Friday, January 7th 2011

Welcome to 2011. Happy New Year!

What a first week- Terrible weather everywhere, markets thin and edgy. Someone has been listening to our predictions for 2011- equities are up globally, US Treasuries are down, Gold and other commodities are down as well. The US Dollar is rising against most all other currencies, Oil touched $92 and drifted down towards $88/Bbl as the US$ rose. Economic data has been encouraging from all corners of the World, topped by the largest rise in the American ADP report on Wednesday. We await confirmation with the official Non Farm Payroll data a little later- Expecting about 175'000 new jobs for December. Oh yes, the Republicans took the gavel of House Speaker. Things are looking up! ☺

Some of our concerns into year-end have been relaxed- North Korea didn't act on its threats, Iran has invited all the foreign ambassadors to visit its nuclear facilities, Spain and Ireland seem to be holding-up as countries and some analysts are now separating the National issue from the specific country's bank woes. Ireland's problem is now just because they guaranteed their banks. Some focus… Maybe the Euro will not collapse? If nothing else, the Swiss are breathing more easily now, as their Franc has been under heavy buying pressures having risen to 1.2430 against the Euro, now back over 1.25 and over 0.96 to the US$. The Chinese are smiling at the West, coming to Europe (their largest export market!) with offers to buy Spanish debt, talking of a further 5% Yuan appreciation on the US$ Is everything falling back into shape? Is Goldilocks back with us? We are seeing confirmation of economic growth, inflation still low albeit upward pressures are becoming evident and central banks (in the industrialized world) holding short rates at zero or thereabouts. The yield curves are steep and for students of financial history this prefaces a strengthening economy.

We lightened-up on our Gold holdings and our emerging markets' debt and remain comfortable holding good corporate and high yield debt. Companies are making money and generally speaking their credit quality is improving in-line with their earnings. As we watch Equities rise we find that are looking better and better. We are watching the Facebook saga unfold here. Are we in a new reality, or is it DotCom 2.0? Goldman Sachs evaluates the company at $50Bn or so and then tells us the company earns $325million. The P/E ratio does not compute… echoes of 2000… If this is a bubble, why then, using Warren Buffet's views lets ride the rise for as long as we dare…

Another year has gone by, a new one has started. If the implicit aging depresses you, think of the alternative! Let's remain optimists and believe that the World is getting better!

Enjoy 2011 with us ☺

Currencies

- The US Dollar rose this week versus most of its major counterparts following the release of a report from the ADP Employer Service which showed the biggest jump in company payrolls since records began in 2001, almost three times as many jobs as economists had forecast. The Dollar Index, which tracks the value of the Greenback versus a basket of major currencies, jumped 2.5% this week. This index declined by 3.5% in 2010…
- The ADP employment figures were very positive and markets are currently awaiting confirmation of better employment data from this afternoon's (for us Europeans) US reports on payrolls. The more positive tone on US economic data should continue and this will be a positive for the Greenback.
- Meanwhile, the Euro was under serious pressure this week as the region's fiscal crisis lingers on. There remain serious concerns over the ability of the governments in the "eye of the tiger" to raise funds and worries grew further as news emerged that the European Commission will is planning to spread the cost of bank failures to senior bondholders. The Euro is currently at 1.298 versus the US Dollar, having started the year at 1.338 and dropped from a high for the week of 1.2726 to 1.249 currently versus the Swiss Franc.
- The other major mover this week was the Australian Dollar, which declined across the board as worsening floods will hamper Australia's production and export capacity. The Aussie Dollar declined from 1.0233 in the beginning of the week to 0.9914 currently versus the US Dollar.
- Separately, the Canadian Dollar remained strong, rising against the Euro and the Australian Dollar, boosted by the positive economic data of the US.

Fixed Income

- US Treasuries declined this week following the ADP employment report which showed a very strong jump in company payrolls. Yields on US 2yr bonds rose by 7 bps and on US 10yr bonds by 12 bps.
- The more positive tone on US economic figures did not have a dramatic impact on long term European government bonds, which are flat for the week, but shorter term European government bonds did decline in line with US ones.
- Meanwhile, the European sovereign debt crisis, which had seen some slight easing in the last month of 2010, resumed this week after European regulators issued a proposal on bank bailouts that would hurt bondholders. The cost of insuring against Western European debt soared to record highs, as measured by the Markit iTraxx SovX Western Europe Index of credit- default swaps insuring the debt of 15 countries. For the first time ever, it is now more expensive to insure against the risk of default of Western European countries than of developed European nations!!!
- Corporate bond markets were robust this week, with issuance soaring in the first week of the year and spreads on credit instruments tightening. High yield bonds outperformed investment grade securities this week, with these tending to react with more punch to improving economic data.
- Within the fixed income arena, we remain keen on higher yielding securities than investment grade corporate bonds, and stay away from government bonds.

Equities

- Equity markets are marginally up as we write this. Global equity markets jumped early in the week on the release of the US ADP employment figures, confirming the much better economic picture in the US. But since then they have been marginally trickling lower, with markets cautiously awaiting today's U.S. nonfarm-payrolls data.
- Equity markets were also negatively impacted by renewed European sovereign debt concerns. In line with the overall market activity of 2010, equity markets of the crisis countries are down, with Greece and Spain both down around 3% for the week, while markets of the strong European countries (France, Germany) are up for the week. Overall European stock markets are up around 1% for the week, as shown by the EuroStoxx 50 index, in line with the performance of the S&P 500 and Dow Jones Index.
- Japanese stocks continued to do well generally this week as the Japanese Yen weakened, with the Nikkei 225 up 1.9% while Australian stocks dropped by around -1.75% as massive flooding takes its toll on production.
- Natural resources related companies underperformed broad markets this week as commodity prices declined in general, as energy and metal prices slip from recent highs.
- BP however bucked the trend, gaining roughly 5% this week as this week's release of the US presidential commission's report on last year's Gulf of Mexico oil spill seems to reduce the likelihood that BP will be found guilty of gross negligence.
- Consumer staples also underperformed this week as the strong US employment data encouraged investors to move away from defensive sectors into more cyclical ones. Indeed, the best performing sectors were financials and technology this week.
- Technology stocks were also boosted by news over the private investment from Goldman Sachs and a Russian investment firm into Facebook, valuing the company at $50 billion USD. This has triggered a flurry of IPO speculation, with some technology firms expected to go public sometime this year (although not Facebook which is now anticipated to list in 2012).
- We remain optimistic on equities in general for the year given improving economic growth, attractive valuations and strong corporate health combined with the relative unattractiveness of fixed income securities.

Emerging Markets

- Emerging Market equities performed in line with their developed counterparts this week, and seem headed for a slight gain for the week. China and Brazil, two of last year's underperformers, are outperforming other countries this week, up by over 2.5%. Investors are now possibly moving back to these markets on better valuations.
- Indian and Indonesian stocks underperformed this week given heightened inflationary fears and speculation that these countries will have to raise rates. Indian stock markets are down by more than 3% this week.
- EM currencies declined this week versus the US Dollar, but more on dollar strength rather than anything new from the EM. The South African Rand was the worst performer amongst the major EM currencies, seeing sharp losses with the decline in prices of precious metals.
- Various governments are taking measures to stem the recent rally in their currencies, with the most active being Brazil which this week set reserve requirements on short dollar

positions held by local banks in its third attempt since October to stem a rally in its currency. The Brazilian Real is at 1.687 versus the US Dollar, having started the year at 1.66.

Commodities

- Commodities are down for the first week of the year by around -1.75%, with declines across the various types of commodities. The major culprits are the strength in the US Dollar and the recent high prices of commodities in general.
- Precious metals are down the most, with gold down by more than 4% for the week. It is currently at $1358 an ounce having started the year at $1420.
- Energy, agriculture and industrial metals are also down this week. Again it is more likely that the declines have been caused by the stronger Dollar and a correction from the recent rallies in these.
- Still, supply and demand fundamentals should push commodity prices higher in general, as demand remains strong with the better economic prospects and supply being negatively affected by the severe flooding in Australia.
