Weekly Market Commentary

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Overview A difficult week where most stock indices crept quietly across the page (for a fifth consecutive one), though bank stocks took the Nikkei to 10,170, its highest since October's plunge. The US dollar held within last week's ranges, sterling doing best taking EUR/GBP to £0.8497 and its strongest since December. Treasury yields backed up further still to levels not seen since October or November, some hitting the psychological 4.00%, with two-year maturities moving suddenly out of established ranges so that curves flattened. Benchmark ten and thirty-year British, German and US Treasury bonds now yield close to or just below their averages of the last decade, despite official interest rates at their lowest post-WWII **and** Quantitative Easing. So much for a low interest rate environment to help a world in recession. Money markets recovered their poise after last Friday's upset, yields and futures contracts roughly back to where they have held since mid-May. Many commodities traded higher, Nymex Crude $73.23, LME 3-month Copper $5381 per tonne (highest since October), Aluminium lagging a bit at $1700 (best since December) and CBoT Soybeans $1291 (best September). Baltic Tanker rates are trying to stabilise at their lowest levels in at least ten years.

Political and Economic Developments Brazil slashed its key Selic interest rate 100 basis points to 9.25%, the lowest in a series that started off at 45.00% in 1999, as Q1 GDP shrank by 1.5% (when average growth since 1992 is about 4.00%). Japan's Capital Goods Price Index, calculated since 1961, dropped –5.4% Y/Y to May, close to the record low –6.1% of January 1987. French April Industrial Production collapsed by a record –18.8%, likewise Italy's –24.2%, UK less bad at –12.3% but still almost a forty-year record. Canada's March Capacity Utilisation plunged to 69.3%, the lowest for this series, and US Continuing Weekly Unemployment Claims set a new all-time high of 6.816 million, way above the 4.6 million previous peaks of 1975 and 1982.

Underlying Themes S&P cut Ireland's sovereign credit rating for a second time this year, to AA with a negative outlook from AA+, caused by an increase from €15B to €25B in the estimated costs of bank bailouts. The Swedish Riksbank borrowed €3B from the ECB, as part of a swap agreement, in case it needed more money to bail out its banks' exposure to the Baltic states. This after stress tests said the banks were able to withstand 'extreme' pressures plus a new two-year Eurodollar bond issued by the debt office to beef up its coffers. Next week ten of the US's largest banks will be able to give back $68B of government TARP funds, lifting caps on staff remuneration among other things. But does this mean that these institutions are sound or are they still 'too big to fail'? The latter, unfortunately, plus the added complication of new discrimination between the haves and have-nots is likely to emerge. The US dollar money market is still seized up, Libor rates an indication only of what some would like others to believe, the risk to reputation a highly sensitive issue. Strident calls for transparency, for the need to come clean, for more regulation and so on are understandable but possibly misplaced. If those riddled with problems were to pour out their woes and reveal the full set of horrors in store, let alone provide guesstimates for business going forward, we know who would be the first to run a mile.

What to watch for next week Parliamentary election in Lithuania Sunday. Monday Eurozone Q1 Employment, US April Long-term TIC flows, June Empire State Manufacturing Survey and NAHB Housing Market Index. Tuesday the Bank of Japan MPC sets rates (expected unchanged at 0.10%), Tokyo May Condominium Sales, UK and EZ16 CPI, US PPI, Housing Starts, Industrial Production and Germany's June ZEW Survey. Wednesday UK April Average Earnings, May Unemployment, Minutes from the Bank of England's meeting, EZ16 April Trade Balance, Construction Output, US Q1 Current Account and May CPI. The Norges Bank meets and will probably hold rates at 1.50%. Thursday Tokyo and Nationwide May Department Store Sales, UK Retail Sales, Money Supply, Public Finances, US Leading Indicators, June Philadelphia Fed Survey and CBI Industrial Trends. The Swiss National Bank meets and is expected to keep rates unchanged at 0.25%. Friday just Minutes from the Bank of Japan, German May PPI and Mid-summer's Eve holiday in Scandinavia.

Positioning and Technical Analysis Recent moves in several markets cannot be explained and do not make sense. If the world is already on the road to economic recovery, as many are claiming, how will they manage without good lines of credit? If the banking system is still terribly fragile (as we believe), then why are interest rates rocketing skyward? If the US is likely to be the first to emerge from the mess, then why sell the greenback? We see the back up in yields and stock market rallies since March as corrective and that their long term trends lower should resume imminently. Our outlook for the US dollar is still for generalised weakness, something that does explain in part commodities price rises. Banking is still a mess and its outlook over the short, medium and long term, bleak.

Have a nice weekend!

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