Friday, May 20th 2011

Friday again. Another week went by in which we didn't hear anything on the Atomic situation in Japan, nothing about the massacres in Syria or the fate of the Libyans. It was the "DSK Week"… The head of the IMF and his personal deviations, whilst indecent and arguably intriguing they are hardly world-changing. Yes, the IMF will change as it gets a new head. Possibly a woman (Christine Lagarde), a hedge against future indiscretions?

We are already deep into May, having already seen the Arab uprising which changed Egypt and Tunisia and has Yemen (yes, remember them?), Syria and Libya still in-fighting for freedom, Japan was shaken and stirred, England wedded some Royals, Bin Laden was found and killed, The Federal Reserved disrobed in its first ever press conference and now, the Dominique Strauss Kahn affair. It isn't even an election year… amazingly, whilst all these events rolled across our TV screens, the financial markets have done little; The Dow Jones is now up almost 9% for the year, The German DAX up 5%, the materials heavy UK's FTSE is up 2%, bonds are generally up in prices (down in yield), Gold after being spanked together with all other commodities in early May, is now still up 5% for the year. Silver, arguably the most volatile of commodities (this year) after its collapse in May is still up 15% ytd… Yes, Oil… it is at $100 per barrel, up from $91 at the beginning of the year. The only "Big Down" is the US Dollar, off 7% against the (troubled?) Euro, flat against the Japanese Yen and off 1.5% against the all mighty Yuan. We are truly amazed at the resilience of the markets! Is it blind stupidity or is there really a powerful motor propelling the economies of the world? A bit of both we say. Yesterday's IPO of LinkedIn up 140% or so in day one with little if any earnings to show, was reminiscent of the dotcom times of the naughties. But then, with the reference ten year Treasury or Bund yielding both 3.20% or so, is a market multiple of 15X expensive? Probably not.

Going into what promises to be a sunny weekend, we leave you with some words of Abraham Lincoln "The best thing about the future is that it comes only one day at a time" ☺

Currencies

- The Japanese Yen was the biggest loser of the week as Japan slid into its third recession in a decade and Prime Minister Naoto Kan said he expects the central bank to maintain a flexible monetary policy. The Yen dropped to 81.60 currently versus the US Dollar from 80.80 earlier in the week and to 116.70 currently against the Euro from 113.50 earlier in the week.
- The Dollar was also under pressure this week after a drop in housing sales and slowing in a regional gauge of manufacturing bolstered speculation the Federal Reserve will maintain stimulus and keep interest rates low. The US Dollar dropped from 1.4050 in the beginning of the week to 1.4345 versus the EUR, before reversing now and stands at 1.4215, and from 0.8925 to 0.8850 currently versus the Swiss Franc.
- The British Pound weakened against the Euro this week amid speculation that the Bank of England won't raise interest rates this year while the European Central Bank is expected to continue to tighten monetary policy. The Sterling went from .8720 at the beginning of the week to .8780 currently against the common currency.
- Currencies of commodity exporters gained as investors sought higher-yielding assets. The Aussie Dollar gained as traders bet that the Reserve Bank of Australia will raise interest rates over the next twelve months and the New Zealand Dollar was also strong. The Swedish Krone and Norwegian Krone also gained this week.
- Meanwhile, the Swiss Franc remained very strong this week, despite the announcement from the Swiss economic minister that authorities will consider taking appropriate measures should the franc continue to strengthen.

Fixed Income

- Yields on US government bonds are largely unchanged for the week. Yields on most US maturities dropped slightly during the week as various data release dented hopes for a strong recovery in the US but these have recovered and are back to the levels where they started the week. The US 10yr bond is yielding 3.165% while the 2yr note is yielding .528%.
- Yields on long term European bonds ended the week slightly higher, with the yield on UK 10 year Gilts and on German 10yr Bunds up 2bp and up 5bps on France 10 yr bonds.
- Meanwhile, yields on periphery European countries also rose this week, as with the spread between yields on German bonds and Spanish or Italian bonds widening this week. Greek bonds also fell this week as it seems increasingly likely that the Mediterranean nation will be forced to reorganize its debt.
- Despite the European sovereign crisis and disappointing US economic data, credit markets were robust this week, as investors look for yield. This week, with yields on government bonds roughly flat, investment grade securities outperformed high yield bonds.
- Interestingly, on May 16th, the average absolute yield on junk bonds fell to a record low of 7.19 percent from 7.85 percent at year end, according to the Bank of America Merrill Lynch U.S. High Yield Master II Index. Companies have sold $149.5 billion of the bonds this year through yesterday, compared with $110.5 billion during the year earlier period.

Equities

- Developed equity markets are slightly positive for the week, with the MSCI World up by 0.2% as of yesterday's close. European stock markets are up today, so it looks like the week will end in positive territory.
- US and European markets have moved in similar fashion this week, with the only clear regional laggard being Japan.
- The Nikkei is down roughly -0.5% for the week after a report showed that Japan had slipped into another recession. The utilities sector, which is the most affected by the nuclear crisis and the fallout from the earthquake/tsunami of March 10th, was the biggest loser.
- Tepco, the utility which operates the Fukushima Daiichi nuclear power plant, announced this week a massive loss of JPY1.247 trillion ($15.3 billion) for the fiscal year, the largest corporate loss outside of the financial sector ever seen in Japan…
- In terms of sector, energy and materials outperformed this week, as energy and certain industrial metals, as some of these stocks recovered from their sell-off in the last few weeks. Various corporate events within these sectors also helped. The very much awaited IPO of Glencore this week also attracted attention to the sector. On its first day of trading the share ended flat.
- Defensive sectors lagged somewhat this week, with consumer discretionary and utilities down slightly for the week.
- The other major loser this week was the technology sector, which is down close to -0.9% for the week as of yesterday's close, as measured by the MSCI Info Tech index. Technology stocks have had a very good run over the last couple of months and there are losing some steam as corporate results stop being so impressive.
- However, in contrast to Glencore ending flat on its first day of trading, LinkedIn more than doubled on its first day of trading! Having been already priced at the high end of its range for the IPO, many are thinking of this as the beginning of a new tech bubble…

Emerging Markets

- Emerging markets equities underperformed slightly developed markets this week, with the MSCI EM Index down a little while the MSCI world index is up a little, as of yesterday's close.
- For the YTD, the MSCI EM continues to lag big time, being slightly down while the MSCI World index is up over 5%.
- All major EM regions were down for the week, with Chinese, Brazilian, Russian and Indian stocks all down for the week. This week also saw the first weekly outflow from EM equity funds since the last 8 weeks…
- Meanwhile, Asian currencies continued to gain, as shown through the Bloomberg-JP Morgan Asia Dollar Index, as many of the component currencies experience higher inflation rates and as interest rates go higher.

Commodities

- Broad commodity indices are roughly flat on the week, but performance across the major sectors of commodities varied significantly.
- Industrial metals are flat, while energy is down over -1% for the week, with crude oil (WTI) at \$98.72 currently, having this week crossed the \$100 level.
- Precious metals were slightly lower for the week, with gold slightly higher and silver lower for the week. However, market activity was quite volatile, with both precious metals tumbling in the early part of the week, but then bouncing back up. Gold finished above its level at the beginning of the week while silver is still below that level.
- The major gainer for the week were agricultural commodities, with bounced almost 7% as of yesterday's close! These had however taken quite a whooping over the last few weeks. The increase in price in many of these soft commodities is linked to speculation of an increase in demand given their lower prices.
- We have mixed views on commodities – over the long term, energy, certain industrial metals and agricultural commodities should continue to experience supply/demand pressures and therefore should appreciate. However, in the short term, we remain cautious given the fact that these have come a long long way…