

Bedrock Newsletter Friday, January 9th 2015

Welcome into 2015! Happy New Year with our wishes for a lucrative year to all ☺

We closed last year with news that the U.S. economy grew at its quickest pace in 11 years in the third quarter, the strongest sign yet that growth has decisively shifted into a higher gear. The Commerce Department on Tuesday revised up its estimate of gross domestic product growth to a 5.0% annual pace from the 3.9% rate reported last month. It was looking good for the start of this year, except that oil prices continued their collapse; Russia's economy worried us into the close with a decimated Ruble and a falling stock market. We left our offices with a smile into the celebrations... But then, we had a grumpy start for the year. Four consecutive down days on equities until the New Year hangover finally cleared on Thursday after the worst start to a year since 2008! U.S. stocks climbed, with the Standard & Poor's 500 Index erasing its 2015 declines after the Federal Reserve signalled caution on interest rates even as growth shows signs of accelerating. The Euro sank on speculation that policy makers in the region will need to bolster.

Are market jitters being lubricated by "Greecey" Oil worries?

The factory data from Germany, which narrowly avoided a recession in the middle of 2014, added to evidence that Europe is in an economic slump and strengthened the case for broad-based asset purchases by the European Central Bank, which next reviews interest rates Jan. 22. European shares extended gains Thursday after European Central Bank President Mario Draghi said in a letter published on the bank's website that policy makers' may undertake measures including buying sovereign bonds.

The U.S. trade gap narrowed in November to its lowest level in nearly a year due to falling prices and weaker demand for foreign oil had pushed down imports despite record inbound shipments of consumer goods. The trade deficit fell 7.7% to a seasonally adjusted \$39 billion in November from the prior month's deficit of \$42.25 billion. The reading marks the smallest deficit since December 2013. Economists surveyed by The Wall Street Journal had forecast a trade deficit of \$42 billion in November. The U.S. exported a record amount of crude oil in November after a five-year run of production growth that has made the country the most oil-independent in 20 years. Shipments surged 34% to average 502,000 barrels a day in November, surpassing the previous monthly peak of 455,000 barrels set in March 1957 (!), according to U.S. Census Bureau data compiled by Bloomberg.

We have all been focussed on oil prices, but then, the sticky black stuff isn't the only commodity that's getting cheaper. From nickel to soybean oil, plywood to sugar, global commodity prices have been on a steady decline as the world's economy has lost momentum. That lower demand helps explain, in part, why nearly everything from crude oil to cotton has been getting cheaper. The global cost of most commodities has been on a long-term downward trend since the Great Recession.

Well, with high unemployment, albeit declining in the USA, lowest ever cost of capital, excess industrial capacity everywhere, clearly fears of inflation are misplaced! Indeed, the bond markets have been telling us this for quite some time! This week we saw the 10-year U.S. Treasury yield was trading around 1.98% late Tuesday in the U.S. after starting the year around 2.17%. Germany's 10-year bund was around 0.47%, around all-time lows, after ending 2014 around 0.54%, while the Japanese government bond (JGB) was around 0.30%, a tad up from the record low 0.275% touched earlier this week. We like to think that the fair historic return on the best sovereign 10 year debt was about 3% over inflation. The current yields imply a global true inflation well below zero! In the US, the implied inflation is about negative 1%, Germany at minus 2% or so and let's not even go to Japan...

Looking forward into this year, we believe that there is little worry on the interest-rate front. Then on equities, we remain constructive and concur with the average 2015 forecast of 15 top Wall Street strategists for a roughly 7.5% gain in the S&P 500 to 2,220, fairly modest, but still a decent showing on top of 2014's advance. Underlying those forecasts are also expectations for more volatility which is likely to help returns in the Alternative sector (hedge funds).

As we write, just ahead of the US December employment report, we see stabilization in the FX markets and a quiet settling-down in oil prices. Perhaps the storm has passed? Then with all this excitement we nearly forgot that Q4 Earnings' Season is upon us!

We leave you with cheers to a new year and another chance for us to get it right.

This Week's Highlights:

- The Dollar carried on through the holiday season moving higher and higher. EURUSD slumped from 1.21 to briefly hit 1.1754 yesterday which has not been seen since 2005, almost back to the level that the EUR was initiated at in 1999. The CHF broke through parity for the first time since early 2010 and briefly touched as high as 1.0217 yesterday. It looks like the negative rate policy will maintain the weakness of the CHF against the USD, the question becomes - will they be able to defend the 1.20 level against the EUR? The JPY is almost unchanged for the year so far, in fact the JPY is the only major to have withstood the full force of the USD rise. This pause on the downward move for the JPY is not a game changed but a welcome pause in the recent one way trading for the JPY. The Ruble has managed to take a little breather as Russia is effectively shut for its annual holiday season. Although the currency pair has moved about the 60 RUB/USD level, it is on very low volume and with no real domestic participation.
- The US 10Yr Treasury saw yields drop from 2.18% to briefly hit 1.8850% as equity markets took a battering on low volumes and New Year jitters. As the equity markets have rallied the yields have moved higher again and they now stand at just above 2%. The German 10 Yr Bund is trading at 0.50%; however, it did put in a new low in terms of yield on Wednesday at 0.43%!! The periphery in Europe saw their yields rise this week, widening the spread over the Bund. Italy's 10 Yr fell to 1.87% (137Bps over the Bund) and with Spain falling to 1.70% (120Bps over the Bund). Japanese 10Yr yields moved lower again and saw them fall to 0.275% hitting new lows again for their 10 year debt – the lowest even through the 20 years of stagflation! In fact their 30yr Bonds are trading at 1.15% and are fast approaching their all-time lows of 0.994% from 2003. The UK has fully reversed its course from prior to Christmas where the BOE briefly sent the 10yr Yields to 1.90%, we are now seeing yields as low as 1.63%.
- Equities are a little mixed this year. With low liquidity and some large market participants closed last week, the differences are minimal. The large cap US markets are +0.25% on average, with Europe down about 1.25%. Spain taking a very large hit on the story that Santander will be issuing 7.5Bn EUR of shares. In fact the DAX seems to be the only positive European market at +0.25% along with the Swiss at +1.75%. In Asia there was a diametrically opposed performance between China and Japan, with China +1.33% and Japan -1.45%. Russia has received some respite on the MICEX, seeing the shares rally 9% on the year so far, but the RTS Index is still languishing and is down 2%. Brazil is now completely unchanged for the year having been down 5.5% at the beginning of the week.

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Highlighted items are interesting data points for the week

MARKET INDICES PERFORMANCE

08/01/2015

INDEX NAME	CCY	Last Price	PRICE CHANGE IN % (unless indicated)								P/E
			1D	5D	MTD	1M	3M	6M	1Y	YTD	
EQUITY MARKET INDICES - BY REGION											
MSCI WORLD	USD	1,894.17	1.93	-0.82	-0.91	-1.81	2.49	-2.97	2.90	-0.91	15.72
MSCI WORLD HEDGED	USD	704.66	1.89	-0.10	-0.10	-0.66	4.69	3.85	9.88	-0.10	-
MSCI WORLD LOCAL	-	1,274.17	1.90	-0.13	-0.13	-0.78	4.38	3.11	7.86	-0.13	-
MSCI AC WORLD	USD	413.84	1.92	-0.50	-0.79	-1.52	1.68	-3.71	2.54	-0.79	15.11
MSCI EM	USD	958.83	1.88	0.54	0.26	-0.68	-4.91	-9.62	-0.44	0.26	11.33
S&P 500 INDEX	USD	2,062.14	1.79	0.16	0.16	0.11	6.95	4.53	12.19	0.16	16.69
DOW JONES INDUS. AVG	USD	17,907.87	1.84	0.48	0.48	0.60	7.50	5.43	8.90	0.48	15.81
NASDAQ COMPOSITE INDEX	USD	4,736.19	1.84	0.00	0.00	-0.64	8.17	7.18	13.95	0.00	18.10
RUSSELL 2000 INDEX	USD	1,196.12	1.71	-0.71	-0.71	0.68	12.00	1.90	3.26	-0.71	17.89
EURO STOXX 50	EUR	3,135.08	3.58	-1.02	-1.24	-1.75	2.14	-2.99	0.56	-1.24	13.05
CAC 40 INDEX	EUR	4,260.19	3.59	0.03	-0.45	-0.24	2.71	-2.44	0.67	-0.45	13.45
DAX INDEX	EUR	9,837.61	3.36	0.59	0.17	0.29	9.08	0.14	4.25	0.17	12.70
FTSE 100 INDEX	GBP	6,569.96	2.34	0.16	-0.12	0.44	1.97	-2.38	-1.99	-0.12	13.78
SWISS MARKET INDEX	CHF	9,139.09	2.68	1.53	1.53	0.77	7.52	6.81	9.94	1.53	15.88
NIKKEI 225	JPY	17,167.10	1.67	-1.45	-1.45	-3.46	11.10	12.38	8.30	-1.45	18.14
HANG SENG INDEX	HKD	23,835.53	0.65	0.26	1.33	1.85	1.64	3.21	4.97	1.33	10.78
SHANGHAI SE COMPOSITE	CNY	3,293.46	-2.39	1.57	1.57	15.02	37.50	61.16	82.03	1.57	12.35
S&P BSE SENSEX INDEX	INR	27,274.71	1.36	-2.47	-1.09	-2.15	2.11	6.90	31.31	-1.09	17.13
RUSSIAN RTS INDEX \$	USD	812.02	8.79	-0.81	-0.06	-7.85	-27.42	-43.70	-43.10	-0.06	4.49
BRAZIL IBOVESPA INDEX	BRL	49,943.30	0.97	-0.13	-0.13	-0.50	-12.79	-8.88	1.26	-0.13	10.42
MSCI AC ASIA x JAPAN	USD	563.22	1.38	-0.61	-0.09	-0.21	-0.34	-3.58	5.39	-0.09	11.87
MSCI EM LATIN AMERICA	USD	2,688.53	1.67	-1.44	-1.44	-3.32	-18.39	-21.03	-11.43	-1.44	12.65
MSCI EM Eur, ME & Africa	USD	276.78	3.57	2.96	2.22	-1.11	-7.96	-17.96	-12.07	2.22	9.98
EQUITY MARKET INDICES - BY SECTOR											
MSCI ENERGY	USD	229.40	2.26	-3.63	-3.54	-1.58	-12.11	-25.71	-15.23	-3.54	15.93
MSCI MATERIALS	USD	220.67	2.25	-0.72	-1.07	-2.56	-1.85	-13.58	-5.71	-1.07	14.79
MSCI INDUSTRIALS	USD	195.92	1.95	-1.37	-1.71	-2.03	3.75	-4.52	-1.81	-1.71	15.88
MSCI CONS DISCRETIONARY	USD	183.80	1.69	-0.50	-1.29	-0.78	7.54	0.53	2.44	-1.29	16.75
MSCI CONS STAPLES	USD	200.56	2.07	1.13	0.32	-0.18	4.23	0.11	7.53	0.32	19.28
MSCI HEALTH CARE	USD	205.06	2.23	2.50	2.59	-0.49	7.50	8.35	17.95	2.59	17.90
MSCI FINANCIALS	USD	100.54	1.50	-1.99	-2.16	-3.36	0.65	-3.32	-1.55	-2.16	12.80
MSCI INFO TECH	USD	140.62	2.22	-0.28	-0.47	-1.00	6.26	6.22	15.42	-0.47	16.82
MSCI TELECOMS	USD	67.62	2.04	-0.78	-1.08	-2.84	-0.92	-8.14	-4.11	-1.08	15.52
MSCI UTILITY	USD	121.93	1.24	-0.81	-0.92	-0.80	3.68	-0.59	12.67	-0.81	16.25
MSCI WORLD REAL ESTATE	USD	198.72	0.72	1.44	2.20	1.85	7.99	4.09	14.09	2.20	24.77

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HEDGE FUND INDICES											
HFRI GLOBAL HEDGE FUND	USD	1,211.28	0.21	-0.59	-0.59	-0.90	-1.38	-3.02	-1.07	-0.59	
HFRI EQUAL WEIGHTED	USD	1,186.12	0.16	-0.42	-0.42	-0.66	-1.50	-2.92	-0.85	-0.42	
HFRI GLOBAL EUR	EUR	1,115.23	0.20	-0.83	-0.83	-1.16	-1.75	-3.51	-1.70	-0.83	
FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)											
US 3 MONTH	USD	0.02	0.00	0.00	-0.02	-0.01	0.01	-0.01	-0.02	-0.02	
US 2 YEAR	USD	0.61	0.01	-0.05	-0.05	0.00	0.17	0.14	0.18	-0.05	
US 10 YEAR	USD	2.00	-0.02	-0.11	-0.17	-0.21	-0.31	-0.55	-0.96	-0.17	
FIXED INCOME INDICES - BY TYPE OF ISSUER											
GLOBAL AGG TR HEDGED	USD	478.22	-0.10	0.56	0.56	1.26	2.18	4.00	7.93	0.56	1.57
US GOVERNMENT TR	USD	2,093.51	-0.26	0.79	0.79	1.28	1.75	3.27	5.74	0.79	1.57
US CORPORATE TR	USD	2,612.00	-0.34	0.95	0.95	1.43	1.39	2.88	8.24	0.95	3.02
US HIGH YIELD TR	USD	1,622.66	0.42	0.10	0.10	-0.12	-1.33	-2.83	2.03	0.10	6.84
EU GOVERNMENT TR	EUR	239.71	-0.07	0.26	0.26	1.11	2.70	5.56	12.09	0.26	0.78
EU CORPORATE TR	USD	245.95	-0.08	0.15	0.15	0.64	1.59	3.44	8.23	0.15	1.04
EU HIGH YIELD TR	EUR	269.06	0.13	0.11	0.11	-0.41	1.02	0.59	5.26	0.11	4.32
JACI GLOBAL	USD	251.85	0.22	-0.42	-0.14	0.78	-2.33	-4.49	1.36	-0.59	-
GLOBAL EM TR (HEDGED)	USD	319.47	0.30	-0.27	-0.27	-1.25	-2.10	-2.45	4.53	-0.27	5.36
S&P/LSTA U.S. LEV LOAN	USD	95.38	0.14	0.04	0.04	-0.82	-1.70	-3.70	-3.45	0.04	5.24
COMMODITY INDICES - BY TYPE OF ISSUER											
GSCI INDEX TOTAL RETURN	USD	3,066.08	-0.03	-5.16	-5.16	-14.66	-29.84	-38.82	-34.26	-5.16	
GSCI ENERGY TR	USD	578.05	0.28	-8.24	-8.24	-21.63	-41.54	-50.10	-48.29	-8.24	
GSCI INDUSTRIAL METALS TR	USD	1,244.27	0.82	-1.64	-1.64	-5.71	-7.10	-12.06	-7.91	-1.64	
GSCI PRECIOUS METALS TR	USD	1,495.40	-0.27	2.38	2.38	1.09	-0.36	-10.13	-3.57	2.38	
GSCI AGRICULTURE TR	USD	540.97	-0.67	-0.09	-0.09	-1.42	3.33	-8.93	-9.37	-0.09	
GENERIC 1ST 'CL' FUTURE	USD	48.79	0.45	-6.98	-6.98	-23.93	-43.23	-49.76	-42.53	-6.98	
GOLD SPOT \$/OZ	USD	1,208.73	0.19	1.83	2.20	-1.62	-1.09	-8.80	-1.38	2.20	
CURRENCIES											
DOLLAR INDEX SPOT	USD	92.37	-0.15	1.26	2.17	3.99	7.84	15.30	13.86	2.17	
Euro Spot	EUR	1.18	0.09	-1.65	-2.43	-4.81	-6.99	-13.47	-13.26	-2.43	
Japanese Yen Spot	JPY	119.66	0.29	1.00	0.39	0.32	-9.81	-14.81	-12.14	0.39	
British Pound Spot	GBP	1.51	0.12	-1.44	-3.01	-3.57	-6.26	-11.95	-8.33	-3.01	
Brazilian Real Spot	BRL	2.66	0.77	-0.18	-0.18	-2.33	-10.71	-16.86	-9.98	-0.18	
China Renminbi Spot	CNY	6.21	0.09	-0.02	-0.05	-0.34	-1.26	-0.16	-2.47	-0.05	
Singapore Dollar Spot	SGD	1.34	-0.07	-0.48	-0.91	-1.59	-4.95	-7.19	-5.02	-0.91	
Norwegian Krone Spot	NOK	7.63	-0.11	-0.58	-2.40	-6.67	-15.21	-19.41	-19.10	-2.40	

All data is compiled from Bloomberg

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