Friday, July 15th 2011

The Fed minutes were released and the markets delighted in the fact that QEIII was debated. The participants clearly centred on this part, ignoring the offset discussion of the end of QEII. This was followed on Wednesday, with Ben Bernanke testimony on the Hill- he implied that QEIII could be envisaged if the economy needed it. The DJIA raced 160 points until Boehner said there were no assurances of a deal on the debt ceiling, taking away 120 of these points.
Then on Thursday in part 2 of his testimony, our fearless leader Ben backed-off and said that QEIII will not happen. Confusing, to say the least…
More confusion came from the US Trade Deficit which crossed the $50Bn for June, up from $43Bn. Is the US economy growing again? Imports are growing again so someone is spending money earned somewhere…
China definitively is… they gave GDP data, up 9.50% with Industrial Production up 15.10% and some analysts were saying that they were slowing down. Most economies would love such a slowdown… Ireland for one, as they certainly didn't enjoy their downgrade to Junk, nor did the US appreciate the rating agencies warnings that the US may lose its "AAA". Then we have Italy in the spotlight, but somewhat surprisingly, they reached a quick decision on austerity and backed it with a big debt issuance. Someone bought it, so maybe "contagion" will stop here?

Well, with all the problems the various administrations are facing around the globe, we got last night more evidence that the private sector can and does better- Google announced its results. Way up on all counts, ahead of expectations and showing us all that 25% growth is doable, even when you are big! Maybe China is a private enterprise?
Separately, we had been supporters of the ECB and its staunch and successful stance on inflation management. But why did they raise rates last week? With the periphery falling apart, this appears to be unreasonable, at least to us. They clearly are clever but light on memory- in 2008 they raised rates and immediately thereafter the yields on longer Bunds fell below the overnight rate. The market told Trichet that he was wrong. And surprise, the same thing happened this time- within 24 hours the German 2 year yields went below the new rate by 40 basis points. Will Trichet reverse his rise before passing the Chairmanship baton?
Well, perhaps Obama will search his own memory banks and recall a speech he gave- "The fact that we are here today to debate raising America's debt limit is a sign of leadership failure. It is a sign that the US Government can not pay its own bills. It is a sign that we now depend on ongoing financial assistance from foreign countries to finance our Government's reckless fiscal policies. Increasing America's debt weakens us domestically and internationally. Leadership means that 'the buck stops here.' Instead, Washington is shifting the burden of bad choices today onto the backs of our children and grandchildren. America has a debt problem and a failure of leadership. Americans deserve better." - Senator Barack H. Obama, March 2006

Perhaps one should look back before going forward… Driving 101 ☺

Currencies

- The Euro declined this week again versus most of its major counterparts, due to the fallout of the Euro Debt Crisis and its contagion to Italy. The EURUSD pair plunged to 1.3830 before rebounding strongly to 1.4280 on another warning, this time against the US! However, the gains did not last as the Euro dipped again below 1.4100 on news that Bernanke said that he did not have any immediate plans to start a new QE. The Euro continued its decline versus the all mighty Swiss Franc to reach a record low of 1.15! What we can say is that we do not expect the EUR to recover versus the USD or the Swiss Franc by any meaningful way until the debt crisis is clearly resolved.
- The Swiss Franc has also risen to a record high versus the Sterling Pound, and reached a level of 1.3130. The strength of the CHF prompted the Swiss National Bank to issue some statements vaguely showing concerns about the strength of the currency and its negative effects, but to no avail....
- The Sterling remains a weak currency also and we believe the Pound will drop even further versus the USD in the coming weeks.
- In Japan, the JPY continued to strengthen, also prompting BOJ officials to issue some statements calling for a halt of this strengthening and its detrimental effect on Japanese corporations. The USD Yen went as low as 78.60 before rebounding a bit.
- Emerging Market currencies were mixed with the Brazilian Real staying as firm as ever, but with the Turkish Lira or the South African ZAR dropping quite a bit.

Fixed Income

- Government bonds declined after Standard & Poor’s followed Moody’s Investors Service in saying it may cut its AAA rating on the world’s biggest economy.
- US 30 year Treasuries dropped 1 bps at 4.26% during the week while yields on 10 year US treasuries were down 7 bps to 2.95% and down 2 bps for 2 year securities at 0.367%.
- In Europe, yields on 10 year UK and German bonds dropped by 12 bps for the week, while yields on 10 year French bonds dropped by 5 bps during the week.
- Meanwhile, the troubled zone yields kept rising at an incredible pace pushing Irish, Greek, Italian and Spanish yields by 95, 60, 41 and 24 bps respectively. The cost of insuring Greek, Irish and Italian sovereign debt rose to records, pushing an index of sovereign bond risk to an all-time high, on concern bank stress tests released later today will not be tough enough.
- Overall, corporate and government debt lost ground this week while higher yielding securities outperformed investment grade credit.

Equities

- Developed equity markets plummeted this week, with the MSCI World down by -2.40% as of yesterday's close. The Index lost about -1.5% month-to-date, with Europe being again the major laggard. The MSCI is now up 2.4% for the year.
- The Euro Stoxx lost -4.65% during last week, on speculation European stress tests will show banks do not have enough capital. Meanwhile, Greek two-year bonds tumbled, driving the yield to a record 34%.
- The S&P 500 lost -3.28% this week on fears that Standard & Poor's may cut the US's top credit grade if it concludes Congress and President Barack Obama's administration have not achieved a credible solution to the rising government debt burden.
- Japanese stocks rose, trimming the Nikkei's decline for the week, as appliance retailers gained on a report the government may revive subsidies to encourage consumers to buy energy-saving products.
- MSCI Sectors Indices were all in negative territory last week, with Financials and Information Technology being the biggest laggards, while defensive sectors such as Consumer Staples and Healthcare pulled through the week relatively well. Healthcare remains the best performing sector for the year along with Consumer related sectors and Energy while Financials and Utility remain the worst performing ones.

Emerging Markets

- Emerging markets equities performed in line with their developed counterparts this week, with the MSCI EM Index down by -2.45% while the MSCI World was down by 2.40% as of yesterday's close. For the year, the MSCI EM continues to lag, down about 1.4% while the MSCI World index is up about 2.4%.
- Performance across EM regions was negative overall. Latin America lagged as Brazil continues to be penalized by expectations for higher interest rates pulling down Brazilian banks and retailers. The Bovespa lost about 5% last week while Argentina and Colombia lost over 5%.
- Except the Shanghai Composite (up about 0.8%), nearly all Asian marketplaces were negative this week. Chinese stocks rose, capping a fourth weekly gain, as drug makers rallied on the prospect of increased investment in the industry and the nation's biggest cement producer estimated a three-fold jump in profit. However, the Hang Seng was negative this week (-3.95%) as development and real estate companies fell after the government disclosed its intention to limit residential prices in smaller cities.
- Meanwhile, Asian currencies continued to gain, as shown through the Bloomberg JP Morgan Asia Dollar Index, as many of the component currencies experience higher inflation rates and as interest rates go higher.

Commodities

- Commodities rose during this week due to the possibility of a further QE in America and due to the market angst about the Debt issues in the EU and in the US.
- Precious metals roared ahead with Gold printing a new record high around $ 1'592 before shedding back some of the gains to stand currently at 1'579. Silver just soared like a rocket, rising 10% from $36 to $39 in the space of 3 days, before it also shed some of the gains to stand at $38. We believe these moves had more to do with the debt issues than any other thing (QE) and metals should stay supported as long as this situation endures. However we would caution that if a liquidity crisis would ensue, the precious metals will suffer a lot as well.
- Agriculture also rose strongly this week with corn, soy and wheat all rising between 5 and 10%! Volatility has clearly returned and we strongly advise not to take heavy bets here.
- Oil has been the only exception as it dropped from $99 to $95.50 on the WTI on news that US oil demand reached a 2 month low and after Fed's chief doused growing expectations for a near term continuation of a US economic stimulus program.