Friday, May 24th 2013

To taper or not to taper? This is the question that Chairman Bernanke tried to avoid responding in a straight manner when he appeared in front of the Joint Economic Committee. He raised the possibility that the pace of QE purchases could potentially be tapered "in the next few meetings" if the outlook for the economy continues to improve but also noted that the next move in the purchase rate could either be up or down! Typical Fed Talk! Then, a subsequent release of minutes from the Fed's April 30-May 1 Fed policy meeting added to investor anxiety about the Fed's plans. The minutes disclosed that some officials were prepared to start pulling back the program as early as the Fed's next meeting in June, though the group as a whole, too, expressed hesitance.

After a few minutes of euphoria that sent the Dow Jones and the S&P indexes to new record highs, the markets quickly reversed and finished down 1% in a classic reversal day. Japan then followed and dropped by as much as 9% before finishing down 7.3%! The reversal in Japanese shares was the largest since the earthquake and tsunami in March 2011, and erased a staggering 314 Billion USD in market value! Volatility is coming back with a vengeance, in all markets as currency and bond markets also show quite an increase in volatility. This means that the months ahead risk being quite bumpy (fasten your seat belts!).

On Friday, China brought new worries to the market as China HSBC Flash Markit PMI came in weaker than expected (49.6 vs consensus 50.4). The reading suggests manufacturing growth momentum weakened further in May, with overall orders index falling significantly.
In the currency markets, the USD Index broke through a very important technical point, exceeding the levels seen last September and rising to levels last seen in July 2010. The rally in the USD is broad based and against all currencies (except the Chinese Yuan) and show us that the move is for real. Many currencies are at multi month lows against the Greenback, such as the Swiss Franc, the Australian Dollar, the Canadian Dollar, and the Singapore Dollar. And all these currencies were very strong for very long periods before...
We have increased our USD exposure for non based USD accounts as we believe that the move up in the Greenback has further to go.
The Bond Market also saw quite big sell offs following the Bernanke appearance and the huge drop in the Japanese Equities. It seems that the market now believes that sooner or later, the US Fed will start rolling back its QE program and that the Japanese Big experiment will lead to inflation at one point.

We cannot help but agree with two of the most respected investors who spoke last week about the prospects of the Fixed Income sector. Buffett, the billionaire chairman of Berkshire Hathaway, told Bloomberg Television this month that he felt “sorry” for fixed-income investors with yields on corporate bonds so low, and Bill Gross, manager of the $293 billion Total Return Fund for Newport Beach, California-based Pacific Investment Management Co., said in a Twitter post on May 10 that a three-decade bull market in bonds probably ended April 29... Buffett said he isn’t investing in corporate debt, including Apple’s record offering, because yields are too low.
Gross, known as “The Bond King” in media outlets and named fixed-income manager of the decade in January 2010 by Morningstar Inc., said May 10 that returns will probably be in the range of 2 percent to 3 percent.

As has been seen this week, the Central bankers are more than ever the ones who rule the world, and not the politicians (although they might think otherwise).
Enjoy a restful weekend and for our European readers, be patient, eventually winter will taper down...

Currencies

- EURUSD strengthened throughout the week from 1.2845 to as high as 1.30 on the initial comments of Bernanke's speech. This euphoric rise was very… very short lived and the Euro dropped to as low as 1.2817. With the conceived possibility that the FED cash-cow might be withdrawing the "gogo-juice" from the market place the immediate response was clear: buy the USD against everything! The ship has steadied since and we are back above 1.29 for now. The time of the USD strength should be creeping in and we believe that the EUR will weaken significantly.
- The tide is turning finally for the CHF and with the SNB no longer needing to actively defend the 1.20 floor, the market has taken it into their own hands and is doing the job of the SNB for them! EURCHF reached as high as 1.2680 and USDCHF touched 0.9840. We see further CHF weakness and as we have stated several times, this is in the interest of the Swiss economy.
- USDJPY saw highs of 103.74 on Bernanke's comments and the USD bid tone. However, as the Nikkei collapsed by 7.3% on Thursday, the JPY saw a rally taking USDJPY from 103.50 to 101.0 within the space of a few hours. We have managed to regain some USD strength since, at around 101.30. EURJPY followed a similar path from as high as 133.80 to 130.00 on Thursday but back to 131.50. We view this correction as healthy and believe that although the main direction is still downwards for the JPY, we might see some more correction after such hefty moves.
- AUD continued its weakening and saw the Aussie move from as high as 0.9840 on Tuesday to as low as 0.96 on Bernanke news and the global meltdown Thursday. We do not see this direction changing any time soon and look for further weakness around the corner.
- The Pound had a poor week trading from 1.5280 down to 1.5014 USD bids caused most pairs to drop against the USD. With little news other than weak retail sales data, poor RPI and CPI figures we cannot see any other direction for the pound except downwards. We believe the sideways trading is more a downward slanting trading scenario for now. Slowly but surely the market will continue to chip away at the relative strength of the Pound (or perhaps we should phrase that as reinforce the un-priced weakness!).

Fixed Income

- US Treasuries continued their slide in light of the huge equity rallies we saw touching newer and newer highs each day. The 10Yr moved from 1.95% to 2.05%, the 30Yr moving from as low as 3.10% prior to Bernanke's speech to as high as 3.24% prior to the Japanese storm.
- The German 10-year Bund saw heavy sustained selling causing the yield to rise from 1.35% to as high as 1.47% this morning. Although short term rates remained under pressure this week, seeing the 2 year paper spend most of the week at -0.02% to finally sell off to +0.03% this morning.
- The Japanese 10 Year bonds gently moved from 0.82% to 0.86% before opening on Thursday at 0.99% only to correct back to 0.82% after the massive Japanese equity sell off.
- The Spanish 10 year bonds were almost unchanged up till Thursday, where the Risk Off world scenario cause the resilient Spanish debt to finally succumb to a weakening of the price and the yields jumped from 4.18% to 4.37% as we write. With news out that the banks require a

further 10Bn EUR to sure-up their balance sheets we wonder how many more surprises there are in the Spanish woodwork! Will they seek a bailout… we await the straws to pile up again.

- The Italian 10 Year was relatively unchanged until the Japanese equity setback. The 10 year yields moved from 3.92% to as high as 4.09%. As risk is moving away from the periphery and the worries of balance sheet funding becomes more apparent then the yields start to climb again.

Equities

- Developed equities fell 1.3% for the week, as of yesterday's close, as measured by the MSCI world index. Equities lost on the back of fears that the Fed might scale back its bond-purchases program, and Chinese manufacturing unexpectedly contracted, triggering profit-taking across the board.
- European shares lost 1.17% for the week. Equities gained at the start of the week following positive Japanese data and supportive remarks from the Fed. The EuroStoxx however dropped more than 2% on Thursday due to headwinds from the US on worries over the continuation of their stimulus plans.
- The S&P 500 snapped its 4 week winning streak – losing 1% for the week, as of yesterday's close. US shares initially rose – making new all-time highs – as a Fed official supported its bond buying program to bolster economic recovery. The gauge turned negative on Wednesday as the Fed policy meeting showed some officials were open to cutting back the stimulus, with Ben Bernanke stating that such concerns will materialise when the jobless rate falls to 6.5% or inflation rises above 2.5%.
- The Nikkei dropped by as much as 3.5% for the week – the biggest weekly decline in 7 months. Japanese equities started the week on a strong foot – extending a 4.5 year high - as Japanese Machine tool orders improved from previous month and the BOJ raised its economic outlook. The gauge sank 7.3% on Thursday as Chinese manufacturing data unexpectedly contracted in May, and worries grew over the Fed's willingness to continue with its bond purchases, causing investors to realise profits.
- In terms of sectors, Financials and Telecoms posted the biggest losses (-2.56% and -2.16% respectively), while Healthcare and Energy stocks fared better (+0.03% and -0.29% respectively).

Emerging Markets

- Emerging Market equities lost 1.9% for the week, as of yesterday's close, as measured by the MSCI EM index. EM Asian and Latin American stocks were the biggest contributors to the losses -2.04% and -1.48% respectively), while EM European shares fared better (-0.44%).
- The Shanghai Composite gained 0.24% for the week. Chinese shares gained for the week as the nation's economic planning agency said that certain large scale investment projects will no longer require pre-approval, taking the country's economic reform one step forward. Most of the weekly gains were lost on Thursday following the announcement that Chinese manufacturing unexpectedly contracted in May, intensifying worries over global growth.
- The Bovespa gained 2.1% for the week, as of yesterday's close. Brazilian shares posted gains at the start of the week, as optimism over China's expected economic reforms lifted mining stocks from depressed levels. Additional gains were made amid gains of Brazilian electrical

utilities, as bargain hunters considered the current levels as attractive entry points, signalling the fall in utility stocks might have bottomed.

Commodities

- Commodities dropped by 1.14% this week, as measured by the S&P GSCI total return index, driven down by Energy (-1.98%) while Precious Metals and Agriculture posted gains (+1.80% and +1.21% respectively).
- Agriculture rose, driven by a rally on soybean prices which rose for a seventh consecutive session today and struck an eight-month high on tight domestic stockpiles as droughts last year in the US and South America are still curtailing production.
- Gold rose by about 2.3%, and is currently trading around $1’391 per troy ounce. Gold edged up this week as investors sought its safe-haven status after the dollar and equity markets were hit by disappointing manufacturing data from China and the United States. The yellow metal is still rising today and is on track for its strongest week in a month after US Fed’s Chairman Bernanke said there was no rush to end the monetary easing programme, boosting the bullion's appeal as a hedge against inflation. We continue to strongly believe that monetary easing coupled with currency debasement will keep lifting Gold prices significantly over the long run.
- Oil dropped by nearly 2%, and is currently trading around $94 a barrel. Crude oil futures tumbled sharply on Wednesday and Thursday, falling to a three-week low after U.S. and Chinese data pointed to slower growth in the world's two biggest economies. Market sentiment was also dampened after Federal Reserve Chairman Bernanke said on Wednesday the central bank could begin tapering its bond-buying program in the near future.
