Weekly Investment Bulletin

9th 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*****

Overall it's been a positive week for equity markets - just. General positivity from European action the previous week helped buoy the major indices and shock/horror allowed some risk appetite to come back into play.

Towards the end of the week the gains began to peter out after a flurry of stimulus measures, which were more coincidental than coordinated. In the space of 45 minutes, the central banks of Europe, UK and China (where much desire for action resonated from investors) moved to jump start their economies.

The ECB cut its benchmark interest rate to a record low to 0.75% in a much expected move to incentivise lending and borrowing. The UK extended its QE program and injected £50bln in electronic money into its system, taking the total program to £375bln, leaving the base rate unchanged at 0.5%. Meanwhile China's second surprise rate cut in a month shows that Beijing wants borrowing to play a greater role in reviving an economy struggling with its weakest pace of growth since the global financial crisis. The benchmark one-year lending rate was cut by 31 basis points to 6% and the one-year deposit rate by 25 basis points to 3%.

Normally so keen to welcome stimuli, markets frowned as the reality of the ongoing task of global recovery hit home hard. Spanish 10 year bond yields crept back above 7%.

US jobs data did little to help on Friday. Hiring slowed notably in the second quarter as (just) 80,000 jobs were created in June. The expected number was more like 100,000. Jobs growth for the second quarter averaged at 75,000 per month compared to a colossal 226,000 for Q1. After the May we have had, can we be surprised?

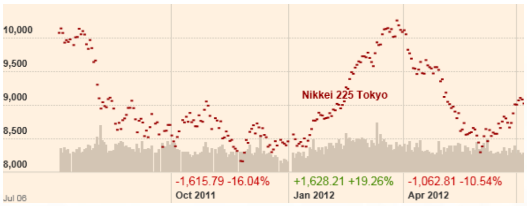
Market Data (12 month):

S&P 500:

FTSE100:

FTSE Eurofirst 300:

Nikkei 225:



Shanghai Composite:

Source: www.ft.com

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The US complex with China:

So it begins. Pantomime season kicks off. Seeking re-election, Barack Obama set off on his neither not so tax payer nor environmentally friendly armoured bus (in a direct reference to the rejuvenated US auto industry, which we focussed on 2 months ago).

Before rolling into Toledo, home of both General Motors and Daimler Chrysler, Obama launched another attack on China, over $3bln owned in duties for US auto exports. Beijing's response was ice cool in comparison to previous swipes from the West, for example when the US imposed steep tariffs on Chinese tires. So ironic it seems how the now revived US auto industry has come along, mostly thanks to imported Chinese parts.

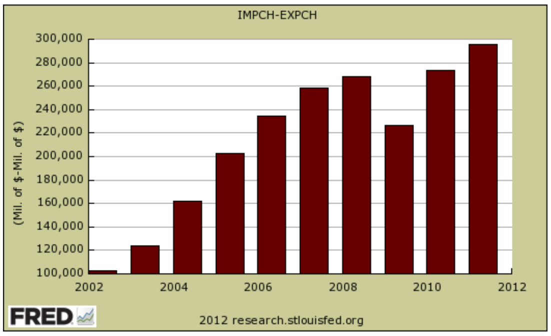
During the US election campaign trail, China it seems is getting from both sides. Where Obama chooses a fair trade angle, Republican candidate Mitt Romney is going the currency route. From emotionally charged editorials to political rallies and commercials about shipping U.S. jobs to China, the attitude is the same: China is to blame for America's economic uncertainty.

US exports to China, where growth is also slowing, fell 14% in April. As previously mentioned China's central bank cut interest rates for the second time in a month (the first rate cuts since the global financial crisis) in a bid to bolster growth. So it's hardly a case of one's pain is another's gain. China has been one of the fastest-growing markets for US goods, and exports to that country were up 4.3% for the first four months of 2012.

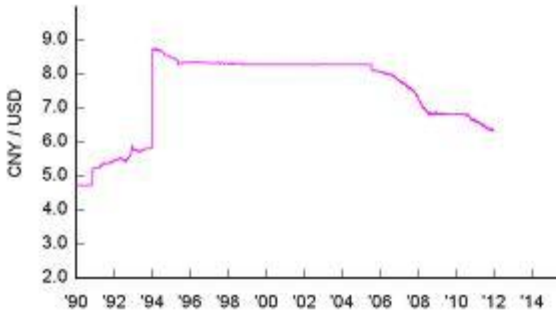
The U.S. bilateral deficit with China hit a record $295 bln for last year. Protectionist sentiments are running high with recent complaints filed with the WTO that China doesn't follow the rules. These efforts are bolstered by repeated calls for the Yuan to be re-valued upwards to offset China's alleged currency manipulation.

However this isn't the true story.

US Trade Deficit with China:



CNYUSD in Real Terms:



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Cont:

From a Chinese perspective, this appears to nothing short of absurd. China's current account surplus has declined from 10 % of GDP five years ago to less than 3% last year. Moreover, Beijing finds it perplexing that after gradually appreciating the Yuan by nearly 40% in real terms since 2005.

Furthermore by focussing ever on the trade imbalance, we fail to look from a global perspective. Chinese policy makers are reminded that the US took a similar approach in complaining decades ago that an undervalued yen was the major reason for Japan's sustained trade surpluses.

The truth is that China's surpluses aren't driving America's deficits. This is illustrated by the differences in timing for when changes to both countries' trade balances occurred. The US trade deficit began increasing rapidly around 1998 and peaked around 2005. China's trade surpluses began increasing around 2005 and peaked in 2008. This pattern suggests that US deficits and China's surpluses aren't directly related, but reflect global shifts and country specific circumstances.

Clearly, "manipulating" the value of the Yuan had little to do with the emergence of China's trade surplus since its value was pegged to the dollar until 2005. And only as the Yuan began to appreciate, did China's surplus increase.

The driving force behind the US deficits and China's surpluses lies not in exchange rates but in structural factors that built up over time. Three factors largely explain the emergence of China's trade surpluses: surging US consumption that fuelled import demand, maturing of the East Asian production sharing network centred on China and an increase of China's savings rates.

Cont:

When President Barack Obama welcomed his counterpart from South Korea to Washington last year, he commented approvingly that South Korea's trade with the U.S. was in balance "as it should be." What Obama should have done was congratulate by noting that South Korea, along with several others, has been able to avoid US criticism by hiding its trade surpluses behind the Great Wall of China.

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Currencies:

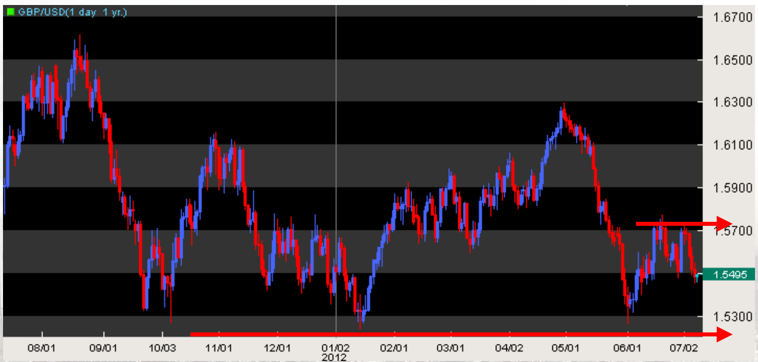
EURUSD

EURUSD broke below 1.2288 previous low, following ECB intervention last week suggesting that the downtrend from 1.45 has resumed. Further decline could be expected this week, and next target would be at 1.2000. Resistance levels are at 1.2500 and then at 1.2747.

EURGBP

EURGBP slumped last week by taking out and reached as low as 0.7924. Further downtrend is likely with near term support now at 0.7812 then 0.7782. Key resistance now lies at 0.7964.

GBPUSD



GBPUSD had formed a cycle top at 1.5776. With BoE's resumption of QE last week, a further decline to test 1.5236 support is likely then the next target would be at 1.5000 area. Key resistance is therefore at the previous 1.5776 near term high.

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USDCHF

USDCHF has broken above 0.9769 previous high resistance level. Further rise is likely with the next target at the 1.0000 area. Key support is now located at 0.9421.

USDJPY

USDJPY remains in uptrend from 77.66. Support is at the upward trend line, as long as this holds a rise towards 83.00 is the next target. On the downside, a clear break below the trend line support could bring the price back to 76.00 area.

USD Weighted Index

With central banks of the eurozone and the UK moving to adjust monetary policy to stimulate growth, it comes as little surprise that the USD index surged last week. This will naturally impact the approach of the Fed this week as to how they react to the situation. Indeed, speculation for additional monetary support resurfaced amid the stunted recovery in the US labour market, but wage growth has ticked upwards and may encourage the Fed to follow suit so soon from quantitative easing as the stickiness in underlying price growth raises the threat for inflation.

Gold:

Gold remains in range. However prices are likely to tick upward as traders will eye possible Fed moves to follow moves from China, the EU and UK to stimulate the economy. Disappointing data concerning Japanese machinery data continued early this morning and will likely fuel speculation that the Fed will move to jolt the economy via easing measures as well. Easing measures such as large-scale bond buybacks from banks tend to weaken gold's traditional hedge, the dollar, to boost recovery.

Crude:

Fears on the cooling economic recovery hit crude. Disappointing economic indicators continued to push oil prices down, especially weak jobs numbers out of the U.S. On the New York Mercantile Exchange, light, sweet crude futures for delivery in August traded at USD84.41 a barrel on Friday, down 0.05%, off from a session high of USD84.50 and up from an earlier session low of USD84.34.

Summary:

So the market which craves action and stimulus shuns once given: a sure sign that the positive movement of the last 7 trading days was quite enough fun for now. For Spain, despite the Pamplona festival, the bulls are not charging here. Markets have also been digesting reports over the past few days that the final agreement opening the EU tap to let €100 billion flow to Spain's troubled banks, could be delayed until July 20, against prior expectations for a deal-signing on today. Spoiling the fiesta further, Finnish Finance Minister Finance Minister said while the country is the committed to the euro, it isn't so keen to pick up the debts and risks of other members. Now imagine if the cries from Berlin grow louder..