Weekly Investment Bulletin

16th July 2012

MITHRIL ASSET MANAGEMENT

Market Roundup:

*****We wish to point out that Mithril Asset Management, Mauritius has no affiliation whatsoever with Mithril Capital Management*****

It was fast becoming a very dreary week for stocks. After 2 weeks of net positive movement, 4 consecutive days of losses condemned markets to their worst week since May. Of course this time around, there was neither a Greek non election, imminent Spanish banking collapse nor the usual speculation of doom in Brussels. The stimuli loving market had also made a muted reaction to intervention from the central banks of the euro zone, UK and China last week. Even a €30bln bailout for the aforementioned Spanish banking sector couldn't lift markets or a €5.25bln Italian debt auction. The latter, despite higher yields was oversubscribed once again and defiant in the face of a confidence shaking downgrade from Moody's to Baa3 with a negative outlook.

China reported its growth had slowed to 7.6% last year from a year earlier period, the slowest pace in 3 years.

US consumer sentiment data dropped to 72 points, down from 73.2 the previous month. Whilst not growth, it's still above its lowest levels and persuaded traders to believe that there is still some life in the American consumer yet.

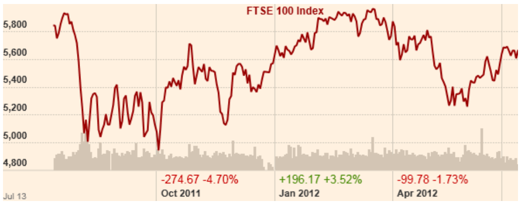
As earnings season kicked off, the much anticipated numbers from JP Morgan showed a $5bln profit, which even was able to include the $4.4bln loss stemming from its credit derivatives desk.

Market activity appears to be more of a valuation play after 4 days of decline. Now that China has played a stimulus card, we await to see what the US will plan..if anything.

Market Data (12 month):

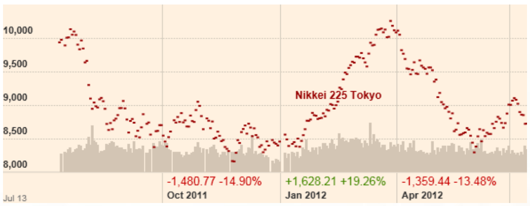
S&P 500:

FTSE100:



FTSE Eurofirst 300:

Nikkei 225:



Shanghai Composite:

Source: www.ft.com

Hungry for QE – but how does it work?

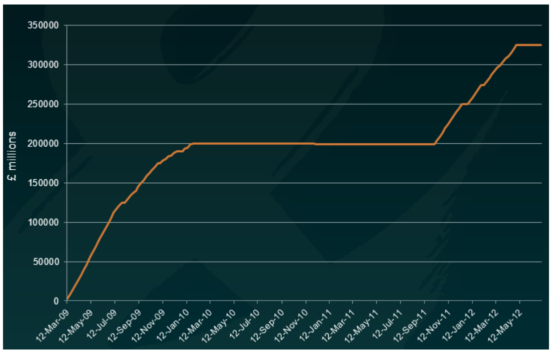
After the Bank of England injected another £50bln into its economy the cries for the US Federal Reserve to follow suit grew more and more profound. Make no mistake the market is desperate for another round of QE (Quantitative Easing) from Washington, most probably without really knowing what it actually entails.

As Mervyn King of the BoE moved to kick start the economy, he did so under the backdrop of historically low interest rates. With the benchmark rate currently at 0.5% policy arsenal is severely hampered as the usual response to economic hardship would be to cut interest rates to incentivise lending and borrowing. The credit crisis of 2008/09 and the ensuing economic slowdown continue to bite, and thus growth is not nearly sufficient to warrant an increase in rates (to then cut if necessary).

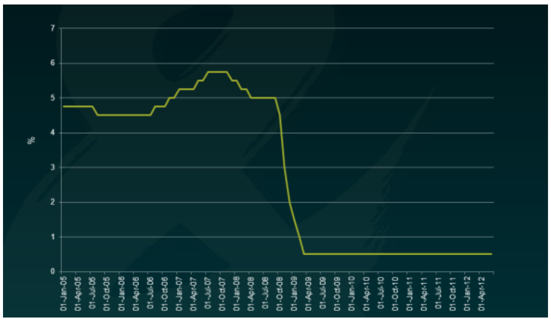
Deprived of its core monetary policy, the only option is to pump money directly into its system. The way central banks do this is by simply buying financial assets of the government or corporate institutions, using money it simply creates from nothing. Normally these financial assets are in the way of debt such as bonds. Those selling the assets such as banks or ailing South European economies are then able to shift these liabilities from their balance sheets (as the reserve bank is now the holder of these assets) , replacing it with fresh cash to then spend or lend.

These days the term 'printing money' is used. Naturally given the electronic nature of modern banking this is no longer the case and will now be numbers on a PC monitor.

Creation of Money via QE in the UK:



Bank of England Official Rate:



Source: M&G investments

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So the aim is to get the institutions lending again and put the multiplier effect into action. Now that a proportion of their liabilities have been bought/removed thanks to QE in exchange for liquidity, they can indeed start lending to businesses and individuals.

From a UK perspective, the first round of QE was said to boost GDP by up to 2% however many analysts feel that it has actually to not be an exercise in stimulating lending but a way for banks to repair their balance sheets and horde cash to stave off bankruptcy.

Also for the central bank to purchase debt instruments such as bonds, it effectively decreases its supply therefore increasing demand. By increasing demand, the price of the remaining bonds in the system increase therefore pushing down their yields. It's these yields by which key lending rates are set.

This is essentially the theory behind the not so exciting Operation Twist by the US Federal Reserve. Operation Twist should, in theory, drive down the interest rate on 10 year bonds (once again by removing supply, the demand for remaining bonds rises, driving down yields and hence helping interest rates to fall). Several other interest rates including mortgages are tied to the 10-year Treasury rate. So this should drive down interest rates across the board, which will affect the entire economy from a corporate to a household level.

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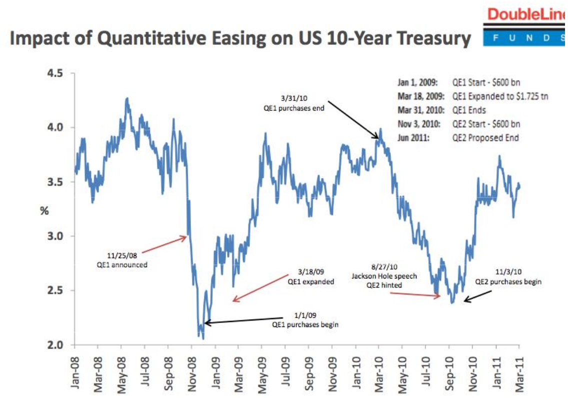
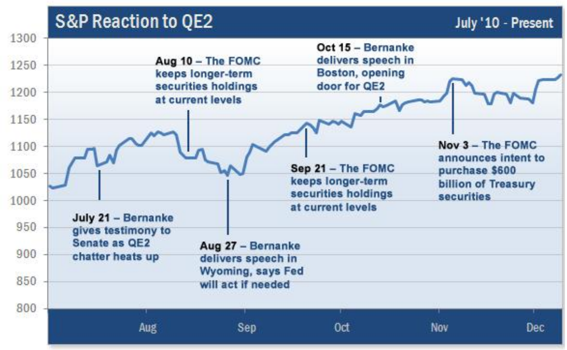


Source: Business Insider



Source: www.listocks.com

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Currencies:

EURUSD

EURUSD's downward movement from 1.3235 extends to as low as 1.2162. Having bounced from that level, resistance is at 1.2350, only breaking above this level will target a further rise to 1.2500-1.2600.

EURGBP

EURGBP remains in downtrend and key support is now at 0.7812. On the upside, a break of 0.7912 resistance should indicate a short term bottom and facilitate a rebound.

GBPUSD

GBPUSD fell to as low as 1.5393 but bounced last week to close above 1.5500. Resistance on the upside is at the 1.5700 area, as long as this level holds, the downtrend could be expected to continue. On the upside, a break above 1.5700 would like see another rise towards 1.6000.

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USDCHF

Uptrend continues from 0.8931 and reached as high as 0.9872. The next target would now be at 1.0000. Support is now at 0.9700, a break below followed by a lengthier consolidation would then test 0.9421 key support.

USDJPY

USDJPY has formed top for the year at 80.61. A break below the red line will target the 76.00 area as the next support. Key resistance is at 80.61, only break above this level could trigger another rise to 83.00 zone.

USD Weighted Index

After general uptrend spanning several months, the USD index pulled back slightly, led by a rally in GBP. Indeed, the Bank of England announced that its new lending program may boost private sector credit by at least GBP 80bln, and the measure may dampen expectations for more quantitative easing amid the stickiness in underlying inflation. At the same time, the Fed's semi-annual monetary report may also prop up USD as the central bank softens its dovish tone for future policy, and we may see Chairman Ben Bernanke talk down speculation for QE3 as growth and inflation moves slowly upward.

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Gold:

Gold appreciated 1.5% Friday to close just under its 50 day MA at $1592. Should the dollar continue to trade lower an inverse relationship with gold should play out here. The next resistance level lies at $1625 followed by $1635, then $1650.

Crude:

Crude finished 1% higher on the day and 3% higher on the week. The 8 day moving average at $85.50 is seen as first support followed by $84 with resistance at $90. Although EU oil consumption will weaken and China's economic growth has slowed relative to prior years, the recent drop in oil prices already more than reflects these headwinds. Moreover, current prices don't reflect the potential for emerging-market oil consumption to pick up in the second half of the year. Investors also shouldn't discount the stimulating effect that lower oil prices will have on the US economy and demand as holiday season approaches.

Summary:

The stimulus cards await China and the US. Profit warnings early this morning from China will likely add pressure from the global investor market to act in some capacity. Keep in mind that China has acted twice in June on its interest rates (most notably both actions were the first since the global financial crisis). It will be unlikely for a 3rd to follow so soon. However should that happen, it will paint a picture that their economy needs more help than we would wish to acknowledge. Annual GDP remains in target and given what has happened in Europe it is hardly surprising that shock and awe figures are scares.

For the US, QE3 or no QE3 will remain one of the primary questions that investors will seek answers to this week. Although the rally in the US dollar against the euro and other major currencies in the last month suggests that bets are being lowered on a third round of stimulus, the inconsistent movements in other markets indicates that many market participants are still undecided.