AMG Market Commentary

August 2008

The Stormy July

Seems like no one is discussing about the supporting level for major indices on moving averages any more.
3 factors were haunting the global markets in the month of July. i.) US financial Institutions, namely Fannie Mae and Freddie Mac, ii.) Earnings of Financial institutions and iii.) Inflation, highly influenced by oil prices.

SEC actually put in restrictions to limit the short selling of 19 financial institutions including the 2 mortgage companies from 21st July, 2008 for a period of 30 days to avoid speculators to take advantage of the weakening US financial institutions, forbidding short selling without the actual equity on hand first. Such arrangement prevented the market to panic on news like Merrill Lynch announcement on July 28 about the write down related to the US$30.6 billion CDO sale to Lone Star for the price of US$6.7 billion.

Both US Secretary of the Treasury Paulson and Fed Reserve Chairman Bernanke mentioned on multiple occasions that US financial system is sound and also seeing growth would be coming back soon. As quarterly earnings started announcing, surprised results were seen from Amazon even with the weakening US consumer spending and also the impressive earnings with Bank of America.
The global markets stabilized after seeing the drop in commodities at the middle of the month which strike many speculators unarmed, it especially helped some emerging markets to recover some lost grounds towards the end of the month.

US: Negative
The S&P/Case-Shiller home-price index, which tracks prices in US home markets, found that in the 10 metropolitan areas it has tracked since 1987, prices declined 17% in May compared to the same month a year earlier, the largest annual decline since the survey began. The 20-city index dropped 16% in May from a year earlier, which recorded as the biggest decline since 2000. (1)

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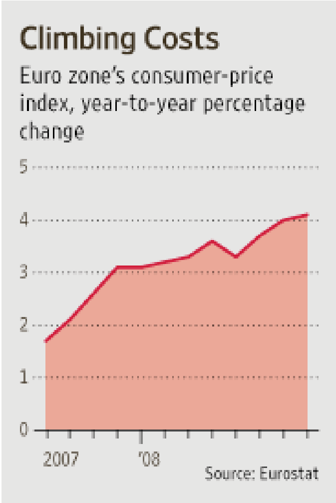
Europe: Negative
Eurostat, the EU statistics agency, reported that the flash estimate for euro-zone inflation rose to 4.1% in July from a year earlier, up from June's annual pace of 4%. That is the highest level since Eurostat began collecting this data in 1997 and is more than twice as high as the European Central Bank's preferred medium-term range of "below, but close to" 2%.
Separate data showed the euro zone's seasonally adjusted jobless rate held steady at 7.3% in June from May's upwardly revised figure, but economists said hiring is likely to slow sharply as the impact of the global credit crunch takes its toll on the region's economy. (2)



Japan: Negative
On July 15th the Bank of Japan (BoJ) raised its forecast for “core” inflation in the fiscal year ending in March 2009 to 1.8%, up from 1.1% three months ago. Goldman Sachs thinks core inflation, which strips out volatile fresh-food prices and is the most widely followed measure, reached 2% in June, up from 1.5% in May. As elsewhere in Asia, higher prices for oil and food are the main cause of the jump in headline inflation. (3) Some analyst believe that the inflation can bring bargaining power back to companies on prices.

Greater China: Positive
With the disappointing performance of the Taiwan market after the start of the greenlight for Mainland tourist to visit Taiwan, investors started to realize that conceptual believes might not be able to bring new life to the bearish market. With the index dropped to close to 6800 points, technical traders kicked in and brought it back to 7000 level. Towards the end of the month, President Hu Jintao said sustaining the mainland's rapid growth was the country's top priority, according to media reports. The remarks raised hopes China will initiate measures to boost the economy after months of monetary tightening to fight rising inflation. Monetary controls were also mentioned to forbid foreign investors to flood the market with cash in exchange for the en-valuing RMB. Trading volume for all 3 markets in the greater china region stunk as investors take a more conservative approach and observe the trend of interest rates and also if any more macro policies are needed to be introduced in order to have inflation under control.

Hong Kong: Neutral
Hong Kong was influenced by both US and also China market. The announcements of quarterly results from the major banks will be the focus of investors. Trading volume continue to shrink, while investors were also worried with the direction of where the market is heading. July's GDP growth is expected to slow down, after 2 years of continuous growth.

Latin America: Neutral
While inflation will create challenges for governments, central bankers and consumers, it will also provide benefits. Latin America is one of the world’s largest producers of commodities. It supplies half of the world’s soybeans, 40% of its copper and 9.3% of its crude oil. (2) Half of all Latin American exports are raw materials or primary products. The region has already benefited from rising commodity prices and the fall in the US$. Commodity prices, which are usually expressed in US$, have skyrocketed providing windfalls to the region’s many commodity-rich countries. This has helped Latin America double its share of exports to China to around US$50 billion a year over the past five years. (5) But with the recent hint of declining of commodities prices and also the bottom out of US$, some investors might shift their interest to elsewhere.

Commodities: Neutral

With crude oil down 15% from the settlement record above $145 reached in early July, oil futures have reasserted their volatility. This is in sharp contrast to the first half of 2008, when rising oil prices appeared to be a sure bet. July's drop snapped oil's three straight months of gains.

Crude's scorching run past $100 a barrel this year was partly underpinned by the belief that demand from emerging economies, such as China and India, would offset shrinking US consumption. Sentiment, however, has shifted in recent weeks, and market participants already are attempting to call a near-term floor. Weaker economic growth indicates lower demand for oil products. Adding to the anxiety, analysts point to US fuel demand, which is off by 2.4% over the past four weeks, compared with the same period last year. (4)

Weather still plays like a wild card on oil prices, along with geo-political tension between Iran and Israel.

Hedge Funds: Positive

For June, hedge funds performed well compared to global equity markets, such as the S&P 500 Total Return Index, which was down more than 8% in June. The highest performing sectors for the month were Managed Futures and Dedicated Short Bias, both of which were well-positioned to take advantage of volatility in equity and commodities markets. (6) While things should be quite different for July as there were significant drop in commodities on the 18th and onwards.

Things to Look Forward:

With the meetings of rates discussions for both US$ and also Euro, the market's focus is on the comments afterwards from the central banks. The consumer spending figures are also the key to see how bad the economy is really heading. Beware of the commodities bubble as the trend has reversed and no one is certain how far it can go. Olympics will shrink the trading volume in China while with the ease of the oil prices; there is no rush for new macro policies to be introduced.

1, 2 and 4 from WSJ, Asia Edition, August 2nd, 2008
3 from Economist, Asia Printed Edition, July 17th, 2008
5 from Fidelity Hong Kong, July, 2008
6 from Credit Suisse Tremont, www.hedgeindex.com

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