AMG 安柏 FINANCIAL GROUP

AMG Market Commentary

October 2013

The U.S. Fiscal Problem Was Just Settled Temporarily, The Problem Will Extend to Year 2014

The dispute in U.S. Congress was a mess in the past month. Democratic and Republican have agreed to fund the federal government and raise the debt ceiling just right before the deadline (before 17 Oct 2013).

However, it is just a very short-term solution as it only allows funding the federal government to Jan 15 and extending the government's ability to borrow to Feb 7. Thus, it is likely that we will see the next round of fiscal dispute in early 2014.

Before the agreement reached between the Democratic and Republican, the U.S. Government was shut down for 16 days due to lack of funding. It is the first time since 1996. The last government shutdown was happened when Bill Clinton was the President. The shutdown lasted for 4 weeks. It was also caused by the disagreement between the Democratic and Republican over the fiscal budget. According to the forecast from economists, it will cost U.S. economy about US$1.5 billion per day from the government shutdown. In sum, the recent 16-day shutdown will be equivalent to 0.6% of the Q4 GDP growth.

However, the impact is significantly smaller than the possible consequence if the U.S. government failed to raise the debt ceiling before the deadline. It is because the government shutdown only hurt the GDP growth by at most 1% and its impact will be lasted to just Q4 2013 or at most Q1 2014. However, if the U.S. government failed to raise the debt ceiling before the deadline, it will affect the government's ability to repay debt. In history, U.S. government did not have any experience of not repaying its debt. Thus, if the U.S. government failed to do so, it will cause an unexpected shock to investors. It will be a disaster to the U.S. economy as well as the global financial market. Luckily, both parties realized the seriousness and reached a solution (though it is just a short-term solution) before the deadline and avoided any possible default and financial crisis to happen.

As a result, investors may become more optimistic in short-term

Although it is just a short-term solution, it is still a positive factor to the market as it took out one of the biggest uncertainties in the market. On the other hand, as it is likely that we will see the next round of fiscal dispute in early 2014, most investors think that the U.S. Fed may extend the observation period and delay the launch of tapering. A later start of tapering, of course, will be another positive factor to the stock market.

The Fiscal Dispute Will Be Extended to Year 2014

We expect investors will remain optimistic to Dec 2013. However, please reminder that the fiscal dispute is just extended rather than settled. The problem will occur again in the beginning of next year and become an uncertainty again to the U.S. economy and the global financial market. Thus, investors should pay attention to it again starting from Dec 2013.

Market Review & Outlook

U.S. Economy & Financial Market

U.S. fiscal dispute should be regarded as the main factor affecting the economic outlook at this moment. Although the U.S. Congress has eventually found the solution (but it is just a short-term one), the U.S. economy was already being hurt. The 16-day government shutdown will cost the U.S. economy by about US$20 billion and we expect the Q4 GDP growth will be lowered by 0.5%.

The employment market was also affected by the government shutdown. For example, the weekly initial job-less claims was in average 361 thousands in Oct which is much higher than the TYD average of 347 thousands. Although the rising claims were partially due to the compute problem happened in California, it was more or less related to the fiscal dispute and the government shutdown.

We are confident that the above negative impact on economy will not last long and it will not have any impact to the long-term economic growth potential. But, we need to be ready another fiscal dispute will happen again in the beginning of next year and have a good preparation before it really come.

For stock market, we expect it will have a good performance in the coming 2-3 weeks because investors become more optimistic due to the removal of the uncertainty from fiscal problem (though it is just a temporary removal) and the later than expected tapering from the U.S. Fed.

U.S. Initial Jobless Claims – Affected by the U.S. fiscal dispute, the jobless claims have increased from 300-320 thousands in Aug & Sept to more than 350 thousands in Oct

Sources: Bloomberg

U.S. GDP Growth – Affected by the fiscal dispute, the Q4 GDP Growth may be lowered to less than 2%

Sources: Bloomberg

EU Economy and Financial Market

Economic figures continue to show the economic recovery in EU is stronger and stronger. For example, the PMI Manufacturing Index was improving; Spain has recorded GDP growth (QOQ) since Q2 2011. All of them lead to investors having a more positive view on EU.

PMI Manufacturing Index for EU countries

	Oct 2013	Sept 2013	Aug 2013	Oct 2012	Sept 2012
Germany	51.5	51.1		46.0	
France	49.4	49.8		43.7	
Italy		50.8	51.3		45.7
EU	51.3	51.1		45.4	

Sources: Bloomberg

Instead of just focusing on economic outlook, investors also started to concern about the health of the banking sector. It is because ECB will launch a "stress test" to banks located in EU starting from early 2014. There will be about 100 banks being tested. Among them, 24 banks will be come from Germany, 16 in Spain, 15 in Italy, 13 in France, 7 in the Netherlands, 5 in Ireland and 4 each in Greece, Cyprus and Portugal. The test will mainly focus on the capital ratio and see if any capital raising is needed. It is expected that if ECB is using a tougher test criteria, banks will need to raise EUR 50 billion in total. Although the number is not that big or unacceptable, we are afraid that it may turn out to be a negative factor to the EU economic growth or financial stability. To be honest, it is good for investors if ECB can tell them which bank is good and which bank is bad. However, it can easily lead to a confidence crisis as bad banks are labeled. Those bad banks need to raise more capital (according to the requirement from ECB) by issuing more shares in the market. However, it is not sure whether there is sufficient demand. If not, the government may be required to provide the assistance and it will once again affect the fiscal health of the government. Besides, apart from raising more capital, it is highly possible that those bad banks will at the same time suffer from capital outflow from existing investors due to market panic. All of them may eventually trigger another round of EU Debt Crisis.

However, we expect the stock markets in Europe can remain their strong performance at least in the coming 1-2 months. They are mainly supported by the expectation of a possible economic recovery.

EU PMI Manufacturing Index - The index has rebounded to above 50 starting from July 2013. It is the 1st time for the index to be over 50 (above 50 means the sector is expanding) since July 2011.

Sources: Bloomberg

Japanese Economy & Financial Market

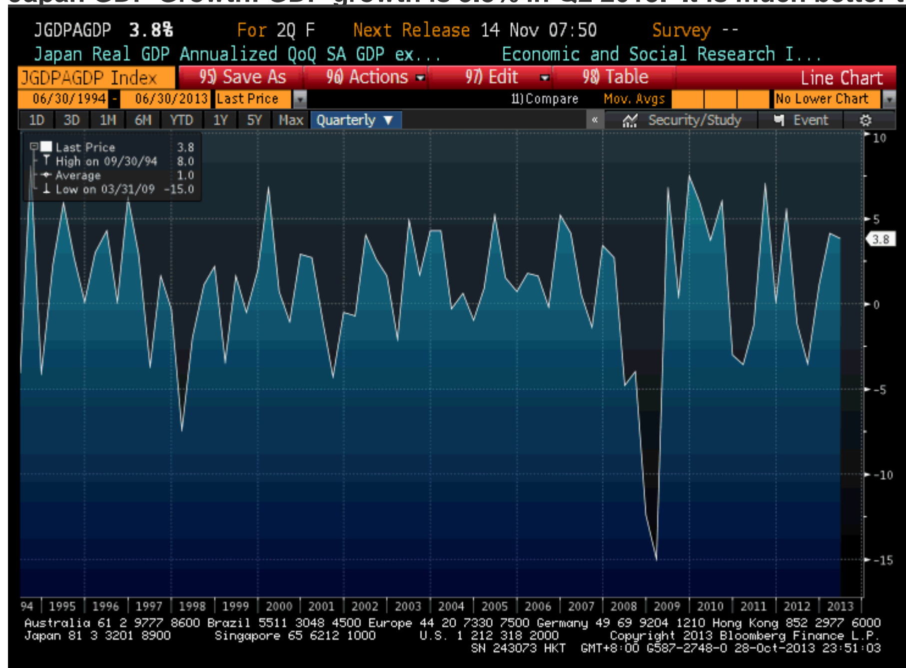
We regard monetary policy as the major factor affecting Japanese economic growth and the stock market performance. Although investors kept on expecting BOJ to enhance its monetary policy, BOJ stayed calm and remained its policy unchanged in the past few months. It is because BOJ think that the existing monetary policies are already functioning and having a positive impact to the economic growth as well as to the inflation expectation.

The Tankan Survey has shown the continuous improvement in the manufacturing sector. The Manufacturing Index has increased from -12 in Q4 2012 to +12 in Q3 2013. The GDP growth was 3.8% in Q2 2013 which is much stronger than the 20-year average of 1%. CPI was 1.1% in Sept 2013. Although CPI figure is still below the official target of 2%, it is still at the high level in the past decade and obviously overcome the problem of deflation.

We think that the ups and downs of JPY will still be the most important factor affecting the performance of the Japanese stock market. We expect JPY will remain at the current low level for the coming 6-12 months. The

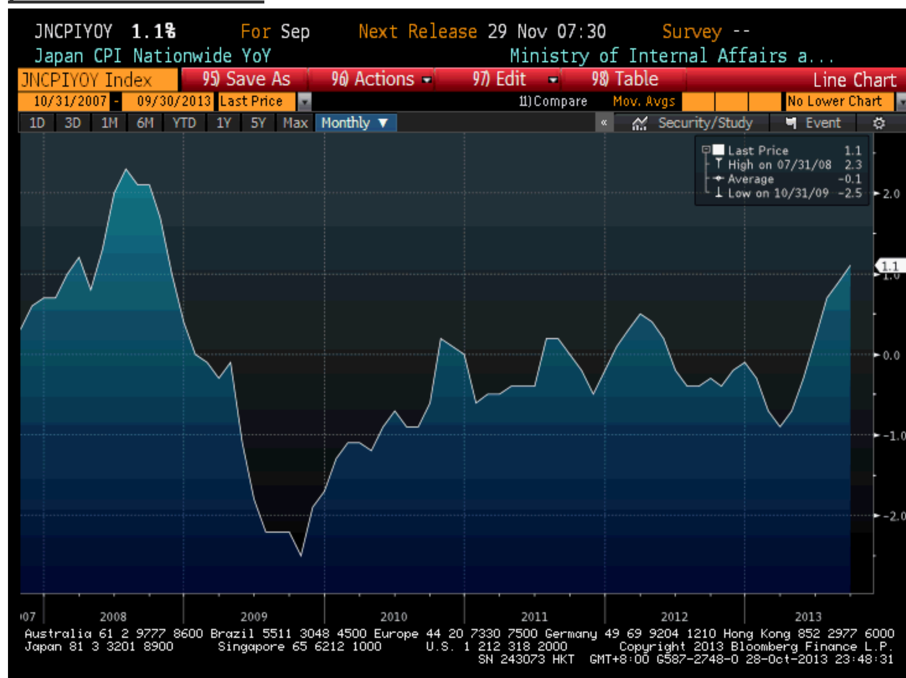
weak JPY will be a positive factor to the Japanese economy as well as the stock market. It is because a lower JPY will enhance the competitiveness for the export sector and will increase the earnings for the exporting companies.

Japan GDP Growth: GDP growth is 3.8% in Q2 2013. It is much better than the 20-year average of 1%.



Sources: Bloomberg

Japan CPI: CPI is 1.1% in Sept 2013. It is at the high level in the past decade and obviously overcome the problem of deflation



Sources: Bloomberg

Japanese Yen: We expect the Yen will remain weak in the coming 6-12 months. It will be a positive factor to the economic growth and stock market performance

Sources: Bloomberg

China Economy and Financial Market:

Although we have seen some stronger economic figures, the China economic growth remains slowing in the past months. Government policies remain the main uncertainty to the economic outlook. The new government leadership is quite different to the previous ones. Unlike the previous leadership, the new leadership did not provide any help to stimulate the economy even though the economy keeps on slowing. In contrast, they continue to implement the economic reforms which may further lower the economic growth in the short-term future (though the reforms are necessary and good for long-term economic growth). As a result, it significantly affects the performance of both HK and China stock market.

The stock market in Mainland China remains underperform in the past months. However, the stock market in HK has seen some rebounds. It is because investors are encouraged by the better than expected economic figures announced recently. However, please pay attention that it is still unclear whether the China economy has already bottomed and thus investors' optimistic outlook can quickly disappear.

China PMI Manufacturing Index: The figure has slightly improved in Sept 2013. However, it is still around 50 (above 50 means the sector is expanding) and may drop below 50 in the future.

Sources: Bloomberg

The performance for HK stock market is better than the China stock market in the past months.

Sources: Bloomberg

Economy and Financial Market in Emerging Countries

Most emerging markets have rebounded since Sept from the big loss suffered during June to Aug in 2013. During June to Aug, most emerging markets have suffered a big loss in their stock, bond and currency market due to the capital outflows accelerated by the expectation of a possible tapering from Fed in Sept. Since Sept, most emerging markets have recorded a significant rebound due to the slowdown of capital outflows as the Fed did not start its tapering as expected in Sept.

As the Fed did not start the tapering as expected in Sept, investors were happy and started to reposition their wealth back to riskier investment, such as stock, bond or currency in emerging markets. In Sept and Oct, most emerging stock markets have recorded 10%+ return. Apart from good stock market performance, most emerging countries have also recorded a sharp rebound in their currencies. Thus, although the rebounds in Sept and Oct may not be large enough to offset the drop suffered in June to Aug, the markets have rebounded a lot when compare to the bottom happened in June to Aug.

Stock Performance in Sept and Oct

	Sept - Oct	June to Oct
India	10.7%	4.8%
Brazil	10.1%	2.9%
Russia	15.7%	12.7%
South Africa	8.3%	9.5%
Indonesia	9.5%	-8.7%
Thailand	12.3%	-6.2%

Sources: Bloomberg

Fx Performance in Sept and Oct

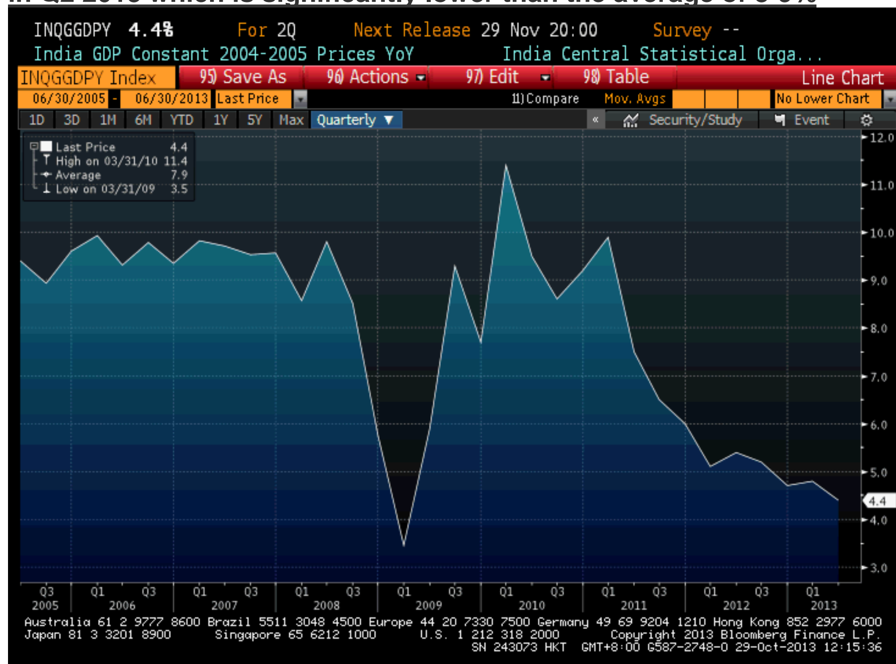
	Sept to Oct	June to Oct
India	6.4%	-8.8%
Brazil	8.6%	-1.7%
Russia	4.0%	-0.3%
South Africa	4.2%	2.3%
Indonesia	0.7%	-12.3%
Thailand	3.3%	-2.3%

Sources: Bloomberg

Although the worst time for emerging markets may be over, we keep on having a cautious view on some emerging markets, such as Brazil and India. It is because there are some problems in their long-term economic growth. Besides, these economies are also suffering from inflation problem which make their government difficult to adjust their economic policy to stimulate the economy. For example, if the government wants to implement an expansionary policy to stimulate economic growth, it may at the same time increase the inflation pressure and

further worsen its inflation problem. In contrast, if the government wants to fight the inflation problem by implementing a contractionary policy, it can lower the inflation pressure but will hurt the economic growth.

India GDP Growth: GDP growth rate has dropped continuously since 2011. The growth rate was 4.4% only in Q2 2013 which is significantly lower than the average of 8-9%



Sources: Bloomberg

India CPI: The inflation pressure is increasing in the past months. It is especially more significant after the Indian Rupee has depreciated sharply this year (the depreciation of Indian Rupee has increased the import cost for India)

Sources: Bloomberg

Commodities

Oil Price - The oil price has continued to correct in the past month. It was due to the stability of political issue in the Middle East. Since June, the political issue in Syria has aroused investors' concern (afraid it may affect the supply of oil from Middle East) and pushed up the oil price. The oil price has broken the US$100 level and increased to US$110. However, since the political conflict in Syria has not resulted into military affairs, investors become less worry and the so-called "risk premium" has reduced. We think that the reasonable price for oil should be between US$90-100 if the risk from Syria is ignored. We expect the impact from Syria issue will become lesser and lesser and the oil price will return to normal and determined by the global demand and supply. Since the

global economic growth is still relative weak at this moment (& will limit the growth in demand), we expect the short-term upside for oil price is relatively limited.

Oil Price: Since the political conflict in Syria has not resulted into military affairs, investors become less worry and the so-called "risk premium" has reduced

Sources: Bloomberg

Gold – The gold price has a substantially rebound in the past few days due to the expectation that the Fed will delay its tapering because of the concern of the negative impact from the fiscal dispute. The gold price has rebounded from 1,300 in mid-Oct to 1,350 on 29 Oct. However, we tend to be less optimistic on gold as capital is still flowing out from the gold market. For example, the shares outstanding for the biggest GOLD ETF have continued to decrease. It reflects that capital is continuous to flow out from the gold market.

Gold Price: Although the gold price has rebounded recently, capital is still flowing out from the gold market

Sources: Bloomberg

Shares Outstanding for Gold ETF: The shares outstanding for the biggest GOLD ETF have continued to decrease. It reflects that capital is continuous to flow out from the gold market.

Sources: Bloomberg

* Unless otherwise stated, all figures and information are collected from WSJ, Bloomberg or Haver Analytics.

Important Note & Disclaimer:

This document has been prepared mainly as information for internal professional advisers and nothing contained in this document should be construed as an invitation or an offer to invest or a recommendation to buy or sell any particular security or to adopt any investment strategy. Although the information provided in this document is obtained or compiled from what we believe to be reliable sources, AMG Financial Group Limited and its affiliates and the author cannot and does not warrant, guarantee or represent, expressly or impliedly, the accuracy, validity or completeness of any information or data made available to the recipients of this document for any particular purpose and no liability in respect of any errors or omissions is accepted by AMG Financial Group Limited or its affiliates or any director or employee of AMG Financial Group Limited or his/her affiliates or the author. The author's views are subject to change without notice to the recipients of this document. Past performance is not necessarily a guide to future performance, the value of any investment and the income from it can rise as well as can fall as a result of currency and market fluctuations. The recipients of this document should seek for professional advice if they are in any doubt about any of the information contained herein.

For any comments, please send email to us at enquiries@amgwealth.com.

AMG Financial Group
5/F, Guangdong Investment Tower, 148 Connaught Road Central, Central, HONG KONG
Telephone: (852) 3970 9531 Facsimile: (852) 3426 2650