As Robbie Williams once said, “You gotta get high before you taste the lows.” It looks like the lows were briefly looked at by the Market and has decided that it prefers the highs, for now… The market is still being pumped with steroids as the ECB’s Coeuré announced that the shape of their QE would be slightly amended. The average monthly purchases over the life of the policy would remain the same but the intra-month amounts may vary, noting that they would frontload purchases prior to the summer doldrums. Stating that "We are also aware of seasonal patterns in fixed-income market activity with the traditional holiday period from mid-July to August characterised by notably lower market liquidity," said Coeuré. As if the idea of frontloading was not enough to tempt the bond traders back to the table, he also advised that, if needed, they would be able to backload purchases in September should they not be able to fulfil their mandate during the summer months! The ECB has effectively become a portfolio manager and with it taken a view that the risk to its portfolio deployment are in liquidity… no surprises there we hear you shout. Well, perhaps we should revisit this fundamental idea of liquidity which was best summarised by Howard Marks in a memo to his clients; “Liquidity can be transient and paradoxical. It’s plentiful when you don’t care about it and scarce when you need it most. Given the way it waxes and wanes, it’s dangerous to assume the liquidity that’s available in good times will be there when the tide goes out.” However, in the case of the Central Banks the exit from their holdings will not be an open market transaction. In the case of the debt they are holding, this shall be maintained until maturity - as such the normal rigours of exiting the program will be governed by the state of the economy at that point in time. If the issuer (European governments effectively) has enough cash on the balance sheet to repay the debt when they expire then the exit from QE will be smooth. However, if the issuers need cash, they will be required to rollover their outstanding debt leading to one of two scenarios; either the central banks continue to buy (no exit from QE) or the market will be in a position to buy the new debt and hence QE will be exited and the “Old Normal” will return.

With higher highs for equities in the US and lower yields in the bond markets, the world is still spinning. The short term rout in bonds that was experienced seems to have abated but the short term movement has shown that fixed income trading is not a one way bet – regardless of the size of the market counterparty who is buying irrespective of the price. With weaker economic data, expectations for the U.S. Federal Reserve to delay a rise in interest rates and jitters about a possible debt default in Greece are all reasons why yields could creep lower in the weeks ahead. Still, while some analysts expect yields to tick lower, they do not expect them to fall as low as they did before the rout in debt markets. Citi, for instance, no longer anticipates the German 10-year Bund yield to turn negative this year. It now forecast 10-year yields to end the third quarter at around 0.2%, up from a previous forecast of -0.05%. And Goldman Sachs now see the 10-year Bund yield climbing to 0.9% by the end of the year, from a previous forecast of 0.5%. However, if we have learnt anything from being invested in the markets for many years, it is that movements do not happen in straight lines. And as the ECB believes the summer months may have lower volumes - we would not want to disagree with them –it is likely we see some increased volatility as volumes are adjusted throughout the next few months.

Looking at the year so far we have been trying to find anomalies that help direct us going forward. The Dow Jones Industrial Average has in fact been relatively stable; with yesterday’s +0.0019% daily change we are not exactly seeing large amounts of index volatility. In fact, "If you look at the high-to-low range for the Dow Jones industrial average for the first half of this year, as of now it's just over 6 percent," technical analyst Jonathan Krinsky said. This would make it the narrowest first-half trading range in the history of the Dow, which dates back to 1896. History may not repeat itself but it does rhyme; since 1896 there have been 19 times that the Dow has traded in a range of less than 10 percent high to low. Thirteen out of those 19 times the Dow went on to gains in the second half of the year, and only three times of those 19, the Dow closed negative. The average year-to-date return of those 19 occurrences is + 8.25%. If we couple this with the fact that “sell in May and go away” has not in fact been the worst month for the last 10 years, but in fact “sell in June and go away” would have been more appropriate, we may see some weakness in the next couple of weeks. With the Dow up 2.6% so far this year we still see plenty of upside in equities. Based on an 8.25% average, this would put the Dow at 19,293 and the S&P 500 at 2,228. Without wanting to count our chickens before they have hatched, we wrote in our end of year letter that “If indeed both these predictions materialise, then we can comfortably deduce a target for the S&P 500 index at year-end 2015 of 2,229”. Although we have not reached the half way point of the year yet, and there are plenty of big question marks in the Investment Universe, we are comfortable to favour equities over fixed income based on the current risk reward. But as Thomas Jefferson said, “He who knows best, knows how little he knows”. Then again, the drafts he wrote for the Declaration of Independence were written on hemp paper… perhaps the effects of the plant were still wearing off when he said that… Have a wonderful long weekend.

This Week's Highlights:

- This week's movement was again dominated by the USD which has regained some ground after the recent weakness; with the DXY (US Dollar Index) moving back to 95 from 93.60. EURUSD moved lower throughout the week from 1.1460 to 1.1065 and trading at 1.1160 as we write. The Pound has oscillated between 1.5811 and 1.5449 settling at 1.5670. The CHF lost some ground this week, with the USD strengthening from 0.9117 to slightly above 0.94; EURCHF gently gliding lower from 1.0530 to touch 1.0385 yesterday. JPY has continued its weakening against the USD, moving from 119.18 to 121.50 after being almost unchanged for several weeks. In the emerging markets, the RUB seems to have stabilised around 50 and in Brazil, the Real has remained relatively steady, oscillating around 3.00 – perhaps an equilibrium point for the short term? The Chinese Yuan was almost unchanged on the week at a shade above 6.20.
- The US 10Yr Treasury continued to have a bumpy time, the yields temporarily soared from 2.13% to hit 2.30% and are now heading lower again at 2.17%. The German 10Yr Bund has stabilised around 0.60% after the volatility of last week. The Spanish 10Yr yield opened the week higher to hit 1.885% but slipped back to 1.67% and is now trading around 1.74%. Italian 10Yr followed the same line as Spain, moving back down from 1.93% to be at 1.82% now. In the UK, the yields are slightly higher on the Gilts at 1.93%. Swiss 10Yr yields have remained slightly positive this week, with the bonds yielding 0.023%.
- In general the US equity markets are higher on the week. Both the Dow and the S&P500 have closed higher this week, +0.18% and +0.46% respectively as at yesterday's close, with the NASDAQ being +0.79%. The S&P 500 putting in another new all-time high of 2,134 during yesterday's session. Europe saw the DAX at +3.59%, CAC40 at +2.90% and the UK FTSE at +1.14%. With the Shanghai +0.61% and the Nikkei +2.69%.

Bedrock Newsletter

Highlighted items are interesting data points for the week

MARKET INDICES PERFORMANCE 21/05/2015

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y	
				PRICE CHANGE IN % (unless indicated)								
EQUITY MARKET INDICES - BY REGION												P/E
S&P 500 INDEX	USD	2130.82	0.25	**0.46**	2.17	1.08	0.97	3.26	3.49	12.59	61.84	17.80
DOW JONES INDUS. AVG	USD	18285.74	0.03	**0.18**	2.50	1.37	0.80	2.67	2.60	10.53	46.25	16.35
NASDAQ COMPOSITE INDEX	USD	5090.794	0.38	**0.79**	3.02	1.10	2.72	8.02	7.49	22.54	79.31	19.39
RUSSELL 2000 INDEX	USD	1256.737	-0.07	**0.93**	3.00	-0.69	2.03	7.19	4.32	12.83	65.44	19.06
EURO STOXX 50	EUR	3688.72	0.19	**3.21**	2.00	-0.98	5.65	15.45	17.21	15.69	68.17	15.95
EURO STOXX 600	EUR	407.87	0.41	**2.91**	3.08	-0.24	6.73	18.18	19.11	19.64	66.69	17.18
CAC 40 INDEX	EUR	5146.7	0.26	**3.11**	2.03	-1.19	6.58	18.44	20.51	14.98	66.95	16.68
DAX INDEX	EUR	11864.59	0.14	**3.74**	3.68	0.07	7.46	22.02	21.11	22.16	84.53	14.96
FTSE 100 INDEX	GBP	7013.47	0.17	**1.22**	1.22	0.24	1.88	4.36	7.30	3.30	30.39	16.97
SWISS MARKET INDEX	CHF	9365.35	0.49	**2.68**	3.05	-0.04	5.20	3.01	4.13	7.59	58.27	18.35
NIKKEI 225	JPY	20202.87	0.03	**2.69**	3.81	0.65	10.54	16.75	16.12	41.34	132.14	19.37
HANG SENG INDEX	HKD	27523.72	-0.09	**0.61**	-0.51	0.20	12.72	19.43	18.58	21.94	47.02	13.45
SHANGHAI SE COMPOSITE	CNY	4529.421	1.88	**8.10**	4.86	5.89	43.45	87.29	43.99	130.43	96.25	18.55
S&P BSE SENSEX INDEX	INR	27809.35	-0.10	**2.49**	3.68	0.41	-4.19	-1.16	1.84	14.90	74.74	15.95
RUSSIAN RTS INDEX $	USD	1047.47	1.50	**-2.36**	1.95	4.52	15.26	-0.89	32.71	-20.08	-20.61	6.38
BRAZIL IBOVESPA INDEX	BRL	55112.05	0.38	**-2.73**	-1.99	0.91	7.56	-1.73	10.21	4.37	0.13	12.39
MSCI WORLD	USD	1810.84	0.40	**0.21**	1.82	1.35	2.42	4.24	5.92	7.00	50.92	17.46
MSCI WORLD HEDGED	USD	763.102	0.30	**1.22**	2.17	1.04	3.28	7.66	8.19	16.13	72.71	-
MSCI WORLD LOCAL	-	1368.401	0.28	**1.16**	1.91	0.72	2.56	6.60	7.26	14.13	62.89	-
MSCI AC WORLD	USD	442.7	0.32	**0.08**	1.47	1.05	2.67	4.09	6.13	6.14	45.89	16.79
MSCI EM	USD	1032.7	-0.32	**-1.03**	-1.44	-1.42	4.90	2.82	7.99	-0.82	12.34	12.67
MSCI AC ASIA x JAPAN	USD	621.56	-0.43	**-0.39**	-1.60	-2.16	6.37	9.78	10.26	9.00	31.43	13.21
MSCI EM LATIN AMERICA	USD	2654.1	0.20	**-2.74**	-1.44	0.35	1.01	-15.29	-2.70	-20.59	-22.22	14.69
MSCI EM Eur, ME & Africa	USD	295.71	0.31	**-1.30**	-0.20	2.46	3.09	-5.00	9.21	-12.64	-2.87	11.41
EQUITY MARKET INDICES - BY SECTOR												P/E
MSCI ENERGY	USD	239.84	1.20	**-0.60**	-2.64	-1.37	0.50	-9.92	0.85	-18.66	7.94	23.48
MSCI MATERIALS	USD	237.77	0.53	**-1.05**	1.55	3.19	-0.27	1.85	6.60	-3.69	14.04	17.98
MSCI INDUSTRIALS	USD	209.91	0.61	**0.23**	2.03	1.27	1.19	3.70	5.31	4.19	50.78	17.40
MSCI CONS DISCRETIONARY	USD	203.13	0.33	**0.74**	2.46	1.88	3.13	11.05	9.09	15.34	73.56	18.45
MSCI CONS STAPLES	USD	209.3	0.28	**-0.38**	1.96	0.73	1.24	3.52	4.69	6.15	41.16	20.75
MSCI HEALTH CARE	USD	223.14	0.36	**1.15**	3.75	0.91	5.43	10.51	11.63	22.14	95.27	19.26
MSCI FINANCIALS	USD	107.28	0.17	**-0.01**	1.70	1.89	3.51	3.74	4.40	5.61	60.17	13.97
MSCI INFO TECH	USD	149.77	0.31	**0.44**	2.53	1.53	1.73	6.26	6.01	19.56	60.35	17.76
MSCI TELECOMS	USD	72.84	0.64	**0.33**	0.17	1.97	2.05	1.77	6.55	1.31	34.12	16.58
MSCI UTILITY	USD	119.99	0.14	**0.38**	1.51	2.01	0.47	-1.77	-2.49	0.42	21.44	16.31
MSCI WORLD REAL ESTATE	USD	200.7	-0.17	**-0.86**	0.39	-1.08	-1.74	3.14	3.21	7.70	34.13	25.34

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y
HEDGE FUND INDICES											
HFRX GLOBAL HEDGE FUND	USD	1249.55	0.00	**0.52**	0.27	-0.28	1.35	2.40	2.56	2.24	11.42
HFRX EQUAL WEIGHTED	USD	1219.85	-0.01	**0.33**	0.26	-0.06	1.42	2.31	2.41	1.47	9.87
HFRX GLOBAL EUR	EUR	1150.24	0.00	**0.49**	0.22	-0.38	1.18	2.07	2.28	1.67	9.97

MARKET INDICES PERFORMANCE 21/05/2015

INDEX NAME	CCY	Last Price	1D	5D	MTD	1M	3M	6M	YTD	1Y	3Y	
				PRICE CHANGE IN % (unless indicated)								
FIXED INCOME INDICES - YIELD ON US GOVERNMENT BONDS (Change in bps)												
US 3 MONTH	USD	0.0101	0.00	0.00	0.01	-0.01	-0.01	0.01	-0.03	-0.02	-	
US 2 YEAR	USD	0.5734	0.00	**0.04**	0.01	0.03	-0.06	0.07	-0.09	0.23	-	
US 10 YEAR	USD	2.1758	-0.01	**0.03**	0.14	0.20	0.06	-0.13	0.00	-0.37	-	
FIXED INCOME INDICES - BY TYPE OF ISSUER												Yield to Worst
GLOBAL AGG TR HEDGED	USD	477.47	0.09	**0.26**	-0.86	-1.62	-0.32	1.49	0.40	4.56	11.45	1.62
US GOVERNMENT TR	USD	2086.59	0.28	**0.20**	-0.63	-1.23	0.13	1.16	0.46	2.84	3.51	1.62
US CORPORATE TR	USD	2597.75	0.37	**0.19**	-1.18	-2.26	-0.64	1.31	0.40	2.80	12.73	3.13
US HIGH YIELD TR	USD	1684.08	0.12	**0.11**	0.13	0.08	1.57	2.44	3.89	2.07	26.29	5.98
EU GOVERNMENT TR	EUR	240.67	-0.05	**0.45**	-1.89	-3.05	-1.29	2.43	0.66	8.00	23.28	0.76
EU CORPORATE TR	EUR	246.22	-0.05	**0.29**	-0.65	-1.41	-0.98	1.01	0.26	4.68	20.11	1.13
EU HIGH YIELD TR	EUR	277.6	-0.02	**0.28**	-0.15	0.06	1.00	3.54	3.29	4.85	40.03	3.92
JACI GLOBAL	USD	251.853	0.22	**-0.42**	-0.14	0.78	-2.33	-4.49	-0.59	1.36	25.72	-
GLOBAL EM TR (HEDGED)	USD	333.7708	0.26	**0.39**	0.09	0.28	2.89	2.11	4.19	3.86	19.00	4.66
S&P/LSTA U.S. LEV LOAN	USD	96.5041	0.01	**-0.07**	-0.14	-0.11	0.16	-0.72	1.22	-2.17	3.77	4.81
COMMODITY INDICES - BY TYPE OF ISSUER												
GSCI INDEX TOTAL RETURN	USD	3295.841	1.70	**-0.83**	0.02	4.58	4.78	-19.17	1.95	-34.95	-30.75	
GSCI ENERGY TR	USD	675.806	2.48	**-0.34**	0.22	6.54	7.39	-23.80	7.28	-42.06	-35.64	
GSCI INDUSTRIAL METALS TR	USD	1227.017	0.06	**-3.71**	-5.30	0.91	4.13	-10.82	-3.01	-8.15	-20.46	
GSCI PRECIOUS METALS TR	USD	1495.024	-0.33	**-1.74**	2.30	0.80	0.38	0.68	2.35	-7.52	-27.56	
GSCI AGRICULTURE TR	USD	484.4694	0.45	**-0.99**	0.71	-0.52	-5.19	-10.37	-10.53	-28.81	-30.01	
GENERIC 1ST 'CL' FUTURE	USD	60.72	-0.30	**0.20**	0.30	6.42	12.65	-24.89	6.68	-40.68	-35.47	
GOLD SPOT $/OZ	USD	1206.35	0.46	**-1.00**	2.32	2.07	0.82	0.86	2.28	-6.35	-22.74	
CURRENCIES												
DOLLAR INDEX SPOT	USD	95.255	-0.23	**2.04**	0.46	-2.95	0.83	7.62	5.28	18.42	16.62	
Euro Spot	EUR	1.1112	0.46	**-2.52**	-0.54	4.08	-1.52	-10.28	-7.73	-18.26	-11.99	
Japanese Yen Spot	JPY	121.04	0.24	**-1.24**	-1.13	-0.70	-1.61	-2.05	-0.80	-15.74	-33.78	
British Pound Spot	GBP	1.5662	0.09	**-0.32**	2.12	4.25	1.42	-0.19	0.64	-7.08	-0.55	
Brazilian Real Spot	BRL	3.0382	-1.17	**-1.45**	-0.78	-0.19	-5.25	-17.19	-12.53	-27.35	-32.79	
China Renminbi Spot	CNY	6.1968	-0.04	**0.12**	0.06	-0.07	0.92	-0.92	0.10	0.58	2.00	
Singapore Dollar Spot	SGD	1.3367	0.47	**-0.73**	-0.50	1.32	2.19	-2.07	-0.37	-5.93	-4.25	
Norwegian Krone Spot	NOK	7.57	0.70	**-2.78**	0.20	5.13	1.31	-9.81	-0.87	-20.86	-20.39	
VOLATILITY / LIQUIDITY INDICES												
CBOE SPX VOLATILITY INDX	USD	12.11	-5.98	**-4.95**	-16.77	-4.72	-15.31	-6.12	-36.93	0.67	-46.13	
USD SWAP SPREAD SEMI 2YR		26.19	1.68	**-0.56**	5.22	-0.93	-8.96	16.75	16.09	69.08	-24.69	
TED SPREAD		27.19	1.34	2.26	**-2.47**	5.80	9.90	19.36	23.53	38.02	-32.16	

All data is compiled from Bloomberg

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