Bedrock Friday 13 October 2017 Newsletter

It is Friday the 13th… Some fear this combination of a weekday and a number. Indeed, things can and have gone silly on Fridays dated thirteen. Bundesbank board member Andreas Dombret cited a 2012 paper by physician and researcher Franz Messerli that studied the correlation between chocolate consumption and the number of Nobel laureates per population. Unsurprisingly, the strongest link was found in Switzerland. Dombret says the research serves a perfect example for the kind of false conclusions populist movements have drawn from separate data. “Confusing correlation with causation is amusing -- but it is also disturbingly similar to what we are seeing in current political debates. Is the idea that more chocolate leads to more Nobel prizes really any different from the idea that protectionism brings back old jobs?”. If only this kind of reasoning were limited to the effects of chocolate…

Well, we are into Earning Season yet again. It started well with both Citigroup and JP Moprgan Chase beating expectations. Both stocks declined a little immediately afterwards as within the “beats” were hidden some disappointing sub-sector performances. Notwithstanding this, optimism reigns over equity markets just about everywhere- As if investors predicted a broad-based earnings’ beat. We are at all-time highs just about everywhere and if these implicit expectations are to materialize yet again, further all-time highs are a reasonable outcome. And then, both the Fed an the ECB are telling us that their “mood” favours tightening, i.e., telling us that the economies are doing well… More fuel onto the earnings’ effects?
European Central Bank officials are considering cutting their monthly bond buying by at least half, starting in January and keeping their program active for at least nine months, according to officials familiar with the debate. Reducing quantitative easing to 30 billion euros ($36 billion) a month from the current pace of 60 billion euros is a feasible option, said the officials. After more than 2 1/2 years of trying to revive the region’s economy through bond purchases, some governors see the recent period of robust growth as a reason to rein in the support. Others are concerned that inflation remains too weak. In the meantime, Draghi said in Washington that the ECB’s promise that interest rates remain low “well past” bond-buying is “very, very important.” And indeed, the prospect of a slowing QE didn’t hurt European bonds, quite to the contrary, they rose in price on the back of these words, i.e., yields slipped down (German 10 year Bund is at 0.43% vs. 0.48% at the start of October). The IMF this week predicted the euro area will see inflation of 1.5% this year and 1.4% next year. ECB staff see inflation even lower in 2018, at 1.2%, before an acceleration to 1.5% in the following year. That’s still undershooting the institution’s goal of just below 2%.

The minutes of the last FOMC showed detailed debate last month over whether forces holding inflation down were persistent or temporary, with several policy makers looking for stronger evidence of price gains before supporting a third interest-rate hike this year. Several policy makers said their decision on whether to raise rates this year “would depend importantly on whether the economic data in coming months increased their confidence” on inflation rising toward their 2% target. The U.S. central bank left the target range for the federal funds rate unchanged while projecting another increase before the end of the year and announcing an October start for a gradual unwind of its $4.5 trillion balance sheet. Clearly in concert with the ECB… the yield on the US 10 year Treasury is at 2.33% now, unchanged from 2.34% on the first of the month. And the yield-curve has flattened… Hummm…. Maybe we need to adjust our expectations on interest rates? We hold the conviction that there are forces away from politicians and bankers holding down prices (the “Amazon effect”) and that it is probable that we will be operating in a very low interest rates’ environment for very, very long. Bonds are probably not a slow-motion train wreck as some predict, but are likely to remain in a narrow band around very small numbers. No pains expected, but no rewards either…

We are trying very hard to understand our environment (financial, not climate!). We went back to our finance text books and tried to identify causality. We re-read the chapter on risk-reward equations, and maybe found something reassuring: The book tells us that as risk diminishes, investors are willing to pay higher prices. Well, risk measures such as volatility are down and low in absolute as well as relative terms. The VIX is below 10, perhaps being the cause of high values rather than a result? What if the low volatility is a driver, if not THE driver for the high valuations? There is little to no volatility in bonds and FX, unusually none in commodities too. A world of certainty as an explanation for rising valuations? The observed price trends are supported in basic financial logic! Yes, the Fed and the ECB are loking at tightening which will further squeeze inflation out of our already deflating price environment. Back to our friend TINA, and asset prices are likely to rise further. The yield curves are poised to invert as the short-end is pressured upwards by central banks and the long end pressed down as investors buy duration into a “no-inflation” future. Hunt, a former economist at the Dallas Fed, speaking about Treasury yields, said: “We do not believe that the secular low is at hand. We believe it’s in front of us.” Some consider a flat and inverted yield curves to be harbingers of recessions, but when considered with the goggles of causality, maybe this isn’t applicable this time? Amazon-effect, and low volatility offsetting the implications of inversion… Time will tell. We hold our view that the world has reactivated most of its cylinders. With a 2% gain in September, the S&P 500 Index has set a record: positive returns in each of the first 10 months of the year. There’s never been a full calendar year when this has happened every month. We may be revendicated with our fundamental view.
… and Bitcoin is back to breaking its own, irrational highs. Jamie Dimon called it a fraud, but Goldman Sachs is playing in this sandbox and the IMF’s Lagarde says “it’s time to get serious about digital currency”… Your call. We stand aside for now.

Market Weekly Highlights:

- After a four week rally the Dollar set its first weekly losses. The DXY lost some ground this week to 93, the EUR is trading higher against the USD for the week, currently just above 1.1830, USDCHF is stronger somewhat at almost 0.9750. The Pound, which hit 1.3657 last month came off to almost 1.30 last week and is now trading back up at 1.33.
  The Japanese Yen regained some ground against the USD showing 112.

  The Russian Ruble has traded sideways against the USD at about 58. The Brazilian Real declined against the USD this week to trade at just about 3.17.

  Crude oil WTI is at almost $51.33, slightly up, whilst Brent stands at just above $57.18.

- 10Y U.S. Treasuries are trading up in price with yields going back to 2.33% after hitting nearly 2.40% earlier this week.
  The Japanese 10 year JGB yield has moved up this week from 0.045% to 0.07% and continues to offer POSITIVE yields, actually trading at 0.064%.

  In Europe, we saw the German Bund yield moving sideways this week at around 0.43%. The French 10Y Yield followed a similar path trading just below 0.85% as we write.

  In Peripheral Europe Italian 10Y yields crossed the 2% level again showing 2.1%, having started the year at 1.73%, whilst the Spanish 10Y yields trade some 50bps lower than Italy at 1.62% but higher than where they started the year at 1.30%. The Catalan fiasco is not helping Spain's outlook.

- Equity markets had a slightly positive week in the USA with all three indices S&P, NASDAQ and DJIA hitting new all-time highs yet again. The DJIA is at 22'841 up about 0.29% for the week as of yesterday's close, SP500 at just above 2'550, about flat for the week and Nasdaq at about 6'600, adding another 0.09% positive return this week.

  In Europe the situation is similar with the Eurostoxx50 up 0.16%, with the DAX, CAC40 and FTSE100 at respectively +0.27%, 0.01% and 0.10% for the week while the peripheral Spanish IBEX 35 is up a strong 0.83% in comparison.
  The Nikkei trades strongly higher at +2.55% for the week and shows positive returns for the year at 10.68%.

Highlighted items are interesting data points for the week

All data is compiled from Bloomberg

MARKET INDICES PERFORMANCE — 12/10/2017

PRICE CHANGE IN % (unless indicated)

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y		
EQUITY MARKET INDICES - BY REGION												Fwd P/E	T12m P/E
S&P 500 INDEX	USD	2,550.93	-0.16	-0.04	1.25	2.10	4.21	9.53	13.94	19.62	36.07	19.37	21.81
DOW JONES INDUS. AVG	USD	22,841.01	-0.14	0.29	1.95	3.08	5.98	11.67	15.58	26.20	39.95	18.49	19.47
NASDAQ COMPOSITE INDEX	USD	6,591.51	-0.18	0.09	1.47	2.03	5.05	13.55	22.45	26.44	56.43	24.02	42.79
RUSSELL 2000 INDEX	USD	1,505.16	-0.11	-0.46	0.96	5.49	5.58	11.89	10.91	23.81	43.44	32.81	56.72
EURO STOXX 50	EUR	3,605.54	-0.05	0.11	0.34	2.39	2.25	4.61	9.62	21.25	20.31	15.51	18.51
EURO STOXX 600	EUR	390.28	0.06	0.48	0.81	2.62	1.34	2.82	8.27	16.60	21.69	16.27	21.64
CAC 40 INDEX	EUR	5,360.81	-0.03	-0.06	0.51	2.67	2.32	5.63	10.17	21.60	31.34	15.78	18.60
DAX INDEX	EUR	12,982.89	0.09	0.26	1.25	3.47	2.76	7.27	13.14	24.73	47.40	14.47	18.15
FTSE 100 INDEX	GBP	7,556.24	0.39	0.06	2.10	2.00	1.54	2.73	5.38	7.88	18.24	15.34	25.13
SWISS MARKET INDEX	CHF	9,297.34	0.35	0.50	1.53	2.70	3.27	7.75	13.12	16.23	11.46	18.48	24.73
NIKKEI 225	JPY	20,954.72	0.35	2.55	3.92	6.49	5.25	14.81	10.68	26.12	38.26	18.21	19.11
HANG SENG INDEX	HKD	28,459.03	0.35	0.00	3.28	2.03	8.02	17.30	29.36	23.57	22.97	12.97	14.17
SHANGHAI SE COMPOSITE	CNY	3,386.10	-0.06	1.24	1.24	0.19	5.36	3.50	9.24	10.75	43.30	14.80	17.78
S&P BSE SENSEX INDEX	INR	32,182.22	1.09	1.88	3.60	0.70	1.17	10.01	21.73	17.25	22.84	20.92	23.91
RUSSIAN RTS INDEX $	USD	1,143.96	0.17	0.97	0.75	2.41	11.21	5.13	-0.61	15.92	6.39	7.30	7.80
BRAZIL IBOVESPA INDEX	BRL	76,659.80	-0.31	0.09	3.19	2.85	18.24	19.98	27.28	25.63	38.60	14.72	23.92
MSCI WORLD	USD	2,023.64	-0.03	0.48	1.15	1.86	4.48	10.39	15.56	19.77	25.41	17.85	21.26
MSCI WORLD HEDGED	USD	900.86	-0.03	0.19	1.31	2.59	4.44	8.98	14.45	20.74	37.57	-	-
MSCI WORLD LOCAL	-	1,530.33	-0.03	0.20	1.25	2.31	3.62	8.21	12.17	18.39	30.11	17.85	21.26
MSCI AC WORLD	USD	493.92	0.02	0.62	1.45	1.88	4.85	11.08	17.09	20.47	24.21	17.31	20.53
MSCI EM	USD	1,121.62	0.39	1.68	3.69	2.02	7.77	16.49	30.08	25.93	13.12	14.05	16.34
MSCI AC ASIA x JAPAN	USD	686.75	0.46	1.58	3.90	2.46	7.33	17.39	33.52	26.96	23.86	14.57	15.79
MSCI EM LATIN AMERICA	USD	2,950.48	-0.19	-1.65	1.16	-0.21	9.79	13.24	26.05	19.55	-10.04	15.95	21.97
MSCI EM Eur, ME & Africa	USD	274.76	0.69	2.75	3.27	0.40	5.87	8.49	12.25	18.72	-7.14	11.85	13.44
EQUITY MARKET INDICES - BY SECTOR												P/E	P/E
MSCI ENERGY	USD	210.21	-0.36	0.42	-0.37	3.67	7.35	1.85	-4.01	2.34	-16.57	27.01	41.75
MSCI MATERIALS	USD	264.58	0.17	0.24	1.48	1.56	6.87	13.04	19.24	26.44	20.95	17.07	19.07
MSCI INDUSTRIALS	USD	252.23	0.43	0.74	1.11	3.24	5.11	12.68	18.71	23.99	36.95	18.31	21.31
MSCI CONS DISCRETIONARY	USD	225.26	-0.38	-0.22	0.96	1.23	3.55	8.73	14.67	18.10	35.12	17.52	19.61
MSCI CONS STAPLES	USD	230.04	0.42	1.87	1.77	-0.37	1.31	3.42	10.84	7.38	21.12	20.51	22.75
MSCI HEALTH CARE	USD	228.27	-0.11	-0.18	0.92	0.06	3.15	10.28	18.38	15.44	22.90	17.85	24.22
MSCI FINANCIALS	USD	121.73	-0.32	-0.09	0.70	3.47	3.46	13.52	14.65	31.74	23.86	14.14	16.41
MSCI INFO TECH	USD	208.77	0.05	0.87	2.27	2.62	7.31	17.91	29.49	31.54	64.00	19.75	25.42
MSCI TELECOMS	USD	69.36	-1.24	-0.60	-1.61	0.65	2.33	0.79	-0.25	1.60	3.52	14.62	19.40
MSCI UTILITY	USD	131.42	0.48	2.50	2.33	-0.15	5.03	7.40	14.31	14.26	12.33	16.78	20.09
MSCI WORLD REAL ESTATE	USD	208.47	0.68	1.59	1.93	0.21	4.09	3.79	9.67	7.39	13.87	24.79	18.60
HEDGE FUND INDICES													
HFRX GLOBAL HEDGE FUND	USD	1,261.90	0.05	0.11	0.41	0.84	1.98	3.17	4.86	6.21	4.05		
HFRX EQUAL WEIGHTED	USD	1,265.30	-0.01	0.03	0.15	0.46	1.39	2.39	3.96	5.36	6.04		
HFRX GLOBAL EUR	EUR	1,114.87	0.05	0.10	0.31	0.65	1.35	1.93	2.97	3.83	-0.51		

MARKET INDICES PERFORMANCE — 12/10/2017

PRICE CHANGE IN % (unless indicated)

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y	
LIBOR RATES AND YIELD ON US GOVERNMENT BONDS (Yield in %, Change in bps)												
US 3 MONTH	USD	1.06	-1.03	-0.13	2.04	2.66	2.92	25.84	56.35	77.68	-	
US 2 YEAR	USD	1.51	-0.36	0.51	2.64	16.20	14.58	30.38	32.08	67.46	-	
US 10 YEAR	USD	2.32	0.36	-3.76	-1.23	13.30	-2.31	8.39	-12.30	58.02	-	
US LIBOR 3M	USD	1.36	0.19	1.19	2.47	4.19	5.51	20.35	36.07	48.11	-	
EUR LIBOR 3M	EUR	-0.38	0.00	0.20	0.36	-0.02	-0.37	-1.52	-3.94	-5.54	-	
GBP LIBOR 3M	GBP	0.37	0.79	3.13	3.56	8.39	7.35	3.09	0.40	-2.50	-	
CHF LIBOR 3M	CHF	-0.73	0.00	0.00	0.00	0.00	0.04	0.72	0.32	0.52		
FIXED INCOME INDICES - BY TYPE OF ISSUER												Yield to Worst
GLOBAL AGG TR HEDGED	USD	511.09	0.08	0.20	0.13	-0.12	1.02	1.16	2.35	0.55	9.12	1.62
GLOBAL HY TR	USD	1,302.79	0.03	0.31	0.32	0.54	3.04	6.02	9.84	9.89	19.50	5.08
US GOVERNMENT TR	USD	2,165.24	0.11	0.17	0.04	-0.50	0.60	0.68	2.29	-0.82	5.12	1.62
US CORPORATE TR	USD	2,875.99	0.09	0.21	0.27	0.49	1.59	3.01	5.47	2.80	11.60	3.14
US HIGH YIELD TR	USD	1,944.80	-0.05	0.03	0.20	0.78	2.06	4.03	7.22	8.65	19.05	5.45
EU GOVERNMENT TR	EUR	249.79	0.11	0.24	0.13	-0.08	1.19	0.64	-0.20	-2.00	6.99	0.55
EU CORPORATE TR	USD	269.58	0.11	0.24	0.33	0.33	1.69	2.12	3.51	3.19	11.37	0.75
EU HIGH YIELD TR	EUR	315.35	0.08	0.21	0.37	0.66	2.08	4.25	6.46	8.21	18.89	2.93
BARCLAYS GLOBAL CONVERT.	USD	238.07	-0.10	-0.19	0.40	0.40	0.87	3.46	6.96	8.97	15.43	-
GLOBAL EM TR (HEDGED)	USD	382.74	0.12	0.24	0.30	0.11	2.46	3.68	7.60	5.31	17.32	4.11
S&P/LSTA U.S. LEV LOAN	USD	98.53	0.02	0.13	0.23	0.22	-0.06	-0.22	-0.09	0.82	1.88	4.77
COMMODITY INDICES - BY TYPE OF ISSUER												
GSCI INDEX TOTAL RETURN	USD	2,314.78	-0.42	-0.37	-0.50	2.20	7.10	-1.55	-4.24	-0.39	-46.37	
GSCI ENERGY TR	USD	395.88	-0.95	-0.89	-1.71	2.83	13.45	-3.52	-8.95	-4.57	-59.39	
GSCI INDUSTRIAL METALS TR	USD	1,384.74	1.05	0.96	4.36	2.73	14.76	17.62	23.37	32.11	3.61	
GSCI PRECIOUS METALS TR	USD	1,565.93	0.61	2.06	1.23	-2.72	6.27	0.18	11.20	1.85	2.99	
GSCI AGRICULTURE TR	USD	383.86	0.49	-0.25	-0.89	-0.54	-10.83	-9.25	-10.95	-13.40	-25.65	
GENERIC 1ST 'CL' FUTURE	USD	51.27	1.32	4.02	-0.77	3.41	9.83	-6.61	-10.70	-8.69	-53.82	
GOLD SPOT $/OZ	USD	1,296.01	0.18	1.52	1.24	-2.06	6.44	0.63	12.47	3.01	4.87	
CURRENCIES												
DOLLAR INDEX SPOT	USD	93.06	-0.04	-0.83	-0.06	0.54	-2.82	-7.43	-8.99	-4.61	8.76	
Euro Spot	EUR	1.18	-0.06	0.79	0.08	-0.52	3.73	11.40	12.42	6.94	-7.29	
Japanese Yen Spot	JPY	112.28	0.29	0.63	0.50	-1.30	1.19	-2.55	4.48	-7.36	-4.55	
British Pound Spot	GBP	1.33	0.36	1.87	-0.66	0.75	2.87	6.45	7.86	8.62	-17.25	
Swiss Franc Spot	CHF	0.98	0.04	0.47	-0.70	-1.13	-0.81	3.17	4.50	1.14	-2.78	
Brazilian Real Spot	BRL	3.17	0.23	-1.20	-0.33	-2.21	2.57	-1.12	2.59	0.71	-23.44	
China Renminbi Spot	CNY	6.59	0.06	1.05	1.05	-0.64	3.04	4.66	5.49	2.19	-6.94	
Singapore Dollar Spot	SGD	1.35	-0.14	0.79	0.24	-0.27	1.47	3.26	6.83	1.99	-6.07	
Russian Ruble Spot	RUB	57.72	0.22	0.96	-0.06	0.60	3.83	-2.27	6.85	9.43	-29.67	
Norwegian Krone Spot	NOK	7.90	0.04	1.31	0.82	-0.24	4.58	8.71	9.40	3.20	-18.14	
VOLATILITY / LIQUIDITY INDICES												
CBOE SPX VOLATILITY INDX	USD	9.91	0.61	8.16	4.52	-5.33	0.40	-37.72	-29.20	-40.44	-53.20	
USD SWAP SPREAD SEMI 2YR	USD	25.88	-	-1.66	2.18	9.02	8.17	-21.25	2.68	14.40	-2.12	
TED SPREAD		29.05	-	0.55	-0.99	-0.68	6.88	-15.13	-41.96	-45.81	29.17	

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