

Bedrock Friday 17 February 2017 Newsletter

We think that as investors, we should try to look through the Trump-related media frenzy. It may be difficult to do, but we will try anyway. We are observing a trend of equity markets melting upwards, as are commodities. At the same time bond markets have been drifting downwards in price (and consequently, up in yield). These trends have begun before Trump's election, just accentuated by market expectations for added fiscal stimulus from the new administration. We believe that the real driver for all this is anchored in the change in economic fundamentals. Economies are at last, moving away from the big recession into a growth phase. The anticipated US tax reform and other Trump driven promises for infrastructure investments are just adding fuel to an already burning fire. We believe that the trend is set in place by fundamental economic improvement in the USA and even in Europe. For the former, this has been ratified by the Federal Reserve hike in rates in December and nailed further by their planned further rises this year. Trumps Tweets and other acts have and will cause wiggles in the trend-line, but are not the basis for the trend itself.

Yes, we believe that the world is normalizing, at last. Shaking off the vestiges of the Great Recession, suppressing the memories of its pains and now looking forward to a sustainable and accelerated recovery. If we needed proof that we are returning to "Old Normal", we saw that Playboy has decided to go back to its ways of old, adorning again its pages with images of naked women... We say Amen ☺

If we add our bit of "Old Ways", we think that it is time to look at markets to predict the future and stop trying to predict the future based on news flows: The markets are after all, the most efficient tool available for discounting the future. What are they telling us? In short, we see rising prices of equities, and these represent the discounted present value of their respective futures. The expected future cash flows brought back to the present at the expected applicable interest rates. The ten year Treasury yield is commonly viewed as appropriate. Rising yields reduce the present value of any sequence of future cash flows. As we expect the said rates to gradually rise, the fact that the equity prices are rising, suggests to us that the expectations for future cash-flows are rising even faster. Yes, the economy is mending, and looking rosier through the pages of Playboy too. Yes, equity indices are at all-time highs and interest rates are still close to all-time lows. Some investors worry about being at highs, but we say that it is not the past that is being discounted, but rather the future. Remember the circus around breaking 20'000 on the Dow Jones? We struggled with it... then broke it, and lo and behold, we are now at 20'600 and some. We would wager that in ten years' time we are likely to be at 40'000 (the typical 7% compound return on ten year intervals for equity indices). The next four years under Trumponomics may well see acceleration in growth due to tax reduction, regulation reduction and then, some added capital spending on infrastructure projects. This thinking reinforces the risks of inflation seeping back into the system and that may justify Central Banks' thinking that interest rates should indeed be raised.

Do note that last Monday, for the first time ever, the S&P 500 reached (then crossed) the US\$20 Trillion market capitalization! But not everything is a rosy as those reinvented Playboy pages...

We believe we will see and suffer from wiggles to the positive outlook from many sources. We recite the 90 year old Alan Greenspan (remember him?) who said this week "surprise electoral wind of Donald Trump" in the U.S. and the Brexit vote in Britain are the two most glaring examples of a movement that is taking the world by storm. Populism is not a structured economic philosophy such as capitalism, socialism or communism," he told an audience at the Economic Club of New York. "But it's a cry of pain by the populace for some leaders to arise to take charge and lessen their pain." He added "The political system has demonstrated unequivocally in the existing structure that (it) is unable to handle this problem". This brings us to look at the reawakened Greek Tragedy of Greece, back in the news now. Deja vue, but now with the shift to the right in the European Union (or what's left of it), will the EU be ready and willing to handle this problem?

Then, what will be the socioeconomic effects from a return of inflation? Global central banks have spent trillions of dollars and the years since the financial crisis battling to ward off deflation and with mounting signs that their efforts are now paying off. "The annual average CPI is likely to be about 2.0% in 2017 versus 1.3% in 2016," notes Omar Sharif, Senior U.S. Economist at SocGen, in recent research. Well, this is Janet's target...

If you look at the euro zone landscape overall we are not sure you see quite so many inflationary signs and think that puts the ECB in a little bit of a dilemma with push and pull coming from different parts of the union. Despite consumer price inflation jumping over expectations to hit 1.8% in January, Draghi recently said the ECB would need to see underlying inflation show more of a sustained uptick before tightening policy. Until Tuesday's weaker-than-expected inflation read of 1.8 percent, the situation in the U.K. pointed towards pricing pressures stemming from the beleaguered sterling potentially forcing the Bank of England to reconsider its pledge to "look through" a certain amount of inflation in favour of supporting the economy. We still remember the days in which inflation was the devil eating away at our capital. Now it is the saviour, invited repeatedly to return by most central bankers around the world. So long that this devil comes back in a small size, i.e., size 2% or so, it may indeed be beneficial. The fear we should harbour is of it growing to large sizes, pressuring those same bankers to put us on a belt-tightening diet of much higher interest rates. After all, we do understand them - they don't know how to deal with disinflation and do have tools for handling inflation... that is their comfort zone, but it might not be ours, as citizens and as investors...

But we remain concerned primarily on the political scene. Europe's drift to the right and the sequence of important elections ahead, could take us to new uncertainties of the Brexit kind. We expect that the Oxford Dictionary will be expanded with new words like Brexit, Frexit, Itexit and the like... We also ask ourselves what is the meaning and possible impact of the Bundesbank confirming Thursday that it has already moved 583 tons of gold out of New York and Paris. We remind them of Mark Twain's words "Everything has its limit - iron ore cannot be educated into gold".

Market Weekly Highlights:

- The greenback has marked a pause since last year's strong rebound against all currencies. The DXY reached 103.80 and has lost some ground so far this year to trade now just at about 100. The USD is trading around 1.065 against the EUR and about at parity against the CHF. The Pound is trading this week at roughly \$1.250, a nice 3pts rebound for the year. The Japanese Yen is trading a little lower for the week against the USD at 113.12, remaining up strongly vs the Dollar YTD. The Russian Rubble is trading up against the USD at 57.75. The Brazilian Real is now trading up for the week at 3.08. Gold is now at \$1'238, up about \$100 since the start of the year. Crude oil WTI which had reached \$55.24 a barrel on the first day of trading on January 1st, is now trading at about \$53.35.
- The yield on 10Y U.S. Treasuries is slightly lower than the year-end levels, is holding between 2.40 to 2.50%, having bounced in a rather tight range around unclear tweets and talk from Trump. The Japanese 10 year JGB is up in yield since the end of last year and continues to offer POSITIVE returns trading at 0.08%.
In Europe, over the last month we saw the German Bund trading higher in yield almost every day reaching almost 0.50% and now it is trading down, losing almost half of it in a week yielding now 0.37%
The Swiss 10 year bond yield is also down to Negative 0.16% after the "rally" since the Trump election. In Peripheral Europe Italian 10Y yields crossed the 2.00% level having started the year at 1.71% and are currently at 2.12% while the Spanish 10Y yields trade 60bps lower having started the year at 1.30% and currently trading at 1.58%.
- Since 1st of January all markets are up globally with the FTSE All-World index, which is priced in dollars and measures more than 7,000 companies in 47 countries, closed at 293.31 points on Wednesday afternoon and pushed even higher as stocks opened on Thursday. Reuters data showed this was the first record high reached since the end of May 2015. The benchmark is heavily geared towards America with U.S. stocks having just over a 50% weighting.
In the USA, all the major indices were up with Nasdaq reaching new all-time highs to show 8.10% for the year and the DJIA trading comfortably above 20'600. The NASDAQ gained for the week +1.1% and the DJIA rose by +1.34%. The SP500 also was up for the week showing +1.21% and almost 5% for the year.
In Europe, stocks have been around flat so far for the week with UK FTSE up fractionally, as was the CAC40 and the Swiss SMI. The DAX is up for the week as we write at +0.57%. The Nikkei is down about 0.85% for the week.
In LATAM and ASIA, markets were up for the week with Nikkei up 2.44%, the BOVESPA at +0.60%, Hang Seng up 1.93% Shanghai Composite up 1.80% and Indian Nifty 50 up 0.60%.

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Highlighted items are interesting data points for the week

All data is compiled from Bloomberg

MARKET INDICES PERFORMANCE

16/02/2017

INDEX NAME	CCY	Last Price	PRICE CHANGE IN % (unless indicated)									P/E
			1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y	
EQUITY MARKET INDICES - BY REGION												
S&P 500 INDEX	USD	2,347.22	-0.08	1.71	3.00	3.50	7.32	7.56	4.84	21.82	27.66	17.99
DOW JONES INDUS. AVG	USD	20,619.77	0.04	2.22	3.80	4.00	9.08	11.01	4.34	25.32	27.64	17.18
NASDAQ COMPOSITE INDEX	USD	5,814.90	-0.08	1.74	3.56	4.99	9.02	11.21	8.02	28.25	37.01	19.63
RUSSELL 2000 INDEX	USD	1,399.13	-0.36	1.49	2.74	3.46	6.85	13.97	3.10	38.37	21.75	19.54
EURO STOXX 50	EUR	3,311.04	-0.38	1.19	2.45	0.75	8.81	11.05	0.59	14.22	6.12	14.19
EURO STOXX 600	EUR	370.10	-0.29	0.79	2.82	2.17	8.72	8.76	2.45	12.63	10.68	15.18
CAC 40 INDEX	EUR	4,899.46	-0.52	1.35	3.05	0.70	8.08	10.77	0.64	15.59	12.88	14.48
DAX INDEX	EUR	11,757.24	-0.31	0.79	1.94	1.90	10.05	11.59	2.42	25.40	21.77	13.65
FTSE 100 INDEX	GBP	7,277.92	0.04	0.24	2.49	0.77	7.09	6.08	1.87	20.66	8.02	14.77
SWISS MARKET INDEX	CHF	8,467.52	-0.22	0.18	2.17	2.01	6.36	3.90	3.06	6.61	0.66	17.08
NIKKEI 225	JPY	19,347.53	-0.47	-0.74	1.02	2.24	7.68	14.86	0.63	21.46	33.64	17.97
HANG SENG INDEX	HKD	24,107.70	0.47	1.95	2.88	5.22	7.95	5.41	9.24	27.00	6.65	12.00
SHANGHAI SE COMPOSITE	CNY	3,229.62	0.52	0.17	1.36	3.00	-0.20	2.98	3.17	11.67	49.95	13.48
S&P BSE SENSEX INDEX	INR	28,301.27	0.53	0.50	2.97	4.56	8.57	1.68	6.95	21.79	39.15	19.82
RUSSIAN RTS INDEX \$	USD	1,176.11	0.30	0.47	0.48	1.14	17.45	21.16	1.51	58.97	-13.19	6.58
BRAZIL IBOVESPA INDEX	BRL	67,814.24	-0.24	4.39	4.86	5.38	13.46	14.31	12.60	62.89	42.54	13.15
MSCI WORLD	USD	1,836.56	0.20	1.20	2.46	3.01	7.59	6.06	4.87	18.92	11.07	16.96
MSCI WORLD HEDGED	USD	820.54	-0.09	1.65	2.87	2.58	8.60	9.54	4.25	25.18	28.46	-
MSCI WORLD LOCAL	-	1,418.89	-0.12	1.08	2.74	2.91	7.63	8.46	4.00	20.26	20.53	-
MSCI AC WORLD	USD	444.52	0.22	1.26	2.63	3.30	8.02	5.83	5.38	19.87	9.70	16.34
MSCI EM	USD	945.62	0.42	1.66	4.00	5.67	11.62	3.95	9.67	28.52	-1.94	12.59
MSCI AC ASIA x JAPAN	USD	563.86	0.30	1.21	3.24	5.16	9.20	3.33	9.63	24.44	5.48	13.08
MSCI EM LATIN AMERICA	USD	2,662.32	0.00	4.17	5.80	9.12	17.15	6.74	13.74	50.40	-10.25	14.62
MSCI EM Eur, ME & Africa	USD	259.12	1.00	2.37	3.72	3.29	14.33	3.19	5.86	26.43	-18.16	10.86
EQUITY MARKET INDICES - BY SECTOR												
MSCI ENERGY	USD	210.32	-0.70	-0.99	-0.97	-3.87	3.36	2.96	-3.96	21.47	-21.53	22.65
MSCI MATERIALS	USD	240.29	0.33	1.06	1.46	4.15	11.12	11.67	8.30	37.95	-1.88	17.23
MSCI INDUSTRIALS	USD	223.76	0.24	1.18	2.52	3.46	7.11	7.18	5.31	22.61	13.08	18.21
MSCI CONS DISCRETIONARY	USD	205.77	-0.09	0.81	1.30	1.75	6.64	5.17	4.75	15.99	15.40	16.85
MSCI CONS STAPLES	USD	215.35	0.35	0.68	2.13	2.82	6.29	-3.93	3.76	3.62	15.84	20.22
MSCI HEALTH CARE	USD	205.20	0.31	2.08	4.18	4.27	5.07	-2.31	6.41	7.23	13.88	16.00
MSCI FINANCIALS	USD	112.31	0.17	2.43	3.57	4.80	10.54	20.92	5.77	33.16	11.42	13.39
MSCI INFO TECH	USD	175.38	0.32	1.53	4.06	5.75	9.98	11.60	8.78	30.22	41.33	18.49
MSCI TELECOMS	USD	68.92	0.57	-0.26	-1.12	-2.31	6.03	-6.22	-0.88	0.82	-0.48	14.39
MSCI UTILITY	USD	116.62	0.88	0.14	0.86	0.28	6.22	-3.24	1.44	3.95	2.18	16.13
MSCI WORLD REAL ESTATE	USD	195.44	0.44	0.14	2.04	1.53	6.14	-5.74	2.81	10.95	10.59	25.13
HEDGE FUND INDICES												
HRFX GLOBAL HEDGE FUND	USD	1,225.53	0.38	0.55	1.33	1.13	3.33	3.12	1.83	9.39	-0.37	-
HRFX EQUAL WEIGHTED	USD	1,235.56	0.32	0.46	1.08	0.94	2.87	3.03	1.51	9.11	2.56	-
HRFX GLOBAL EUR	EUR	1,099.42	0.38	0.54	1.23	0.98	2.78	2.03	1.54	7.28	-3.52	-

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LIBOR RATES AND YIELD ON US GOVERNMENT BONDS (Yield in %, Change in bps)												
US 3 MONTH	USD	0.52	0.00	-1.53	0.50	-0.51	9.14	22.35	2.03	21.76	-	
US 2 YEAR	USD	1.21	0.85	2.11	0.62	5.82	16.45	48.49	2.23	46.87	-	
US 10 YEAR	USD	2.45	0.19	4.13	-0.45	12.33	14.60	89.95	0.43	62.96	-	
US LIBOR 3M	USD	1.04	0.45	0.81	0.72	1.86	13.56	23.77	4.39	42.36	-	
EUR LIBOR 3M	EUR	-0.35	0.03	-0.19	-0.66	-0.87	-1.87	-2.87	-1.37	-14.89	-	
GBP LIBOR 3M	GBP	0.36	0.00	-0.06	0.22	-0.04	-3.97	-2.76	-0.86	-23.48	-	
CHF LIBOR 3M	CHF	-0.72	0.00	0.12	0.42	0.28	1.08	1.72	0.48	4.98	-	
FIXED INCOME INDICES - BY TYPE OF ISSUER												
											Yield to Worst	
GLOBAL AGG TR HEDGED	USD	498.46	0.23	-0.06	0.18	-0.41	-0.04	-2.46	-0.18	2.11	11.11	1.65
GLOBAL HY TR	USD	1,216.11	0.17	0.26	0.67	1.01	4.62	3.35	2.53	19.84	12.93	5.46
US GOVERNMENT TR	USD	2,121.65	0.30	-0.22	0.00	-0.49	-0.23	-3.59	0.23	-1.32	5.89	1.65
US CORPORATE TR	USD	2,742.51	0.32	-0.05	0.27	-0.37	0.92	-2.21	0.58	6.82	11.68	3.36
US HIGH YIELD TR	USD	1,853.82	0.00	0.20	0.74	0.94	4.77	5.15	2.20	23.80	15.44	5.74
EU GOVERNMENT TR	EUR	246.28	0.39	0.23	0.31	-1.04	-0.80	-4.25	-1.60	-0.10	13.28	0.60
EU CORPORATE TR	USD	260.94	0.10	0.07	0.61	0.22	1.04	-0.24	0.19	6.20	13.39	0.90
EU HIGH YIELD TR	EUR	300.35	0.06	0.31	0.66	0.83	3.59	3.36	1.40	14.20	16.33	3.63
BARCLAYS GLOBAL CONVERT.	USD	229.74	-0.26	0.56	1.80	1.81	5.37	4.25	3.22	15.35	8.61	-
GLOBAL EM TR (HEDGED)	USD	363.05	0.11	0.01	0.92	0.70	3.02	-0.13	2.07	11.66	18.19	4.34
S&P/LSTA U.S. LEV LOAN	USD	98.74	0.05	0.08	-0.10	-0.29	1.30	6.86	0.13	14.86	0.30	4.70
COMMODITY INDICES - BY TYPE OF ISSUER												
GSCI INDEX TOTAL RETURN	USD	2,397.10	-0.43	-0.07	0.59	-0.40	9.57	4.74	-0.84	24.03	-50.99	
GSCI ENERGY TR	USD	413.51	-0.23	-0.49	-0.25	-1.65	12.03	5.36	-4.89	39.69	-63.57	
GSCI INDUSTRIAL METALS TR	USD	1,236.29	-0.89	2.41	1.59	2.61	9.58	18.37	10.14	31.19	-7.09	
GSCI PRECIOUS METALS TR	USD	1,524.26	0.68	0.58	2.58	4.09	1.67	-8.92	8.24	3.24	-8.82	
GSCI AGRICULTURE TR	USD	457.59	-1.09	0.25	2.62	2.04	4.21	1.57	6.16	4.57	-26.88	
GENERIC 1ST 'CL' FUTURE	USD	53.36	0.22	-0.71	1.27	0.38	11.32	5.73	-1.91	27.36	-53.81	
GOLD SPOT \$/OZ	USD	1,239.10	-0.10	0.35	2.25	1.72	1.76	-8.22	7.43	2.43	-6.84	
CURRENCIES												
DOLLAR INDEX SPOT	USD	100.44	0.17	-0.19	1.10	0.28	-0.28	6.22	-1.57	3.95	25.55	
Euro Spot	EUR	1.07	-0.27	0.02	-1.42	-0.63	0.18	-5.70	1.22	-4.34	-22.34	
Japanese Yen Spot	JPY	113.24	0.04	0.02	-0.35	-0.51	-2.72	-11.41	3.32	0.80	-9.96	
British Pound Spot	GBP	1.25	0.01	-0.01	-0.71	0.61	0.59	-4.23	1.22	-12.62	-25.27	
Swiss Franc Spot	CHF	1.00	-0.26	0.27	-1.05	0.18	0.74	-3.76	1.93	-0.72	-10.82	
Brazilian Real Spot	BRL	3.09	-1.05	1.21	1.90	4.91	10.89	3.64	5.35	31.65	-22.68	
China Renminbi Spot	CNY	6.85	-0.25	0.12	0.20	-0.37	0.11	-3.44	1.09	-4.98	-11.74	
Singapore Dollar Spot	SGD	1.42	0.00	0.28	-0.48	-0.08	0.30	-5.20	2.13	-0.94	-11.12	
Russian Ruble Spot	RUB	57.62	-0.08	1.12	4.38	3.02	12.51	11.26	6.72	30.06	-38.87	
Norwegian Krone Spot	NOK	8.29	-0.24	0.69	-0.74	1.68	2.81	-1.25	4.01	2.84	-26.85	
VOLATILITY / LIQUIDITY INDICES												
CBOE SPX VOLATILITY INDX	USD	11.76	-1.75	9.22	-1.17	-0.17	-11.24	-2.79	-15.60	-46.88	-12.68	
USD SWAP SPREAD SEMI 2YR	USD	35.60	-	11.10	20.26	18.26	51.41	40.60	36.63	556.12	168.00	
TED SPREAD		53.88	-	7.61	3.24	7.57	20.59	2.16	7.65	59.22	138.62	

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