AMG Market Commentary

January 2010

Stimulation policy exit brings along uncertainties

Direction of government policies is starting to change in 2010, it is no longer correct to assume more stimulation will come in all countries and every segment of the economy. Recently, China joined Australia to cut back on stimulation efforts. In an attempt to rein in excess loans growth and inflation risk, China lifted interest paid on central bank notes and required reserve ratio.

And more importantly, the action of Australia and China only marked the beginning of policy exit. As inflation risk and economic growth comes back, more and more countries will join them. For investors, the question is how will it affect the economy and stock market performance?

For the economy, it will very much depend on whether private sector will take over and becomes the driver for economic growth.

For Australia and China, it is not a worry. Internal sources of growth such as private consumption and investment has returned to double digits growth in China. While for Australia, resources exports and job market also turned up rapidly. Thereby, investors need not worry about double dip for them.

But for the major economies, of which the recovery is more subdue. It is more questionable if they can afford to take back policy support. For them, private consumption, corporate spending and job market has yet to turn around. So, the risk of early exit is still there. Fortunately, their governments have showed that they are willing to adjust the policy according to the real situations e.g. subsidy for home buyers was extended in November for U.S.. So, it is likely that they will gauge the pace of exit to ensure that it will not choke off the budding recovery. And thus far, they have yet to start taking back policy stimulus except liquidity measure of which the market need has died down already. So, investor better wait till later half of 2010 to see if the risk early exit will come.

For the investment market, it is a bit more complicated. So far, market consensus is that policy exit will only come in late 2010. Thereby, the interest rate by RBA and the lift of required reserve ratio by China are perceived as a negative surprise to the market. As a result, risky assets come under pressure as worries about political uncertainties looms. Still, the pressure is expected to dissipate as their economies are well supported by private sector led growth.

US : Positive

A key part of the financial tsunami was that banks were over-leveraged and devaluation of trouble assets eroded their capital. With an aim to tackling the systematic risk associated with excess risk taking by banks, U.S.

President Obama is proposing to forbid the banks from engaging in high leverage businesses e.g. investment banking, hedge funds…etc. The aim is righteous. However, it could hurt banks' earnings. The financials were heavily reliance on trading revenue in the last few quarters while traditional lending business was still weak. So Obama's suggestion put financials stock under pressure and they dragged on the overall market.

Europe : Positive
The budget problem of Greece led to concerns about impact of weaker members on the Euro. Though that the Greek government handed out a plan to cut the budget deficit to 3% of GDP in 3 years, it failed to win the trust of peers and investors. European Commission officials regarded the plan infeasible and urged for stricter control over government spending. Looming uncertainties about government financial position of Greek and some other Eurozone members e.g. Spain, Portugal weighed on Euros as investors are concerned about stability of Eurozone.

China : Positive
The central government announced policy changes to rein in liquidity once and gain. It has lifted the interest rate paid on 3 months and 1 year central bank bills and raised the required reserve ratio to 16% for commercial banks since mid January. The effect is that cost of capital shall go up and ability for banks to lend is curbed. Investors now fear that more policy shift will be announced and it dampened the performance of Hong Kong and China stocks.
While on the other hand, economic performance is very encouraging. Private consumption and industrial output kept growing in double digits and international trade also revived. In sum, the numbers tells that Chinese economy is returning to strength and it should be positive for stock market.

Commodities : Positive
Investors flee to safe heaven assets such as USD and Japanese Yen, the risk aversion hurt commodities also. The support level for gold price is still at USD 1,000-1,030/ounce. For crude oil, easing snow storms in Northern hemisphere and rising temperature dragged on it. So, crude oil fell to around USD 75/barrel.

Hedge Fund : Neutral
For the whole year, Barclay Hedge Fund Index was up by 23.91%. The spectacular performance was very much attributable to recovery in asset prices. Since the market is no longer underpriced, performance of hedge fund is expected to be a lot slower in 2010.

Government Bonds : Negative
Attractiveness of U.S. Treasuries issues is limited to the sake of safety. The price of U.S. Treasuries have traded in range since the later half of 2009, when the worst of the financial crisis was past. Since then, Treasuries issues fell to climb back to level in the early half of last year despite risk aversion came back from time to time.

Things to Look Forward :
Policy exit by China surprised the market and brought about some selling pressure. Still, it is unlikely that the mild shift in policy will derail the economy from recovering. So, we remain optimistic about China and Hong Kong equities.
From a broader perspective, more and more governments will start to reduce or remove policies stimulus as time goes by. So, we are just in the beginning of the trend for policy exit and government action will remain a major risk factor.

* All figures and information are collected from Bloomberg.com & Barclay Hedge.

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 9595 Facsimile: (852) 3426 2650