AMG Market Commentary

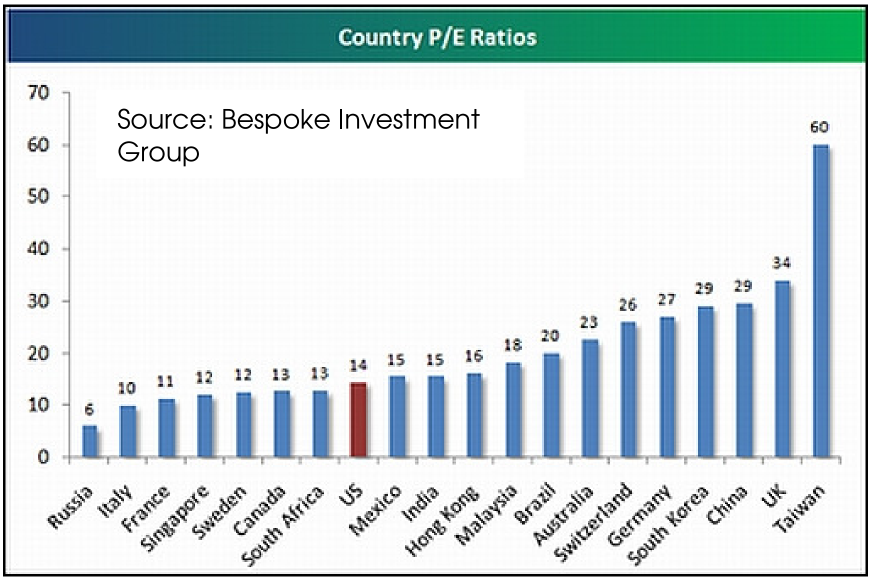
July 2009

Uneven road for global economy and stock market

Very obviously, the stock market had lost its momentum in June. Many stock markets reported the first monthly loss since March. Many attributed the weakness to worries about the pace of global economic recovery.

In fact, slow recovery should never a surprise. The economic data had always been mixed in the last few months. PMI indices for manufacturing and service industry climbed in U.S., Eurozone, China and several other countries. As a leading indicator for commercial activities, it showed that the economic contraction is easing. But, on the other hand, employment, world trade and bank credits were still sluggish. The picture really had not changed much between March and now.

However, stock markets rose substantially on hopes of recovery and strong capital flow. Now that most of them are no longer a bargain judging on PE ratios. The rise in stock prices and thus PE ratio showed that investors expectation are much higher now than 3 months before.



So, there is still a lot of uncertainty in the economy while the over-pessimistic atmosphere has gone. That's why the market stalled in recent days. In times when uncertainty looms over the market, investor sentiment often swings on news and leads to market fluctuations.

For us, we would maintain that "buy on dip" is the preferred strategy. The reason is that the worst time should have been past and liquidity condition is favourable for risky assets.

First of all, government around the world showed their determination to fight any risk of systemic meltdown in their rescue efforts. Aids were given to large financial institutions, as well as to government who needed external funding. Thus, chances for market panic like that in October 2008 on Lehman Brothers bankruptcy or Feb 2009 on worries about Eastern Europe debt crisis to come back is low. It unlikely for equities markets to revisit the extreme low points again.

And for liquidity, the interest rates are just next to zero or at historical low in near every developed country. It makes cash a very unattractive asset class and give investor strong incentive to risk with their money. At such, it is favourable for risky assets such as equities, commodities.

US : Neutral
Both manufacturing and non-manufacturing PMI made another step toward the 50 point market between expansion and contraction in May. Manufacturing PMI rose to 44.8 while non-manufacturing PMI reached 47. It showed that the near term outlook for business continued to improve.
Unwelcomed surprise came from job market. Improvements in Non-farm payroll failed to follow through from April's data. A 467K job losses was reported in May. Choppy development in non-farm payroll dashed on hopes for quick recovery in job market.

EU : Neutral
Germany reported higher exports, industrial output and factory orders in May compare with April. Exports edged up by 0.3%, industrial output gained 3.7% and factory orders jumped by 4.4%. It is good to see some improvement. Still, it was just the first improvement after the country reported record contraction in GDP in 1Q2009. It is too early to conclude that the slump is over.

China : Positive
Hong Kong stock market stalled as investors' hesitated to get into the market. But, Hong Kong and China remains the preferred investment destination for us. Recent data showed that the government policy to prop-up housing and automobile demand was a success. Home sales were 45% higher while car sales jumped 20% in the first 5 months of the year. It demonstrated the strength of domestic demand in China.

Emerging Markets Korea : Positive
Korea avoided an economic recession technically with a 0.1% GDP growth in 1Q2009. Government stimulus spending and quicker than expected recovery in domestic consumption and exports helped Korea to outperform in economy as well as stock market performance.

Commodities : Positive
Commodities also receded as market sentiment changed. Crude oil was bit by a 10% strong decline. It now trades at around USD 60/barrel after touch USD 72/barrel earlier in June. Gold remains in range trading and not expected to break away any time soon.

Hedge Fund : Neutral
Barclay Hedge Fund Index gained 0.65% despite weaker equities market performance. Convertible arbitrage extended the lead in the year. The convertible arbitrage index gained another 3.40% and YTD return rose to 25.26%. On the other hand, Barclay CTA index dropped 0.8% and YTD return went back to negative figure at -0.73%.

Government Bonds : Negative
The Fed shrugged off speculation about rate hike to come within the year. It did not only keep interest rate at record low, but also reassured the market that it has no intention to lift interest rate as the economy is still struggling. It kept the medium to long term Treasuries yield from rising.
Borrowing demand for government to support economic stimulation policy and concerns about the return of inflation shall remain headwind for high grade government bonds. Thus, high grade government bonds are still unattractive to us.

Things to Look Forward:
Earnings season is coming again. Market estimates for the quarter is another 30% yoy decline in profit the quarter. So, the expectations are not very demanding and no big surprise is expected. Still, the companies often review the outlook for the remainder of the year when they announce the results. It would tell how's the recovery is going for businesses.

* All figures and information are collected from Bespoke Investment Group, Bloomberg.com & Barclay Hedge.

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