

# Bedrock Friday August 5<sup>th</sup> Newsletter

Interesting week... It started in the shadow of last Friday's information that the US preliminary Q2 Gross Domestic Product ("GDP") grew at 1.2% (annual rate) vs. the expected 2.6%, and this after rising by a downwardly revised 0.8% pace in the first quarter (vs. the previously reported 1.1%). An interesting ray of light came through in the details though- Despite the lingering effects of the dollar's rally and weak global demand, exports rose in the second quarter, helping to narrow the trade deficit. This in itself gives more support to the Dollar- A trade deficit suggests net sales of Dollars to acquire other currencies. All in all, the figures gave reason to the Fed's inaction on interest rates- the economy clearly isn't in an overheating condition... You, when driving uphill do not hit the brakes, do you?

In Japan, things are clearly not wonderful either- Japanese Prime Minister Shinzo Abe's cabinet approved 13.5 trillion yen (\$132.04 billion) in fiscal measures on Tuesday as part of efforts to revive the flagging economy, with cash pay-outs to low-income earners and infrastructure spending. The stimulus spending is part of a renewed government effort to coordinate its policy with the Bank of Japan, but growing concerns that the BOJ policy has reached its limit, triggered the worst sell-off in government bonds in three years. The package comes days after the Bank of Japan eased policy again and announced a plan to review its monetary stimulus program in September, which has kept alive expectations for "helicopter money", printing money for government debt. Analysts were not overly impressed- Japan's government spending plan has been panned as just not big enough, but it may have already had one big effect: Pushing deeply negative bond yields toward the zero line. Japan government bond (JGB) yields have climbed, with the benchmark 10-year yield rising from as low as negative 0.273% shortly before the Bank of Japan (BOJ) announcement, to within a smidgen of the zero line, touching negative 0.009% on Tuesday. Arguably, Japan's move to fiscal spending instead of further action from the central bank may have spurred the view that monetary policy had reached the limits of its effectiveness. And this re-think in Japan may find followers in the US and Europe. A new paradigm for investing lies ahead?

And then, if all this data from the States and actions from Japan were insufficient to excite us, on Thursday the Bank of England cut rates for the first time in over seven years, slashed growth forecasts and launched a new monetary policy weapon in the battle to stop a post-Brexit slump in the U.K. Mark Carney, the governor of the Bank of England, pledged that the bank would "stand ready to act in exceptional circumstances" as he made one of the most dramatic announcements of his tenure. The new monetary policy should "help make Brexit a success," he told reporters. The central bank has made its biggest quarterly downgrade of growth forecasts, reducing expectations for 2017 growth from 2.3% to 0.8%. So he cut interest rates from 0.5% to 0.25%, and signalled a further rate cut before the end of the year. Sterling fell sharply against the dollar after the announcement and hit 1.3140 where it is now. British gilt yields also hit record lows. Then Carney added some Tabasco to the dish, announcing a new Term Funding Scheme worth up to £100 billion (\$132 billion) and the purchase of up to £10 billion in U.K. corporate bonds. A £60 billion hike in the bank's government bond-buying program, known as quantitative easing, to £435 billion was also announced.

The real meaning of the BoE actions? Any chance the Federal Reserve had of raising rates this year has been quashed. BoE's decision to not only cut interest rates but to restart its money-printing program makes the corner in which the Fed had found itself even more claustrophobic. That's because the U.S. central bank will find it even harder to tighten monetary policy as another one of its closest peers loosens. The dollar is down about 3% this year against its global peers, but Fed officials worry that raising interest rates will strengthen the greenback and make financial conditions tighter. The interconnected nature of the global economy has unequivocally spread to monetary policy. Central banks around the world have been racing to ease in hopes that low and sometimes negative interest rates, coupled with asset purchases, can spur growth and keep their respective currencies weak. In fact, the CME's FedWatch tracker looks all the way out to July 2017 and sees only a 41.4% chance of a rate hike by then. Individual fed funds futures contracts going out to July 2018 see the central bank's overnight rate at just 0.55%, or 0.15 percentage points higher than the current level.

"Under no circumstances should you listen to the Fed. Cover your ears and maybe hold your nose," says a money manager. It seems that markets have lost belief, not to say trust in central banks.

Applying Okum's Razor (the simplest explanation is usually the best), we ask our leaders to borrow a few more trillions (or just print them) and invest in rebuilding infrastructures. Some \$11.5 trillion in sovereign debt now carries negative interest rates. There are trillions more with yields barely in positive territory. Investors seem willing to pay governments to use our money. Makes the true cost zero! Well, Q2 reports of S&P 500 are now 85% in, 78% beating on EPS and 56% on sales. Youpee!!! Buy stocks! Statistics- If you live to be one hundred, you've got it made. Very few people die past that age...

## Market Weekly Highlights:

- Yesterday the Bank of England (BoE) announced its monetary policy and the Bank arguably surpassed expectations, lowering the rate by 25bps to an historic 0.25% low, and announcing a "package of measures" to boost UK growth increasing the asset purchase program by GBP 60 bn from GBP 375 bn to GBP 435 bn. The package is including the purchase of up to GBP 10 bn in UK investment grade, non-financial corporate debt.
- Today Investors are now switching their focus to the nonfarm payrolls update in the U.S. Economists predict the report will show continued improvement in the labor market, a key factor for the Federal Reserve, which is mulling whether to stick to its plan to continue tightening monetary policy in 2016.
- The Dollar is slightly up for the week with the USD Index (DXY) trading at round 95.688 or +0.17% WTD, bringing the YTD performance to -2.98%. The USD is now trading at about \$1.1148 against the EUR (-0.29% WTD) and at 0.9735 against the Swiss Franc. The GBP weakened on the back of the BoE decision, declining to USD 1.3103. Further weaknesses are expected on the GBP as UK yields are likely to stay low, which should weigh on the currency given the funding needs related to the UK's large external deficit.
- The Yen rose 0.96% during the week and is trading at 101.09 at the time we write. YTD the Yen against the USD has fallen from the 120 mark, almost a 19% gain for the Japanese currency. The Russian Ruble rose 0.50% against the USD this week, at 65.60. The Brazilian Real increased 1.74% against the USD this week and is trading at or around 3.19.
- Gold is trading at \$1'363.69 an ounce, heading for a 1 percent climb for the week before the payrolls data later today.
- Oil has rebounded this week as U.S. government data showed gasoline inventories decreased, while crude stockpiles unexpectedly rose for a second weekly gain. Both are at the highest seasonal level in at least two decades. The WTI is trading at \$41.69 and the Brent at \$44.10 a barrel.
- Big swings in the Bond markets as well- the yield on 10-year JGBs increased more than 22Bp since its low of July 27<sup>th</sup> on the back of a disappointing stimulus package approved earlier this week by Prime Minister Abe. The current 10- Yr HGBs yield is negative 8Bps. Over the week, the US 10 year note lost 4Bp to stabilize at the 1.50% mark. The German Bund rose 3Bp to NEGATIVE 0.09%. The Swiss 10Yr yield is at NEGATIVE 0.54%. The Italian 10Yr has lost 1.4Bp to trade at 1.16%, while the Spanish 10Yr yield rose 1.7Bp and is trading at around 1.04% as we write. In the UK, following the BoE decision to cut rates, the UK Gilts 10yr yields declined from 0.80% to the 0.65% mark.
- European markets started the month in the red territories before positively welcoming the BoE rate cut and stimulus package. However markets remain negative with the Eurostoxx 50 still negative 1.45%WTD. The UK FTSE100 is up +0.9% WTD following the decrease of the GBP.
- Within the US, even if the earnings season is continuing to show encouraging results from US firms, the non-manufacturing ISM gauge declined slightly in July and was below expectations leading markets down this week. The S&P500 and the Dow are both down more than 0.40% while the Nasdaq is flat at +0.08% WTD. Volatility of US Market represented by the VIX index is remains low around the 12 level.  
US nonfarm payrolls data (NFP)-for July will be the most important data release this Friday with investors expecting the pace of job gains to normalized following the surge seen in June at 180k.



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