wide divergences in performance across the different types of commodities.
- Oil dropped to its lowest price in four months in New York on concern the Greek debt crisis will threaten Europe's economic recovery, curbing fuel demand. Brent crude oil shed 4.7% this week but the price is still 45% higher than last year…
- Agriculture commodities were the weakest performers in the commodity arena, with the S&P GSCI Agriculture index lost -6.6% for the week. These were impacted by slower demand and some larger than expected stockpiles in certain specific agricultural commodities.
- Precious metals were the best performers, although still lower for the week. Gold is down by roughly -0.5% for the week while silver is off -3.3%.
- Finally, industrial metals dropped by -1% as measured by the S&P GSCI Industrial index. Within this group copper rose given strong demand from China, while most other base metals declined given concerns over global growth.

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