Friday, November 8th 2013

Sometimes the sound of silence can be deafening, sometimes you can't see the woods for the trees… however right now the calm before the storm is very much here in Europe. This is nothing new and we have been waiting patiently for the right time to see actions rather than words. We have a new Bernanke-esque figure as the Central Banker in Europe; all hail the Mighty Mario (Draghi). With the flick of his magical interest-rate-wand he reduced the borrowing costs for the Euro-Bloc nations, weakened the Euro currency, (hopefully) bolstering exports and brought back belief in the ECB's mandate - all without spilling his post-lunch macchiato.

In a week that has very much been focused on Europe, Monday through to Thursday midday could be described as almost stationary, like running on the spot. The currency traded in an unusually tight range, European stocks traded 0.50% either side of where they opened and traders held their proverbial breath whilst awaiting the results for the ECB news conference. Mighty Mario laid out his cuts, dropping the central bank rate from 0.5% to 0.25%. With inflation at only 0.7% and unemployment across the 17-nation economy at its all-time high (since 1999) of 12.2% we applaud his decision. He had an air of "Bernanke 08" about him, after two years in office he has cut the rates four times. This time feels different however, with a focus on long term sustainable growth and an attempt to allow unfettered inflation – maybe a little strong, but to stop deflation at least.

The problems for the Eurozone and Mario Draghi come next year or maybe the year afterwards though. What happens when the rates are zero and there is no further room for cuts? Does he instigate his negative deposit rate scheme? If he chooses this path, the banking and shadow banking systems will start to unpick at the seams as they would be less likely to lend both to institutions and credit supply would likely slow. With France being downgraded today (if this really means anything) from AA+ to AA by Poor Standards… apologies Standard and Poor's rating agency… we just hope that his arsenal of inflation fighting tools will be sufficient. Unlike the US where the FED is able to expand its balance sheet and to print in the name of the state, the European Union does not have the treaties in place to issue Euro-State paper. Ben had his helicopter and bazooka… Mighty Mario needs more than a Fiat 500 and a paperknife.

Equities in the US, prior to the press conference, had soared higher with the DJ Transportation Average (often seen as a market indicator of strength or a forebear of weakness) reaching new highs, only to have a little wind taken out of its sails post the Draghi conference. When a butterfly flaps its wings in Frankfurt… not that we are saying chaos is about to ensue, but we do begin to wonder where the future lies. We do not pretend to know the future, but as long as the rates are kept artificially low to stimulate growth, finally there will come a point where someone has to pay the bar tab. With economies drunk on their current elixir of life – "free money" – we are not that confident that the long term sustainability of QE will have a happy ending. The first step to recovery is recognizing that one cannot control one's addiction… we are nowhere near the final steps that include making amends for our errors and certainly in a different stratosphere to where we will be learning to live a new life with a new code of behaviour. For now we watch and wait as the indices are supported by easy monetary policy, we won't stand in its way…

We leave you with a thought from the late, great, Sir Winston Churchill; a man who knew how to foster growth though troubled times, "What this country needs is institution, constitution and pros… perity". Have a restful weekend.

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Currencies

- EURUSD traded at 1.35, give or take a few points, for the days leading up the Mario Drahi's speech on Eurozone economics. Some call this a central bank meeting, but those traders who watch every word would say it is more a directional weather vane for the future. They were not disappointed. Mighty Mario is pointing his vane towards winter, a cold front and with the rates being cut to stimulate inflation and encourage employment the EUR sank instantaneously. Perhaps people had forgotten that this is a pair, with USD being the second half. On the US employment data the EUR fell even further, dropping on the day from 1.35 to 1.3286, practically in a waterfall straight line. We have recovered somewhat this morning to 1.3425, but unfortunately it looks like this will be short lived.
- EURCHF is unchanged on the week at 1.23, however we saw highs of 1.2340 and down to 1.2285 after Draghi cut the rates yesterday. USDCHF on the other hand was almost a vertical line jump from 0.9125 (where it had been all week) to 0.9250. The USD rebound has continued from the lows of 0.8890 of only a week or so ago. The moves here you can see are USD driven and not CHF focused and we have had very little noise from the SNB as the market has seemingly created a new floor for the EUR at around 1.23. Amazing how the different QE strategies have impacted the different markets – stability for the CHF and their economy and large moves for the US and EU.
- USDJPY was incredibly steady at 98.70 for the whole week, jumping to as high as 99.41 prior to the ECB meeting, only to slide rather dramatically to 97.62. The USD bullishness was not felt in the USDJPY pair. We have recovered somewhat to 98.20 this morning but this shows us that the move was purely a EUR play and not USD positive across the board.
- AUD stayed below the Chinese smog levels and finishes the week (for the moment) almost exactly where it started at 0.9440. On little data and practically no stories for the start of the week the paid recovered some of its lost ground to read 0.9540, however it does not look like it can maintain these levels and we expect that in coming weeks the Aussie will resume its downward trend again.
- The GBP recovered its lost ground from the previous week and saw the British pound trade as high as 1.6118. We are now at 1.6080 and expect that sideways trading will abound until supposition catches up with reality. The UK debt issue will have to be solved, maybe with a massive devaluation of the currency (a la ERM or Mad Cow Disease)? There is now a Canadian at the helm of the BOE who was known for cutting interest rates in Canada… let's see how you cut rates in the UK when they are already practically at 0%!
- USDBRL rallied further this week, seeing the BRL devalue again. The pair moved from 2.24 to 2.30 yesterday afternoon.

Fixed Income

- US Sovereign bonds are set to end the week relatively flat (10YR at 2.611%), following a volatile week. Treasuries gained at the start of the week - yields on the 10YR falling to as low as 2.587% - in anticipation for US data. The bonds were soon to reverse their gains and post losses - yields rising to as high as 2.675% - as US services sector grew faster than expected, bringing tapering prospects one step closer. Treasuries have since recouped their losses as the ECB cut its interest rate and the US grew more than forecast. All eyes are on today's jobs report for further indications on the health of the economy.

- Spanish bonds lost for the week – with yields rising from 3.968% to 4.092% currently. The bonds sold off early in the week ahead of the ECB meeting but have recouped some of the losses as the ECB surprised the markets by cutting interest rates by 0.25%.
- Italy traded in line with its Spanish counterpart, with yields rising from 4.074% to as high as 4.224% before falling to current levels of 4.122% post the unexpected rate cut.

Equities

- Developed equities fell 0.59% for the week – as of yesterday's close – as measured by the MSCI World index. Equities sharply fell on Thursday as better-than-expected US growth figures increased concerns that the Federal Reserve might soon moderate its asset purchases.
- The EuroStoxx index lost 0.87%, slipping from five-year highs hit last week, as optimism following surprise decision by the ECB to cut its main interest rate to an all-time low was offset by S&P's credit rating downgrade of France, which revives worries over the health of the Euro zone.
- The S&P 500 dropped by 0.82% (as of yesterday's close), as investors were fretting about stronger-than-expected US economic growth data, which rekindled expectations that the Federal Reserve may trim its stimulus measures this year. However, frenzied buying in Twitter shares grabbed Wall Street's attention on Thursday, as the social media stock surged by over 72% in its first day of trading!
- Meanwhile, the Nikkei declined by 1.19% after Wall Street's fall on Thursday dented risk appetite, keeping investors on the defensive ahead of the crucial US jobs report later in the day. A strong jobs report would give the US Federal Reserve a reason to taper its monthly purchases of $85 billion in assets sooner rather than later, particularly after a much better-than-expected US gross domestic product report on Thursday.
- In terms of sectors, Telecom and Consumer Discretionary lost the most (-1.39% and -1.32% respectively), while Materials and Consumer Staples fared better (+0.61% and 0% respectively).

Emerging Markets

- Emerging Market equities dropped by 1.72% for the week – as of yesterday's close – as measured by the MSCI EM index. Latin American shares tumbled by 2.84%, followed by Asian (-1.56%) and EM European shares (-0.91%).
- The Shanghai Composite slumped by 2.02% for the week, as China is expected to unveil a host of "unprecedented" economic reforms at its upcoming four-day policy meeting starting this weekend. According to market strategists, the highly-anticipated event, to be held from November 9-12 in Beijing, is unlikely to be a watershed moment for the country's stock market.
- The Bovespa plunged by 2.36% for the week, as of yesterday's close. Brazilian stocks fell to their lowest level in nearly a month, on concerns about the future of the US Federal Reserve's monetary stimulus program.

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Commodities

- Commodities dropped 1.27% for the week, as measured by the S&P GSCI Total Return index. The main losing sectors were Industrial metals (-1.71%) and Energy (-1.37%), while Agriculture loss less severely (-0.42%).
- Gold lost 0.35% for the week and is currently trading around $1'311 per troy ounce. The metal was little changed during the majority of the week in anticipation for Thursday's US data. Gold fell to as low as $1'296 as the ECB cut interest rates and the US expanded more than forecast – causing a dollar selloff.
- Crude oil is set to end the week roughly unchanged (-0.14%) at is currently trading at $94.50 a barrel. Crude sold off to as low as $93.07 early in the week as data showed that Supplies have increased. However, crude was soon to recover as inventory build-up came in less than expected.

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