Bedrock Newsletter

Friday, May 2nd 2014

We are now in May. A rather stoic week has passed, or nearly passed- Ukraine is still unsettled and more sanctions are being levied by the USA and the EU, earnings are still flowing-in, the DJIA reached a new high on Wednesday (the second new high of any major index for the year!), the US GDP for Q1 came in at a disappointing 0.1% further underpinning the low rates of the bond markets. M&A activities are continuing to be announced, some big ones across the puddle with GE trying to buy Alstom of France and Pfizer buying Astra-Zeneca (possibly for US tax purposes?). The US Dollar remains weak, with the Euro edging up towards its eventually unacceptable level of 1.40 USD/Euro at which we would expect the ECB to act by reducing rates; adding QE… The reason being that a strong Euro reduces inflation pressures within the zone, and the ECB wants inflation to rise to 2%- impossible if the Euro rises… Gold has been sinking slowly through its $1’300/oz. whilst oil has held steady at about $100/Bbl. for WTI. And all this with the Federal Reserve announcing yet another reduction in its QE, now budgeted at $45Bn/month, down by the expected $10Bn… Amazingly, on the announcement, US government bonds rose some in price and down in yield! A quiet week indeed… Nice!

But now we are in the month of May. The classic Wall Street aphorism “Sell in May and go away” is yet again part of headlines. Perhaps the big Wall Street shops want investors to create trade-volumes by selling all equities; buying bonds now, then immediately after Halloween reverse the trades- buy stock again and sell the bonds. *‘‘I do not regard a broker as a member of the human race”*, Honoré de Balzac. The myth has some statistical support, but then in 2013 the S&P 500 soared 10 percent from the end of April to the beginning of November. And with the economy just shaking off a tough winter, some experts predict that another good summer may be ahead. Intelligent investors should agree that blindly following the patterns of the past will generally make for poor returns.

A gauge of U.S. manufacturing rose in April, jobless claims climbed to a nine-week high last week and household purchases, which account for about 70 percent of the economy, added the most since August 2009. China’s factory output increased to 50.4 in April, less than the 50.5 level predicted in a Bloomberg survey of economists (good call, for a change!).

More talk of an equity price- bubble is polluting the markets, some of which talk is “interesting”, at least in its linguistic value- A stern warning comes with a verbal hedge- for example, Jeremy Grantham, chief investment strategist at Grantham & Co., said the S&P 500 will climb above 2,250 before collapsing after the next U.S. presidential election. Let’s buy and ride the wave from here to the 2’250 level… but if we miss it, we were warned, “n’est ce pas” as say the French?

We are perplexed by the US- The regulators are pushing banks to raise more capital, then the justice department removes bank capital with fines- What investor in his right-mind will buy shares of American banks? Just this week Bank of America was fined another $20Bn for wrong-doing in its forced acquisitions. These wrong-doings (we don’t argue this) happened pre-2008, in companies BOA didn’t own at the time, acquisitions which were forced upon BOA by the US Treasury- Why should today’s shareholders pay? We can’t argue morality, but logic? China is set to overtake the U.S. as the world's number one economy, while India has jumped into third place ahead of Japan, according to a new study from the International Comparison Program (ICP), which involves the World Bank. But before we panic, this comparison is on Purchasing Power Parity basis, not absolute GDP. On a PPP basis, the US is now 17% of world GDP, China at 15% and India at 6.5%. Well, if you ever doubted what can be achieved with statistics, think of these words by Benjamin Disraeli whenever statistics are presented- “There are three types of lies: Lies, damned lies… and statistics”.

<u>Core View</u>: The world's economies are mending from the fallout of the "Great Recession". The economics are settling back into a reasonable growth pattern and stability is expected to continue. Volatility as a measure of risk is low in bonds, FX and equities.

- **Fixed Income -** The Fixed Income world is dealing with low yields and investors are struggling with accepting low inflation. As all (!) Central Banks are seeking somewhat higher inflation than they have, it is hardly reasonable that they raise rates. With the ECB's talk of further easing it is likely that Europe will embark on large scale QE in the not too distant future, a la BOE and FOMC – The strong Euro contributes to low inflation in the zone and the ECB wants inflation to rise somewhat!? In conclusion, we see no need to worry in the short term about rising rates. But do keep an eye on the horizon as it will eventually show signs of rising rates, if and when inflation rears its head. No immediate threat though- In Japan, the BOJ has not succeeded in over 20 years!
- **Equities –** After the dust settles on the showdown at the "OK(etski)-corral" in the Black Sea the global markets are more or less unchanged. The Dow Jones made a new all-time high on Wednesday April 30th, on the day the US published a very disappointing GDP figure for Q1 at +0.1% With PE ratios around the globe at historically reasonable levels (+-15X) and Q1 earnings having come in mostly ahead of expectations, we feel secure in owning equities. Consumption around the globe is still expanding (albeit slowly) which should mean a positive environment for cash-flow growth… so at sensible PEs and positive cash flow growth, equities would seem like a fair choice for the year ahead.
- **Alternatives -** In a normalizing financial-world, with new-found economic stability and a clearing horizon, fundamentals are returning to base text-book relative values allowing traders and investors to take views and positions. We expect this active management allocation to maintain if not exceed its recent results- similar to equity returns but with low correlation to any sector, with about 10% per annum, albeit with significantly lower volatility than equities.
- **Currencies -** The market still has very low volatility and the Euro is still very strong (and strengthening) versus the USD. We maintain belief in the fundamental strength of the US$ and would not bet against it at this time. This said, we do see a short-term level of 1.40 US$/Euro as a short-term ceiling to the Euro move.

Weekly Highlights:

- The FX markets moved around the data points but with the result that the week stands relatively unchanged (sorry to keep repeating this!). The major crosses are finishing the week roughly where they started – EUR is trading at about 1.3850, GBP at 1.6890, CHF at 0.8805 and the JPY at 102.50. AUD however, managed to maintain its level after last week's drops on poor CPI. EMs had a better week and saw broad strength versus the USD. The DXY (USD index) was down on the week from 79.75 to 79.50. With such low volatility and only good news priced in perhaps we would venture to say that the AUD looks weak again – its moment in the sun may be shortly over! On a net positioning basis GBP has the largest net long position since the 29th May 2011 – when we saw a 15 figure correction. History rarely repeats itself, but if often rhymes… We currently have full UK QE priced, what further news will push the Pound higher?
- The US bond market briefly sold off to see the yields reach 2.72% prior weaker consumer confidence and big miss on Annualised GDP (missing by 1.1%!). The yields tumbled and continued in that vein as the Jobless numbers were worse than expected. The yields found a bottom at 2.60% and we are trading slightly above that figure at the moment. (We note that the weather was blamed for the data misses and hence the down move was not more severe

– in fact we would venture to say it is an aberration). But we reiterate that this is still in our 2.5%-3.00% trading band. The Bunds were relatively similar in the direction and timing of their moves. The Bund is trading at 1.46%, having dropped from 1.53% after the poor CPI numbers for Germany on Tuesday.

- Global equities had a steady week, with a few European markets being shut on Thursday. The S&P 500 held steady and maintained its level from last week and the Dax rallying from 9,450 to 9,610. As earnings grow, the PE expansion should mean that equities will continue higher… we believe they will, and feel comfortable remaining in Equities.

MARKET INDICES PERFORMANCE 01/05/2014

			PRICE CHANGE IN % (unless indicated)								
INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	1Y	YTD	
EQUITY MARKET INDICES - BY REGION											P/E
MSCI WORLD	USD	1,690.39	0.16	1.17	0.16	0.17	5.75	5.79	15.01	1.77	15.35
MSCI WORLD LOCAL	-	1,198.92	0.15	0.40	0.15	0.05	4.68	5.27	14.82	1.22	-
MSCI AC WORLD	USD	414.71	0.15	1.08	0.15	0.06	5.81	4.80	12.72	1.51	14.68
MSCI EM	USD	996.01	0.07	0.27	0.07	-0.89	6.35	-3.10	-3.98	-0.67	10.67
S&P 500 INDEX	USD	1,883.68	-0.01	0.27	-0.01	-0.38	5.67	6.93	17.91	1.91	15.97
DOW JONES INDUS. AVG	USD	16,558.87	-0.13	0.35	-0.13	-0.09	5.48	6.04	11.65	-0.11	14.84
NASDAQ COMPOSITE INDEX	USD	4,127.45	0.31	-0.50	0.31	-3.48	0.57	5.24	23.55	-1.18	17.99
RUSSELL 2000 INDEX	USD	1,125.97	-0.08	-1.61	-0.08	-5.60	-0.43	2.77	19.80	-3.24	18.59
EURO STOXX 50	EUR	3,186.95	-0.37	1.26	-0.36	-0.02	5.74	4.42	17.21	2.51	13.87
CAC 40 INDEX	EUR	4,470.63	-0.37	-0.20	-0.37	0.99	7.32	4.62	15.92	4.07	14.25
DAX INDEX	EUR	9,592.74	-0.11	0.46	-0.11	-0.11	3.08	6.49	21.22	0.42	13.50
FTSE 100 INDEX	GBP	6,803.50	-0.08	1.76	0.35	2.17	4.50	1.02	5.31	0.81	-
SWISS MARKET INDEX	CHF	8,466.94	-0.11	0.69	-0.11	0.11	3.36	2.98	7.09	3.22	16.33
NIKKEI 225	JPY	14,457.51	-0.19	0.36	1.07	-3.27	-3.06	1.80	5.58	-11.26	16.28
HANG SENG INDEX	HKD	22,232.98	0.45	-1.46	0.45	-0.96	0.90	-4.37	-2.22	-4.61	10.31
SHANGHAI SE COMPOSITE	CNY	2,026.36	0.30	-1.98	0.00	-1.03	-0.33	-5.73	-6.96	-4.24	7.85
S&P BSE SENSEX INDEX	INR	22,468.97	0.23	-1.78	0.23	0.10	9.53	6.00	15.20	6.13	14.25
RUSSIAN RTS INDEX $	USD	1,146.33	-0.81	0.06	-0.81	-7.24	-11.89	-22.29	-18.54	-20.54	4.70
BRAZIL IBOVESPA INDEX	BRL	51,626.69	-0.41	0.11	0.00	2.70	8.37	-4.42	-7.66	0.23	10.29
EQUITY MARKET INDICES - BY SECTOR											P/E
MSCI ENERGY	USD	294.24	-0.18	1.32	-0.18	4.75	13.73	9.84	17.94	6.77	14.13
MSCI MATERIALS	USD	246.08	-0.26	0.38	-0.26	0.44	6.19	5.46	11.17	2.54	15.62
MSCI INDUSTRIALS	USD	201.85	0.01	0.53	0.01	-0.49	4.49	5.52	20.25	-0.05	16.04
MSCI CONS DISCRETIONARY	USD	176.02	0.50	0.78	0.50	-2.31	1.99	1.36	17.39	-3.16	16.04
MSCI CONS STAPLES	USD	195.38	-0.09	0.95	-0.09	2.72	8.57	4.00	5.91	2.58	18.13
MSCI HEALTH CARE	USD	181.68	0.35	2.03	0.35	0.01	5.08	10.57	20.62	5.72	16.98
MSCI FINANCIALS	USD	102.17	0.26	0.98	0.26	-0.72	4.77	3.70	11.34	0.27	13.22
MSCI INFO TECH	USD	124.31	0.14	1.75	0.14	-1.72	3.78	8.82	20.71	0.93	15.86
MSCI TELECOMS	USD	71.75	0.42	2.76	0.42	0.99	4.47	1.73	11.90	-0.33	14.95
MSCI UTILITY	USD	121.13	0.34	0.89	0.34	2.90	10.09	8.59	7.32	10.24	15.83
MSCI WORLD REAL ESTATE	USD	183.66	0.57	1.37	0.57	2.49	6.46	1.32	-6.85	4.96	23.13
HEDGE FUND INDICES											
HFRX GLOBAL HEDGE FUND	USD	1,230.12	0.01	-0.24	-0.73	-0.43	0.50	1.52	3.23	0.38	
HFRX EQUAL WEIGHTED	USD	1,208.81	0.02	-0.22	-0.46	-0.26	0.78	1.89	3.81	0.98	
HFRX GLOBAL EUR	EUR	1,139.18	0.18	-0.28	-0.72	-0.44	0.60	1.37	3.09	0.30	

All data is compiled from Bloomberg

MARKET INDICES PERFORMANCE

01/05/2014

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FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)										
US 3 MONTH	USD	0.02	**0.00**	0.01	-0.01	0.01	0.00	-0.02	-0.02	-0.05
US 2 YEAR	USD	0.41	**0.00**	-0.02	0.00	-0.04	0.08	0.10	0.21	0.03
US 10 YEAR	USD	2.63	**0.02**	-0.03	-0.01	-0.17	-0.01	0.01	1.01	-0.40
FIXED INCOME INDICES - BY TYPE OF ISSUER										
GLOBAL AGG TR HEDGED	USD	454.66	**0.11**	0.30	0.11	0.84	1.40	2.31	0.93	2.86
US GOVERNMENT TR	USD	2,020.10	**0.17**	0.36	0.17	0.83	0.72	1.12	-1.44	2.04
US CORPORATE TR	USD	2,516.50	**0.33**	0.53	0.33	1.68	2.66	4.54	0.89	4.52
US HIGH YIELD TR	USD	1,640.33	**0.04**	0.18	0.04	0.60	2.95	4.76	6.09	3.67
EU GOVERNMENT TR	EUR	222.33	**0.01**	0.31	0.01	0.99	2.41	4.22	3.87	4.54
EU CORPORATE TR	USD	234.01	**0.01**	0.40	0.01	0.97	1.93	3.07	3.82	3.29
EU HIGH YIELD TR	EUR	264.36	**0.02**	0.21	0.02	0.91	3.35	5.77	10.06	4.09
JACI GLOBAL	USD	261.91	**-0.22**	-0.19	-0.59	-0.23	2.47	4.72	13.05	3.38
GLOBAL EM TR (HEDGED)	USD	317.04	**0.13**	0.23	0.13	1.04	4.23	3.38	-0.26	3.92
S&P/LSTA U.S. LEV LOAN	USD	98.38	**0.11**	0.32	0.11	-0.02	-0.30	0.36	-0.22	0.14
COMMODITY INDICES - BY TYPE OF ISSUER										
GSCI INDEX TOTAL RETURN	USD	4,978.46	**-0.60**	-1.95	-0.60	1.39	4.80	6.00	8.63	3.09
GSCI ENERGY TR	USD	1,131.19	**-0.46**	-2.56	-0.46	1.62	2.47	5.64	11.36	0.45
GSCI INDUSTRIAL METALS TR	USD	1,310.91	**-0.41**	-2.84	-0.41	1.12	0.21	-4.31	-2.17	-4.09
GSCI PRECIOUS METALS TR	USD	1,608.49	**-0.93**	-0.90	-0.93	-0.18	2.99	-3.80	-12.56	5.59
GSCI AGRICULTURE TR	USD	708.44	**-1.85**	0.24	-1.85	1.20	18.35	12.23	0.90	16.79
GENERIC 1ST 'CL' FUTURE	USD	99.54	**0.12**	-1.05	-0.20	0.30	3.25	5.56	5.69	2.28
GOLD SPOT $/OZ	USD	1,283.44	**-0.07**	-1.52	-0.63	-0.50	3.12	-2.49	-12.52	6.45
CURRENCIES										
DOLLAR INDEX SPOT	USD	79.58	**0.07**	-0.21	0.14	-0.79	-2.12	-1.40	-3.21	-0.56
Euro Spot	EUR	1.39	**-0.12**	0.14	-0.10	0.62	2.43	2.51	6.03	0.80
Japanese Yen Spot	JPY	102.48	**-0.15**	-0.31	-0.23	1.37	-1.46	-3.79	-4.43	2.76
British Pound Spot	GBP	1.69	**-0.01**	0.53	0.11	1.60	3.60	5.79	8.74	2.02
Brazilian Real Spot	BRL	2.23	**0.17**	-0.47	0.00	1.77	8.09	0.34	-10.35	5.81
China Renminbi Spot	CNY	6.26	**-0.01**	-0.12	-0.01	-0.88	-3.19	-2.59	-1.67	-3.29
Singapore Dollar Spot	SGD	1.25	**-0.01**	0.30	0.06	0.76	1.83	-0.83	-1.41	0.81
Norwegian Krone Spot	NOK	5.96	**-0.23**	1.07	-0.13	0.22	5.50	-0.14	-2.61	1.92
VOLATILITY / LIQUIDITY INDICES										
CBOE SPX VOLATILITY INDX	USD	13.25	**-1.19**	-0.53	-1.19	1.22	-28.03	-0.23	-2.50	-3.43
USD SWAP SPREAD SEMI 2YR		13.00	**2.77**	16.80	9.43	10.64	-4.13	10.64	-7.21	23.81
TED SPREAD		0.00	**2.27**	-9.07	2.27	5.17	-6.36	0.15	-8.93	-86.18

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