Bedrock Newsletter

Friday, May 17th 2013

Another week of new highs, much hesitation and incomprehension as stock markets pursue their rises around the globe. One of the funny things about the stock market is that every time one person buys, another sells, and both think they are astute… And if they step back after some time, each will likely indeed find a moment in which he was right. Funny indeed…

This week we saw a continued melt-down of Gold as the US Dollar gained ground against most other currencies. The Japanese Yen at about 102.50 remains weak and the Chinese Yuan remains alone in holding its ground against the all-mighty Green Back.
One reason supporting this Dollar rally is the surprising falling US government deficit- The CBO reduced its expected US deficit to 645Bn vs. 800+ just some months ago. The markets had been expecting to see the US deficit climb towards $1 trillion. Arguably, this change dramatically changes the overall quantity of risk in the market-place. As risk falls, values of everything rise; Equities, real estate and art. Treasury bond prices may rise into the future, as supply of new issuance may slow. We do note that this change is hardly due to expenditure cuts, rather from rising tax receipts, underscoring the equity markets' discounting a better future.

On Tuesday we saw further encouragement on the fundamental health of the US economy- U.S. households reduced debt during the first quarter by 1 percent to the lowest level since 2006, resuming a deleveraging trend in the wake of the financial crisis, according to the Federal Reserve Bank of New York. Households in the first quarter improved their debt payment patterns as delinquency rates on mortgages fell to 5.4 percent from 5.6 percent, on home equity loans to 3.2 percent from 3.5 percent, on credit cards to 10.2 percent from 10.6 percent and on student loans to 11.2 percent from 11.7 percent, according to the New York Fed. 'Deleveraging Cycle' - "We're much closer to the end of the deleveraging cycle than the beginning," said Gennadiy Goldberg, U.S. strategist at TD Securities Inc. in New York. "If the housing recovery continues at the current pace, deleveraging could end very soon."

Away from America we found an interesting tidbit of information- The Swiss National Bank (the Swiss Fed) is a publicly traded entity, quoted on the Zurich exchange! It is trading at a P/E of 25x after disclosing its Q1 earnings of 11Bn from its activities in capping the CHF/Euro exchange rate. That was when the rate was at about 1.22 francs to the Euro. It is now 1.243, and they are massively short Francs vs. the Euro… Q2 will be great…

The world has no inflation and little inflationary expectations with commodity prices falling, no wage pressures given the high unemployment levels and no capacity constraints. No inflation is a fact which is likely to persist; with this in mind we bring to you an observation from Nobel Laureate Milton Friedman which may help explain the global trend to raise taxes- "Inflation is taxation without legislation" and therefore, governments are now compelled to raise taxes "officially"…

We leave you for your weekend with our thought about animals- Bulls make money and Bears make money but Pigs get slaughtered… Weigh your bets with caution!

Bedrock Newsletter

Currencies

- EURUSD posted modest gains at the start of the week – rising from 1.2950 to 1.3030 – as EU Industrial production figures beat expectations. The EUR strength against the USD was short lived as news of higher optimism amongst small US businesses was soon to follow, causing the dollar to strengthen. The pair continued its downward move to a two month low of 1.2850 following news that EU GDP shrank more than expected and German growth cooled. The pair stabilized at these depressed levels for the remainder of the week following USD negative news of shrinking NY manufacturing, as well as a rise in Jobless claims, offsetting speculation that the Fed is getting closer to end the stimulus. The EUR seems to have finally started a new, long overdue, downtrend. We look for lower EURUSD levels in the weeks ahead.
- EURCHF is set to end the week where it started (1.2440). The pair slightly weakened at the start of the week (falling to 1.2390) on EUR weakness following poor Macro publications for the region. Strength of the pair was soon to follow - rising to a 2 year high of 1.2520 – as improving optimism over the world economy caused investors to leave the safe haven currency. USDCHF as well resumed its upward move – rising to as high as 0.9740 (the highest level since August 2012). The new CHF weakness seems to be a new developing trend. We should see USDCHF at parity soon again!
- USDJPY made new 5 year highs (102.70!) as the USD advanced following news that confidence of small businesses has improved. The pair has later modestly consolidated on the back of multiple disappointing US data. Here, although we definitely agree with the direction of the move, the pace of it seems a bit too quick. Thus, we look for a correction in the USDJPY pair that should take us a few percentage points lower, where we will rebuild long USD positions.
- AUD fell sharply from $1.00 to as low as $0.9730 – the lowest level in a year. The pair initially sold off following positive economic news from the US, causing a rally in the USD, as well as falling commodity prices due to Chinese growth fears. The Aussie continued its slide on the back of forecasts of slower growth and lower than expected economic and budget figures in Australia. Here also, a new downtrend seems to have commenced.
- The Pound fell from $1.5360 at the start of the week to $1.5240 currently. Aside from the USD strength, the GBP fell on growing Anti-EU sentiment in the UK, which ties are critical for the UK economy. The pound should weaken further in the coming weeks, sliding below the $1.50 mark.

Fixed Income

- US Treasuries had further losses up to the middle of the week as speculation rose that the Fed may consider tapering its record bond purchase program. However, treasuries snapped their longest losing streak in two months on fears that the economy may be slowing following disappointing US data. The 10yr yield rose mid-week to as high as 1.98% before falling to 1.86%, the 30yr rose to 3.20% before falling to 3.083% and the 5 yr rose 0.86% before falling to 0.773%.
- The Spanish 10 year fell for the majority of the week – with yields rising to as high as 4.39% - amid fears that Eurozone politicians will struggle to control their debt loads and due to confirmation that the Euro area recession continues, overshadowing a successful 6 month bill auction. An additional successful auction on Thursday caused Spanish bonds to rally – erasing earlier weekly losses – with yields currently standing at 4.205%.

- The Italian 10 Year mirrored the moves of Spanish bonds, with yields rising to 4.076% mid-week. Yields are currently at 3.895% following a successful auction where the nation sold €6bn of 30yr bonds.

Equities

- Developed equities rose by 0.81% this week – as of yesterday's close – as measured by the MSCI World index. Global equities continued their rally this week supported by hopes for ongoing Central Bank stimulus bolstering sentiment amid weak economic reports.
- European shares rose 0.75% for the week, as measured by the Eurostoxx 50 index. Shares rose as the euro hit a six-week low against the dollar and after euro zone economic data undershot already weak expectations, strengthening the case for another interest rate cut.
- The S&P 500 broke new highs again – rising by over 1% for the week, as of yesterday's close – as softer than expected data on the manufacturing sector and labor market bolstered hopes for ongoing central bank stimulus. On Thursday, Cisco led gains in blue chips and technology stocks after the network equipment maker posted a higher-than-expected quarterly profit. US equities have risen over the past three weeks with the S&P 500 index racking up a nearly 16% gain so far this year, mainly due to the sea of cash produced by the Federal Reserve's policy of ultra-low interest rates and asset purchases.
- The Nikkei surged by 3.63% this week – pushing the index to a 5-1/2 year high, well above 15,000! – as the weak-yen trend continued to lift exporters. The index has added nearly 46% this year, helped by Prime Minister Shinzo Abe's growth policies and the Bank of Japan's aggressive monetary easing.
- In terms of sectors, Consumer Discretionary and Consumer Staples posted the best returns (+1.69% and +1.14% respectively), while Materials and Energy lost (-1.02% and -0.14% respectively).

Emerging Markets

- Emerging Market equities lost 0.42% – as of yesterday's close – as measured by the MSCI World EM index. EM Europe and Latin America were the main laggards (-1.45% and -1.03% respectively), while EM Asia only lost 0.17%.
- The Shanghai Composite rose 1.76% for the week, posting a third-straight weekly gain. Chinese shares started the week on a negative tone after JP Morgan Chase cut its growth outlook for the nation's economy. The benchmark then strongly rebounded on Thursday and Friday as investors joined a property-led rally – ahead of April home price data due on Saturday – while financial and technology-related stocks were also strong.
- The Bovespa lost 0.61% for the week – as of yesterday's close – as results released by local companies disappointed and a bill to reform the country's sea ports (which are largely viewed as outdated and not fit to handle Brazil's foreign trade) got stuck in Congress. Miners and energy producers also weighed on the index as Vale tumbled for a fifth day amid concern that growth is slowing in China, dimming the outlook for Brazilian raw-material producers, while troubled oil company OGX contributed the most to the benchmark's decline on Thursday.

Bedrock Newsletter

Commodities

- Commodities dropped 0.23% for the week, as measured by the S&P GSCI total return index. Precious and Industrial Metals lost the most over the week (-3.55% and -1.34% respectively), while Energy was about flat.
- Gold collapsed by 5% this week, and is currently trading around $1’380 per troy ounce. Gold dropped to a four-week low, as renewed liquidation in gold exchange traded funds and its recent drop below the psychological $1’400 level spooked bullion investors, prompting them to favour other assets. We however believe that this liquidation will soon be over and that monetary easing coupled with currency debasing will not only provide a floor for Gold prices, but also lift them significantly.
- Oil dropped by about 1% this week, and is currently trading around $95 a barrel, as poor housing and employment data from the United States sparked concerns of weaker crude demand in the world’s biggest economy. Oil prices also struggled due to a broadly stronger US dollar.

Disclaimer

This document is for information purposes only and has been prepared by Bedrock SA, representing the opinions and investment views of Bedrock SA as applied in its investment advisory and management activities. It is a private publication intended for private circulation only. It does not constitute a company survey, a financial research, an offer, a solicitation or a personal recommendation to buy or sell specific products or securities. Bedrock SA disclaims all liability for any losses or damages of any kind relating to such information, which may be changed at any time without notice. The risks inherent in certain investments, particularly derivative products, may not be suitable for all investors. The contents of this publication may have been used for transactions by Bedrock SA prior to their communication. Distribution or dissemination of this document and/or the sale of certain products mention herein are subject to restrictions. Copyright 2013 All rights reserved. Approved for circulation in the UK to professional clients only by Bedrock Asset Management (UK) Ltd which is authorized and regulated by the Financial Conduct Authority. This presentation is being made to you solely for your information and must not be copied, reproduced, further distributed to any other person or published, in whole or in part for any purpose.
© 2013 Bedrock S.A. 4, ch. Des Vergers, 1208 Geneva, Switzerland, T: +41 (0)22 592 5455 F: +41 (0)22 592 5459, www.bedrockgroup.ch