Bedrock Newsletter

Friday, July 26th 2013

An interesting week, for a change... Last Sunday in Japan, Abe's party won the upper house. This mandate will permit Abe to follow-through with his model to pull Japan out of its 25 year doldrums. We wish him success, in the name of Japan and the rest of the world…
Will Abe's QE compensate some of Ben's Tapering? We believe it will help, and when combined with the fiscal improvement in the USA, the odds of the World getting better are rising.
Monday gave Britain and the rest of the world a Royal Baby boy. Analysts estimate the boost to the UK economy could be measured in hundreds of millions... Maybe the Royals do have an economic value?
We are now about half-way through the Q2 reporting… Many beats and many misses, the average so far shows about a 4% average improvement. Apple did well, Facebook exploded up with a 20% beat on forecasts and its stock rose 30% (still below IPO level), Microsoft missed badly and collapsed over 10%, as did Caterpillar.
Markets are thin as usual in the Summer months. Last week saw some large inflows into equities, but not the really big flows which are still expected by many to come... 10 year Treasury Notes traded around 2.50% and Gold was up as the US Dollar was smacked! The "stealth rally" has seen the S&P rise by 25% over the past 12 months! Well, if the S&P earnings will be about $115, at x 15 = 1'725, making the current level of 1'690 appear perfectly priced.

During a congressional hearing on Wednesday, Chairman Ben Bernanke implied that his most important duty is to ensure markets understand where monetary policy is heading. Ben, the Jedi Warrior…The past month has shown how hard that can be when investors hear what they want to hear. Unless Yoda he is, tapering and rate hikes are bound to cause painful lurches. During the crisis, Bernanke was all but the last hope of the U.S. economy. After saving the republic, his next challenge may prove just as great: winding down the central bank's unprecedented bond buying program. Lawmakers wondered aloud just how the Fed would wean Wall Street off gobs of easy money. At $3.5 trillion, the Fed's balance sheet is quadruple its size five years ago.
One year on from his "whatever it takes" speech and less than two years after taking the helm at the European Central Bank, Mario Draghi has won over some of the harshest critics of his controversial methods to fight the euro crisis. Not least in Germany. Draghi's commitment to buy unlimited amounts of government bonds of crisis-hit countries – a scheme known as "Outright Monetary Transactions" or OMTs – is as yet untested. In addition, Germany's constitutional court is expected to rule by the end of the summer on whether the bond-buying program is even legal.
A magician often directs the audience's gaze to one hand while he does something with the other. We have three performing for us… Well, Between Abe, Ben and Super Mario, can we have hope? We think so, and the markets are pricing-in a successful outcome to their support.
On the "naughty-Side", Detroit finally filed for bankruptcy on July 18 after years of a slow decline in its population and its once famous auto manufacturing industry. Detroit's leaders have set an important precedent in siding with residents rather than unions and bondholders in their decision to declare the city bankrupt last week, Meredith Whitney wrote in the Financial Times. As part of Detroit's restructuring plan, Emergency Manager Kevyn Orr wants to treat general obligation (GO) bonds as unsecured debt. If that request is approved by the bankruptcy judge, the $3.7 trillion muni-bond market in the USA could be turned on its head, as would the long-held assumption that GO bonds represent a relatively risk-free investment. Maybe Meredith will be right after all? She did give a stern warning on "Munies" a year ago…

Gold, arguably the US$ offset, has staged a nice rally as the US$ floundered. "I had been agnostic and modestly bearish of gold until about three and a half weeks ago" Gartman told CNBC on Tuesday. "Then I wrote that gold was going to go several hundred dollars higher. "I continue to be bullish on gold, and I think [it] is going higher," he said. Is Gartman expecting Gold's shadow, The Dollar, to fall further?
We leave you into a hot, sunny weekend with a thought that it may be time to "Like" Facebook? And the market as a whole…

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Currencies

- The EUR gained for an additional week against the USD, rising from 1.3139 at the start of the week to as high as 1.3293 currently. The USD sold off across the board at the start of the week on the back of weaker than expected US Existing home sales and US Manufacturing figures. On Wednesday, the EUR saw strong support on surprisingly positive Manufacturing report - showing an expansion reading for the first time in over a year – raising speculation that if the region shows further signs of growth, the ECB might not need to implement additional tools to support the European economy. Finally, the WSJ issued a dovish article late on Thursday speculating that the Fed may alter their message on QE by lowering the 6.5% unemployment threshold and potentially establishing a lower bound to their inflation target – causing the dollar to fall 40 pips against the EUR upon issue.
- USDCHF mirrored the EURUSD moves, with the pair falling from 0.9403 at the start of the week to 0.9275 currently. EURCHF oscillated between gains and losses, breaching momentarily the 1.24 level following the bullish European manufacturing report. EURCHF is currently trading lower for the week (1.2327) as the CHF was bid up due to renewed growth concerns. The SNB once again re-iterated this week that the CHF was still overvalued by 11% in June, and signaled that it will maintain its current policy.
- USDJPY lost 2 figures (from 100.61 at the start of the week to 98.67 currently). The pair initially moved lower on Dollar weakness, triggered by signs of Economic cooling. However, it was the JPY that strengthened on Friday's trading session on reports that Japanese consumer prices rose the most since 2008 – raising speculation that the BoJ might not need to expand stimulus further to combat deflation.
- The AUD as well gained against the Dollar – rising from 0.9180 at the start of the week to 0.9285 currently. AUDUSD however saw a selloff down to 0.9135 midweek amid continued Chinese growth concerns following a weaker than expected HSBC Flash PMI reading.
- Cable rose for the week (From 1.5267 to 1.5402 currently) on a broadly weaker Dollar as well as anticipation for the UK quarterly GDP figures. The GDP reading was confirmed on Thursday at 0.6%, in line with expectations, causing a short term GBP selloff on damped speculation that the BoE is moving closer to ending its accommodative policy.

Fixed Income

- US treasuries sold off for the week following better than expected US housing and manufacturing data, raising speculation that the Fed may reduce its asset buying this year. The US 10yr yield rose from 2.475% to 2.576% currently, and the 30yr from 3.550% to 3.637%.
- Spanish bonds gained marginally for the week as the Spanish treasury's funding costs fell sharply at Tuesday's auction of short term debt, as it sold more than the maximum targeted amount. However, early gains were offset following a weak reading of Eurozone confidence data. The 10yr yields fell from 4.662% at the start of the week to 4.617% currently.
- The Italian 10 Year remained unchanged for the week (4.40%). Italian bonds gained sharply on Monday following news that the ECB announced that it will change the collateral rules, whereby it will increase the haircuts on low grade sovereign bonds and lower those on high grade sovereigns. However, the 10 year bonds gave back earlier gains on the back of weak the Eurozone confidence data.

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Equities

- Developed equities rose by a mere 0.28% for the week (as of yesterday's close) as measured by the MSCI World index, amid mixed results from blue-chip companies on both sides of the Atlantic and renewed concerns about the slowing pace of growth in China.
- The EuroStoxx rose by 1.45% for the week with investor confidence restored by data showing better German business morale as well as the British economy gathering pace and thus confirmation that Europe is slowly dragging itself out of recession.
- Meanwhile, the S&P 500 lost 0.11% for the week (as of yesterday's close) giving investors some pause for thought as the traditional summer lull begins in earnest. Wall Street failed to make new all-time highs amid worries about China's slowdown and its impact on corporate earnings.
- The Nikkei collapsed by 3.15% for the week as slowing demand in China and other economies weighed on sentiment. The index slid by 3% to a near three-week low on Friday, with blue-chip exporters and financials leading declines on the back of a stronger yen and profit-taking.
- In terms of sectors, Information Technology and Telecom led the gains (rising by 1.13% and 1.11% respectively), while Consumer Staples and Industrials lagged (-0.51% and -0.27% respectively).

Emerging Markets

- Emerging Market equities rose by 1.25% for the week, as of yesterday's close, as measured by the MSCI EM index. Latin American and Asian stocks rose the most (+1.68% and +1.60% respectively), while EM European shares slid by 1.82%.
- The Shanghai Composite rose strongly on Monday and Tuesday before sliding for three consecutive days as preliminary China PMI contracts disappointed, signalling that Chinese manufacturing contracted further and showing that the economic slowdown is deepening. As a result, the index rose by 0.91% for the week.
- Meanwhile, the Bovespa surged – posting an additional week of strong gains, with the index rising by 3.5% as of yesterday's close. The rally was led by oil producers and commodities exporters who were supported by statements from a top Chinese official that his government intended to bolster domestic infrastructure investment. China is Brazil's biggest trading partner and a key purchaser of Latin American commodities exports such as iron-ore, soy, copper and petroleum.

Commodities

- Commodities lost 1.53% over the week, as measured by the S&P GSCI Total Return index. Performance was mixed across the board with Agriculture and Energy losing 3.86% and 1.57% respectively, while Precious and Industrial Metals rose by 2.84% and 0.73% respectively.

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- Gold rallied by 3% this week and is currently trading around $1’330 per troy ounce, on a weaker Dollar and as receding worries of an imminent cut to the U.S. Federal Reserve's stimulus burnished the precious metal's appeal as a hedge against inflation. Bullion reached a one-month high on Tuesday after a sharp four-day rally pushed prices up by 6% (the biggest such rise since October 2011) to $1’348.65.
- Meanwhile, Oil slid by 2% and is currently trading around $104.76 a barrel. Crude Oil futures skidded by 1.7% on Wednesday (the biggest one-day percentage drop since June 20) after a modest decline in domestic oil inventories gave traders an opportunity to book profits.
