AMG FINANCIAL GROUP 安柏

AMG Market Commentary

March 2014

We did not see any change in the Fed policy, even after the FOMC press conference from Janet Yellen

The U.S. Fed has met on 20th March for its regular FOMC meeting. After the meeting, the Fed announced that:

- The Fed decided to reduce the asset purchase from US$65 billion per month to US$55 billion per month (it is the third successive months for the Fed to reduce the monthly asset purchase);

- Remain the Fed Fund Target Rate unchanged at 0-0.25%

Although the policy decision was the same as most expected (and most investors did not feel any surprise), the press conference from Janet Yellen has led to a short-term panic in the market.

Investors did feel worried about the wordings from Janet Yellen because she has replied to the reporter in the press conference that she thought that the Fed would raise interest rate for a considerable time after the asset purchase program ended and the reasonable guess for “considerable time” would be about 6 months.

The above wordings from Janet Yellen have immediately caused a small –scale panic in the financial market. Investors were afraid that she was trying to communicate with the market that she was planning to taper in a quicker speed. For example, if the Fed really raises the interest rate 6 months after the asset purchase program ended, it is highly possible that the Fed will raise the interest rate in the 1st half of 2015 (as it is highly possible that the Fed will end the asset purchase program by the end of 2014). It will be a little bit earlier than most investors are expecting now (as most investors expect that the Fed will only raise the interest rate in the 2nd half of 2015).

We are quite confident the U.S. Fed will not change its policy dramatically

First of all, as what Yellen or Bernanke have emphasized again and again, the monetary policy from the U.S. Fed totally depends on the economic growth momentum in U.S. No matter the monthly asset purchase program or the Fed Fund Target Rate, its increase or decrease will totally depend on the speed of economic growth. Therefore, if the U.S. economic momentum has any substantially changes in the future (it can be better or worse), it will affect the Fed’s decision on its policy direction. As a result, whether the U.S. Fed will raise the Target Rate in the early 2015 will be determined by the economic growth in 2014, rather than the decision from Yellen.

Besides, as the Fed interest rate policy was driven by the economic health, it is not a bad thing if the Fed raises the interest rate sooner than expected. It is because if the Fed really increases the interest rate sooner than expected, it just means that the U.S. economy is growing faster than expected (the economic growth is solid enough that even the U.S. Fed is confident to reduce its support to the economy).

Thus, we did not see any dramatically change in the U.S. Fed policy, even after the FOMC press conference from Janet Yellen. The direction for the Fed policy were almost the same in the past year. Any change in the policy will be driven by the economic growth momentum in U.S.. The Fed will reduce its stimulus to the economy if it expects the economy will grow faster but will increase its stimulus to the economy if it expects the economic growth will slow down. Besides, both Bernanke and Yellen are initiator and supporter of the ultra-loose monetary policy. Thus, Yellen will not end the simulative polices before she is fully confident that the economy is totally recovered.

Economic Review and Market Outlook

U.S. Economy and Financial Market:

Investors were still focusing on any change in the U.S. Fed policy. The speech from Yellen during the FOMC press conference has led to a short-term shock to the financial market. But the market returned to stable when investors further digest her message later.

The monthly non-farm payroll figure remained one of the important economic data to assess the economic momentum in U.S.. In general, the employment figures reported in early Mar reflected that the U.S. job market keeps on improving. The nonfarm payroll has increased 175 thousands in Feb and the unemployment rate has increased 0.1% to 6.7%.

US Nonfarm Payroll

Sources: Bloomberg

U.S. Unemployment Rate

Sources: Bloomberg

And for Mar, most of the economic figures have improved when compare to those reported in Jan or Feb. It partially supports the assumption that the disappointing economic figures reported in Jan and Feb may be due to the bad weather.

However, although we expect the U.S. economy can remain a steady growth in 2014, we do not expect the U.S. stock market will have a substantial increase in 2014. It is because the valuation is not cheap anymore when compare to the past few years. For example, the S&P 500 is trading at 17.5x PE (while it was just trading at 14x PE in early 2013). We forecast the U.S. stock market will increase in 2014 but the increase will be limited to single digit only as the further upside for PE revaluation is very limited. Thus, most of the stock price increase will be supported by the earnings growth (but the earnings growth is expected to be single digit only).

EU Economy and Financial Market:
The ECB has met on 3 Apr. After the meeting, ECB announced that it maintained the monetary policy unchanged. It maintained its main refinancing rate unchanged at 0.25%. ECB policy guidance and its assessment on deflation risk have become the hot topics in the meeting. For policy guidance, it is the first time ECB said that they had a discussion on QE (though it is still far from any real action). For deflation risk, ECB remained its assessment unchanged. It said that the recent information remained consistent with its expectation of a prolonged period of low inflation followed by a gradual upward movement in HICP inflation rates. The signals from the monetary analysis confirmed the picture of subdued underlying price pressures in the euro area over the medium term. Inflation expectations for the euro area over the medium to long term continued to be firmly anchored in line with its aim of maintaining inflation rates below, but close to, 2%.

Although ECB has discussed QE during the meeting, it did not mean that ECB will implement QE soon. In addition, ECB President Draghi has clarified that QE is just in discussion. He emphasized that ECB will use unconventional instruments only if all conventional instruments were fully used. But at this moment, ECB has not finished its conventional measures.

Back to economic growth, EU has a steady economic growth in the past few months. For example, the EU PMI Manufacturing Index was 53 in Mar (50 or above means the sector is expanding). It is already the nine successive months to have an increase. The Industrial Production also recorded an increase of 2.1%. Both of them show that the EU manufacturing sector is improving.

EU PMI Manufacturing Index

Sources: Bloomberg

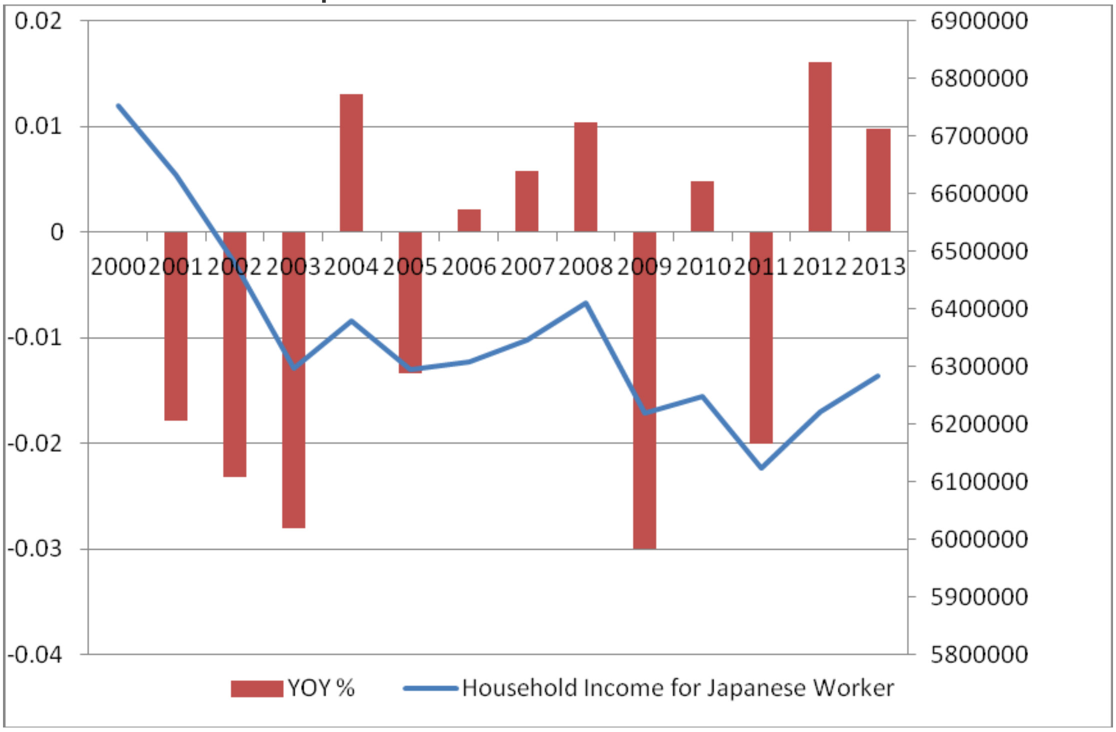
Japan Economy and Financial Market:
The sales tax has increased from 5% to 8% starting from 1 Apr. It is still an unknown how much sales volume will be affected by the tax increase (and also the impact to the economy recovery). But for the stock market, it did not see any impact at this moment as the stock market has increased 3% in the past month.

We expected the sales tax increase will eventually have a negative impact to the economic recovery in Japan. It is because the average income for most Japanese workers has remained unchanged for more than ten years. With a higher sales tax, it is highly possible that the Japanese workers will decrease their consumption in order to offset the sales price increase.

However, it will not change our view on the Japanese stock market. It is because we recommended to buy Japanese stock in the early 2013 was not based on any expectation on economic improvement. We recommended to buy Japanese stock in early 2013 was because we expected a lower Japanese yen would have a positive stimulus to the Japanese stock market. We did not expect any significant economic improvement in Japan because the long-term recession in Japan was a very complicated and structural problem, such as lack of innovation from the Japanese company, inflexible economic structure, etc.. Just a lower value of yen would not solve them all.

Thus, once BOJ maintains its ultra-loose monetary policy, we are quite confident that the Japanese stock market can sustain at the current level and possibly to return back to its 1-year high.

Household Income for Japanese Workers



Sources: Bloomberg

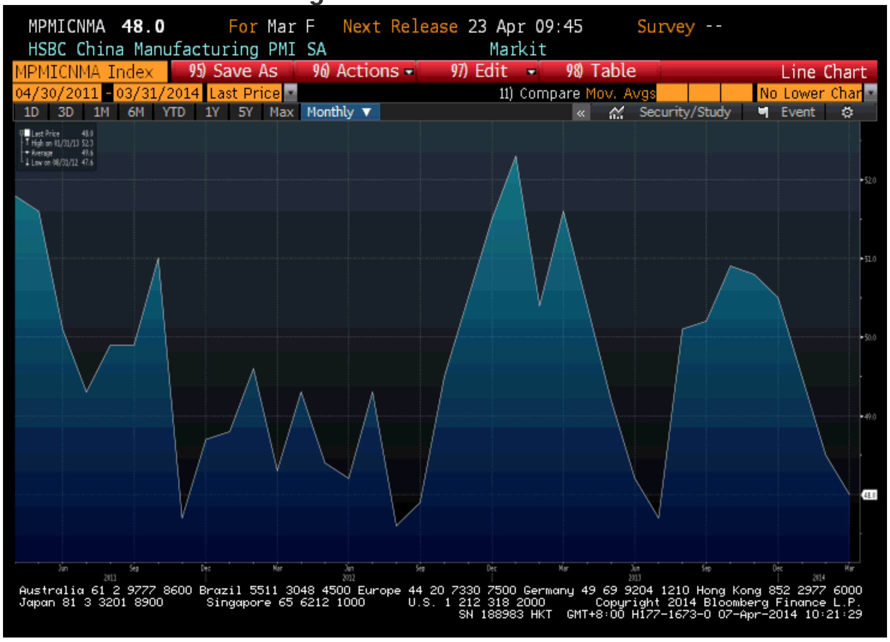
<u>China Economy and Financial Market:</u>

The credit problems have become one of the outstanding issues for China in Q12014. For example, the nearly default of a Trust Product and the default of a listed bond has shocked some investors and further weakened investors' confidence on the economic growth outlook as well as the stability of the financial system.

As affected by the above negative factors, the Shanghai Composite Index has decreased 3% while the Hong Kong China Enterprises Index has decreased 6% YTD (as of 3 Apr 2014). Although both indices were very attractive in valuation, we just expect them to have a short to medium-term rebound rather than a really long-term change of direction in 2014 as the momentum is still not strong enough.

For economic outlook, we expect the China economic growth will remain weak in 2014. It is because the China economic growth will continue to slow down due to the economic restructuring led by the Chinese Government. During the economic restructuring, we expect the economy will have a lesser growth and a more fluctuation.

HSBC PMI Manufacturing Index



Sources: Bloomberg

<u>Economy and Financial Market in Emerging Markets:</u>

As what we expected last year, the emerging financial markets have rebounded from its bottom in the middle of 2013. After the market panic happened in the Q2 and Q3 of 2013, the stock market, the bond market and also the currency market of emerging economics have stabilized and rebounded in Q4 2013 and Q1 2014. The rebound in emerging markets was mainly due to the oversold in mid-2013, rather than there was any significant improvement in their fundamentals (especially some of the emerging countries are still facing the risk of economic slowdown).

MSCI Emerging Markets Index

Sources: Bloomberg

Bloomberg USD Emerging Market Sovereign Bond Index

Sources: Bloomberg

JPMorgan Emerging Markets Currency Index

Sources: Bloomberg

Although there were a sharp rebound in the stock market in the past few months, we remain a cautious view on emerging stock markets in the first half of 2014. It is because the capital outflow from emerging markets is still existing and it will be a negative factor to the emerging stock markets.

Commodities:

The political risk from Ukraine has reduced and thus both oil and gold price have corrected from their recent high.

Oil Price: As what we expected, the political risk from Ukraine has reduced and thus the oil price has corrected from its recent high. The oil price has increased in Jan and Feb was mainly due to the political uncertainty caused by Ukraine. However, there was any serious struggle between U.S., EU and Russia after the referendum in Crimean. U.S. and EU have imposed a series of economic sanctions to Russia but all of them were small in scale and the impact was very minimal. As a result, as the political risk has reduced (at least, the oil supply remained unchanged) at this moment, the oil price has corrected from its recent peak from US$105 to US$100.

Oil Price

Sources: Bloomberg

Again, we would like to emphasize that we do not expect a bull year for oil in 2014. It is because the demand for oil is still not very strong as the economic growth in developed and developing countries is not very promising. As a result, the demand growth is still not enough to lead to a breakthrough in oil price. We expect the oil price will remain at between US$90-110 in 2014.

Gold Price: Similar to oil price, the gold price has corrected from its recent high as the political risk from Ukraine has reduced. The demand from risk-averse investors has decreased and led to a correction in gold price. We remain our forecast in the early 2014 that we are cautious for gold price in 2014.

Gold Price

Sources: Bloomberg

Agriculture Products: A few weeks ago, the U.S. Government has warned that we may have an abnormal weather in 2014 due to the effect from “La Nina”. As a result, it is high chance to happen serious flooding and drought in 2014. Some experts said that the abnormal weather will significantly affect the production of agricultural products. As the supply of agricultural products is highly correlated with the weather, a lower supply may have a significant push-up effect on the agricultural product price. For those aggressive investors, it is worthy to have a more study on the weather and the related effect on the agricultural product price. See if you can discover any outstanding investment opportunity from it.

Rogers International Commodity Agriculture Index

Sources: Bloomberg

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

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