

Bedrock Friday 17 March 2017 Newsletter

This week was full of important events- We had the American Central Bank raising its key interest rate by 0.25% coupled with a quasi-promise for two more such movements by year-end and then we had the Dutch elections which showed us that the anti-Europe, anti-immigration populist far-right failed to get a majority.

The Fed-talk that followed the announcement was reassuring- Janet told us that the economy is progressing and is expected to pursue its steady if unspectacular growth- She told us that we should not expect growth to be much faster than it is for lack of people and slowing productivity growth. Sounded as though Goldilocks is back- Growth there is, inflation is rising slowly towards the 2% target, unemployment is low but not problematic yet. Interest rates are rising towards normal levels as she said- towards a real 1% rate above inflation. Well, the market reacted as if the Fed cut rates, not raised them! Judging by the weakness of the U.S. dollar, the fall in US bond yields, credit spreads, and stock prices- It was effectively a rate cut to the tune of about 15 basis points, according to indexes published by Morgan Stanley and Goldman Sachs Group Inc. "Our financial conditions index eased by an estimated 14 basis points on the day -- about 2.3 standard deviations and the equivalent of almost one full cut in the funds rate -- and is now considerably easier than in early December, despite two funds rate hikes in the meantime," Goldman Chief Economist Jan Hatzius and team wrote in a note. All of this leaves Yellen facing a predicament similar to one that former Fed Chairman Alan Greenspan called a conundrum in February 2005, when the central bank was raising borrowing costs and long-term yields kept falling and equity markets rallied. At the time, the dilemma was blamed on a global glut of savings.

Bond guru Bill Gross of Janus Capital believes the markets are rallying because the Fed's statement was a little less hawkish than some had feared. While the Federal Reserve is gradually raising interest rates in the U.S., the actions by two other central banks are actually the most important thing to watch right now; it is something that could possibly wreak havoc on the bond market, he said, and that's because monetary policy in both Europe and Japan is causing international investors to buy U.S. Treasuries, he explained "Once ECB President Mario Draghi begins to taper, that probably won't happen for a few months, but once he begins to taper and reduce that \$80 billion a month, once that zero to 10 basis point cap is eliminated in Japan, then hell could break loose in terms of the bond market on a global basis".

Yes, the combination of the Fed and the Dutch elections resulted in rather bizarre movements- US Treasuries rallied (yields down), the US Dollar falls, the Euro rises, and equities also, as does gold and oil. Not exactly intuitive moves...

One would have expected the Dollar to strengthen on the back of the immediate and forward looking rate rise. But it fell- Or was this just the side-effect from short coverings on the Euro because of the positive impact from Holland? Many were short Euro as a hedge against populism. As perceptions of this risk (and the future of the EU) abated, cover shorts, i.e., Buy EURO/Sell Dollar. Then the US Treasury bonds rallying can be explained with a thought that the market had priced-in more than it got and adjusted- Same logic- investors were short bonds into the data, now reassured, they covered, i.e., buy the bonds back.

Then why equities rose? Possibly from the language of a rosy economic future... Oil and gold rose as a normal effect of a lower US\$. So the anomalies seem reasonable, no?

That is now the past. What do we see looking forward?

We see equities continuing to rise, as people are buying because they believe the markets will continue to rise. What has been equally evident in this huge uptick has been the fact that the rationale for a new valuation paradigm has been somewhat tenuous. Those who were uncertain when the market was trading at 14 times forward price/earnings ratio are now ecstatically euphoric at 18 times. Those who called a bear market have turned into bull market cheerleaders. But why? Is it because the President has made good on his promises? Is it because we have all decided that Federal Reserve Chair Janet Yellen's potential rate hikes are good, not only for the financials but the whole market? Is it because companies have shown signs in the earnings season of growing into their most lofty of valuations? Is it because the global economic super-tanker is accelerating? All of the above have been cited and may harbour a kernel of truth, but none of them are satisfactory in explaining why equities are failing to see any form of a pause, any form of retrenchment and any of the mounting bubble-like characteristics rearing their head again. Bull markets aren't normally like this. So what is going on here really? It's really that simple. People are buying this market, not for technical, political, economic or valuations reasons. They are buying it because they think it is going to go up. And, let's not forget that our central banks are still adding liquidity to the markets, and honestly, where else can an investor place his or her capital? Would you invest into a ten year bond yielding 2.50% when that same central banker tells you that inflation will be at 2%? A promised loss of purchasing power (the 2.5% after tax is 1.60% after tax or 0.40% less than the inflation).

Then there is the situation in and of Europe. Equities here seem to trade at a discount to the USA, based primarily on fears of a breakup of the European Union from the rise of populism. We doubt that will happen, and in rather short notice these should rise on the dissipation of this risk.

Now what with the US\$? It is near a 14 year high with the DXY, or the Dollar's weighted value, at 100, down some 3pts for the year. Both Goldman Sachs and UBS find that the Dollar is overvalued against both the JPY and the Euro. UBS says the "fair value" for the Euro is \$1.24 and Goldman is close. But that said, the consensus on Wall Street is for 1.05... We prefer the simplistic approach; The "carry" is in favour of the US\$ and is expected to increase. Stay with the USD, even add at these "corrected" levels... Do note that the Chinese reserves have risen, showing their first rise in 8 months and are back above \$3Trillion...

Our worries are for the Sterling as the Brexit event looms closer and messier than had been seen before. For perspective, Winston Churchill had said "we always found the Irish a bit odd. They refuse to be English"...

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 above 100, losing almost 2% this week. The USD is trading around 1.0740 against the EUR and almost at parity against the CHF. The Pound is trading higher at almost \$1.24. The Japanese Yen is a little lower for the week against the USD at 113.28, remaining up strongly vs the Dollar YTD.
The Russian Ruble is up against the USD at 57.86. The Brazilian Real is now at 3.11, up for the week. Crude oil WTI reached \$55.24 a barrel on the first day of trading on January 1st and is now trading below \$50 at about \$48.85 while Brent is trading at 51.79.
- The yield on 10Y U.S. Treasuries are slightly lower than the year-end levels, having bounced in a rather tight range and now are trading at 2.53%. The Japanese 10 year JGB is trading lower for the week and continues to offer POSITIVE returns trading at 0.075%.
In Europe, since the start of the year we saw the German Bund trading higher in yield almost every day reaching almost 0.50% and then dropping back to 0.18% to then bounce back to 0.475% as we write. The French 10Y Yield crossed the 1% level, reaching the high spread-levels of 2014 against the German Bund, reflecting some investors worries on the French Presidential election in May this year; and now trades at 1.128%
The Swiss 10 year bond yield which trades at 0.026, and is finally in positive territory since 2015 and this for several days during this week, with the exception of the slide down at -0.010% after the status quo announced yesterday by the SNB.
In Peripheral Europe Italian 10Y yields crossed the 2% level having started the year at 1.71% and are currently at 2.36%, while the Spanish 10Y yields trade 50bps lower having started the year at 1.30% and currently trading at 1.89%.
- All markets are up globally this week as they have been since the start of the year. In the USA, all the major indices have marked all new time highs this month with DJIA trading just below 21'000, having gained 0.37% for the week, Nasdaq showing 9.62% for the year after posting a positive 1.06% for the week. The SP500 also was up for the week showing 0.70% and over 6.37% for the year.
In Europe, stocks have been up for the week so far with Eurostoxx50 +0.86%, pushing higher thanks to the Peripheral Italian MIB at +2.07% and Spanish IBEX at +2% for the week as we write. UK FTSE up 0.94%, as was the DAX at +0.81% and the CAC40 +0.66%.
In LATAM and ASIA, Bovespa is up 1.85% for the week being among the best performers with a yearly return of 9.22% as is the Hang Seng with a return of 10.50%. The Nikkei was down about 0.42% for the week.

Highlighted items are interesting data points for the week

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All data is compiled from Bloomberg

MARKET INDICES PERFORMANCE

16/03/2017

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	2,381.38	-0.16	0.70	0.75	1.29	5.46	11.32	6.37	16.70	28.11	18.29
DOW JONES INDUS. AVG	USD	20,934.55	-0.07	0.37	0.59	1.51	5.50	15.51	5.93	19.75	28.85	17.46
NASDAQ COMPOSITE INDEX	USD	5,900.76	0.02	1.06	1.29	1.07	8.53	12.51	9.62	23.58	37.87	20.07
RUSSELL 2000 INDEX	USD	1,386.03	0.24	1.90	-0.05	-0.99	1.60	13.17	2.13	27.01	16.65	19.49
EURO STOXX 50	EUR	3,439.96	0.90	0.41	3.33	3.67	5.25	16.86	4.24	12.72	12.50	14.68
EURO STOXX 600	EUR	377.73	0.81	0.84	1.65	1.66	4.54	11.41	4.13	10.47	15.51	15.44
CAC 40 INDEX	EUR	5,013.38	0.56	0.20	2.98	2.79	3.52	15.49	2.90	12.62	17.12	14.76
DAX INDEX	EUR	12,083.18	0.61	0.50	1.60	2.27	5.43	17.00	4.72	21.54	30.96	13.94
FTSE 100 INDEX	GBP	7,415.95	0.78	1.03	2.14	1.63	5.81	10.56	3.86	19.64	12.95	14.88
SWISS MARKET INDEX	CHF	8,667.48	0.30	-0.05	1.40	1.87	5.32	6.58	5.42	10.22	6.17	17.56
NIKKEI 225	JPY	19,590.14	0.07	-0.42	2.11	1.49	0.62	18.17	2.13	15.26	36.73	17.76
HANG SENG INDEX	HKD	24,288.28	2.08	3.15	2.40	1.15	10.40	4.18	10.50	18.56	13.21	12.19
SHANGHAI SE COMPOSITE	CNY	3,268.94	0.84	0.77	-0.13	1.10	3.67	7.81	4.31	11.45	59.98	13.50
S&P BSE SENSEX INDEX	INR	29,585.85	0.66	2.62	3.28	4.28	12.07	3.80	11.49	20.30	36.12	20.73
RUSSIAN RTS INDEX S	USD	1,096.29	3.17	4.22	0.10	-4.49	-3.09	14.47	-4.50	25.95	-1.27	6.21
BRAZIL IBOVESPA INDEX	BRL	65,782.85	-0.68	1.85	-1.32	-2.90	12.66	15.25	9.22	29.20	45.80	12.31
MSCI WORLD	USD	1,864.10	0.57	0.99	1.38	1.50	6.23	9.89	6.45	13.46	12.71	17.22
MSCI WORLD HEDGED	USD	834.92	0.12	0.95	1.51	1.75	5.66	13.04	6.08	19.21	31.54	-
MSCI WORLD LOCAL	-	1,440.64	0.09	0.48	1.38	1.45	5.08	11.87	5.60	15.95	22.73	-
MSCI AC WORLD	USD	451.36	0.73	1.31	1.54	1.62	6.88	9.77	7.00	13.93	11.61	16.58
MSCI EM	USD	963.20	2.10	4.00	2.87	2.57	12.47	8.78	11.71	17.91	2.12	12.76
MSCI AC ASIA x JAPAN	USD	580.76	1.83	3.60	2.91	3.29	12.05	6.99	12.91	17.22	9.80	13.37
MSCI EM LATIN AMERICA	USD	2,624.66	1.40	4.05	0.94	-0.01	17.04	14.10	12.13	22.72	-7.88	14.12
MSCI EM Eur, ME & Africa	USD	259.05	3.61	4.63	3.64	1.28	9.69	9.85	5.84	12.54	-14.44	10.95
EQUITY MARKET INDICES - BY SECTOR												
MSCI ENERGY	USD	206.04	0.44	0.85	-0.37	-1.24	-6.38	5.29	-5.91	8.23	-23.88	21.76
MSCI MATERIALS	USD	237.77	1.31	2.61	1.28	-0.43	7.68	14.71	7.16	22.87	-0.91	16.67
MSCI INDUSTRIALS	USD	226.00	0.65	0.98	1.02	1.17	6.26	11.03	6.36	14.98	14.24	18.32
MSCI CONS DISCRETIONARY	USD	209.36	0.59	1.16	1.86	1.76	5.72	10.26	6.58	10.28	17.46	17.21
MSCI CONS STAPLES	USD	222.00	0.71	1.17	1.05	1.90	7.47	2.19	6.97	3.01	18.97	20.76
MSCI HEALTH CARE	USD	210.36	-0.19	0.20	1.16	2.42	9.04	2.87	9.09	10.12	16.35	16.57
MSCI FINANCIALS	USD	113.43	0.86	0.72	2.32	1.31	6.08	23.08	6.83	23.93	13.05	13.58
MSCI INFO TECH	USD	180.18	0.44	0.92	2.29	2.54	10.95	13.50	11.75	24.64	45.46	18.96
MSCI TELECOMS	USD	70.85	1.03	1.49	1.69	2.58	3.41	1.07	1.90	-2.02	1.90	14.76
MSCI UTILITY	USD	119.77	0.06	1.12	-0.17	2.80	5.03	0.93	4.19	0.60	2.33	16.36
MSCI WORLD REAL ESTATE	USD	195.06	0.70	1.76	-1.79	-0.24	3.87	-1.90	2.62	-0.77	11.11	25.08
HEDGE FUND INDICES												
HFRX GLOBAL HEDGE FUND	USD	1,222.99	0.27	0.14	-0.01	-0.21	1.71	3.39	1.62	6.99	-0.92	-
HFRX EQUAL WEIGHTED	USD	1,233.88	0.17	0.11	-0.07	-0.14	1.47	3.02	1.37	7.38	2.08	-
HFRX GLOBAL EUR	EUR	1,095.51	0.27	0.13	-0.11	-0.36	1.16	2.30	1.18	4.96	-4.17	-

MARKET INDICES PERFORMANCE

16/03/2017

INDEX NAME	CCY	Last Price	PRICE CHANGE IN % (unless indicated)									Yield to Worst
			1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y	
LIBOR RATES AND YIELD ON US GOVERNMENT BONDS (Yield in %, Change in bps)												
US 3 MONTH	USD	0.73	0.51	-1.52	12.20	21.36	23.39	44.72	22.88	44.64	-	-
US 2 YEAR	USD	1.33	0.08	-2.04	7.29	14.48	8.06	57.09	14.47	46.97	-	-
US 10 YEAR	USD	2.53	-1.07	-4.50	13.96	11.48	-6.21	83.69	8.52	63.37	-	-
US LIBOR 3M	USD	1.15	1.08	3.92	8.42	10.64	15.50	29.16	15.03	50.62	-	-
EUR LIBOR 3M	EUR	-0.35	0.00	0.29	-0.14	-0.42	-2.43	-3.42	-1.79	-11.14	-	-
GBP LIBOR 3M	GBP	0.34	0.13	-0.82	-1.26	-1.42	-2.93	-3.80	-2.28	-24.74	-	-
CHF LIBOR 3M	CHF	-0.73	-0.20	-0.70	-0.38	-0.56	0.58	0.74	-0.08	2.22	-	-
FIXED INCOME INDICES - BY TYPE OF ISSUER												
GLOBAL AGG TR HEDGED	USD	498.23	-0.04	0.32	-0.71	-0.14	0.64	-1.88	-0.23	0.27	10.55	1.71
GLOBAL HY TR	USD	1,216.81	0.56	0.38	-0.51	0.17	3.52	3.73	2.59	13.21	11.48	5.64
US GOVERNMENT TR	USD	2,115.14	-0.10	0.36	-0.79	-0.45	0.83	-3.23	-0.08	-1.36	5.33	1.71
US CORPORATE TR	USD	2,735.00	-0.05	0.43	-1.14	-0.41	1.68	-1.55	0.30	3.71	10.89	3.43
US HIGH YIELD TR	USD	1,850.23	0.46	0.20	-0.90	-0.19	2.61	5.06	2.01	15.85	14.12	5.94
EU GOVERNMENT TR	EUR	244.71	-0.32	0.23	-1.42	-0.65	-1.61	-4.06	-2.23	-1.79	11.49	0.70
EU CORPORATE TR	EUR	260.73	-0.10	0.25	-0.75	-0.25	0.69	-0.23	0.12	4.12	12.57	0.95
EU HIGH YIELD TR	EUR	300.82	0.17	0.04	-0.25	0.15	1.98	3.80	1.55	9.05	15.30	3.68
BARCLAYS GLOBAL CONVERT.	USD	229.52	0.13	0.42	0.15	-0.10	3.32	5.10	3.12	10.07	8.10	-
GLOBAL EM TR (HEDGED)	USD	363.86	0.26	0.43	-0.47	0.23	3.26	0.90	2.29	8.56	17.67	4.42
S&P/LSTA U.S. LEV LOAN	USD	98.96	0.04	-0.13	-0.08	0.23	0.54	7.32	0.35	11.64	0.57	4.50
COMMODITY INDICES - BY TYPE OF ISSUER												
GSCI INDEX TOTAL RETURN	USD	2,259.19	0.10	-0.27	-5.42	-5.75	-5.40	3.51	-6.54	4.41	-54.22	-
GSCI ENERGY TR	USD	379.53	-0.30	-1.36	-8.21	-8.22	-10.52	2.60	-12.71	6.91	-66.21	-
GSCI INDUSTRIAL METALS TR	USD	1,219.43	0.63	2.80	-1.48	-1.36	4.90	20.48	8.64	24.58	-3.77	-
GSCI PRECIOUS METALS TR	USD	1,500.76	2.22	1.95	-2.62	-1.54	7.60	-6.90	6.57	0.11	-13.66	-
GSCI AGRICULTURE TR	USD	435.69	0.31	-0.33	-2.09	-4.79	0.54	-1.83	1.08	-3.37	-36.71	-
GENERIC 1ST 'CL' FUTURE	USD	48.85	0.21	0.74	-9.55	-8.98	-9.60	4.54	-10.84	-2.08	-57.15	-
GOLD SPOT \$/OZ	USD	1,227.35	0.08	1.88	-1.68	-0.62	8.15	-6.33	6.52	-2.43	-10.22	-
CURRENCIES												
DOLLAR INDEX SPOT	USD	100.36	-0.09	-0.97	-0.84	-0.67	-2.60	4.33	-1.90	5.81	26.31	-
Euro Spot	EUR	1.08	0.03	0.90	1.82	1.44	3.53	-3.63	2.40	-4.85	-22.65	-
Japanese Yen Spot	JPY	113.31	0.00	1.31	-0.48	-0.41	3.34	-10.04	3.22	-1.69	-10.18	-
British Pound Spot	GBP	1.24	0.00	1.59	-0.16	-0.42	-0.28	-5.14	0.16	-14.65	-25.71	-
Swiss Franc Spot	CHF	1.00	0.09	1.54	1.02	0.70	3.19	-1.55	2.35	-2.81	-12.28	-
Brazilian Real Spot	BRL	3.12	-0.49	2.37	-0.28	-0.94	8.62	4.61	4.37	19.99	-24.76	-
China Renminbi Spot	CNY	6.90	-0.14	0.03	-0.59	-0.59	0.77	-3.46	0.54	-6.23	-10.57	-
Singapore Dollar Spot	SGD	1.40	-0.10	0.71	0.04	1.13	3.31	-2.92	3.14	-3.76	-9.85	-
Russian Ruble Spot	RUB	57.81	-0.14	1.89	0.85	0.69	6.94	11.66	6.30	17.68	-37.35	-
Norwegian Krone Spot	NOK	8.51	0.36	1.40	-1.01	-1.61	2.45	-2.25	1.90	-1.86	-29.81	-
VOLATILITY / LIQUIDITY INDICES												
CBOE SPX VOLATILITY INDX	USD	11.21	-3.61	-2.66	-12.15	-1.22	-6.97	-26.15	-19.16	-21.40	-27.43	-
USD SWAP SPREAD SEMI 2YR	USD	33.27	-	-1.74	-4.31	-7.47	24.76	29.66	30.63	379.97	142.25	-
TED SPREAD	USD	42.05	-	5.52	-6.47	-21.96	-16.73	-27.26	-15.98	22.24	122.13	-

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