

Bedrock Wednesday 19 April 2017 Newsletter

It is not our usual Friday Newsletter- We skipped last week due to the Easter Holidays and Exceptionally, we advanced Friday to today due to operational problems for this Friday.

In keeping with our ways, we will try again to transform Data into Information and then, transform the Information into Insight. This past week has humbled us some- As you know, we had been believers in a strong Dollar, primarily based on our belief in a rising trend for US interest rates and a continued low rate environment in both Europe and Japan. Whilst we hold-on to the interest rate views, we note that the markets have been buying US Treasuries, bringing the benchmark 10-year note's yield back down towards 2.20% (as it was before Trump's election!). As the rally in long duration bonds surprised, the Fed maintains its promise or further rate rises on the short end. The curve is flattening... Why is the Dollar falling? It should have risen further as the "risk-off" market usually sends the Dollar up for safe-haven. Difficult to explain, forcing us to suggest that there must be something we don't see. Or, suggest that this is an opportunity to acquire Dollars which today appear cheap?

Dominic Schnider, head of Asia-Pacific foreign exchange at UBS, said on Monday "The starting point for the dollar into 2017 was just very, very rich in terms of valuation. As we see more disappointment, from Trump's policies and at the same time, the world outside the U.S. looks better, I think we're still going to see that continuation of dollar weakness. It's not going to be a weak currency, but the dollar continues to slide on a trade-weighted basis". Schnider forecast the USD/Euro pair to rise to as high as 1.20 over the next six to 12 months (now 1.07). While the U.S. Federal Reserve appeared to be the only major central bank poised to raise interest rates, which would appear to provide a tailwind for the dollar, Schnider didn't believe that would affect his forecast. "Higher rates per se do not always translate into a stronger currency," he said. "The starting point is very important. The dollar was massively overvalued. We're just going to see some correction of that overvaluation."

We emphasise this Dollar question, as we observe Gold rising, a logical move on a lower Dollar, yet we see oil falling which is counter intuitive on the same logic. Especially when we note that the International Monetary Fund sees a more favourable outlook for the global economy this year and next than in 2016, but it has concerns beyond the near-term, IMF Managing Director Christine Lagarde said on Monday. If she is right, oil should rise, not fall...

But there is much information flowing around it all... From Turkey's Erdogan referendum "win" this Easter Weekend arguably making him Emir; Does this mean Turkish stability as he says or instability as others interpret this questionable win? Then the French who this weekend will tell us who will be the two possible candidates for their Presidency. France's presidential election is a major test for euro zone unity, and the first round Sunday could bring on intense market volatility, depending on which candidates make it to the final leg of the race. It could turn scary, with heavy rhetoric for a "Frexit", yet the Euro is rising... Read the market has been our mantra- this is telling us that the Euro isn't at risk... It won't be Marine's far right that will win, no matter the candidate to run against her in round II... "I think it's potentially huge, or it could be nothing, and we'll know that Sunday night before the market opens," said Andrew Brenner, global head of emerging market fixed income at National Alliance. He said the spread between French and German 10-year bonds continues to widen, a signal of market unease. "It is true that four candidates are coming all within a margin of error. It is impossible to know for sure whether the French electorate will look at these polls and decide to vote with their hearts or get excited by the underdogs," said Charles Lichfield, associate, Europe at Eurasia Group. "Something we can say is Mrs. Le Pen is most likely of those four candidates to make the second round. They're all between 18 and 22%. Ninety percent of Mrs. Le Pen's 22% will vote for her." The candidate favoured by markets is Macron, who is expected to beat Le Pen in the final vote. "If it appears Macron is in the race, all of this goes away for the near term," said Brenner. "I still expect Macron and Le Pen to be in the runoffs," said Marc Chandler, chief foreign exchange strategist at Brown Brothers Harriman. "A lot of people think the French election is about the presidential election. It's also about the parliamentary election in June.

In short, we are not out of the woods... there are so many parts to or portfolio puzzle and they are all spinning...

The latest decibels of noise have come simultaneously from the UK where Theresa May announced snap elections and in the US where Goldman Sachs, no, sorry, the Treasury Secretary now says that the awaited Tax Reform (and cuts) will be delayed...

The UK action made the Sterling rise and the equities sink. Sterling has seen quite a rebound after U.K. Prime Minister Theresa May surprised markets on Tuesday by announcing early elections. The currency surged to a six-and-a-half month high against the dollar on Tuesday trading around \$1.28 levels. While sterling has been driven higher on growing optimism that Prime Minister May will win convincingly, a number of analysts have warned the rally won't last. Some say they were rather surprised with the market reaction on Tuesday after May's announcement. Kallum Pickering, senior UK economist at Berenberg, told CNBC via email that he was surprised at the positive market reaction. "I don't see much merit to the story that an increase in Conservative seats following 8 June election May will dilute the hard-Brexiteers on the Conservative backbenches, enabling May to go for the softer Brexit that she wanted all along." The currency, however, saw a near 4% rally on Tuesday jumping from \$1.25 initially and now trading day around \$1.285.

The American noises explicitly cause the stocks to fall and bonds to rise. Then there is the enigmatic China whose economy grew 6.9% in the first quarter from a year earlier, slightly faster than expected, supported by a government infrastructure spending spree and a frenzied housing market that is showing signs of overheating.

So what's next? Barring a significant escalation with North Korea or a further escalation of the Russia-USA conflict of words, we believe that the IMF is probably correct that the world's economies are indeed on the mend, that inflation is non-existent and that Q1 earnings will likely reignite the equity rally. Stay put, maybe add here and hold those US Dollars!

Winston Churchill once said, "Russia is a riddle wrapped in a mystery inside an enigma...."

Market Weekly Highlights:

- The greenback has fallen back to pre-elections' levels. A rather strange reversal of trend, as we are experiencing a general "risk-off" sentiment on the back of a general increase in risk perceptions- North Korea, US-Russia tensions, French elections this coming weekend, Brexit and the new for the week UK elections...

These and the like geopolitical issues have brought upon us a general malaise. Normally we would expect a shift towards the safe-haven of the Dollar. The opposite has happened, the USD is trading around 1.072 against the EUR and under parity against the CHF. The Pound is trading this week at roughly \$1.2815, a nice rebound on the back of Theresa May's announcement of snap elections in the UK. The Japanese Yen is trading a little lower for the week against the USD at 108.95.

The Russian Rubble is trading up against the USD at 56.10, the Brazilian Real is now trading flat for the week at 3.10. Gold is now at \$1'282, up about \$120 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 \$52.40.

- The yield on 10Y U.S. Treasuries are lower than the year-end levels, having bounced in a rather tight range around unclear tweets and talk from Trump, now at 2.20%. The Japanese 10 year JGB is up in yield since the end of last year and continues to offer POSITIVE returns trading at 0.004%.

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 0.18%. 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% 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%.

- In the USA, the equity markets in the USA have reversed steam and have experienced a reversal of trend. The DJIA is off almost 1% since the end of Q1 at 20'523 as of Tuesday's close, still up over 3% for the year. Similar movements were registered on the S&P500 and NASDAQ. But now we are into Q1 earnings' season and if these 'bat expectations' we may yet get a return to rally mode. In Europe, stocks have been weak since the start of April, drifting lower in tandem with the USA. The DAX whilst up about 3.50% YTD is off for April by 2% or so. Similar moves in Japan with the Nikkei off 2% for April but down some YTD.

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