Investors can't ignore gold for very much longer

Equities based on yellow metal selling at a discount offer a pointer

ASSET MANAGEMENT

By Sean Kelleher
Special to Gulf News

Last week we dropped the "risk off" bomb. Today, with the help of Eric Meyer, hedge fund stalwart and the driver behind DSAM's Kauthar Gold Fund, the Middle East and North Africa's (Mena) top performing fund over the last three years, the message gets worse. Let's start with his rhetorical question: "Where are your investors when the music stops playing?"

"The music" to which Meyer refers is that of Western governments and their ability (inability?) to manage their own economies. Admittedly, Meyer has a keen interest in the "Doomsday View" because after a Lehman-esque "2008 and all that", Global Collapse No 2 would suggest that the asset class with the greatest benefit would be gold. The traditional safe haven at global crash time.

Yet Meyer is not only pro-gold, he is pro-gold equities, currently at a discount of 50 per cent to the gold price. The only other time such a discrepancy occurred was, guess when: in the fourth quarter of 2008, post Lehman's. "We believe that gold equities will revert to their mean," says Meyer in explaining the current opportunity in distress.

For gold and its miners to benefit, there needs to be bad news elsewhere. The doomsday scenario emerges out of a pincer collapse of Europe on the one hand and the US on the other. Both current scenarios look bleak; Meyer sees a commonality in serious political mismanagement. Proof he says that "democracy isn't all that great". However, the worst is yet to come.

Debt repayments

To Meyer, "we have been kicking the can [of debt] down the road too long", where the road is putting debt repayments off for a future date. "We Americans have kicked the can down to December and we can't kick it any further until the $7 trillion (Dh25.70 trillion) has been dealt with. It means that November and December will be actioned-packed and dramatic." For those who view December 2012 as a long way off, Meyer has a more imminent doomsday scenario painted for Europe. Indeed, it could all start this afternoon if the French decide to play their politics down the right wing, instead of a more pro-German formation.

Political factors

A Hollande victory, Meyer believes, opposes a financial policy based only on austerity and has promised to renegotiate the European Fiscal Compact. If France negotiates, says Meyer, why wouldn't Spain, Portugal, Greece, Italy et al?

Meyer concludes: "If France starts spending, it will have to borrow. If Hollande sticks to his campaign promise, the euro is dead. You heard it here first".

If the pro-German Sarkozy wins, Europe's troubles don't disappear, they just get re-focused onto Spain!

The upside to all this calamity, for Meyer, is gold's traditional safe haven status. "Investors should be looking for a higher element of investment insurance at this point in time, and our conviction is that gold will flourish during this uncertainty."

The writer is Chairman of Mondial Financial Partners.

DOOMSDAY SCENARIOS

AMERICAN EXIGENCY

Doomsday in the US suggests that the US has a 'date with destiny' somewhere around November (elections) and December (deficit discussions).

- President Barack Obama has increased the national debt by an average of $4.24 billion per day (US treasury).
- Obama is on course to accumulate more debt than all the US presidents between George Washington and Bill Clinton before the end of this term.
- In December, the US needs to organise around $7 trillion of debt. Issues that need attention to manage that figure include:

1. Borrowings will reach the federal debt limit
2. The expiration of George W. Bush tax cuts on income, capital gains, and dividends
3. The expiration of payroll tax cut
4. The expiration of alternative minimum tax rate
5. The extension of the $1.1-trillion deficit-reduction plan comes due (postponed from Aug of 2011)

EUROPE'S SPIRAL

- George Soros has indicated the euro crisis is worse than earlier estimations.

Only last month, Soros increased his exposure to gold equities.

- John Paulson believes the euro is "structurally flawed".

Paulson invested $1.2 billion in a long/short gold fund last month.

- Nouriel Roubini has said more European countries will be forced to restructure debt.

He recommended gold last month.

- If Spain seek debt financing, it will be the Eurozone's fourth largest economy asking for money — an economy needing to borrow 20.9 per cent of GDP with a 22.4 per cent unemployment rate.

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Rating agencies balance region's culture with Western expectations

REQUIREMENTS HAVE HELPED ENHANCE TRANSPARENCY AND DISCIPLINE

ANALYSIS

By Andrew Shouler
Financial Correspondent

AFP

International standards

The Kuwait Stock Exchange. The enhanced presence of rating agencies in the region and the growth of ratings for GCC entities might still be taken as an indication of the Gulf's internationalisation.

The rating agencies came in for a bit of a rough ride over the course of the global financial crisis, but their enhanced presence in the region and the growth of ratings for GCC entities might still be taken as an indication of the Gulf's internationalisation. That, presumably, is still believed to be a good thing.

Yet, to the extent that foreign funding is sought for local projects, engaging with its providers is required. Even if the intrinsic mechanisms and assumptions of the ratings architecture can be debated, borrowers usually don't dictate the terms of borrowing, and especially not in an environment where the word risk has assumed mammoth proportions.

Sensitivities undoubtedly rose over such matters, notably in the US and Europe. In the Gulf too, the idea of a degree of cultural mismatch as well as material differences might still be in evidence.

When this writer toured the region in the mid-90s as part of a research team conducting due diligence for an international bank, I well remember that whereas most meetings were cordial, one or two had an air of friction, as the hosts felt no need to disclose so much about their implied backing from the state.

Much was to be assumed and left unstipulated. Visiting lenders would struggle to align their findings with Western expectations of hard data and confirmed, formal relationships, while keen to be marketing their wares in a region flush with implicit, resource-based collateral.

It would seem there is still scope today for misaligned views. Still, the experience of having the agencies around has doubtless elicited some measure of change in corporate behaviour.

So what do the rating agencies themselves have to say in this regard?

Stuart Anderson, regional head, Middle East at Standard & Poor's, reaffirms the benchmarking notion in asserting "the ratings we apply to GCC issuers are based on a global rating scale in terms of criteria and methodology, a critical requirement for international investors who need to judge relative credit quality and default risk".

Advantage

In other words, exceptionalism isn't really viable on a continuing basis. But that's to the region's advantage, rather than a drawback, he insists.

"Through ratings, regional corporates have been able to diversify funding sources and debt maturity profiles. For example, Majid Al Futtaim's rated sukuk issuance in February this year may be regarded as an important transaction for a private group that has transitioned successfully in terms of corporate governance, disclosure and financial management."

Jay Leitner, Fitch Ratings's Head of Business and Relationship Management for the Middle East and Sub-Saharan Africa region, confirms the sense of an upward trend. "During the last four years our ratings coverage in the Middle East has increased by 21 per cent, driven primarily by demand from the non-financial corporate sector, where coverage has grown 58 per cent. Despite the global financial crisis and the Gulf's own business cycle, there is strong demand for Middle East ratings from investors around the globe."

Moreover, local interest is trickling down, it seems, enhancing transparency and discipline. Whilst the larger corporate players were always aware of the implications of [seeking] a rating, "we are now also seeing an increase in both communication and good practice from medium-size companies too," he says.

David Staples, Managing Director of EMEA (Europe, the Middle East and Africa) Corporate Ratings at Moody's, Dubai draws another distinction, between two diverging paths.

"The GCC corporates whose ratings have remained broadly stable are those characterised by (i) strong linkages to sovereigns from both a strategic policy and ownership perspective; (ii) strong financial profiles and substantial financial flexibility; and where (iii) the willingness by the sovereign to provide ongoing operational financial policy support as well as potentially extraordinary support remains unquestioned."

Corporates

He cites the state-owned corporates in Qatar, Abu Dhabi and Saudi Arabia — specifically those involved in the utilities, telecoms & infrastructure, and industrial & strategic investment holding sectors.

"In the other category, there has been meaningful downward pressure on ratings among certain private firms, "in particular those that are more directly exposed to local, regional and global macroeconomic developments and that have experienced substantial volatility and declines in asset valuations".

So the business may be evolving for the better, but there remains an underlying belief as to the ultimate source of creditworthiness in the Gulf.

POSITIVE NOTE

RATINGS UPTURN

It's a reflection of the attention given to rating requirements and the improving business condition locally that corporate entities that have addressed their weaker liquidity profiles and refinancing exposures have seen upgrades over the past year.

Developments in corporate ratings in Dubai are a particularly relevant example, according to David Staples, Managing Director of EMEA Corporate Ratings at Moody's.

By way of illustration, he refers selectively to DP World, Emaar Properties, Dubai Electricity and Water Authority (Dewa) and Dubai Holding Commercial Operations Group, upgraded by the agency in turn between April 2011 and January 2012, and each now with stable outlooks.

— A.S.

Copper falls to lowest in a week

Slowdowns in the US and China spark worries about the health of global economy

New York/London *(Reuters)* Copper fell to its lowest level in more than a week on Friday as a second-straight month of soft US employment growth fed worries about the health of the global economy, while tight supplies of the metal outside of China kept losses in check.

Copper fell 3 per cent for the week, snapping two straight weeks of gains and falling in line with other growth-sensitive markets like equities and crude oil. Those markets fell after the Labour Department said US employers cut back on hiring in April more than expected.

Copper's losses paled in comparison with crude oil, which plunged over 3 per cent to trade below $100 for the first time since February.

Reuters

Fading allure

Copper hosing is inspected at a factory in Sao Paulo. Copper registered a 3 per cent drop for the week, snapping two straight weeks of gains and falling in line with other growth-sensitive markets like equities and crude oil.

Slowing

"At their highs in March and April, the stock market and energy markets were pricing in a much stronger economy. Copper never really priced in that strong of an economy, so it doesn't have as much to take out," said James Bianco, president of Bianco Research Group in Chicago.

"You've got the US economy slowing, the Chinese economy slowing ... that's why we're nowhere near $4.50 per pound or why we never got over $4 this year."

London Metal Exchange (LME) benchmark copper plumbed an intra-day low at $8,146 per tonne, its cheapest level since April 25, before ending the day with a $54 loss at $8,175.

In New York, the Comex July contract fell 1.50 cents to settle at $3.7210 per pound after dealing between $3.7025 and $3.7550.

Volumes remained on the light side, with a little more than 54,000 lots traded late in New York — about a third below the 30-day norm, according to preliminary Thomson Reuters data.

US employers added just 115,000 workers to payrolls last month, or 55,000 less than economists expected. The unemployment rate fell to a three-year low at 8.1 per cent, but only because the workforce shrank as people retired or stopped looking for work.

"The macro numbers are becoming worse, especially in the US, so it's going to be difficult for a lot of these metals to hold up," Edward Meir, an analyst at INTL FCStone, said.

"The French elections will also be important, because then the euro might move on that and give the market a bit more direction," he said, referring to polls over the weekend.

Market players said they expect large Chinese copper smelters and trading firms to export refined copper cathodes to LME-registered warehouses over the next two months to help ease tight global supplies and trim near-record stockpiles at home.

As a result, thousands of tonnes of refined copper could go into LME warehouses, boosting inventories and slashing steep premiums of spot prices over those for later deliveries.

CORPORATE BONDS

Goldman plans online bond trading

Fifth-biggest US bank adapts to regulatory changes and competition

New York *(Bloomberg)* Goldman Sachs Group will start an electronic trading system for corporate bonds this month as the fifth-biggest US bank adapts to regulatory changes and competition, according to a person familiar with the plans.

The platform, called GSessions, has been under development for a year, said the person, who declined to be identified because the New York-based firm isn't making details public yet. The *Wall Street Journal* reported the initiative on its website.

The move comes three weeks after BlackRock, the world's largest money manager, said it was planning its own bond-trading platform called Aladdin Trading Network that would allow clients to bypass Wall Street firms such as Goldman Sachs. Last year, Goldman Sachs's revenue from market making and principal investments in credit, including corporate debt and derivatives, fell to $2.72 billion (Dh10 billion) from $8.68 billion in 2010, according to a regulatory filing.

The profitability of Wall Street firms is being challenged by regulations requiring that they hold more capital as a buffer against potential losses from assets such as corporate debt. A US law that seeks to prohibit federally insured banks from making bets with their own money may also hinder lenders' ability to commit money to buy securities from clients, according to analysts including Brad Hintz at Sanford C. Bernstein & Co.

In presentations over the past two years, Goldman Sachs executives have said the firm succeeded in developing electronic trading capabilities in the stock and currency markets and were also preparing for a higher percentage of fixed-income trading becoming computerised.

Connectivity

"Connectivity with clients and what we call owning the desktop is going to be very, very important," Chief Financial Officer David A. Viniar said in a presentation in February 2011.

"Having those capabilities, having first-mover advantage, we think is going to be key coming out after the new regulations."

GSessions will start by offering two five-minute trading sessions a day, one in an investment-grade bond and another in a high-yield, high-risk security, the person said. Speculative-grade, or junk, bonds are rated below Baa3 by Moody's Investors Service and lower than BBB- at Standard & Poor's.

At the start of each session, Goldman Sachs will post a bid and offer price and notify clients of the maximum amount of liquidity the firm is willing to provide to fill orders, according to the person.

Rather than matching trades between clients, Goldman Sachs will act as the counterparty to all trades and collect the spread, or difference, between the bid and offer prices, the person said. That gap will be lower than what Goldman Sachs earns on non-computerised trades, the person said.

BlackRock, based in New York, said on April 12 that it was creating Aladdin Trading Network to lower trading costs for customers. BlackRock is awaiting approval from the Securities and Exchange Commission for its platform. Brian Beades, a spokesman for BlackRock in New York, declined to comment.

Information

MarketAxess Holdings's electronic trading system for US and European investment-grade, emerging markets and other types of bonds said last month that it had a record $58.7 billion of transactions during March. Other electronic trading systems for fixed income include Tradeweb Markets and Bloomberg, the parent company of Bloomberg News, which also provides news and information to the financial community.

CHALLENGE

INCOME DOWN

$2.72b	$8.68b	$58.7b
market making and principal investment revenue	company's revenue from the sector in 2010	transactions recorded in March