Friday, October 11th 2013

Another week passed under the clouds of political disarray in the United States. The world's leading power is chasing its own tail and wagging the rest of us all over the place… The leaders of the free world can't agree to talk about talks of budget and resulting debt ceiling. These are the same fellows on whom we rely to organize talks between Israelis and Palestinians, Syrians amongst themselves, Libyan tribes, Chinese and Tibetans etc., etc…
Truly a worrisome display of confusion. How could we possibly find a serene path to follow?
On Monday the stalemate in Washington shook the markets, the VIX rose 16% to 19.41, Gold rises $12.30, US$ down to 1.3580 against the Euro and the DJIA off 100 points or so. Ben Bernanke says he doesn't understand gold prices. If his peers had paid attention, they might have stopped expanding reserves that lost $545 billion in value since bullion peaked in 2011. Bernanke told the Senate Banking Committee in July that "nobody really understands gold prices and I don't pretend to really understand them either." Central banks, which own 18 percent of all the gold ever mined, will add as much as 350 tons valued at about $15 billion this year, the London-based World Gold Council estimates. They purchased 535 tons in 2012, the most since 1964. Russia is the biggest buyer, expanding reserves by 20 percent since prices reached a record $1,921.15 an ounce in September 2011. Gold slumped 31 percent since then. Should we worry that Central Banks are hedging their countries reserves against some big problem? Or just consider this another misallocation of resources by technocrats?
On Tuesday the first earnings report popped on our screens- Alcoa beats with 11c vs. 5c expected, reaffirms growth at 7% and the stock jumped +2.4% in after-hours trading.
Then, the International Monetary Fund cut its global outlook for this year and next as capital outflows further weaken emerging markets and warned that a U.S. Government default could "seriously damage" the world economy. Growth worldwide will be 2.9% this year and 3.6% next year, the IMF said in its report, compared with July predictions of 3.1% for 2013 and 3.8% for 2014. It sees emerging economies growing 4.5% this year, 0.5 percentage point less than three months ago, as projections were reduced for China, Mexico, India and Russia. The Fund cut the forecast for China to 7.6% this year, from 7.8% in July and to 7.3% in 2014 from 7.7%. The IMF's forecasts factor in a short U.S. Government shutdown and an agreement on the nation's debt-limit before an Oct. 17 deadline. Then, adding oil to the fire, China and Japan - which together hold more than $2.4 trillion in U.S. Treasuries - raised pressure on the U.S. to resolve a political impasse on its debt ceiling that threatens to destabilize global financial markets. "Japan must consider the impact of any default on its bond holdings, even as the U.S. will probably avoid a fiscal crisis", Japanese Finance Minister Taro Aso said. Chinese Deputy Finance Minister Zhu Guangyao also said on Monday that the U.S. should prevent a default…

The good news (in the eyes of the markets) was the announcement that Janet Yellen is Obama's choice for the Fed! The change of the head of the Fed is always a "hairy matter"- this time will primarily be a move in hairiness from face to head... And then Thursday gave us a huge 2%+ rally on the news that there will be a meeting at the White House to set talks of budget… No real news… the power of hope is amazing!

We head into a wintery weekend with a thought for the American leaders from Thomas Edison "Our greatest weakness lies in giving up. The most certain way to succeed is always to try just one more time."

Bedrock Newsletter

Currencies

- EURUSD started the week stable at about 1.3580 briefly topping out above 1.36 on worries about the US debt limit and its ability to fund its own expiring TBills… or to simply keep the government open! Wednesday saw the USD rally from 1.3605 to 1.3486 on news that Janet Yellen would be Obama's recommendation for Fed Chairman, the "Super Dove" as some have dubbed her. As the government shutdown continues and rumours have emerged about a short term debt limit raise (Obama has already said it is not acceptable), EURUSD has crept higher this morning and is pushing back above 1.3575.
- EURCHF traded higher through the week from 1.2260 to 1.2330. As EURUSD dropped and USDCHF rose higher, the net effect was a weakening of the CHF. USDCHF moved from 0.9020 to 0.9120 on the Janet Yellen story and has stabilized this morning at a little under 0.9080. The USD in general has not moved one way or another and for now is waiting for the results of the Government talks to be concluded.
- USDJPY moved steadily from 96.60 to peak this morning at 98.50. The movements in the currency pair are not necessarily in tune with the USD story as there were no spikes from the Yellen story; but it would appear the JPY strengthening from corporate tax rate cuts may no longer be centre of attention in the headlines. Perhaps repatriation of offshore balances will lead to slow movement from offshore to onshore, but not in one immediate wave and it would appear that any immediate effect has been neutralized, with the USD rising again.
- AUD started the week at 0.9440 and has traded in a tight range. From Thursday morning to Friday morning the pair rallied from 0.9400 to 0.9480. As the Chinese data does not seem to really be changing, the stability in the AUD may be here for a while. The markets have already priced in rate cuts and there is little data on the horizon to cause the next big movement. However, structurally… not all is well in the outback!
- The GBP although still in the upward channel took a further stumble this week, moving from 1.6125 to as low as 1.5915 on the back of the USD strengthening. With no further data to support the emotional USD up move, the GBP has regained some of its lost ground to trade back to 1.5980 as we write. The BOE maintained their stance of supporting the economy with repurchases at £375Bn and maintaining rates at 0.50%.
- USDINR this week had a very bumpy ride, oscillating between 61.45 on Monday to as high as 62.30 yesterday, only to collapse over night from 62.18 to 61.07 by this morning… This kind of volatility is partly due to overcrowding in the trade and also reduced overnight liquidity, but either way to see this type straight line moves is not a pretty picture.

Fixed Income

- The US Government shutdown seems to be having "relatively" little effect on the Treasury market, but the short term T-bill market has had dramatic moves; in fact moves propelling the 1M yields back above levels seen in 2008! The 10Yr was steady at 2.63% until Wednesday afternoon when the bonds sold off on news that there was no agreement for a short term debt limit extension, seeing the yields marginally lift to as 2.72%. We are now back to 2.66% and the short term effects do not really seem to be translating into meaningful moves. The 1M paper however, moved from 0.11% on Monday to 0.34% by Wednesday – with large scale institutions like Standard Chartered selling all of their paper that expires in the next few weeks. Storm in a tea cup (perhaps that should be storm in a "tall grande" coffee mug)!

- The yields on the German Bund seem to be repeating themselves for the last couple of weeks. The yield moved from as low as 1.78% to as high as 1.88% yesterday afternoon and it would seem that the yields are maintain that high of about 1.87% this morning.
- Spanish yields seemed to follow the direction and speed of the German Bund – not that we would ever suggest that they were synonymous – moving from 4.20% on Monday to as high as 4.35 this morning. Spain seems to be holding a steady ship at the moment, unfortunately the state of their economy and their unemployment figures makes it very unlikely that this situation is maintainable for the foreseeable future and worry that these yields tend to make the paper expensive for the longer term.
- Italy had a relatively stable week in comparison to its European counterparts, the yields only rising from 4.30% to 4.34%. This compression to the Bunds and also interestingly the Spanish debt after the political debates and arguments would seem to be positive news for the BTP markets… we <u>hope</u> that this continues, but as our grandmother's used to say… hope for the best and plan for the worst.

Equities

- Developed equities remained flat for the week (-0.01% as of yesterday's close) as measured by the MSCI World index. Shares recouped earlier losses on the back of the nomination of Janet Yellen as the next Fed chair and on increased optimism that US lawmakers will lift the debt ceiling, easing concerns over a default.
- The EuroStoxx is set to end the week up 1.36%. European shares sold off at the start of the week as US lawmakers remained deadlocked over extending the debt limit to avoid default. Stocks rose sharply on Thursday on increased optimism that lawmakers will agree to lift the debt limit.
- The S&P 500 is ending the week relatively flat (+0.12% as of yesterday's close). With the US budget talks at centre stage, an early selloff in US shares was halted following the announcement that Obama has nominated Janet Yellen to be the next Fed's chair, which is expected to continue the central banks' stimulus measures. Shares recouped earlier losses as hopes increased for a resolution for the debt impasse, as the White House and Republicans discussed ways to approve a short term extension for the debt ceiling. This week has been quiet in terms of data, with Jobless claims receiving some attention as claims jumped to 374K.
- The Nikkei gained 2.71% for the week. Japanese shares gained on Yen weakness, as investor optimism over the US debt negotiations caused a selloff in the safe haven currency.
- In terms of sectors, Materials and Healthcare lost the most (-1.06% and -0.67% respectively), while Utilities and Financials gained (1.60% and 0.52% respectively).

Emerging Markets

- Emerging Market equities rose by 0.60% – as of yesterday's close – as measured by the MSCI EM index. EM European shares posted the strongest gains (+2.36%) while Latin American and Asian stocks gained less (0.73% and 0.37% respectively).
- The Shanghai Composite rallied 2.45% for the week. Chinese shares posted the strongest gains in a month following news that Shanghai may reform state owned enterprises – which are viewed as long term drag on economic growth – and auto sales figures exceeded expectations.

- The Bovespa gained 0.27% for the week, as of yesterday's close. Brazilian stocks traded in line with developments of the US debt ceiling negotiations. Internally, the Brazilian central bank increased the Selic base rate by 0.5% to 9.5%. In addition, EBX group of companies led gains as OGX met with bond holders to discuss a debt restructuring.

Commodities

- Commodities rose by 0.86% for the week, as measured by the S&P GSCI Total Return index, driven by Energy (+1.35%) while Agriculture, Industrial and Precious Metals were all in negative territory (falling by 0.56%, 0.23% and 0.78% respectively).
- Gold lost 1.85% and is currently trading around $1'285 per troy ounce. Bullion fell below $1'300 an ounce on Thursday on signs Washington was moving towards breaking a stalemate over debt and averting a US default. In result, safe-haven buying, seen in the last few sessions as a result of the shutdown, evaporated as the dollar climbed off eight-month lows, also helped by the nomination of Janet Yellen as the next Fed's chief.
- Meanwhile, crude oil lost 2% and is currently trading at $101.75 a barrel. Crude prices sank over the week to hold near a three-month low on Thursday, as investors continued to monitor negotiations over the US budget impasse and its potential impact on US growth and crude demand. Government data showing that inventories climbed much more than expected also weighed on sentiment.
