Bedrock Newsletter

Friday, September 13th 2013

It is Friday again and for a change it was an interesting week. Last Friday's disappointing NFP at 169K vs. 200K expected, plus a revision down of 69K on the July figures, made the resulting unemployment rate of 7.3% quite suspect- entirely due to a reduction in the labor force? Were we concerned about “Tapering”??? It will happen, but clearly not immediately and will probably be “Tapering Light”...
Then, the Syrian government accepted a Russian proposal to put its chemical weapons under international control to avoid a possible U.S. military strike. The markets rose on this US/Russian concoction of an elegant out. Syria to hand over their chemicals to UN control- Russia's plan on Syria "saves" Obama's honour; He now can say that he always prefers a peaceful, diplomatic resolution. Some are saying that in effect the Sarin gas attack on Damascus was infringed by the rebels in order to induce a US attack on Assad. Putin may have read it right and wasn’t the bad guy here after all…
Monday, Stocks rose in the U.S. and emerging markets and currencies from South Korea’s Won to Malaysia’s Ringgit strengthened as Chinese exports topped forecasts. Japanese shares gained and the yen weakened after Tokyo was selected to host the 2020 Olympics.
Tuesday, China’s industrial output grew at the fastest pace in 17 months in August, adding to signs of a rebound this quarter that include a pickup in export gains. Factory production rose 10.4 percent from a year earlier, compared with a median forecast of 9.9 percent in a Bloomberg News survey. Retail sales advanced 13.4 percent, whilst fixed-asset investment excluding rural households increased 20.3 percent in the January-August period, both topping estimates. Also, Capital Investment is up 20% in 8 months- Chinese slowdown they said?
Wednesday we read that U.S. oil production is at the highest level since May 1989, cutting consumption of foreign fuel and putting the U.S. closer to energy independence. Rising crude supplies from fields including North Dakota’s Bakken shale and the Eagle Ford in Texas have helped the U.S. become the world’s largest exporter of refined fuels including gasoline and diesel. Texas alone pumped 2.575 million barrels a day in June, according to the EIA, enough to rank it ahead of seven members of the Organization of Petroleum Exporting Countries.
Then, The U.S. government posted a narrower budget deficit in August compared with a year ago, keeping the annual gap on track to be the smallest in five years. The Treasury Department says the deficit in August was $147.9 billion, down from $191 billion in August 2012. That brings the budget gap to $755 billion for the first 11 months of the budget year, down 35 percent from nearly $1.2 trillion a year earlier. The deficit is expected to fall from $1’089B in fiscal 2012 to about $600B this year and to $400B next year. The issuance of Treasuries net of QE collapsed from $549B in fiscal 2013 ($1089-$540B in QE) to an estimated $60B ($600B-$540B) in fiscal 2013. This implies that there may a limit to how much interest rates should rise going forward.

An aside, Obama-Care which looms overhead with the implicit cost to the economy of about half a trillion Dollars may have been lightened- On Thursday, AFL-CIO (the US unions) turned against Obama-Care, which may complicate things for the President.

Following his success in keeping Obama out of trouble, Vladimir Putin is gloating as he basks in his success- He actually placed a full page ad in the NY Times- “A plea for caution from Russia”, in which he writes brilliantly a lesson to America- Embarrassing President Obama- Speaker Boehner responded with anger whilst Donald Trump applauds it as a good, well written tome which the President should study! Putin is positioning himself as the World's leader…

We go into next week apprehensive of the FOMC meeting and wondering if Obama will indeed choose Larry Summers over Janet Yellen to succeed Ben Bernanke. 350 economists sent an open letter to Obama supporting Yellen,,. But rumor has it that he prefers Larry… We can prefer the Lady, as it assures continuity and markets like stability.
The usually unpleasant month of September is unfolding nicely… May your weekend be wonderful.

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Currencies

- EURUSD was decidedly positive this week, rallying from 1.3160 to peak at 1.3320 on news that the US were continuing to look at negotiations rather than military intervention. The initial jump in the EUR was driven partly by the lack of military intervention that was already partly priced and large stops that were trigger by the black-box systems. The range bound pair is continuing to remain relatively quiet on no data and little real news. As the tensions build in the Middle East and the story is of moving chemical weapons to avoid US detection, we fear that we have seen this film already… we sincerely hope this does not play out like Iraq.
- EURCHF was driven much higher on the relaxed views of the Middle East, seeing the pair drift higher from 1.2340 to 1.2410 and then giving up ground to slide back to 1.2380 at the moment. USDCHF moved lower on the week seeing a move from 0.9394 down to 0.9280. We are back above 0.93 for now and await further details on Syria to see if the USD will regain some ground or stabilize. The USD has been really stable this year at around this 0.9300 mark.
- USDJPY opened the week much higher than it closed the previous week. Seeing the pair initially spike to 100.00 and by Wednesday to as high as 100.60. Nothing like a little Olympic win to add some intrigue to the currency markets and as Syria subsides and the USD has weakened over the week, the pair has slipped lower to be trading around 99.60.
- AUD had a strong start to the week seeing the pair gently climb from 0.92 to 0.9350, only to tumble in a vertical drop on much worse than expected employment data. (Negative result versus positive expectation!) We are now trading at 0.9250 and we do not see much (any) upside from here for the Aussie Dollar.
- The Pound had a fantastic week surging on USD weakness and a belief that Carney will be able to implement his goals – the fact that the market has COMPLETELY ignored his forward guidance is another matter. As we have said before… make hay whilst the sun shines, but when the rain starts, make sure it is covered!
- The EM currencies had a slightly quieter week than previously and even reversed some of their losses – BRL and INR being the most notable.

Fixed Income

- US Treasury yields yet again followed the newswires for Syria… as they agreed to discuss turning over weapons the yields rose and as they hide those weapons the yields dropped. As the waves come through on the tide of news we believe that these will likely lead to an erosion of belief in the short term and maybe the yields will head generally lower… For bow the yields are trading in the range of 2.96% to 2.86%. The clearest view on the short term rates is the move down from 0.52% on Friday last week to 0.43% this week on the 2 Year notes.
- The German 10-year Bund yields moved from 1.94% to 2.08% on Wednesday morning. In the lead up to the German election we will probably see a few moves that don't reflect the underlying economics but possibly politically motivated. The bonds recovered a little and by this morning the yields are a little lower at 2.02%.
- Spanish debt had another strong week, seeing strong demand for the bonds. Yields dropped from 4.55% to 4.45%.
- The Italian 10 Year had another poor week moving from 4.48% to 4.56%. As we have mentioned on numerous times the Italian debt is slowly repricing. For the first time in a VERY

long time, the yield for Italian debt spent the week above that of Spanish debt. The Italian situation is dire and could be completely corrected if they simply collected taxes! It reminds us of the town that was filled with 150 Ferraris and Lamborghinis and yet no one in the town earned more than 30,000 EUR… The markets are now pricing Spanish debt as a "safer" 10 year security than Italian. Oh, and Berlusconi is still not in jail yet…

Equities

- Developed equities rose by 2.03% this week (as of yesterday's close) as measured by the MSCI World index. Global equity markets rose as fixed income investors gobbled up $49 billion in notes sold by Verizon on Wednesday, the largest-ever corporate bond sale in history!, while Syria tensions eased and the dollar globally fell.
- The EuroStoxx advanced by 1.70% over the week, as intense M&A activity in the health care sector overweighed weak euro-zone data and uncertainty ahead of next week's Federal Reserve Open Market Committee meeting, which some investors believe will kick off a winding down of the Fed's $85 billion-a-month bond-buying program.
- The S&P rose by 1.71%, as US stocks extended a seven-session winning streak until Wednesday with the risk of a conflict in Syria shrinking, before falling on Thursday as investors worried about developments related to Federal Reserve policy moves and a potential scaling back.
- Meanwhile, the Nikkei surged by 3.92%, as the Yen weakening closer to the 100 ¥/$ stimulated export-oriented stocks. Also, further signs of improvements in global manufacturing activity helped boost risk appetite.
- In terms of sectors, Industrials and Telecoms rose the most (advancing by +2.94% and +2.68% respectively), while Energy and Utilities lagged (+1.04% and +1.44% respectively).

Emerging Markets

- Emerging Market equities rallied by 3.63% for the week, as of yesterday's close, as measured by the MSCI EM index. EM European stocks surged by 6% while EM Asian and Latin American stocks also rose quite strongly (+3.44% and +2.83% respectively).
- The Shanghai Composite rallied by as much as 4.50% rising to a three-month high, led by financials, after the country's official August PMI hit a sixteen-month high on Sunday and Premier Li Keqiang said he would accelerate financial reform. The Shanghai index has rebounded 16% since reaching this year's low on June 27 as August data ranging from exports to industrial output showed growth is accelerating and as shippers and port operators rallied after the State Council approved Shanghai's free-trade zone.
- The Bovespa lost 0.82% this week, as of yesterday's close, as oil producer Petrobras sank after saying it doesn't expect to raise fuel prices and Brazilian commodity exporters dropped on lower commodity prices concern that global growth could falter soon. A rally in commodities firms has helped Brazil's Bovespa index reach its highest levels in over three months in recent days, boosted by an improving outlook for Chinese economic growth, but that rally ended this week.

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Commodities

- Commodities fell 1.52% for the week, as measured by the S&P GSCI Total Return index. Precious metals and energy were the worst performers (falling 4.46% and 1.94% respectively), while Agriculture gained 1.09%.
- Gold lost as much as 5.39% for the week – the worst weekly loss since June - and is currently trading at $1’317 per troy ounce. The metal fell as worries on the Syrian crisis eased and following a strong US employment report, raising speculation that the Fed will start tapering asset purchases this year.
- Oil dropped 2.23% for the week and is currently trading at $108.10 a barrel. Oil dropped following an ease in Middle East tensions as the US and Russia started talks over a plan for Syria to surrender its chemical weapons to avert a strike.
