Weekly Investment Bulletin

18th February 2013

MITHRIL ASSET MANAGEMENT

Market Roundup:

Activity in Asia was light due to public holidays as Chinese and Taiwanese markets were closed for all week. However Hong Kong's Hang Seng began its New Year on an upbeat note, advancing 0.9% when markets re-opened on Thursday.

Japan ended the week flat, yet earnings results from exporters helped indices to gain. Data released on Thursday showed that the economy remained in recession during the last quarter of 2012, contracting by 0.1%.

In Europe, GDP data also served as a reality check for markets, which still had a largely positive week. The European Union statistics agency Eurostat said the economy across the 17-nation shared-currency bloc shrank 0.6% in the fourth quarter of 2012, compared with expectations of a 0.4% decline.

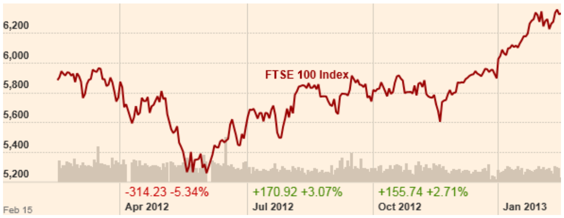
In Germany, GDP for the Q4 shrank 0.6%, while economic activity in France also contracted by 0.3%. Both readings were weaker than expected, stoking fears of a new recession in those countries and the possibility of a rate cut at ECB level.

US markets were also flat for the week. Sentiment was lifted slightly by positive manufacturing data from New York state. US industrial production however fell 0.1% in January, softer than expected. Vehicle assemblies fell back from a new cycle high in the previous month, partly offset by a 3.5% bounce in utility output as colder weather set in. A sizeable upward revision to the post-Hurricane Sandy rebound in Nov-Dec suggests that the surprise 0.1% drop in the preliminary reading of Q4 GDP will be revised away in later estimates.

Market Data (12 month):

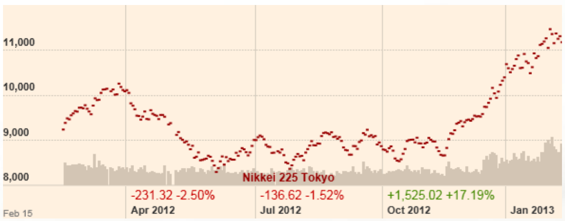
S&P 500:

FTSE100:



FTSE Eurofirst 300:

Nikkei 225:



Shanghai Composite:

Source: www.ft.com

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Market Indicators Suggest US Recession Risk is Low:

When assessing recession risk, how do we expect markets to react? Using history as a guide, we look to the following: stock markets posting negative year on year returns, widening credit spreads, negative treasury yield curve and annual hikes in the oil price.

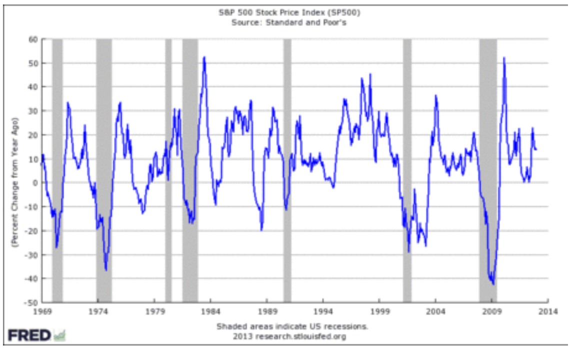
Should those factors exist today, the cyclicality of such matters would be concerning. However that isn't the case at all. Now naturally past performance is never a guarantee to future performance but what we search for is clues. Economic and financial data such as nonfarm payrolls, jobless numbers and industrial and consumer confidence gauges in conjunction with market information can deliver a profile of the current direction.

Indeed financial data, unlike economic data is both current does not get revised months after first release. Imagine the S&P 500 being revised lower in 3 months time. In fact the S&P 500 is offers us a taste of things to come. We should acknowledge that 6 of the last 7 recessions have either preceded or come in tandem with negative stock market performance.

Of course stock markets can still be negative without the onset of recession, which naturally means that one shouldn't treat this indicator in isolation. However from where we stand now versus 12 months ago (check chart on the first page) reaffirms that we are currently in a far stronger position.

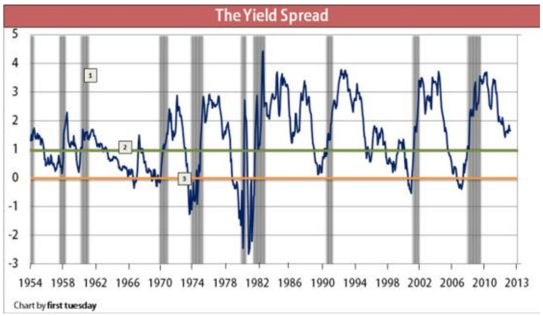
When it comes to credit spreads, when the economy is strong the spread between BB (Junk Bonds) and AAA Bonds or Government treasuries is much lower as the perceived risk of default on payment is lower. The current reading confirms what we have been saying in the past bulletins: the economy will remain on a recovery theme in a muted fashion for the rest of 2013.

S&P500 & US Recessions:



Source: www.seekingalpha.com

Yield Curve Spread & US Recesssions:



Source: www.firsttuesdayjournal.com

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Cont:

We've written about the US Treasury Yield curve in the past. An inverted yield curve is when the yields on bonds with a shorter duration are higher than the yields on bonds that have a longer duration.

In a normal yield curve, the short-term bills yield less than the long-term bonds. That's because investors expect a lower return when their money is tied up for a shorter time period.

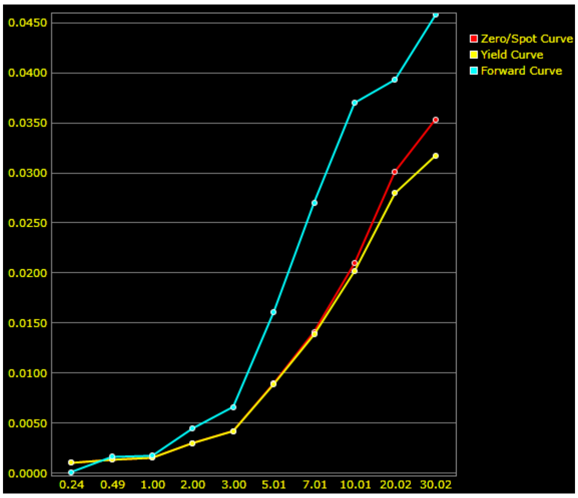
They require a higher yield to give them more return on a long-term investment. Looking to the chart on the right, our yield curve looks un-inverted and holding longer term debt holds greater rewards than short term debt.

When it comes to oil prices, in a nutshell a significant increase here prompts households and businesses to concentrate expenditure here and not elsewhere.

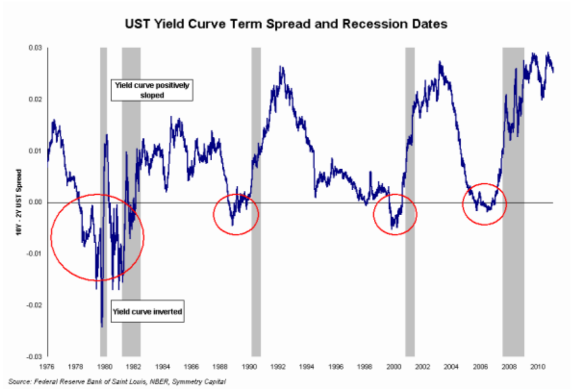
The chart on the 6th page shows that oil prices, whilst steadily increasing on the back of a weakened US dollar, have stubbornly remained below $100. Now all this can change due to supply control which can be affected by geo-political events, inventory levels and supply control.

All in all these 4 key indicators show that the US economy is currently not headed back into recession. Should the debt levels get out of control however, we could have a nasty surprise on our hands and watch the cyclicality of the above get blown out of sync.

Current US Treasury Yield Curve:



US Treasury Yield Spreads and Recessions:



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Currencies:

EURUSD

EURUSD stays above the trend line and remains in uptrend from 1.2100. As long as the trend line support holds, the fall from 1.3711 could be treated as consolidation of the uptrend. A break above 1.3711 should see uptrend resume.

EURGBP

EURGBP recovered to as high as 0.8683 last week but was limited below 0.8716 and lost momentum. Below 0.8570 minor support will indicate that a consolidation pattern from 0.8716 is still in progress and would bring deeper fall to 0.8400 area.

GBPUSD

GBPUSD continued its downward movement from 1.6339, and the fall extended to as low as 1.5462. As long as the trend line resistance holds, further decline could be expected after a minor consolidation, and next target would be at 1.5300 area.

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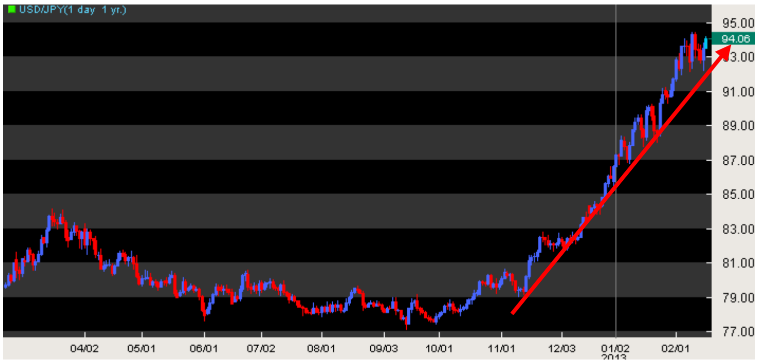
USDCHF

USDCHF remains in a narrowing downward trend from 0.9971. Further rally could be expected, and the target would be at the downward upper trend line on the chart. As long as this resistance holds, the downtrend could be expected to resume, and another fall towards 0.8800 would be the next target on the downside.

USDJPY



USDJPY's upward movement from 79.14 extends to as high as 94.43. Further rise could still be expected after a minor consolidation, and next target would be at 95.00-96.00 area.

USD Weighted Index

Three of the four components weakened against USD, led by a 0.87% decline in the Euro, while the Japanese Yen bucked the trend and rallied 0.40% as the Bank of Japan (BoJ) maintained its current policy this month. However the BoJ tone still remains doveish on monetary policy therefore we will maintain a bearish outlook for the currency.

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Gold:

Gold futures ended Friday's session at a five-month low, falling close to the key USD1,600-level for the first time since August. Indications the U.S. economic recovery was gathering pace also put pressure on prices. Thin volumes from Asia due to public holidays also added to pressure and as gains persist in US equities, the appeal of gold has dampened.

Crude:

Crude oil futures also came under heavy selling pressure on Friday. Sombre news regarding a contraction in Q4 2012 GDP for both Europe and Japan caused concern over oil demand globally. A rally in USD also contributed to pressure on prices.

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Summary:

With the March 1st US debt ceiling deadline approaching, markets are likely to become volatile. Particularly with key indices at multi year highs and US economic data uneven, equities may go through a period of consolidation unless swift intervention and acceptable compromise is reached. US consumer data remains defiant but in Europe the situation still remains unstable. Data on Friday showed that euro zone imports and exports fell sharply in December and over the fourth quarter which makes Europe's return to growth unlikely until Q4 2013 at the earliest.