Bedrock Newsletter

Friday, January 10th 2014

Happy New Year to all! We wish you a 2014 to be as pleasing as 2013 has been. At first view it would seem that the Fed's tapering is only offsetting some of the visibly improving economics around the world, hopefully to be confirmed with the December Employment Report due later today.
And do remember that we are already into Q4 earnings reports… Yesterday we were disappointed by Alcoa (down 4% after hours) and scared by Sears which had nasty sales data to share… Many analysts are optimistic for the whole of the reporting season though…

Tuesday gave us the U.S. current account deficit to be the smallest in four years in the third quarter as exports increased and more income was earned abroad. The Commerce Department said the current account gap, which measures the flow of goods, services and investments into and out of the country, narrowed to $94.8 billion. That was the smallest since the third quarter of 2009 and was an improvement from a revised shortfall of $96.6 billion in the second quarter. It represented 2.2 percent of gross domestic product, the smallest share since the first quarter of 1998. It was down from 2.3 percent in the July-September period. Much of the improvement was due to reduced oil imports, as prices slipped as did actual amounts imported- Energy independence is coming to the USA?

Wednesday, the ADP report showed that US Companies added more workers than projected in December as U.S. employers grew more optimistic about the prospects for demand. The 238,000 increase in employment was the biggest since November 2012 and followed a revised 229,000 gain in November, which was stronger than initially estimated. Then the Fed minutes made markets fall, bonds up in yield- 10yr auction above 3% and the DJIA and S&P down YTD.

Call it the "Hangover Indicator"; it turns out that the S&P's performance over the first five trading sessions after New Year's Eve tends to say a great deal about what the rest of the year is likely to bring. This year, it has been down… all years going back to 1927, the S&P has risen 57 out of 86 times, for a 66 percent positive record. But if the first five trading days of the year are positive, then the probability of a positive year rises from 66 percent to 77%, according to Oppenheimer's chief market technician. On the other hand, if the first five trading days of the year are negative (as they are tracking so far) then the chance of a negative year increases from 36 to 52% The first-five-day trend is an addendum to the well-known "January Barometer," a theory stating that the S&P's move over the month of January predicts where it will go throughout the remainder of the year. Just a thought… To add, HSBC's outlook for 2014: "We believe that the global economic recovery continues, supported by a synchronized rebound across much of the developed world and China." Then the Eurasia Group President, Ian Bremmer, predicted that Oil prices could go well under $80 a barrel if a deal is struck to rein in Iran's nuclear ambitions. The price of oil, as he pointed out, is already going down as an extra 500,000 barrels a day of Libyan supply are coming back online. Last week, oil prices dropped 6.3 percent—its worst week since June 2012. This could help fire-up growth…

The stock market will be up 20 percent in 2014 Byron Wien predicted in a CNBC interview on Tuesday—a day after releasing his annual Top 10 Market Surprises for 2014.
"This will be a 20 percent year, but could experience a correction early in the year of as much as 10%, as per the vice chairman of Blackstone Advisory Partners; In Wien's top prediction for 2014, he described stocks as a "Dickensian market," referring to "the best of times and the worst of times."
Hedge funds trailed the Standard & Poor's 500 Index for the fifth straight year as U.S. markets rallied to record levels. Hedge funds returned an average of 7.4 percent in 2013 (The Bloomberg Hedge Funds Aggregate Index)

Andre Gide had said "Everything has been said before, but since nobody listens we have to keep going back and beginning all over again". We read many views and suggest that we not lose sight of the underlying improvement in sentiment and economics, globally. Into 2014 we are positive on equities, apprehensive on bonds and have a friendlier look on Hedge funds' returns for 2014.

Currencies

- EURUSD started the year on a calm footing, finishing the first full week of trading where it started around 1.36. We briefly saw 1.3660 on Tuesday only to see the pair drop to as low as 1.3560 after the ECB meeting. We however believe that this year could finally be the year of a strong performance of the US$ versus the EUR.
- EURCHF bounced from 1.23 to 1.24 on Wednesday. We are a little lower today at 1.2340,but the CHF has underperformed this week. The USD has finally resumed a bit of an uptrend and the USDCHF moved from as low as 0.9020 to reach 0.9120.
- USDJPY finally broke through the 105.0 mark this week on three occasions and we are teetering at that level as we write. The pair looks steadfastly resolute in its gentle upwards sloping trend and we see no reason in the short term for that to change. The Dollar reigns supreme (well in Japan at least!)
- The Aussie briefly managed to resume a little of its lost ground getting as high as 0.8980 on Monday. Unfortunately the highs were short lived and the paid traded to as low as 0.8860. As we said last year, the Aussie is fundamentally weakening, and doing so at a steady pace!
- Cable is again almost unchanged on the week at 1.6400. However, after the poor industrial production figures this morning it was toppled from 1.6480 to 1.64 in a straight line. The UK economy has improved and the housing bubble is creating cash demand, but ultimately the debt burden is enormous and we hope the additional stamp taxes make up the deficit!
- In EM, the ZAR (South African Rand) weakened sharply to 10.80, a level not seen since the depths of the 2008 crisis. Not a good sign….
- The BRL had a poor week slumping from 2.36 to 2.40 in a couple of days. This is not a great sign of strength in the Real, but unfortunately looks set to stay at the weakened levels for the short term.

Fixed Income

- The US 10Yr yield is a little lower than at the start of the week, but again is still within our 2.5% to 3.0% band. The yield has moved from 3.01% (briefly) to 2.94% on Wednesday. The yield is currently at 2.96% and we see the Job's data this afternoon as painting the picture for the next move in yields.
- The German Bund moved from 1.95% to as low as 1.87%. The yields have fallen a little in the wake of the poor equity performance for this week. We do not believe that the yields will drop too far from here and that the channel trend shall continue.
- Spanish yields dropped this week from 3.9% to as low as 3.67% ahead of the ECB rates announcement. They have recently bounced higher again to 3.8%... pretty amazing really!
- Italy's 10Yr slipped from 3.95% to as low as 3.84% ahead of the ECB announcement but the yields then sold off causing the yield to move higher and we are trading at about 3.90% this morning.
- UK Gilts moved from 3.01% at the beginning of the week to as low as 2.93% as the UK woes were a little less bad than expected but still 0% growth on the industrials, therefore causing the bond buyers to push the yields lower.

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Equities

- Developed equities started the year on a negative tone, down by 0.88% so far this year. However, last week saw a clear improvement as signs of a US recovery have reassured some investors that the world's biggest economy can withstand a Federal Reserve decision to scale its bond-buying programme.
- Even though most investors remain optimistic on prospects for 2014, the economic recovery still faces threats. One is a possible spike in bond yields as the Fed winds down its bond-buying. Another is a rise in oil prices amid unrest in the Middle East and Africa. As for Europe, we believe another nasty surprise could still happen.
- The EuroStoxx rose by 0.69% for the week, as solid German economic data pointed to a pick-up in world trade and kept European shares near five-and-a-half year highs. Data showing that exports from Europe's biggest economy, Germany, rose for a fourth straight month in November was the latest sign that the euro zone economy and world trade are in recovery mode.
- The S&P 500 rose by 0.37% for the week, as of yesterday's close, as news on Tuesday that the US trade deficit was at a four-year low bolstered optimism over the global economy and lifted the dollar.
- The Nikkei tumbled by 2.33% for the week – marking its biggest weekly decline since end October, probably on profit taking. The index surged by 57% last year logging its best annual rise since 1972, driven by Japan's massive fiscal and monetary stimulus campaign.
- In terms of sectors, Healthcare and Financials stocks were the best performers (+1.67% and +0.80% respectively), while Materials and Telecom lagged (-1.85% and -0.93% respectively).

Emerging Markets

- Emerging Market equities were down 1.67% for the week – as of yesterday's close – as measured by the MSCI EM index. Latin American shares dropped the most losing 3.10%, while EM Europe and Asian shares lost 1.87% and 0.97% respectively. EMs lost about 3.95% so far this year, still weighed by slowing growth concerns.
- The Shanghai Composite plummeted by 3.35% this week, led by industrial and technology companies, amid concern new share offerings will divert funds and create concerns for liquidity after the China Securities Regulatory Commission has approved 50 IPOs. Also, inflation came in lower-than-expected hitting 7-month low, meaning a slowdown in consumption.
- The Bovespa plunged by 3.25% for the week, as of yesterday's close, dragged down by mining and steelmaking companies after a slower-than-expected increase in Chinese consumer prices.

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Commodities

- Commodities fell 1.44% for the week, as measured by the S&P GSCI Total Return index. Agriculture and Industrial metals were the worst performing sectors (-1.84% and 1.69% respectively), while Precious metals lost the least (-0.98%).
- Gold fell 0.35% for the week, and is currently trading at $1'235 per troy ounce. The precious metal sold off to as low as $1'220 by mid-week, following a better than expected Jobs report, triggering a Dollar rally on increased likelihood for further stimulus reduction. Gold has since regained some ground in anticipation of today's NFP report.
- Crude oil lost 1.55% for the week, and is currently trading at $92.50 a barrel. Crude has started selling off at the start of the week, following news that US service industries expanded at a slower pace than expected in December, and US fuel supplies rose. A strong Dollar contributed to additional weekly losses before oil recovered to current levels on strong Chinese imports.

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