# AMG Market Commentary

**September 2010**

## New policy initiatives to take on slow recovery

Mid-term election is coming in just 2 months time in November for the United States. And the bad news for the Democrats is that Americans are still suffering from elevated unemployment and the lack of investments and consumption demand. Facing the pressing need to fix the economy and boost the support for the Democrats, President Obama proposed several new policy initiatives to support the economy.

The new initiatives include
1. An Infrastructure improvement plan, which will cost USD 50 billion in the next 6 years
2. Making tax credits for corporate research and development cost permanent and allow them to enjoy the tax cuts quicker
3. Making the tax concessions for individual with annual income below USD 250,000 permanent

The targets for the above policies are creating more jobs through the infrastructure spending and supporting business investment as well as consumption with the tax credits. It is very clear that the U.S. government fully understand that the key to U.S. recovery lies in job creation and the revival of business investment and consumer demand.

But, a weak housing market and severe unemployment is keeping the U.S. household from spending. Without strong recovery in consumption, we do not expect the new policy initiatives to make a big difference.

While for the financial markets, the significance is about the change in U.S. government attitude in economic stimulus. Recently, the Fed has announced that it will revolve the capital invested through the Asset Purchase Program and now Obama is proposing more policy initiatives to help the economy. It seems that the tendency for U.S. government to stimulate the economy is getting more prominent again. As a result, the future of quantitative easing in U.S. has come to investors' attention. If the Fed tries to inject more capital into the market by expanding the size of asset purchase, the over-flown of liquidity could push financial assets prices higher.

**US : Positive**
U.S. job market continued with the slow recovery. In the month of August, private payroll increased by 64,000. The figure was lower than 71,000 reported for Jul and it was the 4th consecutive months when the gain in private payroll shrank. Yet, it still managed to show a positive gain.

**Europe : Neutral**
The sovereign debt problem is heating up again. This time, Ireland is in the spotlight. To be specific, it was the

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Anglo Irish Bank that caused the trouble now. Anglo Irish Bank was a major mortgage lender in Ireland before the financial tsunami and it suffered heavily from the bursting of real estate bubble. In fact, the loss was so severe that it was taken over by the Irish government in Jan 2009 and received capital injection of EUR 23 billion at that time. Unfortunately, the bank kept on losing heavily as the bad debt rose. For the first half of 2010, it has reported a record breaking loss of EUR 82 billion. And now, it needs more capital from the government. Rising bail out spending leads to concerns about the finance of the Irish government, as such yields charged on Irish national debt escalated lately and the country is facing the risk of credit downgrade now.

**China : Positive**

Hong Kong stock market continued to see capital inflow due to the efforts by Chinese government in promoting offshore demand of RMB. As a result, turnover heat up and it helps stock market performance in Hong Kong.
On the other hand, the tightening the government's grip on property market and bank loans seems to have come into a temporary halt. Still, we do think there will be any relaxation on the austerity policies. The reason behind is that monthly new bank loans figures stayed in the range of RMB 500 billion which means it will be in line with policy target of RMB 7,500 billion for the whole year and property prices did not show any signs of adjustment. Rather, the risk is still there for more tightening policy if property market or bank loans heat up again.

**Australia : Positive**

Ms Julie Gilard finally gathered sufficient support in the Parliament to stay in office as the Australian Prime Minister. Still, the coalition government is just having a very marginal advantage in the Parliament. We still expect a tough time for the coalition government to push through its policy in Australia. Besides, Gilard was among the major proponent of the windfall tax on mining companies. So, her re-election seems a bit unfavourable for the Australian resources companies.

**Emerging Markets : Indonesia : Positive, Brazil : Positive**

Monetary tightening was triggered by rising inflation in Indonesia. Last month, the CPI rose by 6.44% on a yearly basis and topped policy target at 4-6%. Thus, Bank of Indonesia raised the required reserve ratio for Indonesian banks from 5% to 8% while policy rate is kept unchanged at 6.5%. Again, we think that higher inflation is a reflection of strong domestic demand and do not expect the start of monetary tightening will disrupt the uptrend in stock market.
For Brazil, Presidential election is coming on 3 Oct 2010. According to poll survey made in early September, Ms Rouseff, the candidate from ruling PT is favoured by 50% of the voters while her major opponent Mr Serra is only favoured by 28% of the voters. It seems that Ms Rouseff will likely be elected the next Brazilian President. As she is having a very close tie with current President Mr Lula, who is also from PT, risk of abrupt policy change in Brazil seems low now.
Looking at the Brazilian economy, it is slowing down. For 2Q2010, Brazilian GDP growth was 8.8% which is lower than the 11.3% growth reported in the first quarter. From the chart below, we can see that private consumption and industrial production growth are moderating. Still, it is expected that the country will continue to benefit from resources exports and domestic consumption and investment are still growing at very decent rate. For whole year of 2010, Brazil GDP growth is still expected to stay above 7%. We think that it is just slowing down to more sustainable level and remains positive on Brazilian economy and stock market performance.

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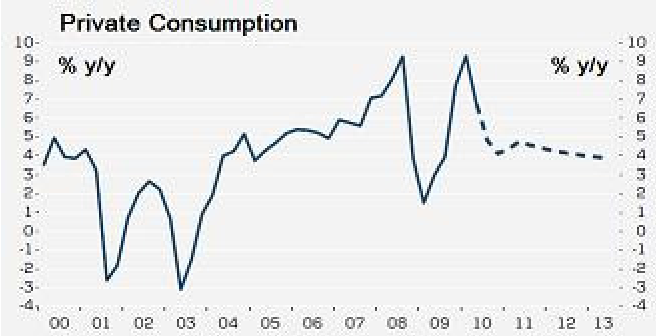
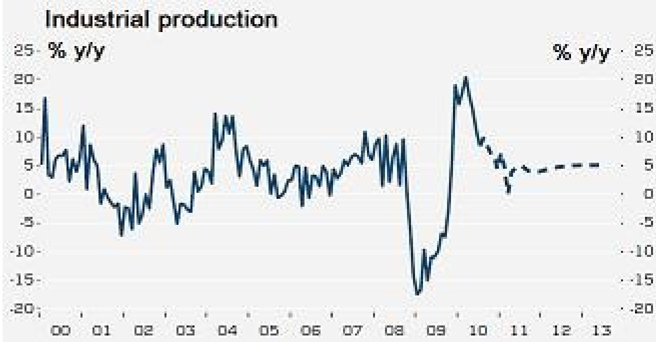
**Chart 1: Brazilian private consumption growth**




Source: Danske Research

**Chart 2: Brazilian Industrial production growth**




Source: Danske Research

**Commodities : Positive**

The appeal of gold as safe heaven asset was make more prominent as the major currencies are all in trouble. Gold price reached new high and it is now standing about 1,300/ounce. And policy change in U.S. seems to be turning more favourable, pledges by President Obama and the Fed to help the economy leads to worries about U.S. dollar and drive gold price higher.

**Hedge Fund : Neutral**

Hedge funds performance, as a group, was just fair in August. Barclay Hedge Fund Index slid by 0.38% and it trimmed the YTD gain to 1.361%.

**Government Bonds : Negative**

The price U.S. Treasuries and German Bunds remains at high level. We still maintain the view that the threat of interest rate hike and inflation for them are low and they will probably remain at high level for months. However, we do not recommend buying into these issues as the return is far from fair not to mention attractive.

**Things to Look Forward :**

Latest economic figures are still pointing to slow recovery, which has always been the market consensus. We still favour assets related to emerging markets as the valuations are still fair.

This month, President Obama proposed new policy initiatives to help the economy. And the Fed has also committed to extend the Asset Purchase Program. It seems that the U.S. policy environment is turning more favourable for loosening of monetary policies. The chance of expansion of quantitative easing by the Fed is on the rise. For the financial markets, it means there could be more liquidity around which can help to push asset prices higher.

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