# Bedrock Newsletter

## Friday, November 4th 2011

It is November. Greece has been the focus yet again. Everything was agreed and set and the markets liked, only to find that the Greeks are no longer convinced they can't do better, now wanting a referendum to ratify their bail-out and the markets collapsed. But maybe not, as a day later the idea of a referendum was suspended and markets rallied. When did Greece become the most powerful nation on the planet? The last time was way back in the BC époque… This isn't funny anymore!
Well, the ECB has a new leader who marked his territory on his first day with a welcomed 0.25% drop of interest rates. 51 of 55 economists surveyed had expected no action. Between this sign of fresh thinking, US employment report due today and a failed G20 meeting in France, it is no surprise that markets can't quite decide where they think they should go. It brings back thoughts of Alice in Wonderland who is lost but doesn't quite know where she wants to go to… Well, markets are calm this Friday morning. It feels good…
And then we have another "big noise" brewing in the background- The "Super Committee" in the US which has just a few more days to present a plan to cut the budget deficit. This is a conundrum- They are seeking to cut a deficit at a time of recession, which if successful (hardly probable) would quite surely be counterproductive for employment and GDP growth. But then again, with a 2.50% GDP growth in Q3 is there a recession? Well, Ben Bernanke in his press conference this week showed two year projections of positive GDP growth, whilst lower than the previous projection levels. Yes, indeed, it will be "noisy" around this process.

Overall, with newly rising volatilities we can see the DJIA above 12'000, and the S&P 500 above 1'260, both about flat YTD supported by comforting corporate earnings excepting the financial sector. European equity markets' returns remain in the red though, DAX off 12% or so.
Yields on Treasuries seem to have fallen back to its levels of March, with 10 years' hovering on the 2.00% mark.
Gold is continuing its rise, trading just north of $1'750 whilst a nervous and volatile US$ is edging up against the JPY on the back of Japanese Central Bank intervention. And let's not forget the Swiss National Bank holding its floor on the Euro Swiss pair at 1.20. But then, we would expect them to let this floor creep upwards as they seem to say that the CHF is still too high! Hardly a free market now is it?
Looking ahead, we believe that the Greek Tragedy will end. At least its effects on everyone else. We must watch the Italian story should it evolve, but that is for "Domani". For your weekend smile; a small bit of news attracted our eye on Monday- Germany found and accounting error in its national accounts. They have been overstating their debts by Euros 55 billion since 2009. We wonder if they had a successful rogue trader in their nationalized banks? To think that Germany said that Greeks couldn't report properly… What should we trust?

Enjoy a (rainy) restful week end

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**Currencies**

- The week started with a bang, when in the early hours of Asian trading on Monday, the Japanese Authorities intervened to weaken the Japanese Yen, just after the currency hit a new record high around 75.30. The authorities intervened massively (rumors of 100 Bio USD) and were successful in pushing the JPY down by 5.5% to 79.50 before the USDJPY retreated again to 78. But it has since respected that level and most probably, the BOJ will intervene again and we should see pretty soon the 80 level.
- The other big story of the week was of course the Greek Drama... the Euro, which had hit a peak against the USD last Friday at 1.4240, was back at 1.3610 2 days later!! Talk about volatility or boredom! The EUR remains pegged to the news surrounding the EU debt crisis, and to each word or sentence of any EU or Greek official. We remain in any case very sceptical of any rise of the EUR as we do not believe that it can be sustained.
- And another bang came with the surprise rate cut given by the newly installed ECB Chief Mario Draghi. We applaud this move as it was long overdue, and is in our eyes, only the first move before more will come. Indeed, the ECB should move interest rates closer to 0 and also embark on a QE program, as their colleagues from the Fed and the BOE did.
- Meanwhile, the CHF gained a little to 1.2130 against the EUR, before the SNB came to the wires and gave a warning to the market not to even think of testing their resolve in defending the peg. The SNB said that it was determined to fight the sill elevated Swiss Franc. We continue to believe that the SNB will be successful in defending the peg.
- The GBP was strong this week, regaining levels past 1.61 at one point. But we continue to foresee a weaker Pound in the months ahead due to the QE program of the BOE that they even risk expanding again, and because of the slowdown in the Euro Zone that will affect also the UK economy.
- Commodity currencies remained quite weak this week with the CAD coming back to its recent lows versus the USD and the AUD and NOK also on the soft side.

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**Fixed Income**

- Treasuries dropped as concern eased that Greece would reject its financial bailout package and the European Central Bank unexpectedly cut interest rates, reducing refuge demand. US 2 year Treasuries dropped 6 bps at 0.23% while yields on 10 and 30 year US Treasuries fell by 25 bps each to 2.07% and 3.12% respectively.
- Treasuries have returned 8.8 percent this year, the most since U.S. government debt returned 14% in 2008 in the midst of the financial crisis, according to Bank of America Merrill Lynch index data.
- The central bank left intact its pledge to leave its target interest rate in a range of zero to 0.25% until mid-2013. The Treasury will sell $32 billion of three-year notes on November 8, $24 billion of 10-year debt on the following day and $16 billion of 30-year bonds on November 10.
- Meanwhile, Greek two-year note yields climbed to more than 100% for the first time yesterday on concern the nation may default on its outstanding government debt. Greek 10yr yields rose by 260 bps over the week.

- Overall, government debt gained some ground this week while risk positive debt (high yield, loans, and convertibles) underperformed investment grade credit.

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**Equities**

- After a strong month of October during which the MSCI World gained 10.26%, this week saw developed equity markets dropping by about -3.8% as of yesterday's close with Europe being again the major laggard.
- US stocks pulled through the week relatively well, the S&P 500 dropping losing only -1.8% as ECB officials unanimously lowered the benchmark interest rate by 25 basis points to 1.25 percent and Greek Finance Minister Evangelos Venizelos, told lawmakers Parliament in Athens, that the nation will not hold a referendum. The US is the only developed market to be currently positive for the year.
- Europe was the worst performer among developed countries with the Euro Stoxx losing -6.29% during last week, driven down by Spain (-6.98%), France (-6.30%), Italy (-6.73%) and Greece (-10.47%) amid concerns surrounding the Greek situation. Prime Minister George Papandreou currently struggles to hold on to power after Greece's largest opposition party rebuffed his overtures to form a national government, raising the prospect of elections that could delay aid needed to prevent default.
- MSCI Sectors Indices were all in negative territory this week, with Financials and Materials being the biggest laggards, while defensive sectors such as Consumer Staples and Healthcare pulled through relatively well. These sectors are the only ones to be positive for the year while Financials and Materials remain the main laggards, down about 17% and 15% respectively for the year.

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**Emerging Markets**

- Performance across EM regions was mixed overall during the week. The MSCI EM slightly outperformed its developed counterparts, down by -3.58% while the MSCI World was down by -3.78% as of yesterday's close. For the year, the MSCI EM continues to lag big time, down over -15% while the MSCI World index is down by about 6%.
- The Bovespa was up by 1.84% this week as commodities and global stocks rose as Greece moved closer to accepting a bailout and the ECB cut interest rates to bolster economies reeling from the debt crisis.
- Nearly all Asian marketplaces were negative this week except the Shanghai Composite, up by 2.22%. Chinese stocks advanced this week as some manufacturing and non-manufacturing reports signalled a slowdown in the economy, increasing speculation the government will cut banks' reserve requirement ratios or introduce more fiscal measures to bolster growth as inflation eases.
- Meanwhile, Asian currencies lost some ground, as shown through the Bloomberg JP Morgan Asia Dollar Index, as many of the component currencies experience lower inflation and interest rates.

## Commodities

- Commodities remained on the strong side this week, amid the ongoing Greek saga...
- Precious metals were on the roar this week, with Gold prices pushing to the $ 1'760 level and Silver hitting the $ 35 mark. Of course, amid all the talk of further monetization of the EU and US debt, precious metals remain underpinned.
- Meanwhile, energy commodities remained also strong with oil WTI prices remaining close to the $95 mark, amid renewed talk of Israeli-Iran tensions based on suspicious military exercises held by the Israeli army this week.
- We have long said and we continue to say that oil will prove resilient on the downside because of the ever volatile Middle East situation, even if there is a slowdown in the global economy. Moreover, talk of further QE in the different of the world will also help to underpin the prices of real assets.
- Finally, agriculture commodities remained very stable on a week to week basis. But we remain confident that agriculture prices will also remain supported.