Friday, October 21st 2011

Going into this week end's Euro group meeting, we see that volatility keeps being the rule. During this week, we have seen 3% intraday moves in equities, and big swings up and down in currencies and commodities. Difficult to have a view and stick to it for more than half an hour in these markets!

In any case, the Euro zone debt crisis remains at the forefront of all news and even kept President Sarkozy away from his wife when she had her baby… he had to be with his best companion these days, i.e., Merkel…

There is clearly a lot at stake in this coming EU Summit meeting, since if there is no concrete plan or action regarding Greece, or Banks recapitalization plans, or an enlargement of the EFSF, then markets could go down very sharply again. We feel that the biggest headwind to economic growth these days is really the lack of visibility and lack of confidence in the Developed world governments, be it in EU, or in US, Japan or UK. This is why we believe (and hope) that the G20 meeting that is going to take place in Cannes at the beginning of November will be the real game changer. We do not see how the US and the BRIC Countries will not have a solution forced upon their European counterparts. We remember that it was the G20 held in London at the beginning of April 2009 that turned both the gloomy mood and the markets. There is so much at stake if no solution is found that there should be enough will and consensus to finally bring about a resolution of the (current) problems.

On pure economic news, we have seen some better than expected figures coming out of the US since the beginning of this month, prompting Fed's member Bullard to say that "current central bank policy is "appropriately easy" and another recession is unlikely". In China, Q3 2011 GDP growth moderated to 9.1% year on year, which was about what was expected. We continue to view this slower rate of growth as very good news.

As far as downgrades are concerned, this week also saw the usual flow of negative news concerning Spain, which was downgraded to A with a negative outlook and with France also risking a downgrade if they expand the EFSF bailout fund.

But three big events occurred this week on the geopolitical scene: Libya was finally freed after 42 years under the tyranny of a mad man, and the Israeli soldier Gilad Shalit was also freed after being abducted for the past 5 years. We hope that these events will bring about more constructive moves in the ever volatile Middle East. And in Spain, the terror Group ETA announced the definitive end of the armed struggle after 43 years of violence and about 1'000 victims.

2011, up to today, may not have been a great year for the financial world, but has been definitely a fantastic year in terms of successes against tyranny and terrorism, with the Arab spring removing from power 3 dictators and Bin Laden being killed after 10 years on the run. The Syrian and Yemeni rulers should be fearful of their future…..

Enjoy a restful week end.

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Currencies

- The Euro weakened from its peak on Monday at 1.3914 and fell to 1.3650, before rebounding some around the 1.3750 area where it stands now. The common currency has been moving according to the different quotes from European officials about the success of this coming week end's summit. Optimism bringing a stronger Euro at a certain moment, while pessimism driving it down the next minutes. It might be possible that a resolution of the Euro Zone debt crisis will bring a stronger Euro for a while, but then, all the money printing and the region economic austerity should drive it down again.
- It seems that the Euro reacts less and less to the recurring news of Spain's downgrades. It did not even react much on news that France was also a potential candidate for downgrade...
- The JPY remained virtually unchanged against the USD as Japanese Officials continue to voice their concerns regarding the persistent strong Yen. It is clear that they want a weaker JPY and it appears that they are working on a set of measures in order to achieve that goal. We remain confident that a weaker JPY will prevail in the coming weeks and months.
- The Swiss Franc appreciated against the USD and the EUR this week rising to 0.8850 on the USD and to 1.22 on the EUR. However, we view this bout of strength as being temporary since we believe that the Swiss National Bank will continue to resist aggressively a stronger CHF. This week brought more bad news for the Swiss financial industry as it announced more layoffs due to the CHF strength.
- Commodity and Emerging market currencies reacted also to the European flow of news. All these currencies rose when there was some sense of optimism and declined when pessimism prevailed. We need to wait for a clarification of the Euro Zone situation before seeing sustained moves in one side or another.

Fixed Income

- US Treasury bonds rose during the week as a split emerged between France and Germany on proposals to leverage Europe's rescue fund, stoking demand for the safety of US government debt. US 30 year Treasuries dropped 3 bps at 3.20% while yields on 10 year US treasuries fell by 8 bps to 2.17%.
- The US Government is scheduled to sell $35 billion of two-year notes next week, an equal amount in five-year securities and $29 billion in seven-year debt, while it sold the same amounts of these maturities last month.
- Meanwhile, the troubled zone yields kept rising at an incredible pace pushing Portuguese, Spanish, Italian and Irish yields by 47, 33, 25 and 12 bps respectively. The cost of insuring these countries' sovereign debt rose further, pushing an index of sovereign bond risk to an all-time high.
- Overall, government debt lost ground this week while risk positive debt (high yield, loans) outperformed investment grade credit.

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Equities

- Developed equity markets dropped this week, with the MSCI World down by -1.64% as of yesterday's close. The Index gained about 5.69% month-to-date, with Europe being again the major laggard.
- US stocks rose this week as the Federal Reserve of Philadelphia's general economic index climbed more than forecast, unexpectedly signalling expansion in Philadelphia's manufacturing area bolstering optimism in the US economy.
- Europe was the worst performer among developed countries with the Euro Stoxx losing -2.72% during last week, driven down by Spain (-2.90%), France (-3.35%) and Germany (-3.35%) amid concerns European leaders will not agree on plans to tame the Euro zone sovereign debt crisis.
- Japanese stocks fell by 1.60% this week as an impasse over European bailout talks sparked concerns the global economic recovery may weaken. The Nikkei is the only developed World's Index to experience losses for the month so far.
- MSCI Sectors Indices were all in positive territory this week, with Energy and Materials being the biggest winners, while defensive sectors such as Consumer Staples and Healthcare did not rise as much. However these sectors are the only ones to be positive for the year while Financials and Materials remain the main laggards, down over 20% year-to-date.

Emerging Markets

- Performance across EM regions was mixed overall during the week. The MSCI EM underperformed its developed counterparts, with the MSCI EM Index down by -2.97% while the MSCI World was down by -1.64% as of yesterday's close. For the year, the MSCI EM continues to lag big time, down over -21% while the MSCI World index is down by close to 9%.
- The Bovespa fell by -1.08% this week as investors pared wagers for further interest-rate cuts in Brazil after the central bank lowered the benchmark rate by half a point, while metals slipped on concern Europe's debt crisis will hurt demand. Brazil became the first among the largest emerging economies to fall into a bear market in July as the government adopted new measures to stem currency gains and inflation quickened.
- Nearly all Asian marketplaces were negative this week led by China's losses. The Hang Seng fell by -2.75% while the Shanghai Composite slumped by -4.69% on concern divisions between France and Germany may hinder attempts to resolve Europe's debt crisis and that China may continue policies to rein in lending. The Hang Seng and the Shanghai Composite have slumped by 22% and 18% respectively this year as the government raised interest rates and took steps to curb bank lending amid efforts to control inflation.
- 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 keeps going higher.

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Commodities

- Commodities declined this week amid growing market tensions on the Euro Zone ability to tackle its differences and come with a real solution to end this crisis, and on slower expected growth in China and in the rest of the world.
- Copper was the hardest hit commodity as the red metal shed 12.5% this week after China published a slower rate of growth. Copper went down from 3.46 on Monday and hit a low on Thursday at 3.03.
- WTI declined also on a week to week basis. It started the week at 88$ a barrel, rose to 90$, then dropped to 84.50, and then rebounded to stand currently at 86.50. Volatility is high and is present in all asset classes. In any case, we continue to see oil prices remaining supported.
- Agriculture commodities were the only commodities to remain stable this week as prices remained virtually unchanged. Unfortunately, political incompetence is the real culprit in making food prices more expensive these days...
- Finally precious metals also declined this week with Gold dropping from a peak around $1’700 an ounce on Monday to a low on Thursday at 1’604 (about 6% decline) before rebounding a bit to 1’630. Silver also dropped from 32.64$ to 30.00$, an 8% move!! We remain negative on the short term prospects for precious metals as we believe we could reach 1’500 $ in Gold in the next few days.