Weekly Investment Bulletin

15th October 2012

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Market Roundup:

There was a retraction for most global markets last week.

Worries on earnings and growth hit Asia, with Japan and Singapore 3% and 2% respectively as China advanced on easing hopes. Brazil's central bank cut the country's benchmark interest rate to 7.25% midweek, and indicated it was at the end of its rate-easing cycle. Rates have been progressively cut from 12.5% in August 2011.

In the West, Spain once again caused markets to churn uncomfortably. Ratings agency S&P slapped a 2 notch downgrade on Madrid to BBB- with a negative outlook making it prime for junk status. Ironically, Spanish 10yr debt currently hovers just above 5.5% from over 7.5% in July.

Stateside, there was surprise as the number of U.S. workers who filed new applications for unemployment benefits dropped by 30,000, last week to 339,000, the lowest level in more than 4 years. This complimented last week's jobs numbers as 114,000 new jobs were created and the unemployment rate fell below 8% for the first time during the Obama administration.

As earnings season kicked off, JP Morgan started things on a good note. Earnings for the giant US bank advanced 34% to $5.71 bln, or $1.40 a share, from $4.26 bln, or $1.02, in the year-earlier quarter. Revenue reached $25.15 bln, up 6% from $23.76 bln.

Matters for the EU ended on a PR high as bafflingly the entire bloc won the Nobel Peace Prize. With such social tension on the streets of Madrid and Athens the timing of a 'Peace' prize is nothing short of a mockery.

Market Data (12 month):

S&P 500:

FTSE100:

FTSE Eurofirst 300:

Nikkei 225:

Shanghai Composite:

Source: www.ft.com

QE3's Easter Entrance:

As we have repeatedly said, the market got what it wanted, and got it generously early. The market has traded on news instead of action and so don't expect the QE rocket fuel to propel stock markets for much longer. That's not to say current levels aren't sustainable but like everything, they need fuel.

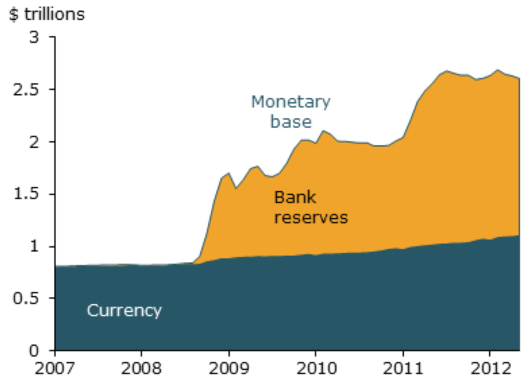
Make no mistake, QE pushes up stock prices, but with the latest version will (should) have a more gradual impact. QE3 will become more and more influential as it grows the size of the Fed's Monetary Base i.e. its own investment portfolio.

The monetary base is the sum of US currency in circulation and bank reserves held at the Federal Reserve. The top chart shows the key components of the monetary base since 2007. Since 2008, the monetary base has risen dramatically, primarily because of a $1.5 tln increase in bank reserves to stave off collapse.

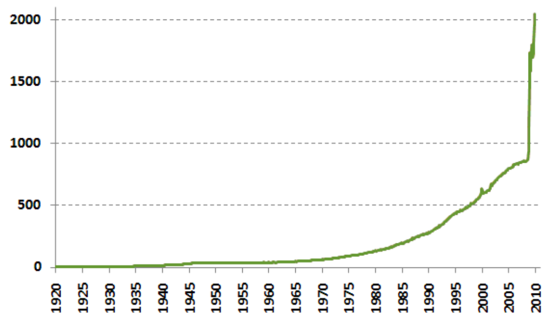
Furthermore banks would rather hold reserves safely at the Fed instead of lending them out in a struggling economy loaded with risk. The opportunity cost of holding reserves is low, while the risks in lending or investing in other assets seem high.

What this shows is that the Monetary Base has not grown since May 2011, which is over 17 months ago. This means that there has been no stimulus from the Fed for nearly a year and a half. We also need to realise that whilst QE3 was announced in mid September, nothing has actually taken place. In fact there appears to be little insight into an exact date as to when the programme will commence.

US Federal Monetary Base Breakdown:



Monetary Base Evolution – US$ Bln:



Source: US Federal Reserve

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Cont:

Therefore, the current QE effect is nothing but emotional and any analysis of QE3 on the economy is rather futile as there hasn't actually been any yet. We still have Operation Twist ongoing as well.

However, should QE3 begin this month, the assumed schedule is $40bln per month. That figure is fairly insignificant, representing less than 1.7% of the total Federal Monetary Base. Also, given Bernanke doesn't seem in much of a hurry, he may not bother for another month.

But assuming the Fed does begin its purchases and we wind forward 6 months to mid April that suddenly takes the increase in Monetary Base from QE3 to $240bln or just over 10%. Beyond that, the numbers get increasingly important and therefore the true effects from QE3 will need to be analysed 6 months after its start date. Whenever that could be..

QE & S&P500:

Source: Barclays Capital

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Currencies:

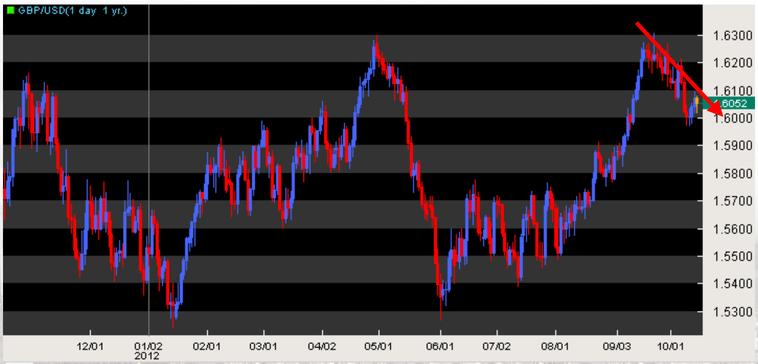
EURUSD

EURUSD stays in a trading range between 1.2803 and 1.3171. Support is at 1.2803, as long as this level holds, uptrend could be expected to resume, and another rise towards 1.3500 is still possible after consolidation.

EURGBP

EURGBP lies at resistance at 0.8114. Initial bias is neutral this week. On the upside, break of 0.8099/0.8114 resistance will confirm resumption of rebound from 0.7755 to 0.8262 next. On the downside, below 0.8022 minor support will bring another fall towards the 0.7922 area.

GBPUSD



GBPUSD's fall from 1.6309 extends to as low as 1.5976. Deeper decline is still possible this week, and the target would be at 1.5900 area. Resistance is at 1.6155, a break above this level could signal completion of the downward movement from 1.6309.

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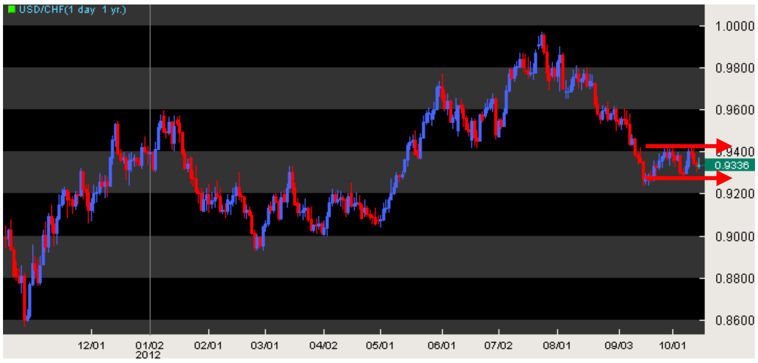
USDCHF



USDCHF now lies in a short term trading range between 0.9239 and 0.9437. Resistance is at 0.9437, a break above will indicate that a further rise to 0.9500-0.9600 area could be seen.

USDJPY

USDJPY is facing the resistance of the downward trend line. A clear break above the trend line resistance will indicate that the fall from 84.17 has completed at 77.14 already, and then the following upward movement could bring price back to 80.00 area.

USD Weighted Index

Three of the four components advanced against the greenback, led by a 0.20 percent rally in the British Pound, and the short-term rebound in the GBPUSD should continue to gather pace. Indeed, the Bank of England Minutes highlights the biggest event risk for the following week, and the policy statement may reinforce a bullish outlook for the sterling as the central bank softens its dovish tone for monetary policy. We may see the Monetary Policy Committee scale back its forecast for undershooting the 2 percent target for inflation, and the board may raise its outlook for the U.K.

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Gold:

Gold Prices have failed to surpass the psychological $1800 level but seem to be able to gather large and quick speculator support at all declines, small or large. It seems that gold prices are looking for a large push, which would likely come in the way of the US fiscal cliff or China hedging its USD exposure. The overall near term outlook still remains bullish with inflationary pressures lingering in an era of ultra lax monetary policy and declines in the US jobless market.

Crude:

Crude is set for its first weekly gain this month as last week's Non Farm Payrolls figure was backed up by better than forecasted unemployment figures in the US. With demand reasserted, one must pay close attention to rising tensions in the Middle East as fears over supply re-ignite. Forecasts predict OPEC will reduce shipments by 0.3% this month. However this is countered by a better than forecasted Crude Oil inventories figure last Thursday. Inventories rose by 1.7m barrels last week as output is reported to be at a 17 year high. The increase in inventories appears to be stemming any possibility of an over inflation of oil prices and will at least provide a buffer to any risk of a disruption in supply.

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Summary:

After the announcement, the dissection begins. Fed Chief Bernanke has had to defend his latest QE programme before the IMF in Tokyo this morning, arguing that this pushes capital flows to emerging economies rather than to its own economy. A clue as to where the most rapid economic transitions are set to take place.

Indeed IMF chief Christine Lagarde is urging Europe to take advantage of the ECBs OMT. Spain so far is the only country to be considering tapping the latest facility. Indeed the reason for avoiding is the harsh deal terms, ie further austerity, at a time when so much has already been bestowed on their respective economies.