Friday, June 28th 2013

June is drawing to a close; and with it, the half year period. We always knew that psychology was very important, but the mood swings that took place lately are quite staggering. From “irrational exuberance” for the first 5 months of the year (remember the stratospheric rise of the Nikkei??) to depression and panic following the Bernanke statement... June was indeed a “brutal” month in terms of market action. Equity markets dropped hard, particularly in Emerging Markets, although the past 48 hours did alleviate some of the pain. What made June really painful was that there was nowhere to hide as Fixed Income markets across all sectors collapsed, as did commodities and precious metals. Not a single asset escaped the blood bath, except for cash. But let’s take a look at the numbers. EM equity indices are down approximately 11% for the month, developed markets by 3%. Fixed Income Indices are down approximately 2%, but EM ones are down 5%, Gold is down 10% and HF indices did not escape the storm, giving back about 2% for the month. So, you might ask, what was the reason for all this? Is this a real change of trend or a usual sharp and steep correction after months of levitation?

Fed Chairman Bernanke said last week, that the central bank may curb bond buying aimed at supporting growth this year and end the so-called quantitative easing program in 2014 should risks to the U.S. economy continue to abate and growth continues in line with Fed projections. Then, the Shanghai Composite tumbled below the key 2,000 mark on Monday when the Chinese central bank refrained from pumping funds into the markets in order to ease liquidity concerns. Marc Faber (Dr Gloom and Doom), then added fuel to the fire saying that, "There are lots of poor credits in the system, because all kinds of companies, instead of manufacturing and making money out of manufacturing, resorted to financial transactions. In other words, they borrowed at low rates from the state banks and then they lent out to very questionable borrowers." Well, it is true that the banking system has problems, but since in China, the banks are state-owned, there will be no bankruptcies allowed. However, the PBOC and the Chinese leadership are willing to take the pain and deleverage. Add to that the social unrest in Brazil, which drove the local equity market and the value of the BRL sharply down and here you have all the ingredients for an explosive cocktail.

However, as exaggerated as the rise was in the first 5 months of the year in all asset classes, the drop since looks also to be a bit of an overreaction. Pimco’s flagship Total Return Bond Fund dropped 3% in June. But don’t panic as “The Bond Market Ship is not sinking”, Pimco’s Gross said. “Bond yields and risk spreads were too low two months ago and global markets that were too leveraged are now reducing risk.” “In trying to be specific about which conditions would prompt a tapering of QE, the Fed tilted over-risked investors to one side of an overloaded and over-levered boat. The U.S. economy is not sinking, nor are the majority of global economies,” “Their markets just had too much risk, and in Pimco’s opinion, too much hope for a constant QE and for the growth that it would produce.”

Bond-fund managers from Gross to Jeffrey Gundlach at DoubleLine Capital LP have said now is a bad time to sell bonds because the economy isn’t strong enough to sustain higher borrowing costs. Gross, said last week those investors who are selling U.S. government debt now are missing the influence of inflation on the central bank’s decisions.

In the latest commentary, Gross advised investors “don’t jump ship now.” “We may have reached an inflection point of low Treasury, mortgage and corporate yields in late April, but this is overdone,”

Well, since mid week, the FED was all out on the wires trying to deflect the damage and reassuring the markets that rate rises are not for tomorrow.... Stay tuned!

Currencies

- EURUSD continued the weakness that we saw from the previous week. Mr Bearnanke was delightfully quiet this week, leaving the rest of the FED and other various Government acronyms to play down the end of the bond buying program. It seems like the Taper was not a pre-approved term by the Government Quangos and a desperate news blanket has been laid out to slow down the market reaction. The EUR slid from 1.31 to as low as 1.2985 on Wednesday as the US GDP QoQ data came in slightly lower than expected but GDP price index rose more than expected. With the USD bid in the market against most currencies, a weak EU agreement on Banking and the German's now no longer in agreement with the French, the cracks would appear to be moving towards crevasses. Without some form of Ice-pick or rope it looks like the downward in the EUR should continue.
- The CHF saw some sustained selling this week that caused the EURCHF to move from 1.2240 to as high as 1.2355. The USD also strengthened against the CHF moving from 0.9313 to 0.9488. It would appear that as a little of the fear has left the Equity markets with no immediately impending removal of the drugs being pumped into the monetary system, that the safe haven plays suffered. As we mentioned before, the lightening of the CHF two weeks ago seems to be continuing across the board and especially so with the USD bid tone. We view further weakness in the CHF, specifically against the USD. Notably though we have not had any large announcements made by the SNB and we suspect that their persistent approach to defending their floor has paid off in the eyes of the market.
- No need for HaraKiri for Abe or Kuroda this week; Gai-Jin's words from last week are still ringing loud and clear in Japanese ears! The JPY weakened further up to 99.02 having traded as low as 97.00 on Tuesday. The continued down move in the Yen has been sustained and we believe that there should be little need for market wrangling or tv appearances to continue the trend. The Yen shall slide and continue to do so… Domo arigato Bernanke san!
- The AUD is almost unchanged on the week, despite the Australian political system being in full swing this week… in fact swinging with bats and mallets and any weapon that can be used as a projectile in the race for the next election! Unfortunately for Julia Gillard, Mr Rudd, the previous PM she ousted, has now ousted her just before the election! This news was received by the market and dismissed equally as fast. The AUD moved from as low as 0.9150 to as high as 0.9345 but is settling at its opening level at the moment of 0.9245.
- Was this the face that launched a thousand ships? Two thousand five hundred years ago the currency of the era was measured in the beauty of women, namely Helen… now we have paper currency… but the face that is launching the ships of war, in our life time, is the face of a man and Bear. Single handedly the USD rally is taking the GBP back to the low-levels and the war is being waged by Mr Bernanke. Cable sank again this week from 1.5477 to 1.5200. The picture does not look pretty and we see continued weakness ahead.
- We feel that EURNOK deserves a mention having surged last week from 7.65 to 8.00 by the end of the week. This week reaching new highs of 8.0820 although has settled back to 7.88 at the moment.
- The race to the bottom is never in a straight line as the BRL strengthened this week moving from 2.26 to 2.18… This is roughly where the currency pair was trading before the explosive action from last week. It looks like the volatility is set to take centre stage and the possibility for further weakness in the BRL is very high, we would not stand in its way.

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Fixed Income

- US Treasuries were decimated this week but have slowly been bought back after reaching yields of 2.66% on Monday, now trading back to 2.45% this morning as the media machine kicks in to abate the massive sell off we have seen. Short term paper was not immune either… reaching 0.43% but coming back to 0.35% this morning, levels last seen in June 2011.
- The German 10-year Bund was not immune to the USD surge and the German yields moved rapidly from 1.70% to peak at 1.85% - although settled back to 1.72% this morning. The Germans are likely to be feeling the pressure this week but even as cracks continue to appear we believe they will outperform the periphery. If they want the EU to survive we believe they may have to have independent agreements with the periphery nations to maintain stability.
- The Spanish 10 year bonds spent the majority of the week above 5%. Reaching a high of 5.13% on Wednesday before seeing buying interest and the yields dropping to 4.70% this morning. With movements like this we are really not in favour of holding this paper unless you have the stomach for the intraday moves or the foreseeable price plunges!
- The Italian 10 Year weakened this week, moving from 4.60% to 4.93% by Wednesday but as the equity markets rallied the bonds strengthened and the yields fell back to as low as 4.43% this morning. We feel that there is another sell off around the corner as the asset dumping continues.

Equities

- Developed equities rose 1.04% this week, as of yesterday's close, as measured by the MSCI World index. Global stocks rose on the back of better than expected US and Japanese economic data as well as assurance by the Chinese Central bank on ensuring money stability.
- The EuroStoxx gained 2.70% for the week. European stocks sold off at the start of the week on the back of cash crunch fears in China, as well as worries that the US will begin curbing stimulus. Stocks have since rebounded on better than expected US figures, and concerns about Chinese interest rates eased. Additional gains were attributed to reassuring comments from Draghi, which announced that he will refrain from reducing monetary stimulus, coupled with positive EU economic figures, where German unemployment claims unexpectedly dropped. The Eurostoxx is set to conclude the month of June down 5.5%.
- The S&P 500 gained 1.30% for the week, as of yesterday's close. US equities recovered from last week's selloff as better than expected durable goods, consumer goods and home sales bolstered the outlook for the US economy. Further gains were made following a miss in GDP figures (1.8% vs 2.4% exp.), raising speculation that the Fed will be in no rush to reduce stimulus. The S&P is set to end the month of June down 1.1%
- The Nikkei rallied 3.38% for the week. Japanese equities lost as much as 3% at the first half of the week amid Chinese growth concerns as well as a brief rally in the Yen. The gauge reversed its losses and posted solid weekly gains on speculation that the US may hold back from reducing stimulus, Japanese industrial production rose the most since 2011, retail sales climbed and consumer prices halted their slide. The Nikkei concluded the month of June down 0.7%.
- In terms of sectors, Telecoms and Financials posted the largest gains (2.15% and 1.82% respectively), whilst Materials lost 1.35%.

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Emerging Markets

- Emerging Markets equities gained 2.1% for the week, as of yesterday's close, as measured by the MSCI EM index. Latin American stocks were the best performers this week (+4.63%), while EM Asia and EM Europe gained 1.19% and 1.17% respectively.
- The Shanghai Composite lost as much as 5.5% this week, sending Chinese equities into bear market territory. The gauge shed as much as 5.3% on Monday's trading session alone due to worries that a recent rise in short term interest rates will increase liquidity risk in the financial system, which will eventually hurt domestic growth. The central bank has since tried to reassure the markets by pledging to ensure money market stability but the efforts have failed to lift local equities. The composite has concluded the month of June down 14%!
- The Bovespa rose 1.17% for the week (as of yesterday's close). Brazilian stocks gained as China's central bank said it will ensure market stability, which is crucial for Brazilian exporters. In addition, positive US figures provided optimism for global growth. The benchmark is set to end the month of June down 11%.

Commodities

- Commodities rose by 0.96% over the week, as measured by the S&P GSCI Total Return index. Precious Metals collapsed as much as 6.34%, and Agriculture lost 2.23%, while Energy gained 2.04%.
- Gold sank as much as 7.25% this week (the biggest weekly drop since April), and is currently trading around $1'202 per troy ounce. Gold fell over 4% on Wednesday following weaker than expect US GDP figures. Further disappointment arose as the slump in the gold prices failed to lure Chinese and Indian shoppers, the world's largest consumers.
- Oil gained 4.0% for the week and is currently trading at $97.36 a barrel. Crude-oil futures rallied due to supply disruption worries caused by floods in Canada which were forced to shut pipelines. Further price gains were attributed to supportive comments from the Fed that monetary policy would not be tightened too quickly.